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Consumer Bankruptcy Update

Office of Continuing Legal Education at the University of Kentucky College of Law

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CONSUMER BANKRUPTCY UPDATE —2000—

December 2000
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EFFECTIVE REPRESENTATION OF CHAPTER 7 DEBTORS

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SECTION A
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EFFECTIVE REPRESENTATION OF CHAPTER 7 DEBTOR

Sandra D. Freeburger

I. INTRODUCTION

It is the goal of the following paper to assist the bankruptcy practitioner in effectively, efficiently and ethically handling Chapter 7 bankruptcy cases. Dealing with cases in this manner will bring plaudits from one’s peers, but plaudits will not pay the rent. Therefore, an emphasis will also be placed upon obtaining, fostering and preserving the goodwill of your clients throughout the attorney/client relationship. After all, good recommendations from former clients are the best, most cost effective form of advertising.

The paper is arranged chronologically as most cases unfold. So we begin with the initial client telephone call.

II. INITIAL CLIENT CONTACT

A. Role Of Secretary

I am uncertain whether we lawyers truly appreciate a well trained staff. Fielding the initial telephone call from a financially distressed individual falls to one’s secretary, receptionist, administrative assistant, etc., whatever title you chose to bestow upon that person who bravely addresses the unknown public each time the telephone rings. For the purposes of this work, I will refer to this staff member as “secretary.” The truism that first impressions are the most important was never more accurate than in this setting.

1. Specific Inquiries Referred to Attorney

If the caller begins the conversation with a narrative of a specific event—a car has been repossessed, a lawsuit has been filed, a contract dispute has arisen—the secretary should go no further with the conversation. The caller should be promptly referred to an attorney.

2. Basic Information and Fee Schedules

However, many inquiries are received from individuals who know that their financial affairs are desperate. As the number of consumer Chapter 7 filings continue to grow, many individuals are facing their second or third bankruptcy under the Bankruptcy Code of 1978. Information about bankruptcy law is more widespread due to legal advertising, press coverage of high profile bankruptcy cases and word of mouth. From July 1, 1997 to June 30, 1998, 1.38 million bankruptcy cases were filed. So often your secretary will receive a call from an individual who knows very well that a bankruptcy case will be required to deal with his or her debts.

Your secretary must impart brief, accurate information about your services and fees. Highly visible advertising has increased the numbers of legal fee price shoppers. Unless your secretary can impart to the caller information about your fees in consumer cases, you may find your calendar cluttered with long office conferences with individuals who really only want to know your charges.
In the author's office, the secretary will advise the caller of the firm's basic fee for consumer Chapter 7 cases but will inform the caller that more complex cases require higher fees. Care must be taken to differentiate between the court costs and attorney fees. Further, the secretary will tell the caller that there may be a charge for the initial consultation unless the firm is retained. This practice has eliminated some unproductive office conferences and distilled those would-be clients with whom the attorneys meet.

3. Specific Inquiries and Preparation for Initial Client Interview

The caller will make inquiries of the secretary about substantive matters. It is important that one's secretary understand that bankruptcy protection from creditors will occur immediately upon filing; so when asked by a caller about the length of time required to stop a wage garnishment, the secretary can answer. See, 11 U.S.C.§362(a). In many areas a secretary is more competent to answer questions than the attorney. For example, when asked about the promptness of getting the petition filed, the secretary is often more aware of the existing workload and time demands. In the event a petition needs to be filed expeditiously, the secretary should know about the availability of skeleton and emergency filings, so the caller can be assured that the office and the court system can work with sufficient speed to meet a critical situation.

The secretary should ascertain the identities of the caller's major creditors. If the firm represents those creditors, then the secretary should advise the caller that a conflict of interest would prevent the firm from representing the caller.

To allow for a productive meeting between the caller and the attorney, the secretary must instruct the caller to prepare for the meeting by gathering financial information which lists the assets and the debts of the caller. The potential client should be asked to value those assets and designate which assets are encumbered by mortgages and liens. If the caller has been sued, the secretary should direct that copies of the complaint and other relevant pleadings be brought to the meeting. Certainly any deeds, wills, notes, and security agreements which the caller has on hand should be included in the portfolio. Tax returns can provide important information. As such, the caller should be asked to bring his/her tax returns for the past two (2) years to the initial meeting.

III. INITIAL CLIENT INTERVIEW

A. Client Relations

Many people who are forced to consider a Chapter 7 filing have never dealt with attorneys. Filled with the images of lawyers provided them by pop culture, they will arrive in the law office for the initial interview anxious not only about their circumstances, but about the lawyer. The attorney and support staff must put these interviewees at ease. Offering coffee or a beverage is elementary, but also think about dress and the conference room environment. By conducting the meeting in your best blue suit you may never develop a rapport with an hourly worker who has come to your office wearing dusty work clothes. By meeting in an austere law library, you may never engage in an open dialog which will fully apprise you of the clients' problems. These guests in your office should be impressed not only by your credentials but also your compassion.

While the stigma of filing a bankruptcy petition may have lessened since 1978, for most people bankruptcy is still an unthinkable act, the very consideration of which is emotionally wrenching. You are meeting people at a low point in their lives and you can observe their depression in their demeanor and posture. Realize that with the privileges afforded by the Bankruptcy Code, you have the power to help them.
B. Ascertaining Conflicts Of Interest

As you move into the actual interview, but before any discussion of specific legal issues, ask to review the list of creditors to whom the interviewee is indebted. Obviously, the attorney must ascertain if she/he has a conflict of interest which would prevent the formation of an attorney-client relationship. Any discussion of the client’s particular circumstances which occurs prior to a review of the creditor list can disqualify the attorney from representing either the debtor or the creditor client. SCR 3.130-1.7, 1.9. Clients will respect an attorney who zealously seeks to avoid conflicts and appearances of impropriety.

C. Immediate Problems And Future Concerns

Assuming no conflict of interest, it is then logical to ask the client about the immediate problem which has brought him or her into your office. In that way one can determine the rapidity of action which is required. For example, a wage earner whose salary is being garnished will need to decide whether to file and which form of bankruptcy relief to seek before his/her next paycheck is issued. Someone who has been served with a summons will have limited time to decide whether a good defense can be raised or whether legal fees are best spent on obtaining a discharge from the claim of the plaintiff. A client who foresees difficult financial times in the future may want to understand bankruptcy’s ramifications and has time for careful analysis.

D. Review Of Financial Statement

The discussion should now refocus on the financial statement. Many clients insist that they have limited credit problems and that but for a delinquency or disagreement with one creditor no bankruptcy relief would be required. As the discussion proceeds, it may become evident that the problems are widespread and the resources limited. As you review the client’s financial information, consider the issues discussed below.

1. Are the Debts Jointly Owed by Husband and Wife?

Assume the husband has participated in a failed business venture, leaving unpaid suppliers and business credit cards. The wife has liability only on bank notes which are secured by the residence and vehicles. The couple agrees that they wish to reaffirm the bank obligations. In such circumstances, there may be no reason for the spouse to join in the filing. Assume the residence has value which exceeds the claim of the mortgagee and the statutory exemptions allowed by KRS 427.060 and KRS 427.160. Recognizing that the trustee can sell jointly owned property after obtaining a judgment in an adversary proceeding, consider whether the trustee is less likely to sell the residence if the co-owner spouse has filed no petition. See, 11 U.S.C.§ 363(g), (h). The spouse will participate in one-half of the sale proceeds with the debtor’s portion of the proceeds being surcharged with the sales expenses and the trustee’s commission. Consequently, it is not as attractive for the trustee to sell marginally nonexempt jointly owned assets as it would have been had the couple filed a joint petition.

2. Should the Debtors have their Assets Appraised?

If the estate’s assets consist of automobiles or other kinds of property which are the subject of independent, well publicized valuation guides, then there may be no need to incur the expense of an appraisal. However, if the asset is out of the ordinary, say an antique automobile or specialty equipment, then an appraisal may be beneficial. It is the author’s experience that clients who have never been involved with the bankruptcy process habitually overestimate the worth of their property. Without an appraisal the client may be adamant that the property is worth much more than the debt it secures; with the appraisal the client, and the trustee, can quickly see that no equity exists.
Conversely, an appraisal could reveal equity which the client did not know existed. Remember that the debtor must sign his/her schedules, under oath, valuing the assets at market value. See, FRBP 1008, 1007(b) which incorporates Official Form No. 6. An appraisal performed before filing must be considered by the debtor while affixing the value of the asset. Valuation of the asset at an amount significantly below the appraised value could conceivably create grounds for action against the debtor. 11 U.S.C.§727(a)(4).

3. What are the Tax Ramifications of Filing?

If the debtor owns property which is encumbered to secure debts far in excess of value, then in all likelihood, this property will be abandoned from the bankruptcy estate and liquidated by the creditor. It is important to discuss the tax basis of such property. If the property is worth more than the taxpayer’s basis, then the taxpayer will have a taxable gain when the property is sold, even if all the proceeds go to the creditor. See, 26 U.S.C.§ 61. The sale of depreciated equipment can lead to tremendous tax liability, for the debtor will be taxed on all the recaptured depreciation, even though the creditor receives all the proceeds. See, 26 U.S.C.§ 1245. These results will occur whether or not a Chapter 7 case was filed, but the attorney has a duty to advise clients of the ramifications of their actions. If the asset has equity and the Chapter 7 trustee decides to sell the property, then the taxpayer’s basis passes to the estate and the tax liability will rest in the bankruptcy estate. See, 26 U.S.C.§ 1398.

Occasionally a creditor will recognize that the value of the asset which secures its debt is the most the creditor can hope to recover. In return for a quick sale, the creditor may be willing to forgive any debt which remains after the collateral is sold thereby eliminating the necessity of a bankruptcy filing. The attorney must advise the debtor that this proposal is fraught with peril. Recall that debt which is discharged as a part of a bankruptcy proceeding creates no tax; but, outside a bankruptcy case, the discharge or forgiveness of debt will likely create taxable income for the debtor. See, 26 U.S.C.§108 (a) (1). Once created, income tax debt can not be discharged for three (3) years. See, 11 U.S.C.§ 523 (a)(1)(A), 11 U.S.C.§ 507 (a)(8)(A)(ii). It may be necessary to decline the offer of the forgiving creditor in favor of filing a Chapter 7 case in order to escape debt forgiveness income.

In cases where significant tax liability may be created as a result of the debtor’s action in liquidating property, a tax professional knowledgeable about the tax aspects of bankruptcy law should be involved in the prebankruptcy discussions.

4. Does the Client have Substantial Equity in His/Her Assets?

Chapter 7 works best for those debtors who have accumulated significant unsecured debt and whose assets are encumbered to the full extent of their value by mortgages which are being paid on a current basis. Counselling the client with unexempt equity must be undertaken carefully. Obviously the client must be told that a Chapter 7 trustee is under an obligation to liquidate assets which will benefit the unsecured creditors. See, 11 U.S.C.§ 704(1). Occasionally a client will respond to that disclosure by expressing a willingness to allow the trustee to sell the asset. In light of the potential tax aspects of a sale, it may be best for the bankruptcy estate to bear the tax consequences of the sale.

Often the debtor will ask the attorney about ways to preserve the asset. For an attorney, danger attaches to the response. Law journal articles and lectures have addressed the role of the attorney in prebankruptcy planning. See, Safford, The Slippery Slope: The Road from Ethical Practice to Attorney Negligence, Contempt or Fraud in Bankruptcy Cases, 2 Workshop for Bankruptcy Judges 227 (NCBJ 1996). These scholars examine the fine line that lawyers must draw between advising the clients of the status of the law and actively participating in defrauding creditors. If the lawyer crosses the line between counselor and becomes an active participant in a scheme to defraud creditors, sanctions can attach. 18 U.S.C.§ 157; SCR 3.130-8.3(c) and KBA v. Newcomer, Ky., 977 S.W.2d 20 (1998).
Clients are entitled to fully understand how state law exemptions can be applied to their property. If a client has significant equity in an asset, the attorney should advise that by selling the assets or borrowing against the equity the client may invest the proceeds in a retirement account approved by KRS 427.150 and protect the equity (albeit in a different form).

If asked about giving property to the client's family, the practitioner should advise the client of the bankruptcy and state fraudulent conveyance statutes. See, 11 U.S.C.§ 548, KRS 378.010 et seq. Advise them that such gifts made within a year of the filing of a bankruptcy case can be easily set aside by the trustee. Clients should also be counseled that while Kentucky fraudulent conveyance law has a five (5) year statute of limitations, its requirements are more difficult to prove than the bankruptcy cause of action. The statement of affairs contained within the petition requires disclosure of gifts made within one (1) year of the filing date, so the overworked trustee may never discover transfers made outside the one (1) year time frame. See, FRBP 1007 (b)(1) incorporating Official Form No. 7.

If the client does not have at least $5,000.00 ($10,000.00 if a joint petition has been filed) equity in his/her home, the homestead exemption will not be fully utilized. See, KRS 427.060. In advance of filing, clients may consider liquidating an asset which has equity and investing those funds in their home. Either real property or mobile homes qualify. Beware that the exemption statute, KRS 427.060, limits the availability of the exemption, for it can be claimed only against creditors with claims acquired after the homestead was purchased. In re Bush, 196 B.R. 378 (Bkrtcy W.D. Ky. 1995). The trustee can use the powers granted under 11 U.S.C.§ 544 (b) to exercise the rights held by any unsecured creditor. So if any creditor's debt was incurred before the homestead equity was created, the trustee can sell the homestead.

When in doubt, the attorney should claim any exemption to which the client is arguably entitled and place the burden on the trustee to object to the petitioner's entitlement. Under Taylor v. Freeland & Kronz, 503 U.S. 638, 112 S.Ct. 1644, 118 L.Ed. 2d 280 (1992), the trustee has only thirty (30) days to object to the exemption.

5. Has the Client Made any Payments to Creditors Other than Regular Installment Payments or Monthly Living Expenses Within the Last Year?

This information may not appear on the client's financial statement, so it is important that you probe. Often the payments which fall into this category are made to family members. It is understandable that the debtor would want to devote his/her limited resources in repaying a relative or friend. The debtor must know that filing a bankruptcy petition within one (1) year of the payment to an insider and within ninety (90) days of the payment to other creditors will entitle the trustee to investigate the preferential payment and probably recapture it for distribution to all creditors. See, 11 U.S.C. § 550(a)(1).

Garnishments are considered transfers by the debtor for the benefit of creditors, even though involuntarily done. In re Winters, 182 B. R. 26 (Bkrtcy W.D. Ky. 1995). The date of the transfer is the date of service of the garnishment order upon the garnishee. If the date of transfer is outside the preference period, then even payments received by the creditor within the preference period escape recovery by the trustee or debtor. In re Edwards, 219 B. R. 970 (Bkrtcy W.D. Ky. 1998). If the garnishment order is served within ninety days before bankruptcy and the amount of the funds paid to the creditor exceed six hundred dollars ($600.00) but do not exceed one thousand dollars ($1,000.00), the debtor may seek to have the preferential conveyance set aside and recoup the garnished funds under his/her general exemption provided by K.R.S. 427.160. In re Towery, 53 BR 76 (Bkrtcy W.D. Ky.1985). Presumably, the trustee will act on behalf of the estate if the amount of the funds exceed the general exemption. Any garnishments which do not exceed $600.00 are not preferences under the Code. See, 11 U.S.C. § 547 (c)(8).

Many Chapter 7 debtors have liability on which third parties have cosigned. These debtors must realize that payments to a bank on an unsecured note that has been cosigned by their parents (or other insiders) can entitle the trustee to recover the payments from the parents if a bankruptcy is filed.
within a year after the payments are made. See, 11 U.S.C.§ 547 (b)(4)(B). Those payments benefited an insider by decreasing the liability of the insider, so the payments are preferential. Note that voluntary payments on the same debt after bankruptcy are not preferential.

Understanding basic preference law can lead the client to consider Chapter 13 relief and thereby protect the preferential payment, to delay the filing of the bankruptcy to allow the payment to fall outside the preference period, or to accelerate the filing to enable the trustee to recover a preference that has been paid to a creditor in order to benefit other creditors, particularly tax creditors.

6. Has the Client Granted any Mortgages or Security Interests to Secure Antecedent Debt Within One Year?

Clearly granting a creditor a mortgage to secure an otherwise unsecured debt can fall within the purview of a preferential conveyance, for such a transfer enables that creditor to receive more in repayment of debt than would have been the case without the transfer. In a Chapter 7 case, the recipient of a preferential security interest or mortgage is likely to be a creditor whose good opinion the debtor believes he/she needs to survive after bankruptcy. In such circumstances, the debtor will want to make every effort to avoid filing a bankruptcy petition until after the preference period has passed.

E. Client Desires And Goals

After a thorough analysis of the debtors' financial information, it is helpful to ask the clients what they realistically hope to accomplish through the bankruptcy process. Often the clients will say that they will be happy if they can save their home or their car. They may proclaim that they just want out from under all their debt. Consider writing the clients a letter after the initial meeting and reiterating your understanding of their purpose. It is important to have this discussion at the very beginning of the representation. Expectations tend to soar as the bankruptcy case progresses, for the protection of the bankruptcy court is narcotic to some debtors, lulling them into false optimism while they are protected from making payments. When the case concludes and the debtors are faced with the reality of having to make payments on debts they have reaffirmed or new debts they have undertaken since filing, one can tactfully remind them that their initial goals have been met. They will feel more positively about their experience and about your representation.

Commonly clients will advise their lawyer that they want to pay all their debts. Attorneys are obligated to discuss Chapter 13 with clients and present it as a means of paying their debts, or at least a substantial portion of them. See, FRBP 1002 incorporating therein Official Form No. 1. As a part of the initial interview the practitioner must give clients an overview of both Chapter 13 and Chapter 7 bankruptcies.

F. Chapter 13 Versus Chapter 7 Bankruptcies

1. Design of Chapter 13

In general, Chapter 13 is designed to permit the payment of a significant amount to unsecured creditors and to return to secured creditors the value of their collateral, be it through the actual surrender of the collateral or the payment of the value of the collateral over the term of the plan with interest at the market rate. See, 11 U.S.C.§ 1325 (a)(5) and Memphis Bank & Trust Co. v. Whitman, 692 F.2d 427 (6th Cir. 1982). Discrimination between creditors who are similarly situated is prohibited. See, 11 U.S.C.§ 1322 (a)(3). Chapter 13 cases tend to be more complicated from the perspective of both the debtor and debtor's counsel; consequently legal fees are higher than fees in Chapter 7 cases, although the payment of these fees through the trustee's office in installments may be easier on the debtor's budget than Chapter 7 fees which are typically paid in one or two installments. At a minimum, Chapter 13 cases require a three (3)
year commitment from the debtor, with court supervision of any additional, nonmedical debt. 11 U.S.C. § 1322 (d). However, Chapter 13 offers a means of dealing with debts which are nondischargeable in Chapter 7 and it offers protection for the debtor’s cosigners, to the extent that the debtor proposes to pay the debt under his/her plan. 11 U.S.C. § 1301(a). No assets will be sold or preferences recovered by the Chapter 13 trustee, as long as the debtor’s plan proposes payment of an amount equivalent to these potential recoveries. See, 11 U.S.C. § 1325 (a)(4).

2. Design of Chapter 7

On the other hand, Chapter 7 is designed to completely discharge unsecured debt, at the cost of the debtor’s equity. Most Chapter 7 proceedings are no asset cases, so debtors risk no equity by filing a Chapter 7 proceeding. Congress has limited the filing of Chapter 7 cases by prohibiting a debtor from filing more than once every six (6) years. See, 11 U.S.C. § 727 (a)(8). A Chapter 7 case is concluded quickly, requiring only one court appearance. 11 U.S.C. § 341(d). The economic value of a Chapter 7 case can be tremendous. The debtor can obtain a discharge from many thousand dollars of debt, while attorney fees rarely exceed one thousand dollars. There is no prohibition against discriminating between creditors after the filing, so a Chapter 7 debtor can voluntarily repay one unsecured creditor, ignoring all other unsecured claimholders. See, 11 U.S.C. § 524(a). Some debts will not be effected by a Chapter 7 filing. See, 11 U.S.C. §§ 523 (a)(1), (3), (5), (7), (8), (9), (10), (11), (12), (13), (14) and (16). Taxes, child support obligations and student loan debts are examples. Other debts may be excepted from discharge if the creditors assert their rights in a timely manner. These debts include debts predicated upon a false financial statement, certain credit card debts incurred immediately before filing, debts arising out of fraud, etc. See, 11 U.S.C. §§ 523(a)(2), (4), (6), and (15).

Having discussed the differences between Chapter 13 and Chapter 7 in general terms, it is then necessary to discuss these alternatives using the specific circumstances of the client. Ask the client if any money remains from his/her salary after payment of living expenses. Most will respond negatively. In those cases, no further exploration of Chapter 13 is required for there is no ability to fund the plan. If the client believes that he/she could make a Chapter 13 payment and meet his/her living expenses, then have the client complete Schedules I and J of the bankruptcy petition and delay further discussion of Chapter 13 until you have reviewed these schedules which list living expenses and income.

G. Discussion Of Bankruptcy Process And Procedure

1. Generally

If your clients have not previously asked how the bankruptcy system works, they will surely do so before the conclusion of the initial conference. Reassure them that bankruptcy relief goes into effect as soon as the petition is filed. Most of these clients will be concerned about their jobs and will ask questions like, “Will my employer be notified?” You can assure them that in all likelihood there will be no need to inform the employer, but that it will be necessary for the client to take off work to attend the creditors’ meeting. Advise the client that the notice of the creditors meeting will come to him/her at the same time as it comes to you and that the “Notice of Commencement of Case Under Chapter 7 of the Bankruptcy Code, Order for Relief, Meeting of Creditors and Fixing of Dates” (herein referred to as “creditors’ meeting”) will be received several days in advance of the meeting, so that he/she can schedule time off.

Explain to clients that the filing of a bankruptcy case draws a line between their prepetition activities and their postpetition affairs. They will be comforted to learn that earnings generated after filing are free and clear of prebankruptcy debt and that property which they acquire after the bankruptcy
filing can not be subjected to the payment of the prepetition debt. See, 11 U.S.C.§ 541(a). There are exceptions to this rule. Advise your clients that any property inherited within six (6) months of the filing of a bankruptcy petition is drawn into the bankruptcy estate and divided between creditors. See, 11 U.S.C.§ 541 (a)(5)(A). A client with an elderly or ailing parent, sibling , etc. may want to suggest to that potential testator that his/her will be rewritten. Further any funds paid to the debtor as a beneficiary under a life insurance policy within 180 days of the petition date may be drawn into the bankruptcy estate for payment of creditors. See, 11 U.S.C. § 541 (a)(5)(C). Finally, any property received by the debtor in a property settlement agreement or divorce decree within 180 days of filing will become part of the bankruptcy estate. See, 11 U.S.C. § 541 (a)(5)(B).

2. Surrender of Property

Reaffirmation, redemption and surrender of property should be discussed during the initial client meeting. Often the client has been attempting to sell a boat or vehicle, having decided that they are unable to make the monthly payment on the collateral. Being told that they can surrender this property to the secured creditor—paying the creditor no additional monies—will be well received. See, 11 U.S.C.§ 506 (a). Redemption of property from the secured creditor is more difficult to explain and, in the author's opinion, underutilized by Chapter 7 debtors.

3. Redemption of Property

Typically, redemption is used with creditors which hold purchase money security interests in household goods. A revolving charge account may retain for the merchant a security interest in anything that was ever financed on the account as long as a debt is outstanding. Appliances, furniture and stereo equipment purchased several years ago may still be held as collateral for substantial debt, even though the property has minimal value. A debt of several thousand dollars may be secured by property worth only a few hundred dollars. Ask the client how much the property is worth in its current condition. Explain to the client that by offering to pay that amount, usually in a lump sum, the creditor's interest in the property can be purchased. See, 11 U.S.C.§722. Both debtors and creditors are aided by redemption. Debtors are spared the humiliation of having their personal items repossessed, and creditors are spared the expense of repossession and sale. You can not force the creditor to allow your client to make installment payments on a redemption, but increasingly, creditors have allowed Chapter 7 debtors this flexibility. Redemption must be approved by the Court and a dispute over the value of the property can lead to a hearing. These disputes are best resolved through negotiations, for the Chapter 7 debtor can rarely afford additional attorney fees arising out of the hearing, and the Court will not deal kindly with lawyers who take up courtroom time to determine the value of a ten year old refrigerator.

4. Reaffirmation of Debt

Frequently the Chapter 7 case will involve at least one reaffirmation of a secured debt. Clients will tell you that they want to "resign" with a creditor. The attorney is advised to inform the client of the legal consequences of such an act. Make sure they realize that by reaffirming the debt, they are recommitting their personal liability on the debt and will be subject to suit and garnishment if they default on the payment.

Reaffirmation is easily accomplished if the clients are current on their payments to the creditor and if the collateral is worth approximately the same amount as the debt which is owed. Local Rule 22 of the United States Bankruptcy Court for the Western District of Kentucky provides a simple reaffirmation agreement form to be signed by the client, the creditor and the debtors' counsel. See, Appendix A to this paper. The completed form must be filed with the court within the time period set forth in the notice of creditors' meeting. It is unclear whether a debtor has an absolute right to reaffirm a debt which is being paid according to contract terms.
Reaffirmation is somewhat complicated when the client is delinquent in the payment of the debt. Clearly, the creditor must consent to this reaffirmation, and the creditor will require some agreement on curing the arrearage in the account. If the debtors have been habitually delinquent in their payments, creditors may refuse to negotiate a reaffirmation of the debt and the Court will not intervene on behalf of the debtors. It has been this author's experience that creditors will usually allow the debtors reasonable time to cure the delinquency and will consent to the reaffirmation. Again, an agreement must be drafted setting forth the terms of the agreement and the document must be filed with the court after it has been signed by the debtors, debtors' counsel and the creditor.

Debtors may want to reaffirm an unsecured debt. Courts rarely approve such reaffirmations and only then if the reaffirmation is done in settlement of a nondischargeability case. You can remind your client that he/she may voluntarily pay any prepetition debt, without reaffirming the debt and resubmitting his/her personal liability to the creditor.

Pursuant to 11 U.S.C. § 524 (d), as a part of the reaffirmation procedure as debtors' counsel, you must sign an affidavit stating:

I, ____________________________, attorney for the debtors in the above captioned bankruptcy proceeding declare that I represented the debtors during the negotiation of the foregoing Agreement and that said Agreement represents a fully informed and voluntary agreement by the debtors which does not impose an undue hardship on the debtors or a dependent of the debtor. I have fully advised the debtors of the legal effect and consequences of this agreement and any default under the agreement. (Emphasis added).

The emphasized language is of concern. Can the creditor assert a claim against debtors' counsel if there is a subsequent default? Conceivably debtors' counsel makes an actionable misrepresentation by signing the affidavit knowing that the clients do not have the ability to repay the debt. There have been occasions when I doubted the wisdom of my clients' decision to reaffirm a debt. On occasions I have refused to sign the reaffirmation affidavit. If debtors' counsel does not sign the affidavit, then a hearing must be held on the reaffirmation. The hearing will necessitate the client's attendance. See, 11 U.S.C. § 524 (c)(6).

H. Timing Of The Bankruptcy Filing

By now, the attorney has formed an opinion about the timing of the petition's filing. If an emergency exists and you practice in a division of court other than Louisville or Lexington, you may need to ask permission from the bankruptcy clerk to file a skeleton petition at the office of the U.S. District Court nearest you. See, LBR 4 (W.D. Ky). You may file the petition in the division of court which is most available to you, even though the case may actually proceed in another division. For example, assume you practice in Henderson, Kentucky which is about 30 miles from Owensboro, the nearest seat of the district court. Your client needs to file an emergency petition to stop a wage garnishment and that client resides in Princeton, Kentucky. The petition can be filed in Owensboro even though the case will be designated a Paducah Division case. Verbal permission of the bankruptcy clerk must be obtained before an emergency petition is filed, but permission is readily granted. Cessation of garnishments, avoidance of the entry of a judgment or cancellation of a judicial sale have all been deemed sufficient grounds for the accommodation. After the bankruptcy clerk has spoken with the attorney, she/he will call the district clerk's office in the division where you plan to file the petition. The deputy district court clerk will be assigned the bankruptcy number which will be assigned to the case. The district clerk will accept the petition and filing fee, stamp it and give it a case number. The district clerk will then mail the petition to Louisville or Lexington and will have no other dealings with the case, unless the case results in an appeal.

Most emergency filings are also skeleton filings. A skeleton petition is composed of the first page of the petition and a list of creditors' names and addresses. Obviously one can complete the necessary paperwork to accomplish a skeleton filing in much less time than that required for the complete
petition and schedules. Your client need only estimate his/her total debt and total asset value for the skeleton petition; specifics about individual creditor claims are not required. Permission of court is not required to file a skeleton petition. After the petition has been filed, you have fifteen (15) days within which to file the statement of affairs and schedule. See, FRBP 1007(c).

Whether the attorney uses the shorthand procedure of a skeleton filing or delays the filing until the complete petition has been prepared, it is most important that one file the petition in conjunction with the timetable agreed upon with the client. Failure to timely file petitions have led to disciplinary sanctions. See, KBA v. Watson, Ky., 862 S.W.2d 317 (1993); KBA v. Goodrich, 851 S.W.2d 479 (1993); KBA v. Reeves, Ky., 851 S.W.2d 478 (1993).

I. Petition Information And Client Questionnaire

As the office conference concludes, give the client a questionnaire which will assist the client in gathering the information necessary to complete the bankruptcy petition. The questionnaire is invaluable for it will allow your staff to work on the petition in the client’s absence and more efficiently utilize staff time. Further, the questionnaire will provide protection should a question ever arise about the failure to list an asset or creditor. A sample questionnaire is set forth in the Appendix to this work for your consideration. See, Appendix B.

The Bankruptcy Court has developed two pamphlets which practitioners are asked to distribute to Chapter 7 filers. The pamphlets reiterate many of the concepts that you will discuss with your client during the initial conference. Supplying the pamphlets is ideal, for the clients can review the information after they have left your office and refresh their memories about some of the important subject matters that you have covered.

J. Discussion Of Attorney Fees

Before the client leaves the office, attorney fees must be discussed. It is customary to require a retainer in Chapter 7 cases. If the retainer is equivalent to the total charges for the representation, then technically the attorney has received a fraudulent transfer because the attorney is going to be paid for work which will not have been performed when the petition is filed – attendance at the creditors’ meeting and creditor negotiations, for example. Fraudulent transfers are defined for bankruptcy purposes as transfers without equivalent value. See, 11 U.S.C. § 548(a)(2). However, the author is unaware of any challenges having been made to a retainer unless the amount appears excessive. If the client is unable to pay the entire fee before filing, an arrangement which requires the payment of one-half of the fee in advance of filing and one-half on or before the creditors’ meeting is standard. The attorney is at peril under this arrangement, for he/she is required to attend the creditors’ meeting whether or not payment has been received. See, LBR 3(d) (W.D. Ky.).

IV. INFORMATION GATHERING

A. Client Inquiries And Additional Creditors

As the client undertakes to complete the questionnaire, be prepared for many questions to arise. Queries about the questionnaire can often be handled by one’s secretary. Often the client needs clarification of an issue which was discussed at the initial meeting. Many times the client will recall a creditor which was omitted from their financial statement and want to discuss that creditor’s position after a Chapter 7 filing.

During this phase of the case, the client may tell the attorney about a creditor that they do not wish to list on their petition – say a family friend or a credit card that they want to retain. Counsel must remind the client that the bankruptcy petition is a document, executed under penalties of perjury, and
that all creditors to whom they are indebted at the time of filing must be listed on the petition. See, 18 U.S.C. §§ 152 and 3571. If the client has the financial wherewithal to pay the debt before filing, then there will be no need to list that entity on the petition.

B. Credit Bureau Report

For a nominal sum, the client-debtor can obtain a copy of his/her local credit bureau report. The report may assist the client in recalling all of his/her creditors and it may provide addresses of collection agencies which hold assignments of claims against the client. Giving notice to these agencies will hasten the notice process and eliminate future collection efforts against the client.

C. Lien Search

Ideally, a courthouse lien search is performed during this period. It is particularly important that counsel learn about any judgment liens which may have been filed against the clients’ real property. Furthermore, the client may believe that a creditor has a lien or mortgage; yet a review of the records may indicate that the creditor did not properly perfect its mortgage or security interest. This knowledge may equip the attorney to negotiate with the creditor to avoid bankruptcy. It may make the bankruptcy more beneficial for the sale of the asset may allow the trustee to pay a priority claim such as a tax or child support. See, 11 U.S.C. § 507.

Conducting even a cursory lien search adds to the time expenditure on the case. Chapter 7 fees are very competitive. As such, charging an additional fee to conduct a lien search may well cost an attorney the representation. Whether a lien search is a necessity or a luxury is unclear. However, creditors are using the judgment lien statute with great frequency and you may not learn about the lien unless you search the records. It is difficult to explain to a client two years after the case is closed why you took no action to remove a judgment lien. The client’s failure to advise you about the lien’s existence will be forgotten; your failure to avoid the lien will be remembered.

D. Inquiries From Creditors

If the client is being hard pressed by collection efforts, the client may wish to tell creditors that he/she is filing bankruptcy is imminent. Be prepared to receive telephone calls from creditors asking whether a filing has occurred. It is best to discuss your handling of these calls with your client. See, Hughes v. Meade, Ky., 453 S.W.2d 538 (1970). In all likelihood, the client will most likely consent to your telling the creditor that you have been retained to file a Chapter 7 petition. Such information will gain the client a respite from collection calls. Make sure that the client understands that you must tell creditors the truth. Clients have been known to tell their creditors that they have actually filed when they have merely made the decision to file. Counsel must not assist the client in misleading creditors.

V. SECOND CLIENT CONFERENCE

Once the actual bankruptcy petition has been completed, it will be necessary for your clients to again visit your office in order to sign the petition. Provide them with a comfortable environment to review the petition if they have not already been supplied a copy of the document via mail.

A. Fee Agreement

If the clients have not already done so, they should be asked to sign a fee agreement. Ideally this contract would have been signed prior to preparation of the petition, although clients are rarely willing to commit to the filing of a bankruptcy petition after the initial conference. The occasion of the petition signing provides the best opportunity to memorialize the agreement of representation.
Attached as Appendix C to this paper is a copy of a fee agreement. Note that the contract leaves the attorney with the option of renegotiating the representation in the event that an adversary proceeding is filed against the client.

B. Fee Disclosure Statement

The attorney is required to attach a disclosure statement to the bankruptcy petition, advising the Court of the amount charged to represent the debtor in the proceeding. If the fee falls outside the normal range ($500 to $1,000), counsel should be prepared to justify the fee. If the Court concludes that there has been an overcharge, the attorney can be required to turn over any excess fee to the trustee. See, 11 U.S.C. §329(b). A sample fee disclosure statement is set forth in the appendix as Appendix D.

C. Post-Execution Filing Deadline

Once the petition has been signed, it must be filed with the bankruptcy clerk's office within fourteen (14) days. If the petition is held in the attorney's office any longer than fourteen (14) days, it becomes stale and the clerk's office will not accept it. See, LBR 5(d) (W.D. Ky.). The filing fee must be submitted to the clerk's office in the form of cash, certified check, money order or an attorney's office check. The client's check will not be accepted.

VI. TELEPHONE AND MAIL TRAFFIC

A. Basic Information

After the petition has been filed and the notices have been sent by the bankruptcy clerk's office to creditors, the attorney will get a flurry of telephone calls from creditors asking for very basic information such as the date of filing, the case number, and the date and location of the first meeting of creditors. These calls can be handled by your secretary.

B. Secured Creditors And Statement Of Intent

There may be inquiries from secured creditors about your clients' intention regarding reaffirmation of their debt. The Bankruptcy Code requires that all creditors with liens on consumer goods receive notice of the debtors' intentions concerning their collateral within thirty (30) days following the filing of the petition. See, 11 U.S.C.§ 521 (2)(A). Regardless of the fact that you have complied with this requirement, expect calls from large national creditors which involve many departments involved in the collection process. The Statement of Intentions will provide an easy reference for one's secretary in fielding the creditors' calls.

C. Reaffirmation Agreements

Debtor's counsel will receive reaffirmation agreements from creditors for the client's consideration. The author usually holds the reaffirmation agreements until the first meeting of creditors. This procedure saves time and is not harmful to clients. Certainly you should review each reaffirmation agreement to make certain that the amount and debt being treated by the agreement is as expected.

D. Creditor Activities

Since most creditors have computerized billing systems, it is understandable that the debtor might receive a bill post-filing. However, bills which continue to be sent to Chapter 7 debtors sixty (60) days after the bankruptcy filing are inexcusable, assuming that the creditor's address used in the petition
is correct. The client is going to want immediate cessation of creditor contact. Tell him/her to ignore the first statement received after filing, but to notify you if subsequent statements are received. Usually a short letter from counsel will bring a halt to postpetition collection activities. If collection activities do not cease, 11 U.S.C.§ 362 (h) provides for significant sanctions, including attorney fees, against creditors who violate the automatic stay of the court.

Assume that prior to filing the bankruptcy case a motion for a default judgment against the client had been tendered in some pending litigation. If the judgment is entered before the judge gets notice of the bankruptcy filing, it is voidable. See, Easley v. Pettibone Michigan Corporation, 990 F2d 905 (6th Cir. 1993). It is good practice to file notices in all pending litigation advising the trial court about the bankruptcy. Attached as Appendix E is a sample of such a notice.

VII. CREDITORS’ MEETING

A. Preparation Of Client

Counsel should arrange to meet with clients a short time before the first meeting of creditors in order to prepare them for their session with the bankruptcy trustee. Suggest that the clients review their bankruptcy petition before coming to court.

It is helpful to get to the creditors’ meeting early so to allow your clients to sit through some of the other debtors’ meetings. Stay focused on your clients’ case. This author once received a compliment and a business referral from a creditor’s attorney, simply as a result of sitting with her clients while they waited for their case to be called and explaining proceedings rather than abandoning her clients.

The rudiments of the first meeting of creditors are set forth in 11 U.S.C.§§ 341 and 343. The trustee will ask the debtors if they have listed all their property and debts in the bankruptcy petition. Remind the clients about the discussion which you had with them during the initial meeting concerning Chapter 13 options. The trustee may ask them if they considered filing a Chapter 13 petition and if they are aware of the effect that Chapter 7 will have upon their credit. The trustee will want to verify that the petition correctly sets forth the debtors’ names and social security numbers.

The trustee will then open the meeting up to creditors. Questions about the location of collateral and the status of insurance are common.

If the client has sold collateral without turning over the proceeds to the creditor or has committed some other act which may constitute fraud or a criminal violation, she/he can claim the Fifth Amendment protection against self incrimination during their testimony. If the client does not testify and the bankruptcy court is asked to determine whether a debt should be excepted from discharge or a discharge should be denied this debtor altogether, then the judge can be expected to infer culpability from the debtor’s refusal to testify. See, In re Edmond, 934 F2d 1304 (4th Cir. 1991).

B. Trustee Report Of No Assets

As mentioned earlier, the vast majority of Chapter 7 cases are declared to be no asset cases as soon as the trustee has conducted his/her examination of the debtors. The trustee will tell the debtors and the assembled creditors that a no asset report will be filed. By so doing, the trustee will abandon any interest which the bankruptcy estate had in your clients’ assets. See, 11 U.S.C.§ 554(c). Counsel is left to deal with the creditors who hold liens or security interests in the clients’ property.
C. Dealing With Creditors

After the hearing, creditors may encircle one's clients, trying to get signatures upon reaffirmation agreements. Try to meet with as many creditors as possible, since clients are present and matters can be resolved quickly. If you return to the office without resolving an issue with a creditor, it will take several telephone calls and letters to get the debt reaffirmed or the property redeemed. If the client has chosen to surrender the asset to the creditor, then counsel can use the creditors' meeting to discuss the time and place of delivery.

The attorney must discuss each reaffirmation agreement with the clients. Remember to tell clients that they are allowed to rescind any reaffirmation agreement if they do so in writing prior to the last date for filing nondischargeability complaints or sixty (60) days after the agreement has been filed with the court, whichever date is later. See, 11 U.S.C.§ 524(c)(4).

VIII. FOLLOW UP

A. Amendments To Petition

In the event a client has omitted a creditor from his/her petition, it will be necessary to file an amendment. Again, the Bankruptcy Court for the Western District has provided a straight-forward form for such an amendment. See, Appendix F. It will be necessary to serve a copy of the amendment upon the trustee, and it will be necessary to certify to the Court that you have mailed a copy of the notice of creditor's meeting to the added creditor. Each time you file an amendment which adds a creditor, an additional filing fee of $20.00 is required. Whether the amendment adds just one creditor or whether it adds 100, the cost is still $20.00.

If the client has failed to claim an exemption to which he/she is entitled or fails to list an asset, an amendment must be prepared and served upon the trustee but no additional fee is required.

B. Redeeming Property

The Debtor's option to redeem property which is the subject of a secured creditor's claim was discussed supra. A written motion seeking court approval of the redemption amount must be filed. Having met with the creditor and client following the creditors' meeting, the attorney will be able to complete the motion to redeem property. A copy of the Western District of Kentucky form, provided in Local Rule 23, is attached as Appendix G. The Eastern District of Kentucky has also adopted a form for use in redeeming property and it can be found in the local rules of that court.

C. Lien Avoidance

If any asset in which a client has claimed an exemption is subject to a judicial lien, counsel must consider filing a motion to avoid that lien under 11 U.S.C.§ 522(f). Let us consider an example.

Assume that your client's residence was worth $12,000.00 and assume further that a debt of $3,800 was owed to a creditor which was properly secured by a real estate mortgage. A general creditor had obtained a judgment of $8,317 and had recorded a judgment lien. Your client has a homestead exemption of $5,000, pursuant to KRS 427.060. You file your motion to avoid the lien of the general creditor because it impairs the exemption of your client. Without the judgment lien, the homestead is worth a sufficient amount, if sold, to pay the first mortgageholder and your client's $5,000 entitlement. Your motion will be granted, in part. The Court will conclude that the amount of the first
mortgageholder's debt and the exemption is $8,800 so the remaining value of the residence, $3,200, will be subjected to the judgment lien. If the sum of the valid mortgage and the exemption exceeded the value of the property, then the judgment lien would be avoided altogether. See, In re Powell, 173 B. R. 338 (Bkrtcy. E. D. Ky. 1994).

Lien avoidance has generated litigation in recent years. The Sixth Circuit ruled that Ohio law prevented the use of lien avoidance unless a foreclosure proceeding had been commenced before the bankruptcy case was filed. In re Moreland, 21 F. 3d 102 (6th Cir. 1990); In re Dixon, 885 F. 2d 327 (1989). Because of similarities in Ohio and Kentucky statutes, Kentucky practitioners generally regarded these cases were dispositive of the issue. In 1994, Judge William Howard was called upon to squarely address lien avoidance, comparing our Kentucky statutes with those of Ohio. He concluded that lien avoidance in the Commonwealth was appropriate even if the creditor had not sued for foreclosure. In re Powell, supra. The Western District of Kentucky followed the Powell decision, but imposed a sixty day time limit, following the first meeting of creditors, within which to file the motion. In re Hunter, 164 B. R. 738 (Bkrtcy W.D. Ky. 1994).

With lien avoidance firmly in Kentucky case law, more recent opinions have focussed on the effect of judgment liens prospectively, after bankruptcy. A judgment lien creditor was forced to release its lien after it had received the value of its judgment liens from estate property, thereby allowing the debtor to acquire additional property post petition without the specter of the lien. In re Stidham, 1995 WL 876391 (Bkrtcy E. D. Ky.). In another case, the debtor owned no real property; nevertheless a judgment lien had been filed to encumber any property which might someday be acquired. Cautioning that he would not make a practice of issuing such orders, the bankruptcy judge required the creditor to release the judgment lien to facilitate the debtor's future real property acquisition. In re Norvell, 198 B. R. 697 (Bkrtcy W.D. Ky. 1996).

Bankruptcy Courts for both the Eastern and Western Districts of Kentucky have adopted Official Forms for use in filing motion to avoid liens. Attached hereto as Appendix H is the Western District form. Also refer to Form Number 5(b) for the Eastern District of Kentucky in the Local Rules.

IX. CONCLUSION

Trial lawyers labor for years and risk thousands of dollars in costs to develop a case which may have an economic effect on their clients' lives as great as the relief which a properly handled Chapter 7 bankruptcy case will bring. Through your efforts, clients can be discharged of thousands of dollars of debt which they otherwise would have struggled for years to satisfy. Within sixty (60) days, an attorney can actually see the fruits of his or her labors. Few other legal specialties provide such positive reinforcement.
UNITED STATES BANKRUPTCY COURT
FOR THE
WESTERN DISTRICT OF KENTUCKY

IN RE: ________________________

__________________________________________

Debtors

CASE NO. ___________________

REAFFIRMATION AGREEMENT

The debtors reaffirmation agreement is as follows:

1. REAFFIRMATION - The debtors reaffirm to pay ________ in accordance with the loan documents, (copies are attached), the sum of $______, the principal balance due, plus interest at the rate set forth in the instruments from __________, at the rate of $________ per month until fully paid, beginning on __________.

2. This agreement does/does not change the terms of the original contract.

Payment is secured by the following property with the value to the secured creditor as indicated:

__________________________________________

3. PAST DUE PAYMENTS - In addition to the monthly payments provided in paragraph one (1) above, the debtors agree to make up payments as follows: ________________________________ (if applicable)

4. RESCISSION PERIOD - THE DEBTOR(S) MAY RESCIND THIS AGREEMENT BY GIVING NOTICE TO THE CREDITOR AT ANY TIME PRIOR TO THE LAST DATE FOR FILING DISCHARGEABILITY COMPLAINTS OR SIXTY (60) DAYS AFTER THIS AGREEMENT HAS BEEN FILED WITH THE COURT, WHICHERVER DATE IS LATER, BY GIVING NOTICE OF RESCISSION TO THE HOLDER OF THE CLAIM.

Executed this the _____ day of ______________________, 19____.

Debtor

Debtor

ACCEPTED AND AGREED TO:

By: ________________________________

Title

Creditor

A - 17
AFFIDAVIT OF ATTORNEY FOR DEBTOR(S)

I, ______________________, attorney for the debtors in the above captioned bankruptcy proceeding declare that I represented the debtors during the negotiation of the foregoing Agreement and that said Agreement represents a fully informed and voluntary agreement by the debtors which does not impose an undue hardship on the debtors or a dependent of the debtor. I have fully advised the debtors of the legal effect and consequences of this agreement and any default under the agreement.

Date ______________________  Attorney for Debtor(s)
B. Bankruptcy Questionnaire

CLIENT QUESTIONS—Individual or Joint

Name and Other Information

You:

1. a. Name:
   (1) Mailing ____________________________
   (2) Address: ____________________________
   (3) ____________________________
   (4) ____________________________
   (5) Telephone: ( ) __________________
   (6) County: _________________________
   (7) Have you moved within the last two years? __ No __ Yes
   (a) If Yes, enter addresses, occupancy dates, and names used:
       ____________________________________________________________
       ____________________________________________________________
   (8) Are mailing address and residence the same? __ No __ Yes
   If No, enter the residence below:
   (a) __________________________________________________________
   (b) __________________________________________________________
   (c) __________________________________________________________
   (d) __________________________________________________________
   (9) Social security number: __ - __ - __
   (10) Tax identification number: __________________________
   (11) Gender: ___ Male ___ Female
   (12) Marital status:
       ___ Never Married
       ___ Divorced ___ Widowed
       ___ Married and living together
       ___ Married and living apart
   (13) Other names used in last six years:
       __________________________________________________________
       __________________________________________________________
       __________________________________________________________

Spouse:

b. Name:
   (1) Mailing ____________________________
   (2) Address: ____________________________
   (3) ____________________________
   (4) ____________________________
   (5) Telephone: ( ) __________________
   (6) County: _________________________
   (7) Have you moved within the last two years? __ No __ Yes
   (a) If Yes, enter addresses, occupancy dates, and names used:
       __________________________________________________________
       __________________________________________________________
   (8) Are mailing address and residence the same? __ No __ Yes
If No, enter the residence below:

(a) 
(b) 
(c) 
(d) 

(9) Social security number: ______-____-____
(10) Tax identification number: 
(11) Other names used in last six years: 

2. a. Are you currently employed?   Yes  No
If Yes, provide the following information about employment:
(1) Employer's name: 
(2) Employer's address: 
(3) 
(4) 
(5) Telephone: (____)____-____
(6) Occupation and nature of business: 
(7) Dates employed: 
(8) Relationship to business described above: 
   Employee  Owner
   If more than one employer, provide the information requested above about other employer(s):

b. Is your spouse currently employed?   Yes  No
If Yes, provide the following information about employment:
(1) Employer's name: 
(2) Employer's address: 
(3) 
(4) 
(5) Telephone: (____)____-____
(6) Occupation and nature of business: 
(7) Dates employed: 
(8) Relationship to business described above: 
   Employee  Owner
   If more than one employer, provide the information requested above about other employer(s):

3. Please provide the gross income received from your principal place of employment (If unemployed, write None at Source(s)):
   You
   (a) This year: 19 _____
      (i) Source: 
      (ii) Amount: $________
   (b) Last year: 19 _____
      (i) Source: 
      (ii) Amount: $________
   (c) Previous year: 19 _____
      (i) Source: 
      (ii) Amount: $________
b. Have you received any other income, other than income received from your principal employment?
  No    Yes
If Yes, provide the following information
You
  (a) This year: 19__
    (i) Source(s): ____________________________
    (ii) Amount: $_____
  (b) Last year: 19__
    (i) Source(s): ____________________________
    (ii) Amount: $_____
  (c) Previous year: 19__
    (i) Source(s): ____________________________
    (ii) Amount: $_____

Spouse:
  (a) This year: 19__
    (i) Source(s): ____________________________
    (ii) Amount: $_____
  (b) Last year: 19__
    (i) Source(s): ____________________________
    (ii) Amount: $_____
  (c) Previous year: 19__
    (i) Source(s): ____________________________
    (ii) Amount: $_____

4. a. Have you made any PAYMENTS to anybody, within the past year of more than $600 other than normal scheduled payments? No    Yes
If Yes, provide for each creditor:
  Name & Address ____________________________
  Amount and Date ____________________________
  Relationship, if any, to you ____________________________

b. Has any creditor ATTACHED/GARNISHED/SEIZED property within last year? No    Yes
If Yes, provide for each garnishment or attachment:
  Name & Address ____________________________
  Date of garnishment or attachment ____________________________
  Property garnished or attached ____________________________
  Value ____________________________

c. Has any creditor REPOSSESSED/FORECLOSED/RETURNED property within last year? No    Yes
If Yes, provide for each repossesion/foreclosure or return:
  Name & Address ____________________________
  Date of repossession/foreclosure or return ____________________________
  Property repossessed/foreclosed/returned ____________________________
  Value ____________________________
Date of repossession, foreclosure or return

Property repossessed, foreclosed upon or returned

Value

d. Have you given any creditor a mortgage or lien against any property within the last year?
   _ No ___ Yes
   If Yes, provide for each lien:
   Name & Address

   Date of lien
   Property mortgaged
   Value
   Relationship to you, if any

e. Has any creditor taken a SETOFF within last 90 days?
   _ No ___ Yes
   If Yes, provide for each setoff:
   Name & Address

   Date of setoff
   Amount setoff

5. Are you named in any LAWSUITS within last year? _ No ___ Yes
   If Yes, provide for each lawsuit:
   Title of lawsuit

   Number
   Type of suit
   Status
   Court name and location

   Title of lawsuit

   Number
   Type of suit
   Status
   Court name and location

6. Has any of your property been placed into a Court appointed RECEIVERSHIP within last year?
   _ No ___ Yes
   If Yes, provide the name and address of custodian; court name and location; title, number, and date of the order; and property description and value:
   Name & Address of custodian

   Court name and location
   Date of Court Order
   Property placed into receivership
   Value

7. Have you made any GIFT or CONTRIBUTION within the past year other than the normal gifts to family members or charitable organizations?
   _ No ___ Yes
   If Yes, provide for each gift or contribution:
   Name & Address
8. Any LOSSES from fire, theft, etc. within last year?  
   No  Yes
   If Yes, provide of each loss:
   Property lost
   Date of loss
   Circumstances of loss
   Covered by insurance?
   Name and address of insurance company
   Status of claim

9. Have you consulted and paid any other attorneys for DEBT COUNSELING?  
   No  Yes
   If Yes, provide for each attorney:
   Date of payments and amounts

10. Have you made any TRANSFERS or CONVEYANCES of your property, within the past year?  
    No  Yes
    If Yes, provide for each transfer:
    Name & Address
    Relationship, if any, to you
    Date of transfer
    Property transferred
    Value received

11. Have you closed any bank ACCOUNTS within last year?  
    No  Yes
    If Yes, provide for each account:
    Name & Address of bank
    Type and number of account
    Final balance
    Date of closing

12. Have you maintained any SAFE DEPOSIT BOXES within last year?  
    No  Yes
    If Yes, provide for each box:
    Name & Address of bank
    Name Address of person(s) with access to box
    Description of contents and values
    Date surrendered (if applicable)

13. Are you currently in possession of any property belonging to another i.e. household goods, cars, etc.?  
    No  Yes
    If Yes, provide for each property:
    Description of property
    Location of property
    Value of property
14. Are you currently a party to any contracts that have not been completed, unexpired lease agreements, or timeshare agreements?  
   ____No  ____Yes
   *If Yes, provide the following information for each contract/lease:*
   
   **Name & Address:**  
   
   **Description of property involved:**  
   
   **Terms of the contract:**  
   
15. Have you been a partner, etc., or five percent owner of any other businesses within the last two years?  
   ____No  ____Yes
   *If Yes, provide:*  
   **Name & Address of entity:**  
   **Nature of business:**
   **Dates of operation:**  
   
17. Has someone other than yourself kept your books of account within last six years?  
   ____No  ____Yes
   *If Yes, provide:*
   **Name & Address:**  
   **Period of time books were kept:**
18. Has any person AUDITED your books of account during last six years?  ____No  ____Yes
   If Yes, provide:
   Name & Address: _____________________________________________________________
   Period of time books audited: ________________________________________________

19. Is any person, other than yourself, CURRENTLY IN POSSESSION of books of account?
   ____No  ____Yes
   If Yes, provide:
   Name & Address: _____________________________________________________________

   Are all your books currently available?
   ____No  ____Yes
   If Yes, explain _____________________________________________________________

20. Have you issued any FINANCIAL STATEMENTS in last two years to creditors or others?  ____No  ____Yes
   If Yes, provide the name and address of person(s) receiving statement(s), and date(s) issued:
   Name & Address: _____________________________________________________________

   Date issued: ________________________________________________________________

21. Have you performed any inventories within the last two years?  ____No  ____Yes
   If Yes, provide the following information:
   a. Last inventory:
      (1) Date: ___/___/___
      (2) Name and address of person with records:
          __________________________________________________________
      (3) Inventory dollar amount (cost, market, other):
          __________________________________________________________

   b. Previous inventory (if no previous inventory, write None in date space):
      (1) Date: ___/___/___
      (2) Name and address of person with records:
          __________________________________________________________
      (3) Inventory dollar amount (cost, market, other):
          __________________________________________________________

TAX CREDITORS:

Do you owe any taxing authorities:  ____yes  ____no
   If yes, please answer the following questions (use a separate sheet for additional tax creditors, if necessary):
   a. Name & Address
      __________________________________________________________
<table>
<thead>
<tr>
<th>Type of tax</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Person incurred debt: you __ spouse __ joint</td>
<td></td>
</tr>
<tr>
<td>Is anyone else responsible for debt: yes ___ no</td>
<td></td>
</tr>
<tr>
<td>If yes, please provide:</td>
<td></td>
</tr>
<tr>
<td>Name &amp; Address</td>
<td></td>
</tr>
</tbody>
</table>

| Relationship to you |  |
| Date debt was incurred |  |
| Amount due |  |
| Do you agree with this amount |  |
| Does the creditor owe you money? yes ___ no |  |
| If yes, explain |  |

| Has creditor brought a lawsuit against you for this debt? yes ___ no |  |
| If yes, include on question 5 on client questions |  |

**b.** Name & Address |  |

<table>
<thead>
<tr>
<th>Type of tax</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Person incurred debt: you __ spouse __ joint</td>
<td></td>
</tr>
<tr>
<td>Is anyone else responsible for debt: yes ___ no</td>
<td></td>
</tr>
<tr>
<td>If yes, provide:</td>
<td></td>
</tr>
<tr>
<td>Name &amp; Address</td>
<td></td>
</tr>
</tbody>
</table>

| Relationship to you |  |
| Date debt was incurred |  |
| Amount due |  |
| Do you agree with this amount |  |
| Does the creditor owe you money? yes ___ no |  |
| If yes, explain |  |

| Has creditor brought a lawsuit against you for this debt? yes ___ no |  |
| If yes, include on question 5 on client questions |  |

**SECURED CREDITORS:**

Please provide the following information about all creditors that have a lien on any of your property. Use a separate sheet of paper for additional secured creditors, if necessary.

| a) Name & Address of secured creditor |  |
| Account number |  |
| Are you related to this creditor in any way |  |
| Person incurred debt: you __ spouse __ joint |  |
| Is anyone else responsible for debt: yes ___ no |  |
| If yes, provide: |  |
| Name & Address |  |

| Relationship to you |  |
| Does the debt involve an unexpired contract or lease |  |
| Date debt was incurred |  |
Amount due__________________________
Do you agree with this amount? ____________
Does the creditor owe you money? ____no ____yes
If yes, explain__________________________

Has creditor turned this account over to an attorney or collection agency? ______yes ______no
If yes, Name & Address__________________________

Has creditor brought a lawsuit against you for this debt?
____yes ______no
If yes, include on question 5 on client questions Description of the collateral________
Market value of collateral__________________________
Do you wish to keep this property__________________________

b) Name & Address of secured creditor__________________________

Account number__________________________
Are you related to this creditor in any way__________________________
Person incurred debt ____you ____spouse ____joint
Is anyone else responsible for debt ____yes ____no
If yes, provide: Name & Address__________________________

Relationship to you__________________________
Does the debt involve an unexpired contract or lease__________________________
Date debt was incurred__________________________
Amount due__________________________
Do you agree with this amount? ____________
Does the creditor owe you money? ____no ____yes
If yes, explain__________________________

Has creditor turned this account over to an attorney or collection agency? ______yes ______no
If yes, Name & Address__________________________

Has creditor brought a lawsuit against you for this debt?
____yes ______no
If yes, include on question 5 on client questions Description of the collateral__________________________
Market value of collateral__________________________
Do you wish to keep this property__________________________

c) Name & Address of secured creditor__________________________

Account number__________________________
Are you related to this creditor in any way__________________________
Person incurred debt ____you ____spouse ____joint
Is anyone else responsible for debt ____yes ____no
If yes, provide: Name & Address__________________________
Name & Address

______________________________

Relationship to you

Does the debt involve an unexpired contract or lease

Date debt was incurred

Amount due

Do you agree with this amount?

Does the creditor owe you money? __ no __ yes

If yes, explain

Has creditor turned this account over to an attorney or collection agency? __ yes __ no

If yes, Name & Address

Has creditor brought a lawsuit against you for this debt?

__ yes __ no

If yes, include on question 5 on client questions

Description of the collateral

Market value of collateral

Do you wish to keep this property

UNSECURED CREDITORS:

Please provide the following information about all unsecured creditors. This will include all credit cards, doctors bills, personal notes, etc. Use a separate sheet of paper for additional unsecured creditors, if necessary.

a) Name & Address of unsecured creditor

______________________________

Account number

Are you related to this creditor in any way

Person incurred debt __ you __ spouse __ joint

Is anyone else responsible for debt __ yes __ no

If yes, provide:

Name & Address

______________________________

Relationship to you

Does the debt involve an unexpired contract or lease

Date debt was incurred

Amount due

Do you agree with this amount?

Does the creditor owe you money? __ no __ yes

If yes, explain

Has creditor turned this account over to an attorney or collection agency? __ yes __ no

If yes, Name & Address

______________________________

Has creditor brought a lawsuit against you for this debt?

__ yes __ no

If yes, include on question 5 on client questions
b) Name & Address of unsecured creditor

Account number
Are you related to this creditor in any way
Person incurred debt __ you __ spouse __ joint
Is anyone else responsible for debt __ yes __ no
If yes, provide:
Name & Address

Relationship to you
Does the debt involve an unexpired contract or lease
Date debt was incurred
Amount due
Do you agree with this amount?
Does the creditor owe you money? __ no __ yes
If yes, explain

Has creditor turned this account over to an attorney or collection agency? __ yes __ no
If yes,
Name & Address

Has creditor brought a lawsuit against you for this debt?
__ yes __ no
If yes, include on question 5 on client questions

c) Name & Address of unsecured creditor

Account number
Are you related to this creditor in any way
Person incurred debt __ you __ spouse __ joint
Is anyone else responsible for debt __ yes __ no
If yes, provide:
Name & Address

Relationship to you
Does the debt involve an unexpired contract or lease
Date debt was incurred
Amount due
Do you agree with this amount?
Does the creditor owe you money? __ no __ yes
If yes, explain

Has creditor turned this account over to an attorney or collection agency? __ yes __ no
If yes,
Name & Address

Has creditor brought a lawsuit against you for this debt?
__ yes __ no
If yes, include on question 5 on client questions
d) Name & Address of unsecured creditor __________________________________________________________
Account number ____________________________________________________________
Are you related to this creditor in any way______________________________________
Person incurred debt: ________________________
Is anyone else responsible for debt: ________________________
If yes, provide:
Name & Address ____________________________________________________________
________________________________________
Relationship to you ____________________________________________
Does the debt involve an unexpired contract or lease? ________________________
Date debt was incurred ____________________________________________
Amount due ____________________________________________________________
Do you agree with this amount? ________________________
Does the creditor owe you money? ________________________
If yes, explain ____________________________________________________________
Has creditor turned this account over to an attorney or collection agency? ________________________
If yes, Name & Address ____________________________________________________________
Has creditor brought a lawsuit against you for this debt? ________________________
If yes, include on question 5 on client questions____________________________________
e) Name & Address of unsecured creditor __________________________________________________________
Account number ____________________________________________________________
Are you related to this creditor in any way______________________________________
Person incurred debt: ________________________
Is anyone else responsible for debt: ________________________
If yes, provide:
Name & Address ____________________________________________________________
________________________________________
Relationship to you ____________________________________________
Does the debt involve an unexpired contract or lease? ________________________
Date debt was incurred ____________________________________________
Amount due ____________________________________________________________
Do you agree with this amount? ________________________
Does the creditor owe you money? ________________________
If yes, explain ____________________________________________________________
Has creditor turned this account over to an attorney or collection agency? ________________________
If yes, Name & Address ____________________________________________________________
Has creditor brought a lawsuit against you for this debt? ________________________
If yes, include on question 5 on client questions____________________________________
PROPERTY QUESTIONS

Please answer the following questions about your property. If you do not own any property of the type requested, simply write "NONE".

What real estate do you own an interest in. Please provide the address of the property, and the market value.

How much cash do you have?

Please list all checking and savings accounts.

Type of account
Balance

On a separate sheet of paper, list all of your household goods with the market value of each item.

What is the value of your wearing apparel

What is the value of your jewelry

Do you own any firearms? If yes, please list with values

Does your life insurance have a cash surrender value? If yes, how much and what insurance company

Value of any annuities

Value and location of any interests in IRA, ERISA, Keogh or other pension plans

Value of any stocks

Value of any interests in partnerships

Value of any bonds

Does anyone owe you money? If yes, who and how much

Are you owed a tax refund

Please list all automobiles, trucks and trailers and their values

Value of any boats

List and value of office equipment

Attach list and values of equipment used in business, if any.

Value of inventory
List and value of any crops, stored or growing

Attach list and value of any farm equipment

List and value any livestock

List and value any other property not listed above
C. Fee Agreement

BANKRUPTCY FEE AGREEMENT

The undersigned, whether one or more persons, hereby retain the law firm of __________ for representation in a bankruptcy proceeding in the bankruptcy division of the U. S. District Court for the Western District of Kentucky. The undersigned agree to pay said law firm the sum of __________ DOLLARS AND no/100 ($_____) as a retainer in this proceeding. The undersigned also agree to pay the filing fee and all other costs of this action. The undersigned further understand that a record of the attorneys' time spent in working on this bankruptcy is being kept and that said attorneys will bill for the same at the rate of __________ DOLLARS ($___) per hour. In the event said attorneys' time, at such hourly rates, exceed the retainer, the undersigned further agree to pay and be responsible for that additional time. The retainer does not apply to any adversary proceedings which may be brought as a result of this bankruptcy. Nor does it apply to negotiations with creditors (other than meetings with creditors which occur at the first meeting of creditors). Additional retainers may be required from the debtors in the event of an adversary proceeding or extensive creditor negotiations. Unless attorney fees are paid promptly, reserves the right to withdraw from this proceeding with court approval at any time.

The undersigned further authorize and direct that any telephone expense may be charged to the number of __________.

This the ___ day of ______________, 19___.

Debtor

Debtor

STATE OF KENTUCKY
COUNTY OF __________...SCT.

SUBSCRIBED AND SWORN to before me by _____, on this the ___ day of __________, 19___.

My commission expires: ________________________________

Notary Public

(Notarial Seal)
D. Disclosure of Compensation of Attorney for Debtor

UNITED STATES BANKRUPTCY COURT FOR THE
WESTERN DISTRICT OF KENTUCKY
DIVISION

In re

Debtor
Social Security No.: ____________________________
and Debtor’s Employer’s Tax Identification No.:____________________

Case No.: ____________________________

Rule 2016(b) - Statement of Attorney Compensation
Chapter ____________________________

DISCLOSURE OF COMPENSATION OF ATTORNEY FOR DEBTOR

1. Pursuant to 11 U.S.C. sec. 329(a) and Bankruptcy Rule 2016(b), I certify that I am the attorney for the above-named debtor(s) and that compensation paid to me within one year before the filing of the petition in bankruptcy, or agreed to be paid to me, for services rendered or to be rendered on behalf of the debtor(s) in contemplation or in connection with the bankruptcy case is as follows:

For legal services in connection with this case I have agreed to accept $____________________ or See Below

Prior to the filing of this statement, I have received $____________________

Balance Due See below

(This is only used if there are special arrangements made for payment other than payment in full at filing)

The debtor agrees to pay the firm of $_______ at filing and an additional $_______ at the ______(first meeting of creditors or other designation) plus any amounts over and above the retainer at their normal hourly rate.

2. The source of the compensation paid to me was:

☐ Debtor ☐ Other (specify)

3. The source of compensation to be paid to me is:

☐ Debtor ☐ Other (specify)
4. I have not agreed to share the above-disclosed compensation with any other person unless they are members and associates of my law firm.

I have agreed to share the above-disclosed compensation with a person or persons who are not members or associates of my law firm. A copy of the agreement, together with a list of the names of the people sharing in the compensation, is attached.

5. In return for the above-disclosed fee, I have agreed to render legal services including:

a. Preparation and filing of any petition, schedules, statement of affairs and plan which may be required;

b. Representation of the debtor at the initial meeting of creditors;

c. Other provisions:

The debtor agrees to pay the firm of _________ at their normal hourly rate, any amounts over and above the retainers.

6. By agreement with the debtor(s), the above-disclosed fee does not include the following services:

The standard fee agreement is for the basic bankruptcy proceedings listed above and does not include representation in adversary proceedings or tax counseling. If any other services are required the fee will be discussed at that time.

In re ____________________________

______________________________
Debtors

Case No. (if known)

CERTIFICATION

I certify that the foregoing is a complete statement of any agreement or arrangement for payment to me for representation of the debtor(s) in this bankruptcy proceeding.

______________________________  ______________________________
Date                                   Signature of Attorney

______________________________
Name of law firm
E. Notice of Stay

COMMONWEALTH OF KENTUCKY
CIRCUIT/DISTRICT COURT
CASE NO. ____________

__________________________________
PLAINTIFF

vs.

__________________________________
DEFENDANTS

NOTICE OF STAY

All interested persons will please take notice that __________, have/has filed, on _____, 199_, in the United States Bankruptcy Court for the Western District of Kentucky, a petition under the provisions of Chapter ___ of the United States Bankruptcy Code where said action is pending as Case No. _________.

You will further take notice that 11 U.S.C. §362(a)(1) provides for an automatic stay of all proceedings of this action.

______________, are/is represented in the above-mentioned Chapter ________ by the undersigned counsel.

Respectively submitted,

DEITZ & FREEBURGER, P.S.C.
536 Chestnut Street
P. O. Box 21
Henderson, KY 42420
(502) 830-0830

By: ____________________________
Attorney for Debtor

CERTIFICATE OF SERVICE

I, the undersigned, hereby certify that a true and correct copy of the foregoing Notice of Stay was mailed, postage prepaid, to __________; this the ___ day of ________, 199__.
F. Amendment to Schedules

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF KENTUCKY

IN RE: )
) )
) )
) )
) )
) )
) )
CASE NO.__________________________

DEBTOR(S) )
) )
) )
) )

AMENDMENT TO SCHEDULES

Comes the debtor(s) and states that through error and inadvertence, ______ failed to list in schedule the following:

INSTRUCTIONS FOR COMPLETING AMENDMENTS
ON REVERSE SIDE OF THIS FORM

**** If amendment lists you as a Creditor, you have 90 days from the date of certification of mailing of amendment within which to file a proof of claim. (ONLY IF CASE IS A CHAPTER 13 OR ASSET CHAPTER 7).

The undersigned certifies under penalties of perjury, that I have read the foregoing amendment, and certify that the statements therein contained are true and complete to the best of my knowledge, information and belief.

Executed on: ___________________________ ___________________________, Debtor

Executed on: ___________________________ ___________________________, Debtor
CERTIFICATE OF SERVICE AND
NOTICE OF AMENDMENT TO SCHEDULES

I hereby certify that a copy of the attached Amendment to Schedules was this the _____ day of
____________, 199_, forwarded to:

(List any creditor who has not been previously listed
and the trustee. Provide complete addresses.)

__________________________, Trustee
__________________________________________

along with a copy of the Order for Meeting of Creditors by depositing a copy of same in the United States mail,
properly addressed and postage prepaid.

______________________________________________
Attorney for Debtor(s)
G. Motion and Order to Redeem Property

UNITED STATES BANKRUPTCY COURT
FOR THE
WESTERN DISTRICT OF KENTUCKY

IN RE: )
) CASE NUMBER
) )
) )
) )
) )
) )
) )
) )
) )
) )
) )
) )
) )
Depot(s) )

MOTION TO REDEEM PROPERTY

Debtor(s) hereby move(s) the Court pursuant to Section 722 of Title 11, United States Code, for an Order permitting the Debtor(s) to redeem an item of tangible personal property from a lien securing a dischargeable consumer debt.

1) The item of personal property involved is __________, which is intended primarily for personal, family or household use.

2) The debtor originally purchased the property on ______ and the original purchase price was $______.

3) The debtor has/has not obtained an appraisal and believes the fair market value of the property to be $______.

4) The debtor represents that the debtor will have cash available to redeem the property within ten (10) days of the entry of the requested Order.

5) The security interest of _________ in said property, except to the extent of the amount of the allowed secured claim of said creditor, is a dischargeable consumer debt.

6) The amount of the allowed secured claim of said creditor has been or should be fixed by Court as the sum of $__________.

WHEREFORE, the Debtor moves the Court for an Order permitting the Debtor to redeem said property by paying said creditor the aforesaid sum, and finding that the remainder of the claim of said creditor is a dischargeable consumer debt.

Attorney for Debtor(s)

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing motion to redeem was served by regular mail upon ________ this the _____ day of ______, 199__.

Attorney for Debtor(s)
IN RE: ) CASE NUMBER

_________________________ ) __________________________

_________________________ )

_________________________ )

_________________________ )

Debtor(s)___________________ )

ORDER TO REDEEM PROPERTY

No objections having been filed,

IT IS HEREBY ORDERED that the motion to redeem the _____ be SUSTAINED.

IT IS FURTHER ORDERED that the debtor shall tender to _____ the sum of $_______ which is

the amount of the allowed secured claim fixed by this Court within ten (10) days of the entry of this Order.

ENTERED BY ORDER OF COURT

Date:______________

United States Bankruptcy Judge

Prepared by:

_________________________ _______________________________

Phone:_________________________
H. Motion to Avoid Lien with Order

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF KENTUCKY

IN RE: )
) CASE NO.______
) DEBTOR(S) )
)

MOTION TO AVOID LIEN

Debtor, by counsel, hereby moves the Court pursuant to Section 522(f) of the Bankruptcy Code to avoid
the lien on the following described property:

In support of said Motion, Debtor states:

1. __________, a creditor, filed a lien in the Office of the Clerk of ______ and a copy of the
lien is attached.

2. The amount of the claim which the lien secures is $__________.

3. The above mentioned lien is a __________ lien.

4. Debtor submits the following information on the value of the property:

A). Fair Market Value: $__________.

B). Value listed in Schedules: $__________.

C). Value according to records of County Property Valuation Administration:
   $__________.

D). Purchase Price: $__________.

E). Date of Purchase: __________.

F). Appraised Value (if recently appraised): $__________.

5. The trustee has/has not abandoned the property.

6. The debtor does/does not claim an exemption of $__________ in said property.

7. The lien held by the creditor impairs the exemption of the debtor in the property described in the
motion.

A - 43
WHEREFORE, the debtor moves the Court to order the lien void and for such other relief as may be entitled. Any objection to this Motion must be filed within 15 days of the certificate of service date below. If no objections are received, an order approving this motion to avoid lien may be entered.

CERTIFICATE OF SERVICE

I certify that a copy of this motion was served by first class mail upon, ___________; this the ___ day of ______, 199__.

Respectfully submitted,

By: ________________________________

Attorney for Debtor
UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF KENTUCKY

IN RE: ____________________________

______________________________

DEBTOR(S) _______________________

CASE NO. ________________

ORDER

No objections having been filed,

IT IS HEREBY ORDERED that the Motion to Avoid Lien of _______ in the following property be, and

is, SUSTAINED.

Property Description:

________________________________________________________

________________________________________________________

A copy of this Order shall be mailed to the attorney for debtor(s), trustee, and the above-named creditor.

Louisville, Kentucky
Dated: ________________

__________________________________________ JUDGE
UNITED STATES BANKRUPTCY COURT
HANDLING CASES WITH THE OFFICE
OF THE U.S. TRUSTEE

Joseph J. Golden
Office of the U.S. Trustee
Louisville, Kentucky

and

John R. Stonitsch
Office of the U.S. Trustee
Lexington, Kentucky

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SECTION B
# HANDLING CASES WITH THE OFFICE OF THE U.S. TRUSTEE

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**SECTION B**
I. INTRODUCTION

The "Bankruptcy Judges, United States Trustees, and Family Farmer Act of 1986" enacted on October 27, 1986, paved the way for the creation of United States Trustee's office which began operating in Kentucky on September 7, 1988. While two states—North Carolina and Alabama—are currently not a part of the United States Trustee system, all other states are. The offices are grouped according to geographical considerations into regions which total twenty-one. Kentucky and Tennessee make up Region 8. The headquarters for Region 8 is located in Memphis, Tennessee, the largest city in the region.

The United States Trustee supervises and maintains chapter 11, 12, and 13 trustees, and a panel of chapter 7 trustees. This section will focus only on the chapter 7 aspects of the United States Trustee’s duties as they relate to consumer bankruptcy matters.

A. Statutory Authority

Those laws involving the establishment of the United States Trustee program are not to be found in Title 11, The Bankruptcy Code, but are located in Title 28, Part II, Department of Justice. The duties of the United States Trustee are set forth at 28 U.S.C. §586. The duties of the United States Trustee most salient to chapter 7 consumer bankruptcy cases are set forth below:

1. The duty to establish, maintain, and supervise a panel of private trustees that are eligible and available to serve as trustees in cases under chapter 7 of Title 11 (28 U.S.C. §586(a)(1));

2. The duty to supervise the administration of cases and trustees in cases under Title 11, whenever the United States Trustee deems it appropriate by:
   b. Taking such action to ensure that all reports, schedules, and fees are properly and timely filed (28 U.S.C. §586(a)(3)(D));
   c. Notifying the United States Attorney of matters that may constitute crimes under the laws of the United States and assisting the United States Attorney in carrying out prosecutions based on such actions (28 U.S.C. §586(a)(3)(F));
   d. Monitoring the progress of cases and taking such actions as are deemed to be appropriate to prevent undue delay in such progress (28 U.S.C. §586(a)(3)(G));
   e. Monitoring employment applications filed under section 327 of Title 11 (28 U.S.C. §586(a)(3)(H)); and
f. Performing the duties prescribed for the United States Trustee under Title 11 and such duties consistent with Title 11.

The last of these duties (found at 28 U.S.C. §586(a)(5)) incorporates the many duties found in Title 11 (the Bankruptcy Code) which the United States Trustee may be either required to perform or may be required to see that other parties perform. The United States Trustee is not a judicial officer, but is an officer under the Executive Branch of government. However, many of the duties now required of the United States Trustee were previously performed by the Judicial Branch of government. For example, appointments of trustees were previously made by the judges.

Some major rights and responsibilities of the United States Trustee as they relate to consumer bankruptcy cases that are mentioned in Title 11 (the Bankruptcy Code) follow:

1. Pointing out abuses to the court with respect to bankruptcy petition preparers (11 U.S.C. §§110(h)(3);
2. Raising and being heard on any issue in any case or proceeding under Title 11 (11 U.S.C. §307);
3. Serving as the chapter 7 trustee in a case when necessary (11 U.S.C. §321);
4. Determining the amount of a trustee’s bond and the sufficiency of the trustee’s surety (11 U.S.C. §322);
5. Convening the creditors’ meetings and presiding over such meetings (11 U.S.C. §341);
6. Questioning the debtor and administering the oath (11 U.S.C. §343);
7. Appointing an interim trustee to serve in the case who becomes the trustee if no election is held (11 U.S.C. §701);
8. Examining the reports and accounts of trustees (11 U.S.C. §704(8), (9));
9. Seeking the dismissal of cases by reason of debtors’ substantial abuse (11 U.S.C. §707(b)); and

As can be seen, Congress intended the United States Trustee to be an important party in the consumer bankruptcy process.

B. Mission Statement

The United States Trustee’s Mission Statement is set forth below:

"The United States Trustee Program acts in the public interest to promote
the efficiency and to protect and preserve the integrity of the bankruptcy system. It works to secure the just, speedy, and economical resolution of bankruptcy cases; monitors the conduct of parties and takes action to ensure compliance with applicable laws and procedures; identifies and investigates bankruptcy fraud and abuse; and oversees administrative functions in bankruptcy cases."

The Mission Statement incorporates the concept set forth in Rule 1001 of the Federal Rules of Bankruptcy Procedure as promulgated by the Supreme Court of the United States, which states:

"These rules shall be construed to secure the just, speedy, and inexpensive determination of every case and proceeding."

Many of the day-to-day goals of the United States Trustee are aimed at speedy and fair case treatment, reasonable fees for those professionals involved in cases, and increased distribution of dividends to creditors.

II. CASE ADMINISTRATION

The United States Trustee has the responsibility for monitoring the progress of cases in bankruptcy and taking appropriate actions to prevent undue delay. Accompanying the duty to prevent undue delay is the United States Trustee’s duty to know (or be in a position to learn) about each case.

A. Review Of Schedules

The 12 month period ending March 2000, 908,802 Chapter 7 cases were filed in the U.S. It is estimated that as many as eighteen thousand Chapter 7 consumer bankruptcy cases will be filed in Kentucky in the year 2000. In an ideal environment, the United States Trustee would make a cursory examination of each case and review the schedules, statements and lists of each debtor. Currently, spot checks are randomly conducted. If a case requires special attention, a file is assembled and a monitoring process begins.

One area of United States Trustee concern is the amount of attorney fees charged consumer debtors. Since most consumer cases involve credit card debt and medical expense debt and involve virtually no unencumbered or non exemptible assets, the skill level of the debtors’ attorneys are not particularly taxed. In this regard, when the United States Trustee identifies cases in which fees appear excessive, the normal course is to call or write the debtors’ attorney and request an explanation. Recourse to the court is permitted by 11 U.S.C. §329. This section governs the debtor’s transactions with the debtor’s attorney and permits an exploration of the fee issue. Section 329 also codifies the court’s authority to govern the reasonableness of the fees charged by attorneys for debtors, and if fees are found excessive, the court has the power to cancel the fee agreement or make other determinations.

Another area of concern in dealing with the debtors’ schedules, is whether or not the schedules provide creditors with a sufficiently clear picture of the debtors’ financial condition in order to explain the debtors’ inability to satisfy debts or determine the cause of bankruptcy. On occasion, when debtors’ schedules are unclear, the United States Trustee has moved the court to require amendments. Therefore, a reading of the schedules by the United States Trustee staff is an important function of the office.
As part of monitoring the schedules and statement of affairs, the United States Trustee routinely checks for multiple filers: Multiple filings are one indication of bad faith. The United States Trustee also monitors whether the debtor(s) has filed a Chapter 7 within the full 6 year period. If the debtor(s) have received a discharge within 6 years, the office will file a motion to dismiss under 707(a). This is usually done if the attorney for the debtor does not voluntarily do so after contact with this office.

The Office of the United States Trustee may use 11USC 707(a) in a motion to dismiss the petition in Bankruptcy for "cause". 707(a) states:

(a) The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including—

(1) unreasonable delay by the debtor that is prejudicial to creditors;
(2) nonpayment of any fees or charges required under chapter 123 of title 28; and
(3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521, but only on a motion by the United States Trustee.

In In Re Zick, 931 F.2d 1124, (6 Circuit 1991), that court determined that bad faith can be determined to be "cause" for the court to dismiss the case. Specifically "fact driven", egregious actions by the debtor(s), such as spending a state court settlement within 30 days of filing, along with other factors, could warrant the United States Trustee to file an action to dismiss.

Occasionally, signatures on petitions are checked to verify authenticity. There have been occasions where one debtor has signed the name of the other to the petition.

B. Substantial Abuse

"Substantial abuse" is a concept intended by Congress to deny a debtor the use of the bankruptcy system in order to discharge debts and achieve a "fresh start". Section 707(b) is set forth as follows:

"(b) After notice and a hearing, the court, on its own motion or on a motion by the United States Trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter. There shall be a presumption in favor of granting the relief requested by the debtor."


In essence and stripped to the barest essentials, if a debtor records sufficient disposable income, as reflected in debtors' Schedules I and J, to make a meaningful payback to creditors over a period of time, the United States Trustee is placed in the posture of considering moving for dismissal of a case. Numerous factors play into the scenario. It may be that the debtor has lost a good job, been involved in a divorce proceeding, suffered serious illness, and the income stream will be interrupted with a corresponding increase in expenses. Efforts are made to communicate with debtors prior to making a motion to dismiss.
This statute is geared strictly to consumer debts. In interpreting the statute, the Sixth Circuit in In Re Krohn, 886 F.2d 123 (1989), ruled that the honest debtor and/or the needy debtor could make use of the bankruptcy system, but denied the "fresh start" to those debtors who weren’t needy or who weren’t honest.

The United States Trustee examines each situation in light of the facts of the case in determining whether to move forward or not. It is suggested that debtors’ counsel carefully prepare Schedule I and point out anticipated changes in income of more than ten percent (10%) on the face of the schedule.

C. Criminal Referrals

Section 586(a)(3)(F) of Title 28 requires the United States Trustee to notify the United States Attorney of the occurrence of any action which may constitute a crime under the laws of the United States. This corresponds to the duties of other parties in the bankruptcy process—judges and trustees—to report potential criminal matters to the United States Attorney as is required by Title 18 Section 3057, which states:

"§ 3057. Bankruptcy investigations

(a) Any judge, receiver, or trustee having reasonable grounds for believing that any violation under chapter 9 of this title or other laws of the United States relating to insolvent debtors, receiverships or reorganization plans has been committed, or that an investigation should be had in connection therewith, shall report to the appropriate United States attorney all the facts and circumstances of the case, the names of the witnesses and the offense or offenses believed to have been committed. Where one of such officers has made such report, the others need not do so.

(b) The United States attorney thereupon shall inquire into the facts and report thereon to the judge, and if it appears probable that any such offense has been committed, shall without delay, present the matter to the grand jury, unless upon inquiry and examination he decides that the ends of public justice do no require investigation or prosecution, in which case he shall report the facts to the Attorney General for his direction."

The United States Trustee has taken a very aggressive role in seeking to uncover situations involving fraudulent schemes, concealed assets, perjury, false proofs of claims, and such other activities which destroy the integrity of the bankruptcy system. United States Trustee personnel have conducted extensive investigations and reconstructions of records, appeared as both fact and expert witnesses in federal trials, lectured other governmental agencies, including the Federal Bureau of Investigation—all with the purpose of advancing integrity within the Bankruptcy system.

Consumer bankruptcy cases normally do not generate the sophisticated schemes seen in business bankruptcies. However, there is no statistical information on the amount of fraud that occurs in consumer bankruptcy cases. Information about consumer bankruptcy fraud matters is most frequently generated in the form of tips from ex-spouses, relatives, and friends who are either co-makers or guarantors of debts.

The policy of the United States Trustee, prior to making a criminal referral, is to request a written statement from the person with information about the debtors’ alleged fraud. Personnel from the United States Trustee’s office will conduct an investigation, and if satisfied, will then make the
referral. Referrals are made without publicity and United States Trustee personnel will rarely discuss referrals with anyone other than federal law enforcement officials. The lack of public knowledge on this subject belies the weight and emphasis the United States Trustee places on this function.

D. Employment Of Professionals

Consumer debtors choose their own counsel. Counsel is required to set forth in a Rule 2016(b) statement the terms of counsel’s employment. This disclosure is attached to the petition, filed with the Court, and also transmitted to the United States Trustee. Usually, this is the last and only matter in which consumer debtors are involved with respect to professionals.

However, about three per cent (3%) of the anticipated eighteen thousand chapter 7 consumer cases for 2000—or perhaps five to six hundred cases—will be denominated as asset cases. Asset cases involve considerably more work than the no-asset cases. Assets for distribution to unsecured creditors need to be collected, liquidated, and disposed of. The panel trustee may hire auctioneers, attorneys, accountants, appraisers, and other types of professionals in order to assist in the handling of the case.

Section 327 of the Code and Rule 2014 govern the procedures involved in the hiring of professionals. The United States Trustee plays a major role in pointing out conflicts to the court with respect to the employment of professionals.

The "disinterestedness" of the professional in the case (defined at section 101) is a determining factor in whether or not a professional may be permitted by the court to be involved in the bankruptcy process. This process places high regard on fiduciary concepts and fiduciary relationships.

E. Petition Prepares

The United States Trustee has been instrumental in the enforcement of 11USC110 and the unauthorized practice of law. 11USC110 deals with penalties for persons who negligently or fraudulently prepare Bankruptcy petitions. In addition to section 110, United States Trustee have grounded their complaints on state law prosecuting the unauthorized practice of law, section 105 and 329, and contempt power set forth in Rule 9020. The courts have generally proscribed all activity except the mere typing of a Bankruptcy petition and schedules from the unauthorized practice of law, although some courts have concluded that prosecution of the unauthorized practice of law rests with the states. United States Trustees have also referred a number of cases for criminal prosecution under 18USC §156. Injunctive relief is routinely obtained. There have been instances where an attorney is involved with a petition preparer or non lawyer. Also a petition preparer may be engaged under the umbrella of an attorney or an attorney over charging for services if all the work is done by a paralegal. There are other ethical considerations such as fee splitting, trust fund or escrow account violations. The United States Trustee office has used 11USC329 motions, injunctions, show cause motions, Bar referrals, and referrals to court disciplinary panels.

F. Complaints

There are instances where a debtor has become dissatisfied with the services of their attorney. The United States Trustee is sometimes contacted by the debtor who has formal complaints about their attorney. The United States Trustee in most instances, directs the debtor to the local Bar Association and recommends that a formal complaint be filed with that entity. There are times though that the United States Trustee becomes actively involved with the local Bar association
directly. This can occur if an attorney has repeated complaints logged against him/her and the United States Trustee becomes aware of these complaints. Also, there are times when a panel trustee files a complaint with our office concerning conduct by a debtor's attorney in filling out the schedules and statement of affairs. Depending on the nature and number of occurrences, the United States Trustee may take some action, from calling the attorney to filing a formal complaint.

III. PANEL TRUSTEE

Panel trustees are the backbone of the consumer chapter 7 process. The consumer debtors’ contact with a bankruptcy system "authority figure" is almost exclusively only the panel trustee, not United States Trustee personnel, the bankruptcy court clerk personnel, or judicial officers. It is the panel trustee who is responsible to the creditor body for making sure their positions are protected when necessary and for determining whether or not the case should be denominated as an "asset" case or a "no asset" case. Since about ninety-seven percent (97%) of the cases will be declared "no asset" cases in 2000, the panel trustee is the consumer debtors’ only brush with the bankruptcy system.

A. Appointment To The Case

Section 701 requires the United States Trustee to promptly, after a case filing, appoint one of the panel trustees to serve as interim trustee until the first meeting of creditors about thirty (30) days later. If no trustee is elected, then the interim trustee becomes the permanent trustee. Section 702(d). Rarely, if ever, is there an election for a trustee in a consumer bankruptcy case. Therefore, as a practical matter, once the United States Trustee appoints an interim trustee, that trustee knows he or she will serve continuously in the case.

The panel trustee qualifies by filing a bond in favor of the United States in an amount determined by the United States Trustee and conditioned upon the faithful performance of the trustee’s official duties. The United States Trustee also determines the sufficiency of the surety on such a bond. The trustee’s bond is a broad instrument and not one that merely guarantees payment if the trustee should abscond with money. The acceptance of the appointment by the panel trustee is an assumption of a number of fiduciary duties owed by the trustee to the estate. A determination by a bankruptcy court that the trustee has breached a duty owed to the estate calls into question the trustee’s lack of faithful performance and liability under the surety bond.

In accepting the appointment, the trustee must carefully determine whether or not conflicts are evident from the schedules as between the trustee and the consumer debtor. Likewise, the trustee should decline accepting a case in which one of the trustee’s clients has a claim against the debtor.

If a trustee declines or rejects a case at or near the time of appointment, the United States Trustee must appoint another interim trustee.

B. Meeting Of Creditors

The meeting of creditors calls for the debtor to be placed under oath and examined by the United States Trustee and other interested parties. §§341, 343. By statute, the United States Trustee presides over this meeting. The Court may neither preside over the meeting nor attend. The United States Trustee has delegated the authority to preside over meetings of creditors to the panel trustee. At the meeting, the debtor is examined by the panel trustee and other interested parties. The proceedings are tape recorded and the tapes are turned over to the United States Trustee which maintains custody of them for two (2) years. Anyone can obtain a copy by writing the United States Trustee and providing the United States Trustee with blank tapes.
Meeting places in the Eastern District of Kentucky are held in Lexington, Covington, Ashland, Pikeville, Corbin and Frankfort. In the Western District they are held in Louisville, Bowling Green, Paducah and Owensboro. Louisville and Lexington meeting places are located in spaces provided by the United States Trustee. All other places in Kentucky make use of facilities where bankruptcy courts are located.

The meeting of creditors not only provides for debtors' examinations, but also operates as a clearinghouse for debtors and creditors to work out reaffirmation agreements, arrange to surrender property, as well as working out other matters. In almost every case the meeting venue provides the only face-to-face contact among the parties to the process—debtors, creditors, their representatives, and panel trustees.

Congress has stepped up its desire to make consumer debtors aware of alternatives to filing a Chapter 7 bankruptcy case. For example, Section 342 requires the clerk to notify the debtors of the availability of other chapters. As seen on the face of the petition, debtors must acknowledge that they are aware of the availability of other chapters. In addition, attorneys for debtors must declare that they have informed debtors of the availability of other chapters.

Recently, Congress enacted 11 U.S.C. section 341(d) requiring the trustee to ensure the Chapter 7 debtor is aware of the availability of relief under other chapters as well as the effects of discharge and reaffirmation. This new law requires the panel trustee to question the debtor about the debtors' knowledge of the impact of bankruptcy and its effects on future actions of the debtors.

C. Trustee Oversight

By statute (28 U.S.C. §586), the United States Trustee is required to establish, maintain, and supervise the panel of private trustees. Private trustees are regarded as independent contractors, not employees. "Establishment of the panel" requires the United States Trustee to be involved in recruitment, background investigations by the Federal Bureau of Investigation, hiring practices, including equal opportunity and diversity issues. "Maintaining the panel" requires the United States Trustee to engage in periodic training, one-on-one training, review of reports, review of bank deposits, other reviews, and to provide trustees with a handbook on policy and procedure. "Supervision" requires the United States Trustee to discuss issues in cases, visit the trustees regularly, and sample the trustee’s legal and accounting practices to ensure that these practices comport with sound fiscal and fiduciary practices. The United States Trustee makes policy, and also litigates with and against panel trustees, creditors, and debtors. Because of these numerous contacts and relationships, the United States Trustee attempts to be forthright in the positions taken, both in policy-making and litigation, and attempts to deal with panel trustees in an even-handed fashion with respect to the United States Trustee's oversight powers.

D. Duties Of Trustee

In the consumer bankruptcy setting the primary function of the United States Trustee is to see that the panel trustee presides at the meeting of creditors, tapes the proceedings, files a memorandum of the proceedings, and submits a final report, referred to as an "NDR" (No Distribution Report) as required by Rule 5009. This permits the case closing process to begin.

Additionally, the panel trustee must ensure that the debtor performs those intentions as specified in section 521(2)(B). For example, surrendering assets to creditors who hold security interests.

The trustee must investigate the financial affairs of the debtor. As a practical matter, panel
trustees satisfy this from an examination of the schedules, statements, and lists as well as the interrogation of the debtor at the meeting of creditors.

E. Asset Collection And Liquidation

In the event the case is an asset case, the panel trustee must collect and reduce to money property of the estate. Section 704(1). One of the primary goals of the United States Trustee is to check the conduct of the panel trustee to ensure that all assets have been identified, that they are physically collected or taken into custody, and timely liquidated.

The practice in Kentucky, as is the case in other jurisdictions, has been for debtors to maintain control of estate assets until the panel trustee requests them. A reading of section 521(4) is clearly contrary to the practice. However, in today’s setting, with consumer bankruptcies at a near all-time high, practicalities seem to take precedence.

The United States Trustee gauges the panel trustee’s efforts at taking possession of estate assets and encourages trustees to quickly liquidate assets. Statistical information is collected from cases in order to determine how much of the assets’ values go toward fees and expenses and how much is distributed to creditors. Since panel trustees represent the interests of unsecured creditors primarily, the United States Trustee encourages diligence and aggressiveness from the panel trustees in order to maximize dividends to creditors.

F. Investment Of Funds

The result of asset liquidation is cash proceeds. The United States Trustee requires the panel trustee to carefully safeguard funds by placing funds in a federally insured depository as set forth in 11 U.S.C. §345. The money is kept in accounts clearly identified as trust accounts. Panel trustees are required to invest funds in interest-bearing accounts when doing so would promote meaningful distributions to creditors.

Since the limit of a federally insured depository is $100,000, the United States Trustee has agreements with authorized banks and the appropriate Federal Reserve branches, that when funds on hand exceed $100,000 the depository bank will pledge its own assets as collateral to guarantee the funds of creditors in the event of a bank failure.

Various documents relative to this collateralization are maintained by the United States Trustee for each panel trustee and each case.

G. Submission Of Reports

Trustees as fiduciaries are required to make periodic reports to the United States Trustee. The United States Trustee examines these reports and makes use of them as a management tool.

A key report is the 180 Day Report. In this report, which the panel trustee is required to submit to the United States Trustee each six (6) months, the trustee records the number of cases to which he or she was appointed during that time period. Also, the trustee reports the number of cases closed. Total funds on hand and total funds for each case are reported. This assists the United States Trustee in determining changes in the trustee’s bond amounts. It also provides a mechanism for the panel trustee to control his or her inventory of cases because the United States Trustee maintains its own data base and can also request the court clerk to provide a listing of cases. All these lists are used by the United States Trustee to ensure cases do not "fall through the cracks" but move along steadily.
For each case the panel trustee must submit a report listing each asset whether the debtor listed it or not.

A form that reflects a checkbook entry process must be filed with the United States Trustee in each case in which the trustee holds cash funds. This permits cross-checking between other reports such as auctioneer reports or bank reports, in order to determine the movement of assets through the liquidation process.

H. Case Closings

The United States Trustee must examine the case closing documents prepared by the panel trustee prior to their submission to court for approval in cases where assets are to be distributed to creditors. These documents include a request by the trustee for his statutory compensation as well as his out-of-pocket expenses incurred during the administration of the estate. Before an asset case can be closed, all professional fee applications must be submitted to the Court for approval and all creditors' proofs of claim examined for objections by the panel trustee.

While asset collection and distribution occur in only a small percentage of bankruptcy cases, debtors are anxious to see if priority creditors will be satisfied. Generally, priority creditors are federal, state, and sometimes local taxing agencies whose debts are not normally extinguished by bankruptcy. Since these debts will survive bankruptcy, the more the trustee is able to pay to satisfy them, the less the debtor will have to pay post petition. Unsecured creditors take the balance of funds held by the trustee. In some unusual situations there will be sufficient funds to pay all administrative, priority and unsecured creditors in full with interest. On occasion, the debtors will receive a refund of sums left remaining after all claims have been satisfied in full.

The distribution scheme in bankruptcy is complex. Trustees are required to strictly follow that scheme in making lawful distributions of dividends to creditors. The United States Trustee's function is to double-check the trustee's distribution proposals and assist the trustee in ensuring that the statutory scheme of payments to creditors is carried out.

The panel trustee disburses estate funds in accordance with the court approved order of distribution. As soon as all checks have cleared the account, the trustee submits a final account along with all canceled checks and bank statements to the United States Trustee for review. If the United States Trustee determines that the funds have been properly disbursed by the panel trustee, the final account is sent to the court for approval and the case is administratively closed.
REPRESENTING CREDITORS IN CHAPTER 7 BANKRUPTCY

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SECTION C
# REPRESENTING CREDITORS IN CHAPTER 7 BANKRUPTCY

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SECTIONS
Having successfully litigated or sought recovery on a claim against a debtor the word “bankruptcy” (in particular Chapter 7, commonly referred to as a “straight” or “liquidation” bankruptcy) can strike fear in the hearts of creditors. “What happens to my claim now?”, “Will I get paid?”, and for the secured creditors, “What happens to my collateral?” are all common and legitimate questions and concerns raised by creditors when a bankruptcy ensues. The ability of a creditor to obtain recovery in a bankruptcy is directly related to the creditor’s knowledge of the proceeding, and its experience (and that of its counsel) in dealing with bankruptcy issues. This outline is designed to provide a general overview of the most important Chapter 7 bankruptcy concepts.

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1. The Automatic Stay and Its Importance.

In the typical Chapter 7 case, a consumer debtor is seeking relief from creditor attempts to obtain recovery on an outstanding debt, either through non-litigation methods such as collection letters and telephone calls, or through legal process, a judgment, garnishment, execution and similar collection measures. It is critical for the creditor and practitioner to remember that the filing of a bankruptcy petition (under any chapter, including 7) creates an automatic stay, stopping virtually all attempts by the creditor to enforce a pre-petition obligation of the debtor.

The automatic stay provided by 11 U.S.C. §362 is one of the most fundamental protections afforded the consumer debtor by the Bankruptcy Code. The stay arises immediately and becomes effective automatically without court order upon the filing of the bankruptcy case. No stay arises, however, until the petition is in-fact filed with the clerk.

The stay stops all collection efforts against a debtor. All collection proceedings (both pre and post judgment) are stayed, including actions against the debtor or any property comprising the debtor’s estate.

In the typical consumer Chapter 7 case, the stay only prevents action by creditors against the debtor and the debtor’s property which is part of the bankruptcy estate. See Midlantic Nat’l Bank v. New Jersey Dept. of Envtl. Protection, 474 U.S. 494, 106 S.Ct. 755, 88 L.Ed.2d 859 (1986). This is different from the protection afforded under Chapter 13, where the stay is made applicable to both the debtor and to “co-debtors” in Chapter 13 by virtue of 11 U.S.C. §1301. Thus, in a consumer bankruptcy filed under Chapter 13, a creditor may not act to collect any part of a consumer debt owed by a debtor in bankruptcy from any individual that is also liable for the debt in conjunction with the debtor (typically friends or relatives that may have co-signed an obligation for the debtor). 11 U.S.C. §1301. In Chapter 7, the co-debtor stay is not applicable and co-debtors and their property are “fair game” through normal state law remedies.

1.1 Scope of the Automatic Stay.

The stay provided by §362 is extremely broad in its scope, and with certain limited exceptions enumerated by statute or carved out by judicial decisions applies to almost any action a creditor might take against the debtor or property of the debtor’s estate. Although there are exceptions, these are narrowly construed and a creditor contemplating action against a debtor or the debtor’s property post-filing should consult an attorney to discuss the effect of the stay on the proposed course of conduct. In determining what constitutes “property of the estate” subject to protection from the stay, the practitioner is advised to refer to 11 U.S.C. 541, which provides a comprehensive list of the types of property and property interests that make up the estate, as well as those interests not included as property of the estate. As a rule of thumb, a creditor should consider any action it is contemplating against the debtor or their property post-bankruptcy “off-limits”, unless a well recognized exception is granted by the bankruptcy court or agreed to by the debtor.
§362 lists those actions which are stayed upon the commencement of a bankruptcy as follows:

(a) Litigation. §362(a)(1) provides for a broad stay of litigation against the debtor and prohibits the commencement or continuation of any judicial, administrative or similar "proceedings" against the debtor based upon any claim which arose prior to the filing of the debtor's petition.

(b) Enforcement of Judgments. §362(a)(2) stays enforcement of any judgment obtained pre-petition against the debtor or against property of the estate. For example, the stay would prohibit actions to commence or continue with wage or non-wage garnishment or attachment, post-judgment replevin of property, pursuing execution against a debtor's real or personal property, and all similar attempts of a creditor to recover on a judgment obtained prior to commencement of the case.

(c) Acts to Obtain Possession of Property of the Estate. §302(a)(3) prohibits a creditor from taking any action to obtain possession of, or to exercise control over, property of the debtor's estate. For example, a creditor's post-petition use of self-help repossession remedies authorized under Article 9 of the Uniform Commercial Code, Sec. 9-503 is prohibited by the stay, absent an order annulling, modifying or terminating the stay (discussed below).

(d) Acts to Create, Perfect or Enforce any Lien Against Property of the Debtor or the Estate of the Debtor. §362(a)(4) and (a)(5) prevent a creditor from, for example, filing a notice of judgment lien against real property, which would otherwise be authorized under KRS 426.720, filing or recording a mortgage lien or perfecting a lien on a motor vehicle owned by the debtor under Kentucky's title lien statutes.

(e) Acts to Collect, Assess or Recover Claims Against the Debtor. §362(a)(6), although similar to paragraph (a)(1), prohibits any "act" (as opposed to a "proceeding") by a creditor to collect a pre-petition debt. Under this provision, informal "acts" (such as demand or acceleration of a promissory note) are stayed, in the same manner as formal litigation is prohibited. The practitioner should further refer to the broad definition of the term "claim" set forth at 11 U.S.C. §101.

(f) Setoff. §362(a)(7) prohibits a creditor's "setoff of any debt owing to a debtor that arose before commencement of the [bankruptcy case] against any claim against the debtor." This section clearly prohibits actions such as the "pure" setoff of a debtor's bank account to pay or satisfy a concurrent obligation of the debtor to the bank. See, e.g., In re Nelson, 6 B.R. 248 (Bankr. D. An. 1980).

Prior to 1995, it had also been held by several courts that the placing of an administrative "freeze" or hold on a debtor's bank or similar account by a creditor was also a violation of this section. See, e.g., In re Patterson, 967 F.2d 505 (11th Cir. 1992). However, in Citizens Bank of Maryland v. Strumpf, 116 S.Ct. 286, 116 S.Ct. 286, 133 L.Ed.2d 258 (1995) the Supreme Court settled this debate by unanimously ruling that the so called "freeze" or administrative hold was not a setoff in violation of the Bankruptcy Code, because the bank's refusal to pay was not permanent and absolute, and was merely a temporary measure to preserve the status quo while it sought relief from the stay in the bankruptcy court to pursue its common law right to setoff against the account. According to the Court in Strumpf, setoff in violation of the automatic stay does not occur until (i)
a decision to effectuate it has been made; (ii) some action accomplishing it has been taken; and (iii) a recording of it has been entered. An important caveat to note here, however, is that the creditor which has placed an administrative hold on an account should be careful to promptly bring the matter to the bankruptcy court’s attention through a form motion for relief from or modification of the stay to all the setoff under 11 U.S.C. §506 and 553. The language of the Strumpf opinion sanctions only a “temporary”, not indefinite, hold on the debtor’s funds to allow the creditor to determine how to proceed.

1.2 Violation of the Stay; Penalties.

A majority of Circuits have held that actions taken in violation of the automatic stay are void ab initio and without effect, regardless of whether the creditor has notice of the stay. See Raymark Industries, Inc. v. Lai, 973 F.2d 1125, 1132 (3rd Cir. 1992); In re Schwartz, 954 F.2d 569, 574 (9th Cir. 1992); In re Calder, 907 F.2d 953, 956 (10th Cir. 1990); Mathews v. Rosene, 739 F.2d 249, 251 (7th Cir. 1984); Borg Warner Acceptance Corp. v. Hall, 685 F.2d 1306 (11th Cir. 1982). It has been held that a creditor which initiates collection activity post-petition, even without knowledge of the bankruptcy, has an affirmative duty to restore the status quo without the debtor having to seek relief from the bankruptcy court. In re Dungey, 99 B.R. 814, 816 (Bankr. S.D. Ohio 1989). Failure of a creditor to restore the debtor to the status quo voluntarily could lead to a finding that the Creditor has acted in willful violation of the stay. In re Dungey, 99 B.R. at 816.

In 1993, the Sixth Circuit reversed its earlier position and concluded that actions in violation of the stay are merely voidable, rather than void. Easley v. Pettibone Michigan Corp., 990 F.2d 905 (6th Cir. 1993). Thus, under some limited circumstances, such as where a debtor unreasonably withholds notice of the stay and the creditor would be prejudiced as a result, or where the debtor is attempting to use the stay unfairly as a shield to avoid an unfavorable result, the protection afforded by §362 may be unavailable to the debtor. Easley, Id. at 911.

The distinction between whether actions in violation of the stay are void or voidable can be important in a practical sense for the creditor. For example, suppose in a Chapter 7 case a creditor acts in good faith post-petition to repossess a vehicle in which it holds a security interest, without notice that the bankruptcy has been filed or that the stay is in effect. Such an action would clearly constitute a technical violation of the stay. However, because the action may now be considered voidable, rather than void, the creditor may be able to request that the court authorize this conduct post-petition, where the debtor has not been harmed or prejudiced in order to expedite disposition of the collateral where voluntary reaffirmation will not occur.

1.3 Penalties and Damages.

Section 362 provides for recovery of actual damages (including out of pocket losses, damages for embarrassment and humiliation), costs and attorneys fees incurred by an individual injured by a willful violation of the stay. 11 U.S.C. 362(h). In certain cases, punitive damages may also be awarded against a creditor. Of course, where the violation of the stay is inadvertent or unintended, a creditor should not be held in contempt. However, it is important for the creditor to remember that a violation of the stay is considered “willful” where the action violating the stay is undertaken with knowledge that the stay is in effect; willfulness in this context does not require a showing of malice.
or specific intent to violate the stay. In re Garofalo’s Finer Foods, Inc., 164 B.R. 955 (Bankr. N.D. Ill. 1994).

1.4 Grounds for Relief From The Automatic Stay.

Relief from the automatic stay is controlled by §362(d) of the Bankruptcy Code and Bankruptcy Rule 4001. After notice and a hearing, stay relief, modification or annulment may be granted by the Court to a “party in interest” upon request for the following reasons:

(a) cause, which includes but is not limited to a showing of lack of adequate protection of an interest in property of such party in interest (typically collateral held by a secured creditor), 11 U.S.C. §362(d)(1); or,

(b) where the party in interest (usually the creditor) can demonstrate that (i) the debtor has no equity in the property in which it has an interest and which it seeks to recover; and (ii) that said property is not necessary for the debtor’s “effective reorganization.” 11 U.S.C. §362(d)(2). The party seeking stay relief need not establish both. In re London Tiles, Inc., 35 B.R. 681 (Bankr. N.D. Ohio 1983); In re Cabe, Inc., 41 B.R. 222 (Bankr. M.D. Tenn. 1984).

In the vast majority of consumer bankruptcy cases, the “effective reorganization” prong of the test outlined in §362(d)(2) would be an applicable consideration only in Chapter 13. In Chapter 7, the debtor is not seeking to reorganize and establish a payment plan to creditors. Rather, the debtor’s non-exempt assets, if any, will be liquidated and a discharge of the debtor’s obligations entered in court.

Note that the pendency of the state court litigation related to the claim may also be grounds to modify or obtain relief from stay. See, e.g., In re Marvin Johnson’s Auto Service, Inc., 192 B.R. 1008 (Bkrtcy. N.D. Ala. 1996); In re Revco D.S., Inc., 99 B.R. 768 (N.D. Ohio 1989) (relief from stay would be granted to allow state court litigation to proceed, in order to liquidate the claim of the creditor, where the creditor’s claims and the debtor’s counterclaims had been previously filed in state court, discovery was in progress and all issues were based entirely on state law).

Technically, it is not proper for a creditor to request the bankruptcy court to authorize a “lift” of the automatic stay. Many practitioners improperly use this term when seeking relief from stay. However, the terms is not found in the Code, and is not generally accepted as an appropriate request by the Bankruptcy Courts in Kentucky.

The bankruptcy court is a court of equity, and will consider the balance of hurt in fashioning relief. In re Phelia Associates, Inc., 26 B.R. 235 (Bankr. W.D. Ky. 1982). Ultimately, therefore, the grant or denial of stay relief by the bankruptcy court will be based on an evaluation and weighing of various factors, depending upon the relative position of the parties. The following cases are illustrative.

The automatic stay would be terminated to permit a creditor to exercise rights in the debtor’s automobile following the debtor’s default, where the debtor continued to use the automobile without adequately protecting the creditor and while failing to execute a

A debtor is not entitled to a continuance of the automatic stay to prevent a creditor from enforcing its security interest or mortgage where no equity exists in the property and no offer of adequate protection was forthcoming at the hearing. In re Tinsley & Groom, 38 B.R. 457 (Bankr. W.D. Ky. 1984).

A Chapter 7 debtor's auto payment, made seven days late, is not cause for stay relief in order to repossess, In re Nikokyrakis, 109 B.R. 260 (Bankr. N.D. Ohio. 1989).

The most common example of "cause" for stay relief under §362, set out by the statute itself, is a lack of "adequate protection" for the creditor in its secured collateral. The concept of adequate protection is discussed in more detail below. It has been repeatedly held that whether cause exists for stay relief must be determined on a case-by-case basis. However, there are other examples of cause which might justify relief from stay.

For example, bad faith on the part of the debtor, as found by examining the totality of the circumstances, may be cause for stay relief. In re Grand Traverse Development Co. Ltd. Partnership, 151 B.R. 792 (W.D. Mich 1993). The requirement that the Debtor come into court with "clean hands" and in "good faith" has been established in Chapter 7 cases (In re Khan, 35 B.R. 718 (Bankr. W.D. Ky. 1984), remanded, 751 F.2d. 162 (6th Cir. 1984); In re Zick, 931 F.2d 1124 (6th Cir. 1991)), as well as in Chapter 13 (In re Memphis Bank & Trust Co. v. Whitman, 692 F.2d 427 (6th Cir. 1982)). Although Khan, Zick, and Whitman dealt with the concept of the debtor's bad faith in the context of the creditors' request for dismissal of the bankruptcy case, the elements of bad faith constituting the necessary prerequisite for "cause" justifying dismissal would likewise appear applicable in the context of a request for stay relief.

1.5 Adequate Protection Defined.

Adequate protection is an important but illusive concept in the retail consumer bankruptcy context. The term is not defined anywhere in the Bankruptcy Code, and yet the "lack" of adequate protection is generally considered to be the foremost reason for the grant of stay relief where the debtor has equity in a creditor's collateral and asserts a need for the collateral in order to accomplish a reorganization plan.

Adequate protection has been defined judicially as: (1) the debtor having equity in the property, or (2) the property is necessary to the debtor's performance under the plan and the creditor's security interest will not be impaired by the stay. In re Milo Ridge Resort & Executive Conference Center, 26 B.R. 277 (Bankr. W.D. Ky. 1982).

Because exactly what constitutes adequate protection cannot be defined with exactitude, the following case examples are provided to assist the practitioner in determining the existence of adequate protection, or the corresponding lack thereof:

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(a) Where the value of the collateral is equal to or greater than the debt owed by the creditor, the creditor is adequately protected. In re W.L. Mead, Inc., 42 B.R. 57 (Bankr. N.D. Ohio 1984).

(b) An equity cushion in and of itself suffices as adequate protection from the stay. In re Epstein, 26 B.R. 354 (Bankr. E.D. Tenn. 1982);

(c) Regular payments to a creditor may serve as adequate protection, where the debtor's equity cushion is inconsequential. In re Shriver, 33 B.R. 176 (Bankr. N.D. Ohio 1983);

(d) A debtor is not required to provide adequate protection to an under-secured creditor seeking relief from the stay where the value of the creditor's interest in the property has increased. In re Cablehouse, Ltd., 68 B.R. 309 (Bankr. S.D. Ohio 1986); and,

(e) An under-secured creditor is not entitled to compensation in the form of adequate protection payments for money that it could earn by foreclosing upon its interest and having investing the proceeds. In re Pullins, 65 B.R. 560 (Bankr. S.D. Ohio 1986).

Note that although the courts have generally held that the existence of equity in a creditor's collateral constitutes adequate protection, there may be instances where adequate protection is lacking, even where there is an equity cushion. For example, the failure of a debtor to maintain insurance covering property damage to the collateral might be inadequate protection, justifying relief from the stay.

1.6 Obtaining Stay Relief: Distinctions Between Chapter 7 and Chapter 13.

In the retail or consumer Chapter 7 case, the secured creditor is generally faced with the dilemma either of obtaining a reaffirmation agreement from the debtor to avoid discharge of the debtor's obligation to the creditor, or surrender of its collateral from the debtor to allow the creditor to liquidate the collateral and minimize its loss. In Chapter 13, on the other hand, the debtor is interested in retaining the majority of its property, rather than surrendering it to creditors. Therefore, in Chapter 13 the creditor must ensure adequate protection of its claim and the collateral securing its claim during the pendency of the debtor's reorganization plan, while it obtains payment from the debtor in the plan.

It becomes readily apparent that the grounds asserted by a creditor for stay relief in the retail bankruptcy case will vary considerably depending upon the type of bankruptcy commenced by the debtor. For example as discussed above, in a Chapter 7 proceeding, §362(d)(2) is not applicable to the inquiry, because the debtor does not seek "reorganization", but rather liquidation of assets and discharge of all indebtedness in a Chapter 7. Because reaffirmation is a wholly voluntary process, and the creditor is not obligated to allow reaffirmation, the debtor has little practical choice but to surrender its property secured by a creditor's lien to the creditor when reaffirmation is not agreeable to both parties. A motion or relief indicating that the creditor will not allow reaffirmation, and that there is no equity in the property for the benefit of unsecured creditors, should result in stay relief as a matter of course, as a debtor has few, if any, objections available.
It should be much easier, therefore, for a creditor to obtain quick relief from the stay in a Chapter 7 proceeding, as opposed to Chapter 13 where the debtor has proposed a repayment plan and has the intention of retaining the majority of its property. For example, a motion for relief from stay in Chapter 7 is granted automatically within 15 days following the filing of the motion, unless an objection is filed by the debtor establishing "good cause" for a hearing on the motion. This is why under the Local Rules of both the Eastern and Western Districts of Kentucky, a party seeking relief from stay has the burden of proof on the issue of the debtor's equity in the property and the party opposing relief has the burden on all other issues. §362(g); See also In re Williams A. Smith Const. Co., Inc., 86 B.R. 115 (Bankr. N.D. Ohio 1985). A debtor must prove that the creditor's interests are adequately protected. In re Milo Ridge Resort & Executive Conference Center, 26 B.R. 277 (Bankr. W.D. Ky. 1982). A creditor bears the burden of proving the validity and perfection of its security interest. In re Vanyas, 50 B.R. 988 (Bankr. E.D. Mich. 1985).

1.7 Procedure for Stay Relief.

The procedure for obtaining relief from the automatic stay is governed by Bankruptcy Rule 4001, and the rules applicable in the Eastern and Western Districts of Kentucky. Under Rule 4001 a request for relief from the automatic stay is brought by written motion, which must state with particularity the grounds for the motion and the relief sought. In a Chapter 7 or Chapter 13 case, the motion should be served by regular mail service and must be served upon the case trustee and on the debtor. See Bankruptcy Rules 9013, 9014 and 7004.

A Motion for relief from stay may be made ex parte, but only where it is shown by sworn testimony that immediate and irreparable injury, loss or damage will result to the movant before the adversary party or the attorney for the adverse party can be heard in opposition. The movant's attorney must further certify to the court in writing his/her efforts to give notice and the reasons why notice should not be required. Bankruptcy Rule 4001(a)(2).

In both the Eastern and Western Districts of Kentucky, a motion for stay relief may not be filed without an accompanying proof of claim with supporting documents establishing the security interest of the movant in the property of the estate that is subject to the motion. See LBR 401. Eastern District of Kentucky; LBR 10, Western District of Kentucky. Notice to all parties in interest is required in both Districts. Note that in the Western District of Kentucky, a request for relief from stay shall not be combined in the same pleading with any other request for relief, and all motions filed must include a proposed order. LBR 10, Western District of Kentucky.

In the Eastern District of Kentucky, all parties to a motion for relief from stay must be given at least ten (10) days notice of the hearing on the motion. LBR 401, Eastern District of Kentucky. In the Western District in a Chapter 7 case, a hearing on a motion for relief from stay will only be set if the party in opposition to the motion so objects within 15 days from the date of service of the motion; otherwise, if no objection is filed, stay relief will be granted within 15 days following the date of service of the motion, without hearing. LBR 10, Western District of Kentucky.

In the Western District of Kentucky, LBR 15 serves as a useful tool for the creditor in a consumer Chapter 7 or Chapter 13 case. The Rule also serves to free up the court's crowded docket from routine stay relief motions involving disputes over claims secured by motor vehicles. Under
the rule, whenever a debtor elects to retain possession of a "motor vehicle" which secures an outstanding obligation, either by paying for the vehicle through a Chapter 13 plan, or through reaffirmation or otherwise, the debtor is required to maintain proof of insurance against physical damage on the creditor's collateral. If the debtor fails to furnish proof of insurance on the vehicle at the Section 341 meeting, the stay shall be deemed terminated. Further, if during the pendency of a case, either before or after the 341 meeting, insurance lapses on any motor vehicle subject to the provisions of the rule, (1) the creditor may notify the debtor and his/her counsel in writing (with a copy to the court) regarding the lapse of insurance; (2) the debtor shall be enjoined from using the motor vehicle for so long as it remains uninsured; and, (3) if the debtor fails to provide proof of re-insurance for a minimum of 90 days to the creditor within five business days following the mailing of the notice, the stay shall be deemed terminated. LBR (WD)15.

Although not required by the rule, it is recommended that a creditor that has complied with Rule 15's requirements, but has not received proof of insurance within the time specified, notify the Court of the debtor's failure to comply with the Rule to insure that the procedure has been carried out properly. This is usually done by local practice or custom through a document filed of record which certifies non-compliance with the Rule.

This rule is currently the subject of focus by the Joint Local Bankruptcy Rules Committee for the Eastern and Western Districts of Kentucky. It is possible that a joint rule for both districts related to insurance on collateral may soon be in place.

2. GENERAL BANKRUPTCY TERMINOLOGY AND OVERVIEW.

2.1 Relief Available. The United States Bankruptcy Code, 11 U.S.C. §101 et seq., sets out the basic avenues of relief available to debtors, these include:

(a) Chapter 7. The purpose is to achieve a fair distribution to creditors of the non-exempt, non-mortgaged property of the debtor and to give the debtor a fresh start through a discharge in bankruptcy. 11 U.S.C. §§701-766.

(b) Chapter 13. A rehabilitation program for an "individual with regular income" where the debts do not exceed a specified amount and the debtor's future earnings are used to pay creditors in full or in part. The fresh start comes from the discharge granted at the end of the case. 11 U.S.c. §§1301-1330.

(c) Non-Consumer Related Bankruptcies: Chapters 11 and others. A reorganization proceeding for use by any debtor generally engaged in business, with the goal of rehabilitating the debtor as a going concern rather than liquidating it. 11 U.S.C. §1101-1174.

2.2 The Parties.

(a) Debtor. The person, corporation, partnership, or legal entity which is the "principal" of the bankruptcy proceeding. 11 U.S.C. §101(13).
(b) Creditor. An individual, corporation, partnership or other legal entity that has a claim against the debtor which arose at the time of or before the beginning of the bankruptcy process. 11 U.S.C. §101(10).

(c) Trustee. The "person" who is charged with the responsibility of supervising the bankruptcy case and estate property. All Bankruptcy Courts now have a United States Trustee. The U. S. Trustee is independent of the Court system and is appointed by the Justice Department. The function of the U. S. Trustee varies by type of case. In a Chapter 7, the U. S. Trustee appoints a case Trustee whose primary function is to take possession of the debtor's property which is neither exempt nor subject to a valid security interest, turn these items into money, and fairly distribute it among the creditors.

2.3 The Debtor's Property - The Estate.

(a) Property of the Estate. The debtor's assets which are to be administered during the proceedings. 11 U.S.C. §541(a).

(b) Property Subject to a Security Interest. The debtor's property on which he or she has granted a consensual lien or security interest prior to the bankruptcy proceedings.

(c) Exempt Property. Under 11 U.S.C. §541, upon the commencement of a bankruptcy proceeding, all property of the debtor becomes "property of the estate". In order to provide the debtor with a "fresh start", debtors are allowed to claim enumerated exemptions to prevent certain property from being liquidated by the trustee, and to protect it from claims of creditors whose claims arose before the commencement of the case. See 11 U.S.C. §522; KRS 427.

The date for determining exemptions is the date the order for relief is entered. In the event of a conversion from one chapter to another, the date for determining exemptions in the converted case is the date of conversion. In re Butcher, 75 B.R. 441 (E.D. Tenn. 1987), affd. without opinion in 848 F.2d 189 (6th Cir. 1988); In re Dyess, 65 B.R. 143, 14 BCD 1379 (Bankr. W.D. La. 1986).

(I) Basic Categories of Exemptions. 11 U.S.C. Section 522(d) lists the federal exemptions to which each debtor is entitled, and also provides that an individual debtor may elect to use either federal or state exemptions, unless the state of which it is a resident has "opted out" of the federal exemption scheme. 11 U.S.C. Section 522[b]. Kentucky has "opted out" of the federal exemptions (KRS 427.170). Thus, Kentucky law provides that the following property of an individual debtor resident in this state is exempt:

(A) All household furnishings, jewelry, personal clothing and ornaments not to exceed $3,000 in value; The terms "household furnishings, jewelry, personal clothing, and ornaments" mean clothing, furniture, appliances, linens, china, crockery, kitchenware, and personal effects of an individual and the individual's dependents, but do not include:

(I) Works of art;
(ii) Electronic entertainment equipment (except to the extent of one television and one radio;

(iii) Antiques; and

(iv) Jewelry other than wedding rings.

(B) Tools, equipment and livestock, including poultry, of a person engaged in farming, not exceeding $3,000 in value;

(C) One motor vehicle and its necessary accessories, including one spare tire, not exceeding in the aggregate $2,500 in value;

(D) Professionally-prescribed health aids for the debtor, or a dependent of the debtor;

(E) Tools, not exceeding $300 in value, of any individual debtor necessary in its trade, and one motor vehicle not exceeding $2,500 in value and its necessary accessories, including one spare tire, of a mechanic or other skilled artisan primarily engaged in the replacement, repair, or emergency servicing of essential, mechanical, electrical or other equipment in general use;

(F) The professional library, office equipment, instruments and furnishings of a minister, attorney, physician, surgeon, chiropractor, veterinarian, or dentist, necessary in the practice of such profession, and not exceeding $1,000 in value, and one motor vehicle not exceeding $2,500 in value with necessary accessories, including one spare tire;

(G) An individual debtor's aggregate interest, not to exceed $5,000 in value, in real or personal property that such debtor or a dependent of such debtor uses as a permanent residence in this state, or in a burial plot for such debtor or a dependent of such debtor. However, this exemption does not apply if the debt or liability existed prior to the purchase of the property or the erection of the improvements thereon; see, e.g., In re Connors, 1999 W.L. 1090829, 1999 Bankr. Lexis 1472 (Bankr. N.D. Ohio 1999) (federal tax lien paid before homestead);

(H) Any money or other benefit to be paid or rendered by any assessment or cooperative life or casualty insurance company, and any money or other benefit to be paid or rendered by any fraternal benefit society;

(I) An award under a crime victim's reparation law;

(J) To the extent reasonably necessary for the support of an individual and his dependents, in addition to the foregoing property which is totally exempt, money or property received and rights to receive money or property for alimony, support or separate maintenance;
(K) A payment on account of the wrongful death of an individual of whom the debtor was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor;

(L) A payment, not to exceed $7,500, on account of personal bodily injury, not including pain and suffering or compensation for actual pecuniary loss, of the debtor or an individual of whom the debtor is a dependent;

(M) A payment in compensation of loss of future earnings of the debtor or an individual of whom the debtor is or was a dependent, to the extent reasonably necessary for the support of the debtor or any dependent of the debtor; and

(N) Assets held, payments made and amounts payable under pensions exempt pursuant to KRS 61.690, 161.700, 427.120 and 427.125, or the right or interest of a person in an individual retirement account or annuity, deferred compensation account, tax sheltered annuity, simplified employee pension, pension, profit-sharing, stock bonus, or other retirement plan described in the Internal Revenue Code of 1986, as amended, which qualifies for deferral of income tax until the date benefits are distributed. However, this exemption does NOT apply to any amounts contributed to an individual retirement account or annuity, deferred compensation account, a pension, profit-sharing, stock bonus, or other qualified retirement plan or annuity if the contribution occurs within 120 days before the debtor files for bankruptcy.

In addition to the foregoing, every debtor shall have a general exemption not to exceed $1,000 in value to be applied toward any property, real or personal, tangible or intangible, in its estate on the filing date.

(2) Claiming Exemptions. The debtor is required to list the property claimed as exempt on the schedules which are required to be filed either with the petition or within fifteen (15) days thereafter. In light of the fact that exemptions are claimed in the bankruptcy schedules, the rule for amendment of exemptions is identical to the rule for amendment of the schedules, which is that amendments may be filed any time before the case is closed. Bankruptcy Rules 4003(a), 1007 and 1009.

In the event the debtor fails to claim exemptions to which he is entitled, for example when the debtor has died or is incapacitated, a dependent of the debtor may file the list within thirty (30) days after the schedules are filed. In the event the debtor fails to file its schedules, the deadline begins to run on the date when the schedules were due to be filed. Bankruptcy Rule 4003(a).

The exemptions are listed in Schedule C of Official Form 6 of the debtor’s petition. Schedule C requires that the debtor estimate the value of the items claimed as exempt, and indicate the statute under which the exemption is claimed. Typically, a debtor lists the maximum statutory amount allowed for exemption of each category of property, regardless of the amount of equity which the debtor has in the property. The exempted property must be listed with sufficient specificity so as to enable the trustee and creditors to determine its nature and value.
(3) **Trustee’s and Creditors’ Right to Object to Exemptions.** The trustee or any creditor may file objections to the list of property claimed as exempt. Bankruptcy Rule 4003(b). Some of the more common grounds for objections to exemptions include:

(A) Sloppiness in claiming exemptions;

(B) Lack of statutory basis;

(C) Exemption of several items of property whose aggregate value exceeds the statutory exemption;

(D) Conversion of non-exempt assets into exempt assets, which conversion appears to be fraudulent, *Abbott Bank—Hemingford v. Armstrong*, 931 F.2d 1233 (8th Cir. 1991); see also *In re Simms*, 243 B.R. 156, 2000 Bankr. Lexis 7 (Bankr. S.D. Fla.) (trustee failed to prove conversion was done with the intent to hinder, delay or defraud creditors); and

(E) Assets which are concealed and later discovered cannot be exempted.

In the event that no objections are timely filed to claimed exemptions, “the property claimed as exempt on such list is exempt”. 11 U.S.C. §522(l). See *In re Rosenzweig*, 245 B.R. 836, 2000 Bankr. Lexis 185 (Bankr. N.D. Ill.) (a tax refund scheduled as exempt, but not listed as asset was allowed because of trustee’s failure to timely object).

(4) **Burden of Proof and Objection Time Lines.** Either the trustee or creditors can file objections to exemptions. In any hearing on objections to exemptions, the objecting party has the burden of proving that the exemptions are not properly claimed. Thereafter, the burden shifts to the debtor to show that the claim to exemption has been properly claimed. *In re Catli*, 999 F.2d 1405 (9th Cir. 1993); *In re Lester*, 141 B.R. 157 (S.D. Ohio 1991).

After hearing on notice, the court will determine the issues presented by the Objection. Bankruptcy Rule 4003(c).

All objections to exemptions must be in writing and must be served on the trustee, the person filing the list of exemptions claimed, and the attorney for such person. Bankruptcy Rule 4003(b). Because an objection to exemptions is a contested matter, no answer to the objection must be filed, unless otherwise ordered by the court. Bankruptcy Rule 9014.

The deadline for filing objections to exemptions is normally thirty days after the date on which the first meeting of creditors is actually concluded. In the event an amendment to exemptions is filed after the conclusion of the first meeting of creditors, the deadline for objecting to exemptions claimed by the amendment is extended for an additional thirty days. The time period for objecting to exemptions may be extended by the court only if the extension is granted within the original time period. Bankruptcy Rule 4003(b). If the time period for filing objections to exemptions expires, due to excusable neglect, it may not be later extended by the court. Bankruptcy Rule 9006(b)(3).
In the event no objections to exemptions are timely filed, the exemption claimed by the debtor is finalized, and the valuation of the debtor's interest in the property is approved. The importance of timely objecting to exemptions was emphasized by the United States Supreme Court in Taylor v. Freeland & Kronz, 503 U.S. 638, 112 S.Ct. 1644, 118 L.Ed.2d 280, (1992), wherein the Court held that there is no "bad faith" exception to the deadline for timely filing objections to exemptions, even where there is no colorable statutory basis for the exemptions claimed. Therefore, although it was apparent that the debtor's claimed exemption was not permitted under the exemption statute, the failure of any party to timely file an objection waived the trustee's right to later challenge the exemption. However, the Court observed that the Bankruptcy Code contains sufficient safeguards against debtors filing groundless claims, such as the denial of a discharge under 11 U.S.C. Section 727(a), or civil or criminal sanctions under Bankruptcy Rule 9011 or 18 U.S.C. §152, to prevent meritless exemption claims from being routinely filed.

(d) Trustee's Avoidance Powers. The right of the debtor or a Trustee to avoid or "nullify" certain liens on property which would otherwise have been exempt, except for the debtor's own actions or actions of the debtor's creditors prior to the bankruptcy proceedings. Harvey v. Fellner, 245 B.R. 834, 2000 U.S. Dist. Lexis 21454 (W.D. Ky. 1999) (reopening case to avoid unknown judicial lien discretionary, not per se disallowed); see also In re Pressley, 242 B.R. 193, 1999 Bankr. Lexis 1556 (Bankr. S.D. Fla.) (same).

(e) Abandonment. Action taken, primarily by the Trustee to surrender or give up any right which the debtor may have in specific property of the estate.

(f) Preferential Transfers. A transfer of the debtor's property usually on the "eve of bankruptcy" which the Court can set aside to restore the parties to their original status. Discussed in detail.

(g) Claims Against the Estate.

(1) Claim. Generally, a right which a creditor has against the debtor or against his property. This right may be unliquidated or liquidated, and may be established by contract (prejudgment) or by order or judgment of a court (post-judgment).

(2) Secured Claim. The claim of a creditor which is secured by some right in the debtor's property usually created by an act of the debtor prior to the bankruptcy proceedings, such as signing a mortgage or security agreement. A claim is generally secured only to the extent of the value of the collateral. The pre-eminent case on valuation is the United State Supreme Court's recent ruling in Associates Commercial Corp. v. Rash, 520 U.S. 953, 117 S.Ct 1879, 138 L.Ed.2d 148 (1997). In Rash, which dealt with a filing under Chapter 13, the Supreme court held that the value of a creditor's collateral (and thus, the amount of its secured claim), is the "replacement value" of the collateral, i.e., the price a willing buyer in the debtor's trade, business or situation would pay to obtain like property from a willing seller. While the case dealt only with valuation in a Chapter 13, valuation for purposes of a creditor's secured claim in Chapter 7, or for redemption purposes, should follow the same standard.
(A) Unsecured Claim. A claim of a creditor which is not secured, i.e., is backed only by the debtor's promise to pay and the creditor's previous reliance on the debtor's general assets.

(3) Terminating the Bankruptcy Case.

(A) Discharge. A formal act of the court and entry of a final order which in effect relieves the debtor from any responsibility for payment of his debts.

(B) Dismissal. An involuntary dismissal of the case (Debtor has failed to comply with rules of court, or for other cause), see Dionne v. Simmons, 200 F.3d 738, 2000 U.S. App. Lexis 294 (11th Cir.) (court improperly dismissed case because cause was not shown by moving party; the moving party was the debtor; In re Turpen, 244 B.R. 431, 2000 Bankr. Lexis 96 (B.A.P. 8th Cir.) (debtor's solvency did not justify dismissal).

(C) Closure of the Case. Typically, a case is administratively closed by the Court upon discharge or dismissal.

3. Basic Concepts in Chapter 7 Bankruptcy.

3.1 Notices in Chapter 7. Notice of Debtor's Bankruptcy filing is sent to all creditors listed on the petition schedules. The notice includes the following useful information:

(a) Name of the debtor and any alias' used in the last six (6) years;

(b) Name and address of the debtor's attorney; and

(c) The time frame in which certain actions may be taken:

(1) Date Petition Filed. Automatic stay goes into effect.

(2) Meeting of Creditors. The date first set for an examination of the debtor by his/her creditors, required by the Code.

(3) Last date to file objection to discharge or complaint of nondischargeability.

(4) Date of Discharge. Generally the last date to file reaffirmation and stay lifted.

3.2 The Automatic Stay. Arises automatically upon the filing of the petition. Discussed in detail above.

3.3 Proofs of Claim (filing procedure).

(a) Generally. Unsecured creditors are informed by the Court's notice not to file a proof of claim unless they are notified that is is likely assets will be realized for their benefit. The vast majority of consumer Chapter 7 cases are no-asset cases, with no distribution to be made to the
unsecured claimants, and a proof of claim should generally not be filed in a Chapter 7, no-asset case unless the creditor is advised by the Court or the Trustee to file.

(b) Notice to File. Should notice be provided that a proof of claim should be filed, it should contain the following information:

(1) Unsecured Proof of Claim. Statement by the creditor of the balance owed by the debtor. Some evidence showing how the balance was derived should be attached to the proof of claim along with a copy of the original obligation.

(2) Secured Proof of Claim. Statement by the creditor of the balance owed by the debtor and evidence that the creditor has a valid and perfected security interest in specified property of the estate.

All proofs of claim should be filed using the official bankruptcy form and all information requested should be included. Note: Do not include any “pre-computed” interest charges in your claim balance.

3.4 Role of the Trustee. The Trustee represents the interests of the unsecured creditors. His or her job is to collect assets and to distribute them to the unsecured creditors on a pro rata basis. The Trustee conducts the meeting of creditors. The Trustee will review the petition and proofs of claim filed and question the debtor at the meeting of creditors to determine if there are any assets for the benefit of the unsecured creditors. To the extent that the Trustee is a "friend" to the unsecured creditors, he is the "enemy" of the secured creditors. The Trustee possesses certain powers which may be used to adversely affect the secured creditor's position. He or she can set aside unperfected security interests, fraudulent transfers, some statutory liens, and preferences.

3.5 Preferences in Chapter 7.

(a) Elements of a Preference. The power to avoid a preference allows the Trustee to set aside any transaction between a creditor and the debtor which improves the position of that creditor to the detriment of the other creditors. The burden is on the Trustee to prove all of the five (5) elements of a preference action:

(1) Transfer must be to or for the benefit of a creditor;

(2) Transfer must be for or on account of an antecedent debt owed by the debtor before the transfer was made;

(3) Transfer must have been made when the debtor was insolvent (the Code provides the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the filing of the bankruptcy petition).

(4) Transfer must have been made during the 90 days before the date of the filing of the petition or between 90 days and one year before the date of the filing of the petition if the creditor was an insider at the time of the transfer; and
(5) Transfer enables the creditor to receive more than such creditor would receive if the case were a case under Chapter 7 and the transfers had not been made. 11 U.S.C. §547.

(b) Exceptions to Preferences. The Code sets out specific exceptions. These include, as a general rule, a creditor's ability to retain up to $599.99 on consumer debt received within 90 days from the filing of the petition (note that transfers less than $600.00 within the 90 day period may be aggregated, resulting in a preference); 11 U.S.C. §547(c)(8) when the transfer in question was a contemporaneous one for new value; 11 U.S.C. §547(c) (1); where the payment of a debt was within the ordinary course of business by the debtor; 11 U.S.C. §547(c)(2) and when the creditor gave new value after the transfer in question. 11 U.S.C. §547(c)(4)

(c) Preferences Under State Law. Under Section 544 of the Bankruptcy Code, a trustee may also seek to assert a preference claim under state law. In Kentucky, the applicable preference period is extended from 90 days under federal law, to 6 months from the date of transfer by virtue of KRS 378.060. However, unlike under the federal statute, in order to succeed on a preference claim under state law a trustee must prove that the debtor intended to prefer the creditor which received the transfer. In the typical case of a garnishment or other involuntary payment by a debtor to a creditor, this will be a difficult burden. See In re Rexplore Drilling, 971 F.2d 1219 (6th Cir. 1992); Omnimflight Helicopters, Inc. v. Kennedy, 567 S.W.2d 123 (Ky. App. 1978). Practitioners are also directed to In re Battery One-Stop Ltd., 36 F.3d 493 (6th Cir. 1994), which holds that a garnishing creditor rises to the level of a lien creditor on the date of the service of the garnishment order upon the garnishee. Thus, where a creditor obtains a lien prior to the beginning of the preference period, no preferential transfer can occur with respect to payments received subsequent to the date of the creation of the lien via service of the garnishment order. See also In re Edwards, 219 B.R. 970 (Bankr. W.D. Ky. 1998).

3.6 Fraudulent Conveyance. In Kentucky, the trustee has two bodies of law at his disposal in pursuing fraudulent conveyances—state law (11 U.S.C Section 544, incorporating KRS 378.010 et seq) and federal bankruptcy law (11 U.S.C. Section 548). Some common examples of fraudulent conveyances are the transfer of property or the grant of a security interest for less than fair consideration and the sale of property by the debtor for less than fair consideration. In such event, the lien may be avoided under either 11 U.S.C. §548 or KRS 378.010 et seq, discussed infra, and any equity which is otherwise exemptible by the debtor may be claimed as exempt, free and clear of the creditor's claim, provided the debtor has not concealed such property, or voluntarily transferred it. In re Gaines, 106 B.R. 1008 (Bankr. W.D. Mo. 1989); In re Roberts, 81 B.R. 354 (Bankr. W.D. Pa. 1987).

3.7 Lien Defects. Under 11 U.S.C. Section 544, the trustee has the power to avoid any transfer of property of the debtor, including defective liens, that would be voidable by a judicial lien creditor or a bona fide purchaser of real property from the debtor. 11 U.S.C. Section 544. This power permits the trustee to strike down invalid or "secret" liens (liens which have not been recorded, as required by KRS 382.010):

No deed or deed of trust or mortgage conveying a legal or equitable title to real property shall be valid against a purchaser for valuable consideration, without notice thereof, or against creditors, until such deed or mortgage is
acknowledged or proved according to law and lodged for record. As used in this section, "creditors" includes all creditors irrespective of whether or not they have acquired a lien by legal or equitable proceedings or by voluntary conveyance. KRS 382.270.

Kentucky law also specifies the place of recordation of mortgages, by requiring that:

All deeds, mortgages and other instruments required by law to be recorded to be effectual against purchasers without notice, or creditors, shall be recorded in the county clerk's office of the county in which the property was conveyed or the greater part thereof is located. KRS 382.110.

In addition, Kentucky law (KRS 355.9-302) requires that certain liens on personal property must be recorded to be effectual.

In the event that a mortgage or lien on real or certain personal property is unrecorded or improperly filed, it may be avoided by the trustee. Any equity which exists after avoidance of such liens and/or mortgages may be claimed exempt by the debtor, to the extent such exemption is allowed by Kentucky statutes.

Lien avoidance on certain exempt property under Section 522(f) is done by motion of the debtor, and is a contested matter under Bankruptcy Rule 9014. Bankruptcy Rule 4003(d). The prerequisites for lien avoidance are:

(a) Existence of property in which the debtor has a valid exemption;

(b) Existence of a lien on such property;

(c) The lien is either a judicial lien or a nonpossessory, non-purchase money security interest in household furnishings or goods, wearing apparel, appliances, books, animals, crops, musical instruments or jewelry, which are held primarily for personal, family or household use of the debtor or his dependents; implements, professional books or tools of the trade of the debtor or his dependents, or professionally-prescribed health aids; and

(d) The lien impairs the debtor's exemption interest.

No deadline for seeking lien avoidance is imposed by either the Bankruptcy Code or the Bankruptcy Rules. Notice of the motion seeking lien avoidance must be given to the creditor whose lien is sought to be avoided. A minimum of five (5) days' notice must be given of any hearing on the motion for lien avoidance, which time may be reduced by the court. Bankruptcy Rule 9006.

The debtor bears the initial burden or proof, and the creditor has the burden of rebuttal. In re Streeper, 158 B.R. 783 (Bankr. N.D. Iowa 1993); In re Maylin, 155 B.R. 605 (D. Me. 1993); In re Mohring, 142 B.R. 389 (E.D. Ca. 1992).
The standard of proof in a lien avoidance action is presumably a preponderance of the evidence.

4. TREATMENT OF THE SECURED CREDITOR - THE THREE "R's" OF CHAPTER 7 BANKRUPTCY. There are three possible ways to resolve a secured claim in a Chapter 7 bankruptcy: reaffirmation, redemption or recovery.

4.1 Reaffirmation.

(a) Generally. Reaffirmation of a debt by the debtor is a method for insuring that the creditor will be paid post-bankruptcy, despite the discharge entered in the case. The basic question is, does the creditor want to allow the debtor to reaffirm the debt (or does the creditor wish to realize on its collateral), and if so, on what terms. Remember that reaffirmation is a voluntary agreement between the debtor and the creditor, and may not be required unilaterally by either party.

(b) Terms All Reaffirmations Must Include:

(1) Name of parties.

(2) Balance as of a certain date, including interest rate, the installment payment, and date of the next payment due;

(3) Identify the security in the reaffirmation and attach a copy of the original obligation and security agreement;

(4) "Subject to the original terms of the contract";

(5) Require proof of insurance;

(6) Provide for fair rental value: this protects the creditor if the debtor later rescinds the reaffirmation;

(7) The debtor's attorney's declaration;

(8) Conspicuous statement that the reaffirmation agreement may be rescinded and that the agreement is not required by the bankruptcy code or other non-bankruptcy law; and,

(9) Signature of both the debtor and the debtor's attorney.

Under the Code, the agreement must be made before the granting of the debtor's discharge. See Chase Automotive Finance, Inc. v. Kinion, 204 F.3d 751, 2000 U.S. App. Lexis 5025 (5th Cir.); In re Collins, 243 B.R. 217, 2000 Bankr. Lexis 98 (Bankr. D. Conn.). The debtor also must not have rescinded the agreement at any time prior to the discharge or within sixty (60) days after the agreement was filed with the Court, whichever occurred later, by giving written notice of the rescission to the creditor. Generally, Bankruptcy Courts will set a filing deadline for reaffirmation agreements to be filed with the court. That date is usually the same date as the date for discharge of the debtor. The Code requires simply that the agreement must be "made" prior to discharge, and filed
with the Court. Failure to file your agreement with the Court could result in the agreement being invalidated and could subject the creditor to penalties from the Court.

(c) Debtor’s Right to Rescind. Anytime prior to discharge or within sixty (60) days after such agreement is filed with the Court, whichever occurs later, the debtor may rescind by giving notice to the creditor. The notice to the debtor that he may rescind the agreement must be set out in the agreement conspicuously. This means that the required language must be underlined, or placed in capital letters so as to be conspicuous within the body of the reaffirmation agreement.

(d) The Effect of the Reaffirmation. If the rescission period is past, the debt is not discharged and the debtor remains liable on the indebtedness as if the bankruptcy was never filed.

4.2 Redemption. A debtor may redeem property by paying the lienholder the amount of its allowed secured claim, as either agreed to by the debtor and creditor, or as established by a valuation hearing. 11 U.S.C. §§722 and 506(a). If the creditor is over secured, the allowed secured claim is equal to the outstanding balance owing at the time of the bankruptcy filing. If the creditor is under secured, the allowed secured claim is the value of the collateral. In re Breckinridge, 140 B.R. 642 (Bankr. W.D. Ky. 1992); In re Polk, 76 B.R. 148 (9th Cir. 1987). Such payment must be made as a one-time lump-sum payment, unless the creditor consents to an installment payment schedule. In re Bell, 700 F.2d 1053 (6th Cir. 1983). Redemption is initiated by the debtor filing a motion to redeem, and is a contested matter. Bankruptcy Rule 6008.

Redemption is a very limited right, and only applies where the creditor’s security is:

(a) Tangible personal property;

(b) Intended primarily for personal, family, or household use;

(c) Is a dischargeable consumer debt; and

(d) Is exempted or has been abandoned.

All of the above conditions must exist or there is no right to redeem.

The Code provides that the debtor may redeem qualified property by paying the secured creditor the amount of the allowed secured claim. However, in cases where the lien exceeds the value of the property, the creditor would only be entitled to the fair market value of the collateral at the time the bankruptcy petition was filed. Note that if all of the conditions for redemption are met, the debtor has an unqualified right to redeem and the creditor cannot keep a debtor from redeeming merely because it would prefer reaffirmation (of course, the creditor always has the right to contest valuation of the collateral for redemption).

4.3 Recovery. If the debtor and creditor have been unable to agree on terms of reaffirmation or the creditor does not choose to allow the debtor to reaffirm, and no motion to redeem has been made by the debtor, then the creditor must begin to think in terms of recovering its security. This a two-fold process. First, the creditor must position itself to take possession by “freeing” its property
from the restrictions imposed by the bankruptcy. Second, the creditor must obtain actual physical possession of the security.

(a) Positioning to Take Possession. There are three (3) interested parties: the debtor who owns the property, the Trustee who is entitled to any equity over and above the properly perfected liens and allowed exemptions, and the secured creditor.

In order to take the property free and clear of claims by the other two (2) interested parties, the secured creditor must obtain stay relief (see above), removing bankruptcy protection provided to the debtor, and obtain the Trustee's abandonment of the property (extinguishing the unsecured creditor's interest). In the best of worlds, the creditor can get the debtor and his counsel, as well as the Trustee, to sign an Agreed Order Terminating Stay and Abandoning the Property. If one or both will not cooperate for one reason or another, then the creditor will have to file motions to have the stay lifted and to have the Trustee abandon the property.

(1) Notification. Motion to Terminate, Annul or Modify the Stay (see above).

(2) Abandonment. Even though the Stay has been terminated and creditor is permitted to obtain possession of its collateral, the creditor must still obtain an abandonment from the Trustee in order to dispose of the collateral free of the Trustee's lien. One of the most common methods of abandonment is obtaining an abandonment from the Trustee at the meeting of creditors, by way of an agreed order. Both abandonment and lifting of the Stay can be achieved by no action on the part of the creditor. In all cases, once discharge has been entered the Stay is lifted as a matter of law. Note that termination of the stay does not equal abandonment, and separate tests are required to be met by the Court for each.

(3) Obtaining Possession of Security. Even though the creditor is free from the bankruptcy proceedings, he still must act in accordance with state law and take peaceable possession of the property, and otherwise comply with Article 9 of the UCC.

4.4 Lien Avoidance.

(a) Introduction. Pursuant to 11 U.S.C. Section 522(f), a debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such nonconsensual lien impairs an exemption to which the debtor would have been entitled, if such lien is a:

(1) judicial lien, other than a judicial lien that secures a debt to a spouse, former spouse or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a court of record; and to the extent that such debt is not assigned to another entity, voluntarily, by operation of law or otherwise; and includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance or support; or

(2) nonpossessory, nonpurchase-money security interest in any household furnishings, household goods, wearing apparel, appliances, books, animals, crops, musical
instruments, or jewelry that are held primarily for the personal, family or household use of the debtor or a dependent of the debtor; implements, professional books, or tools of the trade of the debtor or the trade of a dependent of a debtor; or professionally-prescribed health aids for the debtor or a dependent of the debtor.

Only a nonconsensual lien can be avoided. In re Fagan, 26 B.R. 212 (Bankr. W.D. Ky. 1982); In re Driver, 133 B.R. 476 (Bankr. S.D. In. 1991). 11 U.S.C. §101(36) defines a "judicial lien" as a lien "obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding." 11 U.S.C. §522(f) permits a debtor to avoid certain liens, to the extent that such liens impair an exemption to which the debtor would otherwise be entitled. For purposes of 11 U.S.C. §522(f), a lien is considered to impair an exemption to the extent the sum of (i) the lien, (ii) all other liens on the property and (iii) the amount of the exemption that the debtor could claim if there were no liens on the property exceeds the value that the debtor's interest in the property would have in the absence of any liens. See In re Lehman, 205 F.3d 1255, 2000 U.S. App. Lexis 3418 (11th Cir.) (calculate lien avoidance using entire value of property, ignoring non-debtor spouse's interest); In re Cannon, 243 B.R. 153, 2000 Bankr. Lexis 6 (Bankr. S.D. Fla.) (lien upon dissolution of marriage split between property settlement - avoidable - and support obligation).

For example, if a debtor has household goods worth $3,000 and claims the household goods exemption provided by statute, and a creditor has a nonpossessory, nonpurchase-money security interest in the household goods, the creditor's lien may be avoided. The result of such a lien avoidance would convert the creditor's claim from a secured claim to a general unsecured claim.

Prior to the adoption of the Bankruptcy Reform Act of 1994, the rule adopted by the Sixth Circuit Court of Appeals in In re Dixon, 885 F.2d 327 (6th Cir. 1989) was that a homestead exemption applied only in execution sale situations. Thus, the Court ruled that the debtor's exemption was never impaired in a bankruptcy situation, and consequently a debtor could never avoid liens. As a result of this ruling, Sixth Circuit debtors were confronted with the problem of selling their home after bankruptcy, and being required to pay the lienholder out of the equity which should have been protected as exempt property to provide for their "fresh start".

However, Kentucky courts found that the holdings of In re Dixon and In re Moreland, 21 F.3d 102 (6th Cir. 1994), a case which reaffirmed Dixon, did not apply in Kentucky due to differences in Kentucky and Ohio law. In re Lynch, 187 B.R. 536 (Bkrtcy E.D. Ky. 1995); In re Powell, 173 B.R. 338 (Bkrtcy E.D. Ky. 1994). These decisions, which have been adopted in the Western District of Kentucky, hold that Dixon was based on an interpretation of Ohio law which was contrary to Kentucky case law.

In re Dixon, supra, was probably overruled by the Bankruptcy Reform Act of 1994, which provides that a debtor may avoid a judicial lien, even when the debtor has no equity in the property over and above a lien which is superior to the junior lien which the debtor is seeking to avoid. Thus, a debtor's residual interests in property, such as a possessory interest, are protected from a judicial lien. Section-by-Section Description of H.R. 5116, 140 Cong. Rec. H10, 764 (daily ed. October 4, 1994); H.R. Rep. No. 835, 103d Cong. 2d Sess. 35-37 [1994].
However, Bankruptcy Courts in Kentucky have held that judgement liens are void and need not be released by the Bankruptcy Court.

For example, in Stidham v. Ford Motor Credit, Case No. 91-50019, Adversary Proceeding No. 94-5091 (January 11, 1995), the Bankruptcy Court for the Eastern District of Kentucky was presented with a fact situation wherein Ford Motor Credit held a judgement lien encumbering all real estate of the debtors, including the two pieces of real property which the debtors owned at the time they filed bankruptcy. One piece of property was sold by the Chapter 7 bankruptcy trustee and Ford Motor Credit's lien attached to the sales proceeds. A second tract of property was abandoned by the trustee and later sold at a state court foreclosure sale. After they filed bankruptcy, but before receiving their discharge, the debtors purchased real estate (the "new property") in the same county where the judgement lien was filed. When the debtors later attempted to refinance the new property, they discovered that Ford Motor Credit's judgment lien was still of record. Ford Motor Credit refused to release its judgment lien, and the debtors sought an order of the Bankruptcy Court removing such lien. The Hon. Joe Lee first determined that the discharge of indebtedness was retroactive to the date of the bankruptcy filing, and that the underlying judgment lien was discharged prior to the debtor's purchase of the new property. The Court then addressed the status of the judgment lien and determined that it was extinguished by the sale of the two pieces of real property. Thus, because there was no longer any indebtedness owed by the debtors secured by the judgment lien, the underlying judgment is void and did not survive bankruptcy.

Similarly, in In re William Norvell, III, Case No. 95-34212(1)7 (July 31, 1996), the Bankruptcy Court for the Western District of Kentucky agreed with Judge Lee's analysis and held that because the underlying obligation was discharged and no property to which the lien could attach was owned by the debtor at the time of the bankruptcy filing, the judgment lien itself was also void. Consequently, the Court determined that a KRS 426.720 judgment lien will survive bankruptcy ONLY as an in rem claim against real estate which the debtor owned at the time the bankruptcy case was filed, and will not attach to any real estate acquired by the debtor after the bankruptcy filing.


5. Exceptions To Discharge In Chapter 7.

5.1 Generally. When the drafters of the Bankruptcy Code were developing the "fresh start" approach to bankruptcy, they recognized that there should be certain instances where the debtor was not entitled to the benefits of the discharge provisions of the Code. As a result, the Bankruptcy Code allows creditors and other interested parties the right to object to allowing the debtor the benefit of a discharge of all of his/her debts, or having a specific debt(s) held to be non-dischargeable in the bankruptcy action. This outline provides a general overview of Section 523 claims (exceptions to discharge) and provides a detailed discussion regarding the most common forms of these claims, which are designed to except from discharge isolated debts incurred by fraud, false pretenses, false representations or for willful and malicious injury to property under Sections 523(a)(2)(A), (B), (C) and Section 523(a)(6).
Claims for exception to discharge are filed within the bankruptcy proceeding, and are referred to as “Adversary Proceedings”.

**Practice Note:** What is an “Adversary Proceeding” and how do you file one? Generally, these cases are brought “within” the main bankruptcy case and are styled in accord with the sample Complaint form to these materials. With the complaint, the Plaintiff must complete and file an Adversary Proceeding Cover Sheet (which can be obtained form the Court clerk), along with the filing fee, which is currently $150.00.

5.2 Exceptions To Discharge Generally - 11 U.S.C. §523. The Code provides for exceptions to the discharge of certain debts. These “non-dischargeable” debts or "exceptions to discharge" relate only to the specific debt involved. This section of the Bankruptcy Code will not operate to deny the debtor a discharge of his/her other debts.

Practice Note: You should be careful to distinguish complaints under Section 523 from those under Section 727 and Motions to Dismiss under Section 701. Complaints under Section 523 relate to individual, isolated debts. Complaints under Section 727 are an attempt to prohibit a debtor’s discharge entirely, and different factors are considered by the Court in such a proceeding. Both are brought by adversary proceeding, however. To the contrary, actions under Section 701 of the Code are an attempt by a creditor or other party with standing to dismiss a Chapter 7 case, thus denying the debtor a discharge, for reasons related to the debtor’s bad faith in filing the proceeding in the first place. See, e.g., In re Spangolia, 199 B.R. 362 (Bankr. W.D. Ky. 1995). Unlike Adversary proceedings, Section 701 actions are brought by motion filed in the main bankruptcy case.

The types of debts which are generally non-dischargeable in a Chapter 7 petition under Section 523 are as follows:


(b) **Fraud.** Debts incurred by fraud or under false pretenses or representations, including through false statements made in a written financial statement or other writing submitted to a creditor for the purpose of obtaining credit. See, In re Wiggins, 245 B.R. 726, 2000 Bankr. Lexis 183 (Bankr. M.D. Ga.). The code protects creditors who extend credit based on fraudulent information communicated by a dishonest debtor (see detailed discussion below). But see, In re Bryant, 241 B.R. 756, 1999 Bankr. Lexis 1497 (Bankr. M.D. Fla.) (creditor failed to prove justifiable reliance).

(c) **Unscheduled Debts.** A debtor has a duty to file a list of creditors and if he fails to list a creditor, that creditor will not receive notice of the bankruptcy and will be deprived of the right to participate in the case. Thus, the Code provides that unlisted debts are excepted from discharge. But see In re Madaj, 149 F.3d 467 (6th Cir. 1998) (holding that “the bankruptcy code does not except an
unscheduled debt from discharge if the creditor had notice or actual notice of the bankruptcy case in time for timely filing of a proof of claim"). The Madaj court also held that the unscheduled debt was discharged even though the creditor did not learn of the case until after the discharge order was entered, in light of the fact that the court could find no prejudice to the creditor that could have been avoided if the creditor had received timely information.

(d) **Theft.** Debts which result from embezzlement, larceny and fiduciary fraud. See, e.g., In re Jacks, 243 B.R. 385, 1999 Bankr. Lexis 1729 (Bankr. C.D. Cal.) (fiduciary duty had to exist before misconduct).

(e) **Alimony, Maintenance and Support.** This section is self-explanatory, but it should be mentioned that if the right to receive the alimony, maintenance or support is assigned to a third party, the debt will lose its nondischargeable status. Details will be discussed by other presenters at this CLE. See, In re Ackerman, 247 B.R. 336, 2000 Bankr. Lexis 384 (Bankr. M.D. Fla) (spouse's professional fees are nondischargeable support obligations).

(f) **Willful and Malicious Injury.** When a person or entity is injured or property is damaged as a result of the "willful or malicious" conduct of the debtor, the debtor's liability arising therefrom may not be dischargeable. This might include the deliberate sale of collateral and conversion of the proceeds by a debtor without payment to the secured creditor. Generally, however, under recent case law, the injury must be intentional and the damage caused by the injury must have been intended. See, infra; see also, In re Baldwin, 245 B.R. 131, 2000 Bankr. Lexis 138 (B.A.P. 9th Cir.) (state battery conviction proved intent to injure); In re Sarff, 242 B.R. 620, 2000 Bankr. Lexis, (B.A.P. 6th Cir.) (breach of duty of loyalty was based on willful breach of service contract, so nondischargeable).

(g) **Fines and Penalties.** Fines, penalties or forfeitures owed to a governmental unit, including traffic fines, are generally not dischargeable.

(h) **Student Loans.** The Bankruptcy Code provides that some types of student loans may not be discharged. Recent amendments have changed the rules related to student loans. Sovereign immunity will limit a debtor's ability to sue state educational institutions. See, University of Virginia v. Robertson, 243 B.R. 657, 2000 U.S. Dist. Lexis k766 (W.D. Va. 2000).


(j) **Prior Denials.** Debts from a previous bankruptcy in which discharge was denied.

5.3 **Elements of a §523(a) Claim.** As listed above, there are several different types of Section 523 claims. The most common claims brought by creditors are found at Section 523(a)(2) and (a)(6). Subsections (a)(2)(A) and (B) deal with debts incurred for money, property or services to the extent they are obtained by false pretenses, false representation, fraud, or the use of a fraudulent statement concerning the debtor's financial condition. Subsection (a)(6) relates to debts incurred as the result
of a willful or malicious injury by the debtor to another or to the property of another. The remainder of this outline will examine these specific code provisions in greater detail.

(a) 523(a)(2)(A)

(I) 11 U.S.C. Section 523(a)(2)(A) provides:

(A) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual from any debt;

(B) For money, property, services or an extension, renewal, or refinancing of credit, to the extent obtained by;

(C) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor’s or an insider’s financial condition.

The United States Supreme Court has held that although the burden of proof rests on the plaintiff/creditor to establish the elements of 11 U. S.C. §523(a) in such a claim, the burden of proof required is a preponderance of the evidence standard, rather than that of clear and convincing evidence. Grogan v. Garner, 498 U.S. 279, 111 S. Ct. 654, 112 L.Ed.2d 755 (1991).

(2) To succeed in a non-dischargeability claim under §523 (a)(2)(A), a creditor must prove by preponderance of the evidence that:

(A) The Defendant made certain false statements to the creditor; and,

(B) The Defendant made these representations with the intent to deceive the creditor; and,

(C) The Creditor reasonably relied on the false representation; and

(D) The Creditor sustained the loss resulting from the Defendant’s misrepresentation (causation).


In a case under §523(a)(2)(A), the first 2 elements of the analysis essentially focus on the conduct of the Debtor. In determining whether a debt arising from credit card charging spree is non-dischargeable for fraud under §523 (a)(2)(A), the question is whether at the time of making the charges, the debtor did not intend to pay the debt or did not have a reasonable prospect of being able to pay the debt. See, e.g., In re Chech, 96 B.R. 781 (Bankr. N.D. Ohio 1988); In re Pozucek, 73 B.R. 110 (Bankr. N.D. Ill. 1987); In re Daugherty, 57 B.R. 99 (Bankr. E.D. Tenn 1985).
With respect to the element of intent, a number of factors are considered in determining the Debtor's actual intent concerning repayment of a credit card debt or other cash advances, including but not limited to:

(A) length of time between the charges or obtaining the credit and filing bankruptcy;

(B) financial condition of the debtor when he or she obtained the credit; and,

(C) whether the purchases made or credit incurred were for luxuries or necessities.


(4) Gambling debts present a special "subset" of potential, non-dischargeable debts under this section. Many courts have held that debts incurred for gambling purposes are non-dischargeable. For instance, in Citibank v. Hansbury, 128 B.R. 320 (Bankr. D. Mass. 1991), the credit card issuer sought a determination that the debt owed to it by the card holder was excepted from discharge under §523(a)(2)(A). The Plaintiff alleged that the Defendant, by using credit cards issued by the Plaintiff, incurred a debt in the amount of $47,654.28 at a time when he had no ability to repay and he knew or should have known that he had no ability to repay the debt. Id. The Defendant denied that he had incurred the debt without intending to repay it. The Court in Hansbury stated:

"The defendant does not dispute that he incurred the amount of debt that he is alleged to have incurred. He admits that he incurred most of the debts by taking cash advances to be used to pay gambling debts, and that he hoped to repay this debt and all the debt as issue here by gambling and winning big ... He knew at all times relevant to this proceeding that he lacked the means to honor the credit card obligations that he was incurring.

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Id. at 321.

See also In re Karelin, 109 B.R. 943, 945 (9th Cir. 1990); In re Vermillion, 136 B.R. 225, 226 (Bankr. W.D. Mo. 1992) (where debtor used card only for cash advances and used money to pay off other debt or to gamble, the debtor knew that she did not have the ability to repay the debts, and thus intended to deceive the creditor); In re Bartlett, 128 B.R. 775, 779 (Bankr. W.D. Mo. 1991) (where credit card advances were taken for gambling purposes and debtor did not have...
reasonable basis for believing she could repay her debt through the gambling winnings, but merely "hoped" that she would win enough to pay off the debts, the debtor made implied representation to credit card company when she obtained cash advances and made misrepresentations and knowing them to be false and with the intention and purposes of deceiving her creditors).

**NOTE: The above rules may be partially abrogated by the 6th Circuit’s ruling in Rembert and its holding related to subjective intent to deceive (see discussion below). It is not completely clear what the impact of this new case will be to the body of law related to debts incurred for gambling purposes.

Practice Note: Non-Dischargeability May Be Presumed: 11 U.S.C. Section 523(a)(2)(C) states:

“For purposes of subparagraph (A) of this paragraph, consumer debts owed to a single creditor and aggregating more than $1000 [to be adjusted] for ‘luxury goods and services’, incurred by an individual debtor on or within 60 days before the order for relief under this title, or cash advances aggregating more than $1000 [to be adjusted] that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 60 days before the order of relief under this title, are presumed to be non-dischargeable; ‘luxury goods or services’ do not include goods or services reasonably acquired for the support or maintenance of the debtor or a dependant of the debtor...”

Thus, in some cases, where a debtor has “loaded up” his/her credit card within 60 days prior to filing, purchasing non-essential items that qualify as “luxury goods” (hot tubs, mink coats, lavish vacations, gambling, and other similar items or services), or obtaining large cash advances, the creditor’s burden of proof may be considered satisfied, and the burden of proving an innocent intent or motive shifts back to the defendant debtor. Watch this carefully, however! The fact that non-dischargeability is presumed does not relieve the creditor of its burden of filing an adversary proceeding to obtain an official ruling on non-dischargeability from the court.

The third and fourth elements necessary for a finding of fraud essentially focus on the creditors’ conduct. In the vast majority of cases, there is no dispute that the creditor has suffered a loss (the fourth element), and in any event, this fact may be easily proven. Of course, the issue of “causation” (whether the loss was caused by the debtor’s fraudulent conduct or the creditor’s own negligence) is always in issue.

The third element necessary for a creditor to succeed under the statute is reliance, and this can be a very difficult element to prove. In fact, before filing a complaint under Section 523(a)(2)(A), a prudent practitioner will conduct a sufficient due-diligence review, particularly related to this element. Recent court opinions have greatly limited the availability of the claim. For example, in In re Chincilla, 202 B.R. 1010 (Bankr. S.D. Fla. 1996), the bankruptcy court sternly admonished the creditor for filing what it considered to be a frivolous complaint:
“AT&T’s case is analogous to a gunslinger in the wild west without ammunition. It does not survive. This court is closing the 523(a)(2)(a) “town gates” to credit card issuers. Just don’t ride into town firing blanks and kicking up dust in the hope of rustling up a settlement. Come in armed with facts to prove fraud or you may be driven out of town with a 523(d) bullet in your tail.”

The “523(d) bullet” that the court is referring to is the power of the Bankruptcy Court, under such section, to award a debtor the “court costs of, and a reasonable attorney’s fee for, the proceeding if the Court finds that the position of the creditor was not substantially justified...

In the Sixth Circuit, our courts have determined that in a complaint under §523(a)(2)(A), the Plaintiff/Creditor must demonstrate that it reasonably relied on the representations and conduct of the Debtor. In re Phillips, 804 F.2d 930, 932 (6th Cir. 1986); In re Ward, 857 F.2d 1082 (6th Cir. 1988); In re Woolum, 979 F.2d 71 (6th Cir. 1992); In re Ledford, 970 F.2d 1556 (6th Cir. 1992). In Ledford, the Court stated that "whether a creditor's reliance is reasonable is a factual determination to be made in light of the totality of the circumstances." In re Ledford, 970 F.2d at 1560. According to the Sixth Circuit, the circumstances which may effect the reasonableness of the Creditors' reliance are:

(A) whether the creditor had a close personal relationship or friendship with the debtor;

(B) whether there had been previous business dealings with the debtor that gave rise to a relationship trust:

(C) whether the debt was incurred for personal or business reasons;

(D) whether there were any "red flags" that would have alerted the ordinary prudent lender to the possibility that the representations relied upon were not accurate; and,

(E) whether even minimal investigation would have revealed the inaccuracy of the debtor's representation. In re Ledford, 970 F.2d at 1560.

In both Ward and Ledford, the Sixth Circuit held that a credit card issuer has a duty to investigate and verify a card holder's ability to pay before it issues the card and the Court further inferred that the credit card issuer may not merely rely on the debtor's signature, but rather should conduct some form of independent credit report in approving the debtor's credit. However, see In re Woolum, 979 F.2d 71 (6th Cir. 1992) (in the context of a §523(a)(2)(B) case, the requirement of "reasonable reliance" is not rigorous and is only directed at creditors acting in bad faith; courts should not undertake subjective evaluation and judgment of creditors' lending practices). In re Bridges, 51 B.R. 85, 90 (Bankr. W.D. Ky. 1985) (under 523(a)(2)(A), creditor only required to make "some efforts" to verify information contained in debtors' financial statements and an "exhaustive credit check" is not necessary).
In November, 1995, the Supreme Court of the United States decided *Field v. Mans*, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995). In deciding the case, which was brought by the creditor under §523(a), the Court concluded, contrary to the authority cited above, that the proper standard for determining a creditor's reliance was the less rigorous standard of "justifiable reliance". The proper inquiry was whether the creditor "justifiably" relied on the debtor's conduct in extending the credit. It therefore appears that the burden on the creditor in establishing reliance in the adversary proceeding context has been lessened, although, as a practical matter, it is unknown by how much.

However, just when it appeared that the Supreme Court, under *Field v. Mans*, might be relaxing the stringent standards courts have imposed on credit card issuers in bringing 523(a)(2)(A) complaints, the Sixth Circuit Court of Appeals handed down a decision that severely limits credit card lenders' ability to recover nondischargeability judgments in adversary proceedings under §523(a)(2)(A). The decision, *Rembert v. AT&T Universal Card Services, Inc.*, 141 F.3d 277 (6th Cir. 1998), cert. denied 119 S.Ct. 438 (1998) is significant for several reasons:

(i) First, it holds that the proper inquiry to determine a debtor's fraudulent intent is the debtor's subjective intent to repay; and,

(ii) Second, it holds that each time the credit card is used the debtor makes an implied representation that he intends to repay but not that he has the current ability to repay.

In examining the debtor's representations and intent, the Court wrote:

"[T]he focus should not be on whether the debtor was hopelessly insolvent at the time he made the credit card charges . . . ; rather, the express focus must be solely on whether the debtor maliciously and in bad faith incurred credit card debt with the intention of petitioning for bankruptcy and avoiding the debt. A finding that a debt is nondischargeable under §523(a)(2)(A) requires a showing of actual or positive fraud, not merely fraud implied by law . . . [T]he hopeless state of a debtor's financial condition should never become a substitute for an actual finding of bad faith."

This case appears to adopt Ninth Circuit law, follows the reasoning of an increasing number of courts, and alters current law in the Sixth Circuit. As a result, it now appears that credit card issuers in this Circuit will not be successful in nondischargeability actions unless they can prove that the debtor actually intended to defraud them at the time the card was used. Given the obvious difficulties in proving a debtor's subjective intent, *Rembert* appears to significantly limit a credit card creditor's remedies under §523(a)(2)(A) of the Bankruptcy Code.

(b) 523(a)(2)(B): Use of a False Statement in Writing.

(I) 11 U.S.C. Section 523(a)(2)(B) states:

(A) A discharge under [this title] does not discharge . . . any debt for money, property, services or an extension, renewal or refinancing of credit, to the extend obtained by:
(i) Use of a statement in writing that is materially false;

(ii) respecting the debtor's ... financial condition;

(iii) on which the creditor ... reasonably relied;

(iv) and, that the debtor caused to be made or published with intent to deceive.

Be careful to consider the difference in the reliance standard. Under the decision Field v. Mans, the standard for reliance under 523(a)(2)(A) is that of “justifiable reliance.” Under (a)(2)(B), the statute requires “reasonable reliance”, which appears to be a slightly higher standard.

Further, remember that the statement at issue must be “materially” false. A slight or insignificant error on the document will not suffice to render the debt nondischargeable. The question the practitioner should ask is “would my client have made the loan or extension of credit had it known that this statement was false?”

Finally, “intent” is always the hardest element to prove in these cases. Guidance might be found in the cases cited above related to (a)(2)(A), and in Knoxville Teachers, infra.

The burden of proof, like that under (A)(2)(A), is a “preponderance of the evidence.” See Grogan, supra.

An exhaustive discussion of the elements of this claim is beyond the scope of this summary. The following cases should be consulted by a prudent Kentucky practitioner considering filing an (a)(2)(B) complaint: Coman v. Phillips, 804 F.2d 930 (6th Cir. 1986); Knoxville Teachers Credit Union v. Parkey, 790 F.2d 490 (6th Cir. 1986); In re Woolum, 979 F.2d 71 (6th Cir. 1992); In re Duncan, 35 B.R. 323 (Bankr. W.D. Ky. 1983); In re Rosel, 63 B.R. 603 (Bankr. W.D. Ky. 1986).

(c) Section 523(a)(6): Willful and Malicious Injury.

(1) 11 U.S.C. Section 523(a)(6) states:

(A) (a) A discharge under [this title] does not discharge ... a debtor from any debt —

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity.

In truth, most of the prior case law in Kentucky on this section was abrogated by the ruling of the United States Supreme Court in Kawaauhau v. Geiger, 523 U.S. 57, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998). A detailed overview of the case is instructive on this point:

Margaret Kawaauhau and her husband recovered a state court judgment on a medical malpractice claim against the debtor-physician, Paul W. Geiger. Dr. Geiger prescribed oral
antibiotics to Ms. Kawaauhau, although he knew that intravenous antibiotics would be more effective. Ms. Kawaauhau's condition deteriorated, resulting in the amputation of her leg. Dr. Geiger later filed for relief under the U.S. Bankruptcy Code. The Kawaauhaus brought an adversary proceeding under 11 U.S.C. §523(a)(6) to have the debt determined nondischargeable. Ms. Kawaauhau argued that Dr. Geiger intentionally rendered inadequate medical care to her that necessarily led to her injury. The Bankruptcy Court held that Dr. Geiger's treatment "fell far below the appropriate standard of care and therefore ranked as willful and malicious." Dr. Geiger lost on appeal to the U.S. District Court for the Eastern District of Missouri and appealed to the Eighth Circuit, which reversed. The Supreme Court granted certiorari.

The Supreme Court's decision focused on the plain language of §523(a)(6), reading it to mean that "only acts done with the actual intent to cause injury fall within the exception's scope." According to the Court, the word "willful" in subsection (a)(6) modifies the word "injury," indicating that nondischargeability takes a deliberate or intentional injury, not merely a deliberate or intentional act that leads to injury. For these reasons, the Court affirmed the Eighth Circuit's decision and declared that the debt was, in fact, dischargeable as the plaintiff could not prove that the debtor actually intended to cause her injury.

The ruling is a departure from the standard used in most bankruptcy courts around the country and will overrule a considerable body of case law which requires a much less rigid showing of improper conduct. The decision will make it far more difficult for creditors to succeed in a complaint to deny discharge under the "willful and malicious injury" exception set out in §523(a)(6). See In re Markowitz, 190 F.3d 455 (6th Cir. 1999) (holding that unless an actor desires to cause the consequences of his act, or believes that the consequences are substantially certain to result from it, he/she has not committed a "willful and malicious" injury under the terms of this section). A lack of excuse or justification will not alone make a debt non-dischargeable.

These cases do not, however, make it impossible for a creditor to succeed in the right case and given proper facts. For example, many causes of action under this section entail a debtor's conversion of property given as collateral on a creditor's loan. If a debtor sells a creditor's collateral, without tendering payment from the proceeds of the sale to the creditor, the creditor has a cause of action under this section. See, e.g., In re Cline, 52 B.R. 301 (Bankr. W.D. Ky. 1985).

Likewise, if the debtor were to assault or batter the complaining creditor, this would clearly constitute sufficient "intent to harm" rendering the debt nondischargeable. See, e.g., In re Bishop, 55 B.R. 687 (Bankr. W.D. Ky. 1985) (where debtor struck plaintiff in the head with a hammer, the debt for such damage was nondischargeable).

If a debtor fails to keep or secure insurance on a vehicle subject to a lien, is this non-dischargeable? Generally the answer is no. See e.g., In re Diver, 121 B.R. 509 (Bankr. W.D. Ky. 1990) (while the court found that the knowing failure to keep and maintain insurance on a vehicle was in fact wilful, it was not "malicious" so the debt was dischargeable).

The measure of damages under this section is somewhat unclear. Generally, in the sale of collateral subject to a security agreement, damages are tied to the value of the property sold or converted. In re Thomas, 36 B.R. 851 (Bankr. W.D. Ky. 1984). In other actions under this section
(for example, personal injury), damages might be awarded in a state court tort action and sustained in a bankruptcy court under principals of collateral estoppel.
Unpublished Opinions by Honorable David T. Stosberg

In re: Robert L. Ray, Case No. 99-31519(3), AP No. 99-3098, decided September 3, 1999. Criminal restitution obligation of the debtor owed to the plaintiff in the amount of $1800.00 entered by the State Court for driving under the influence charge was not dischargeable by virtue of Section 523(a)(7). The Court ruled that "any financial obligation imposed as part of a criminal sentence is excepted from discharge under section 523(a)(7)." Relates to Section 5.1 of Outline.

In re: Donald Ray Kennedy and Shirley Jean Kennedy, Case No. 98-40655(3), AP No. 99-4038, decided January 28, 2000: An adversary proceeding brought by the holder of covenant not to compete, requesting an order from the court declaring that the covenant was not a "claim" under Section 101(5) which could be discharged in bankruptcy. The Court determined that the debtors obligation to comply with the covenant did not constitute a "claim" under the statute. The Court terminated the stay to allow the parties to pursue additional claims related to the agreements between them. Relates to Section 2.3 of Outline.

In re: Kenneth Wayne Oglesby and Rachel Michelle Olgelsby, Case No. 99-41539(3)(7), AP No. 00-4014, decided April 5, 2000. Debtor signed a note and mortgage on November 10, 1999 and filed bankruptcy on November 23, 1999. In an adversary proceeding brought by the Creditor seeking a determination that the $22,608.00 mortgage indebtedness was non dischargeable under Section 523(a)(2), Court ruled, without deciding the case on the merits and acknowledging the need for additional evidence, that "the proximity between the date of the execution of the note and mortgage and the date of the bankruptcy filing supports the Plaintiffs allegation of fraud. . . ." Relates to Section 5.3 of Outline.

In re: Michael W. Payne, Case No. 99-41583(7), AP No. 00-4015, decided May 19, 2000. Where the debtors pledged certain collateral to a creditor under the terms of a security agreement and later sold the items to private purchasers and pawn shops, Court refused to declare the obligations non dischargeable under Section 523(c) because, while the Debtor confessed to the sale of the items, the testimony and evidence at trial presented by the plaintiff creditor did not establish the debtor's malicious intent to harm the creditor. The Court cited to Maryfield Grain Co. v. Crump, 247 B.R. 1 (Bankr. W.D. Ky. 2000), a decision by Judge Wendell Roberts, which held that in order to prevail in an action 523(a)6), the Creditor must prove the debtor had the intent to harm either the creditor or the collateral. Relates to Section 5.3 of Outline.

Unpublished Opinions by Honorable J. Wendell Roberts

In re: Clayton & Stacey Crump, Case No. 99-50595, AP No. 99-5029, decided March 20, 2000. Court overruled Creditor's Motion to Reconsider Judgment entered on Debtor's behalf on creditor's Section 523(a)(6) claim. Court ruled that the Debtor's failure to remit proceeds from the sale of collateral (in this case crops) did not
constitute a willful and malicious injury where it appeared the Debtor was using the proceeds for his farming business with the motive of keeping the business afloat. Relates to Section 5.3 of outline.

In re: Charles Lewis Roberts, Jr., Case No. 00-30788(2)7, AP No. 00-3067, decided September 14, 2000. A final judgment had been entered for interest on a child support arrearage. The Court held that it was non-dischargeable under Section 523(a)(5), citing In re: Coleman, 56 B.R. 179. Relates to Section 5.3 of outline.

In re: Selma Ann Slaughter, Case No. 99-34948(7), AP No. 00-3004, decided November 6, 2000. Court refused to allow the debtor to amend her complaint to state a claim for preferential conveyance under Section 544(b) and the Kentucky Preference Statute KRS 378.060, ruling that the statute of limitations for avoidance actions under Section 544 under Section 546(a)(2) barred the amendment where the case was closed on March 14, 2000 and the Plaintiff raised the issue on May 8, 2000, after passage of the bar date. Relates to Section 3.5 of Outline.

Unpublished decisions by Honorable Joan L. Cooper

In re: Nickie Howard Vandagriff, Case No. 99-11171(3)7, decided April 12, 2000. Trustee sought an order declaring that the debtor's IRA Funds were not exempt from estate property. The issue for determination was whether these funds, which were rolled over from a retirement plan qualified under ERISA into an individual IRA within 120 days before the bankruptcy petition was filed, were entitled to the exemption under KRS 427.150. The Court ruled that the funds were in fact exempt, holding that the exemption statutes are to be liberally construed in favor of a debtor and further that, under the IRS Code sections applicable, which are incorporated by reference into the Kentucky statute, the roller was not a “contribution” to the IRA as used in the Kentucky Statute. Relates to Section 2.3 of Outline.

In re: Curtis Wayne Rippy, Case No. 98-11756(1), AP No. 99-1012, decided June 7, 2000. Creditor bank filed adversary proceeding for exception to discharge related to its loan secured by a Harley Davidson Motorcycle. The Trustee counterclaimed alleging that the Bank did not hold a perfected security interest in the motorcycle and other collateral, and that the Bank's sale of said collateral after the bankruptcy violated the stay and constituted a preferential transfer under Section 547. The Court ruled that the Bank did not properly perfect its security interest in the collateral under KRS 186A.190, which requires that the Bank's lien be notated on the Certificate of Title. The Court therefore concluded that the motorcycle was property of the bankruptcy estate and that the Bank's lien was unperfected and therefore subordinate to the interest of the Trustee. Relates to Section 3.7 of Outline.

In re: Timothy W. Alexander, Case No. 00-10025, decided June 12, 2000. Debtor sought to hold his ex-wife and her divorce attorney liable for an intentional violation of the stay when, following filing of the petition by the debtor, they requested the state divorce court to issue an order holding the Debtor in contempt for failure to make payments on certain debt obligations assigned to the Debtor in the divorce decree. The Court held that while the ex-wife and her attorney alleged their actions were in good faith, their actions were clearly intended to enforce a portion of the parties separation agreement which fell into the prohibitions set forth in Section 362(b)(1). The Court awarded the Debtor damages in the amount of $1344.20. Relates to Section 1.3 of Outline.

In re: Martha A. Brumbaugh, Case No. 99-41200 (3) 7, decided July 5, 2000. Debtor sought to avoid judicial lien against home owned jointly with her husband. The Debtor claimed a homestead exemption for the property in the amount of $4,500.00. The Creditor objected arguing that the lien did not impair the debtor's exemption under Section 522(f)(2)(A). The Debtor argued that because, under Kentucky law, a creditor can attach and sell under execution a debtor-spouse's interest in property, the lien impaired her exemption and was avoidable. The Court ruled that under the 1994 amendments to the Bankruptcy Code, Congress provided a federal definition of "impairment" and provided an arithmetic test to determine if a lien impairs an exemption. Under the Code, a lien does not impair an exemption unless the sum of the lien, the other liens and the amount of the exemption the debtor could claim exceed the value of the debtor's interest in the property in the absence of any liens. Utilizing the test, the Court overruled the Debtor's motion. Relates to Section 4.4 of Outline.
UCC UPDATE:
BIG CHANGES TO ARTICLE 9

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SECTION D
PART ONE: COMPARISON OF CURRENT ARTICLE 9 WITH REVISED ARTICLE 9

PART TWO: TRANSITION RULES FOR REVISED ARTICLE 9:

1. Applicability Of Revised Article 9 Over Pre-Effective Date (PED) Transactions

2. Security Interest Enforceable And Perfected Under Both Revised 9 And Old 9 -- 9-703(1)

3. Security Interest Enforceable And Perfected Under Old 9 But Not Under Revised 9 -- 9-703(2)

4. Security Interest Enforceable But Not Perfected Before Effective Date Of Revised 9 -- 9-704

5. After-Acquired Property Under Security Interest Perfected Under Old 9 Other Than By Filing Where Perfection Action Not Effective Under Revised 9 -- 9-705(1)

6. PED Filing -- 9-705(2) & (3)

7. Continuation Of Perfection By Filing -- 9-706 & 9-705(4)

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PART THREE: DEFAULT AND ENFORCEMENT IN CONSUMER TRANSACTIONS UNDER REVISED ARTICLE 9

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A. Transition

B. Major Changes and Clarifications

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SECTION D
BIG CHANGES TO ARTICLE 9

CONSUMER BANKRUPTCY UPDATE

Richard Nowka
Louis D. Brandeis School of Law
### COMPARISON OF CURRENT ARTICLE 9 WITH REVISED ARTICLE 9

<table>
<thead>
<tr>
<th>Current Section #</th>
<th>Rule</th>
<th>Revised Section #</th>
<th>Rule</th>
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<tbody>
<tr>
<td>Perfection by Filing</td>
<td></td>
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<tr>
<td>Contents of Financing Statement</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>9-402</td>
<td>Names of debtor and secured party; addresses of both; description of collateral; ID# of debtor; debtor signature</td>
<td>9-502</td>
<td>Names of debtor and secured party; &quot;indicates&quot; collateral covered</td>
</tr>
<tr>
<td></td>
<td></td>
<td>9-504</td>
<td>Financing statement sufficiently &quot;indicates&quot; collateral if complies with 9-108 [identify by listing, category, or a type of collateral defined in UCC, e.g. inventory], or indicates that financing statement covers all debtor's assets or personal property</td>
</tr>
<tr>
<td></td>
<td>9-502 and Official Comment 3; 9-509</td>
<td></td>
<td>No signature of debtor is needed; however, debtor must authorize the filing; the debtor authorizes the filing of a financing statement by signing as or becoming bound as debtor by a security agreement</td>
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<tr>
<td>Current Section #</td>
<td>Rule</td>
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<tr>
<td><strong>Perfection by Filing, continued</strong></td>
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<tr>
<td><strong>Place of Filing</strong></td>
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<tr>
<td>9-401</td>
<td>Local filing with county clerk’s office; place of filing depends on type of collateral and location of debtor</td>
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<tr>
<td>9-401A</td>
<td>Secretary of State filing; submit file stamped copy of statement filed with county clerk to Sec. of State office; 20 days; $100 fine; information only, not a condition of perfection</td>
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<tr>
<td><strong>What Constitutes Filing</strong></td>
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<tr>
<td>9-403</td>
<td>Present financing statement and tender of fee; or acceptance of statement by filing officer</td>
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<table>
<thead>
<tr>
<th>Revised Section #</th>
<th>Rule</th>
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<tbody>
<tr>
<td>9-501</td>
<td>Central filing w/ Secretary of State’s office; exception for minerals to be extracted, timber to be cut and fixture filing--file in office where mortgage on the real property would be filed</td>
</tr>
<tr>
<td>9-516(a)</td>
<td>Communication of a record to filing office and tender of fee; or acceptance of record by filing office</td>
</tr>
<tr>
<td>9-520(a)</td>
<td>Filing officer shall refuse to accept a financing statement not including addresses of debtor and secured party; filing does not occur if filing officer refuses to accept for that reason</td>
</tr>
<tr>
<td>9-516(b)(4) &amp; (5)</td>
<td></td>
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<tr>
<td>9-520(c)</td>
<td>If filing officer nevertheless accepts the defective statement for filing, it is effective</td>
</tr>
<tr>
<td>Current Section #</td>
<td>Revised Section #</td>
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<tr>
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<tr>
<td>Perfection by filing, continued</td>
<td>9-515</td>
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<tr>
<td>Current Section #</td>
<td>Rule</td>
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<tr>
<td>Transition Rules</td>
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Section 9-705(c) saves an effective financing statement and continues the perfected status of a security interest valid under current Article 9, but only until earlier of June 30, 2006 or expiration of effectiveness under current Article 9.
<table>
<thead>
<tr>
<th>Current Section #</th>
<th>Rule</th>
<th>Revised Section #</th>
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<tbody>
<tr>
<td>Priority of Secured Creditor</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Lien Creditor</td>
<td>Includes bankruptcy trustee</td>
<td>9-301</td>
<td>Unperfected security interest subordinate to person who becomes a lien creditor before perfection</td>
</tr>
<tr>
<td>9-301</td>
<td>Unperfected security interest subordinate to person who becomes a lien creditor before perfection</td>
<td>9-317</td>
<td>Unperfected security interest subordinate to person who becomes lien creditor before the earlier of perfection or filing of financing statement</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>Lien Creditor and PMSI</th>
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<tbody>
<tr>
<td>9-301(2)</td>
<td>Filing a financing statement before or within ten (10) days after debtor receives possession of collateral allows SP to take priority over lien creditor whose rights arise between time of attachment and filing</td>
<td>9-317(e)</td>
<td>Same rule; time for filing extended to twenty (20) days after debtor receives delivery of collateral</td>
</tr>
</tbody>
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<table>
<thead>
<tr>
<th>Buyer</th>
<th></th>
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<tbody>
<tr>
<td>9-307</td>
<td>Buyer in ordinary course of business takes free of perfected security interest created by his seller</td>
<td>9-320</td>
<td>Same as current rule</td>
</tr>
</tbody>
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<thead>
<tr>
<th>Secured Party</th>
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<tbody>
<tr>
<td>312(5)</td>
<td>Conflicting security interests rank according to priority in time of filing or perfection. Priority dates from the time a filing is first made or the security interest is first perfected</td>
<td>9-322(a)</td>
<td>Same as current rule</td>
</tr>
<tr>
<td>Current Section #</td>
<td>Rule</td>
<td>Revised Section #</td>
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<tr>
<td>Priority of Secured Creditor, continued</td>
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<tr>
<td>Purchase Money Security Interests</td>
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<tr>
<td>9-312(3) &amp; (4)</td>
<td>Perfected PMSIs in inventory or in non-inventory collateral have priority over earlier perfected, conflicting security interest in the same collateral</td>
<td>9-324(a) &amp; (b)</td>
<td>Same as current rule</td>
</tr>
<tr>
<td>Double Debtor</td>
<td>no current section</td>
<td>9-325</td>
<td>When debtor acquires property subject to a security interest created by another debtor (typically the other debtor is the seller to the current debtor) a security interest created by the debtor is subordinate to the security interest previously created if the debtor acquired the collateral subject to the security interest and the security interest was perfected at that time</td>
</tr>
<tr>
<td>Current Section #</td>
<td>Rule</td>
<td>Revised Section #</td>
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<tr>
<td>PMSI Transformation Rule</td>
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<tr>
<td>9-107</td>
<td>PMSI that secures non-purchase money obligations, or is secured by non-purchase money collateral, or is renewed or refinanced may lose PM status</td>
<td>9-103(b)</td>
<td>Cross collateralization - a PMSI in inventory can also secure a PM obligation incurred for other inventory, e.g., PMSI in goods A can secure PM obligation of goods B</td>
</tr>
<tr>
<td></td>
<td>Even courts that allow PM status to continue had difficulty allocating the debtor’s payments between PM and non-PM debts</td>
<td>9-103(f)</td>
<td>PMSI does not lose PM status even if PM collateral also secures a non-PM obligation; the PM obligation is also secured by non-PM collateral; or the PM obligation has been renewed, refinanced, consolidated or restructured</td>
</tr>
<tr>
<td></td>
<td></td>
<td>9-103(e)</td>
<td>Allocation of payment in respect to a dual status SI is: first, according to parties’ agreement; second, in absence of agreement according to intention of debtor manifested at or before the time of payment; or third, to unsecured obligations or if more than one obligation is secured by PMSI, in the order in which they were incurred</td>
</tr>
<tr>
<td>Current section #</td>
<td>Rule</td>
<td>Revised Section #</td>
<td>Rule</td>
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</tr>
<tr>
<td>Consumer debtors</td>
<td>Rule</td>
<td>9-103(h)</td>
<td>These rules do not apply to a PMSI in consumer goods and such limitation is intended to leave the determination of the proper rules to the court, with no inference from the limitation of rules of Revised Article 9 to non-consumer goods transactions</td>
</tr>
</tbody>
</table>
TRANSITION RULES FOR REVISED ARTICLE 9
9-702 – 9-709

Richard H. Nowka
Louis D. Brandeis School of Law

1. Applicability of revised 9 over pre-effective-date (PED) transactions

- Applicability of revised article 9—9-702
  
  - On July 1, 2001, revised 9 immediately applies to PED transactions and liens within scope of revised 9 regardless of whether the transaction was covered by old article 9
  
  - Effect is that secured party must comply with revised 9 requirements to insure continued validity of PED transaction

SAVING CLAUSE—9-702(2) except as otherwise provided by the transition rules (these “otherwise provided” rules include length of perfection, and continuation of perfection, discussed infra), transactions and liens not governed by old 9 remain valid without the necessity of action; they can be terminated, completed, consummated and enforced under either revised 9 or law applicable otherwise, at option of secured party

EXAMPLE—agriculture liens are not covered by old 9 but are within scope of revised 9; on July 1, 2001, a PED agriculture lien is governed by the requirements of revised 9, thus necessitating the lienholder’s compliance with revised 9; saving clause effect is that the lien remains valid under revised 9 without any action by the lienholder, and lienholder can choose to enforce lien under either revised 9 or PED applicable law
EXCEPTION TO APPLICABILITY OF REVISED 9—9-702(3)
revised 9 does not affect an action, case, or proceeding, i.e.,
litigation, commenced before revised 9 takes effect, July 1,
2001; if litigation involving a security interest is commenced
before July 1, 2001, the requirements of old 9 for enforceability,
perfection, priority, enforcement, etc., apply in the proceeding
regardless of whether revised 9 changes those requirements

- Priority of security interest—9-709

- Revised 9 priority rules determine the priority of conflicting
claims regardless of whether the claim arises before or after the
effective date of revised 9

EXAMPLE—SP 1 takes a security interest in debtor’s
equipment that attaches on May 1, 2000, but never perfects it;
revised 9 takes effect; SP 2 takes a security interest in the
same equipment on August 1, 2001, and perfects it on August
5, 2001; the priority rules of revised 9 determine the priority of
the competing claims; SP 2 has priority

EXCEPTION—9-709(1) if the relative priorities of the claims
are established before the effective date of revised 9, then old 9
determines the priorities; revised 9 does not define when
“relative priorities” are “established,” but the official comments
to 9-709 indicate that relative priorities are established
whenever two or more entities have an interest in the same
collateral; priorities are established regardless of whether or
when an actual conflict over the collateral arises

EXAMPLE—SP 1 takes a security interest in debtor’s
equipment on May 1, 2000, and perfects it on May 7, 2000;
SP 2 takes a security interest in the same equipment on August
1, 2000, and perfects it on August 5, 2000; these priorities are
established before the effective date of revised 9 and are
determined by the priority rules of old 9; SP 1 has priority

- Claimant’s action taken after the effective date of revised 9 can
change relative priorities established under old 9 resulting in
revised 9 determining the relative priorities
EXAMPLE—SP 1 and SP 2 have unperfected security interests in debtor’s equipment prior to effective date of revised 9; old 9 determines the priorities because the relative priorities are established prior to revised 9; SP 1 has priority; after effective date of revised 9, SP 2 perfects its security interest by filing a financing statement; the post-effective-date action of SP 2 changes the relative priorities which are now determined by the priority rules of revised 9; SP 2 has priority.

- The mere taking effect of revised 9 cannot change relative priorities established under old 9; in a situation where PED action of the claimant is not effective to perfect a security interest under old 9, but is effective to perfect a security interest under revised 9, the relative priorities are not reestablished upon the effective date of revised 9; priority is determined under old 9.

EXAMPLE—in March 2000, SP 1 takes a security interest in debtor’s right to payment for lottery winnings, a general intangible under old 9, but files a financing statement describing the collateral as “accounts” and is not perfected under old 9; in August 2000, SP 2 takes a security interest in the same collateral and files a financing statement describing the collateral as “accounts and general intangibles” and is perfected under old 9; the relative priorities are established and SP 2 has priority; under the accounts definition of revised 9 (9-102(2)), a right to payment for lottery winnings is an account; when revised 9 becomes effective, SP 1’s financing statement is effective to perfect its security interest under revised 9 (assuming all other revised 9 perfection requirements are satisfied); if revised 9 were to govern priority, the first to file or perfect rule would award priority to SP 1 since it was the first to file, and SP 1 is now perfected; however, the relative priorities are not reestablished and SP 2 has priority.

- Priority of security interest dates from effective date of revised 9 for security interest in after acquired collateral acquired after revised 9 effective date—9-709(2); this provision has a narrow application; it is applicable only for after acquired collateral.
acquired by the debtor after revised 9’s effective date, and when secured party’s perfection action was not effective to perfect the security interest under old 9, but is effective to perfect the security interest under revised 9; priority of such after acquired property security interest dates from the effective date of revised 9.

EXAMPLE— in March 2000, SP 1 takes a security interest in debtor’s current and after acquired rights to payment for lottery winnings, a general intangible under old 9, but files a financing statement describing the collateral as “accounts” and is not perfected under old 9; when revised 9 becomes effective, SP 1’s financing statement is effective to perfect its security interest under revised 9 (assuming all other revised 9 perfection requirements are satisfied); after revised 9 becomes effective, the debtor acquires additional rights to payment for lottery winnings; the priority date for the rights to payment acquired after revised 9’s effective date is July 1, 2001.

2. Security interest enforceable and perfected under both revised 9 and old 9—9-703(1)

• A security interest that was enforceable and perfected under old 9 or other applicable law 9 (when PED transaction was outside the scope of old 9) is a perfected security interest under revised 9 if, when revised 9 becomes effective, the applicable requirements for enforceability and perfection under revised 9 are satisfied without further action.

EXAMPLES—purchase money security interest in debtor’s consumer goods automatically perfected upon attachment under both old 9 and revised 9; security interest in debtor’s instruments perfected by possession under both old 9 and revised 9; security interest in debtor’s securities account perfected by control under both old 9 and revised 9.

3. Security interest enforceable and perfected under old 9 but not under revised 9—9-703(2)
• Security interest that is enforceable and perfected under old 9 but does not satisfy the revised 9 requirements for perfection remains perfected for one year after revised 9 takes effect

• Security interest remains enforceable thereafter if security interest becomes enforceable under revised 9 requirements before the year expires

• Security interest remains perfected thereafter if security interest becomes perfected under revised 9 requirements before the year expires

EXAMPLE—SP takes a security interest in debtor’s right to proceeds of a written letter of credit; SP perfects by possession of the letter of credit (effective under old 9-305); revised 9 becomes effective; possession of letter of credit does not perfect such security interest under revised 9 requirements; security interest remains perfected until June 30, 2002; perfection lapses on June 30, 2002, unless effective perfection action taken between July 1, 2001, and June 30, 2002

EXCEPTION—this rule—security interest remains perfected for one year—is subject to 9-705, discussed infra at 6, which allows security interests perfected by filing to remain perfected beyond June 30, 2002

4. Security interest enforceable but not perfected before effective date of revised 9—9-704

• Security interest is enforceable under old 9 but is not perfected under old 9 when revised 9 becomes effective; security interest remains enforceable for one year after revised 9 becomes effective regardless of whether security interest satisfies enforcement requirements of revised 9

• Security interest remains enforceable thereafter if revised 9 enforceability requirements are satisfied during the year; if requirements not satisfied during the year, security interest lapses
• Security interest becomes perfected under revised 9 when revised 9 perfection requirements are satisfied, with or without action by the secured party

EXAMPLE—SP takes a security interest in debtor's instruments under a security agreement signed by debtor describing the collateral as "debtor's instruments"; SP fails to take possession of the instruments and is not perfected under old 9; when revised 9 takes effect the security remains enforceable for one year and thereafter since the authenticated security agreement satisfies the enforceability requirements under both old 9 and revised 9; SP can perfect under revised 9 either by taking possession of the instruments or by filing a financing statement covering instruments; if, prior to revised 9 effective date, SP takes action that is ineffective to perfect the security interest under old 9, but effective under revised 9, e.g., files a financing statement that satisfies revised 9's requirements, the security interest becomes perfected immediately upon revised 9 becoming effective; this possibility is less likely in Kentucky since Kentucky filing office will change from local filing under old 9 to central filing under revised 9.

5. After-acquired property under security interest perfected under old 9 other than by filing where perfection action not effective under revised 9—9-705(1)

• Rule has narrow application; affects only security interest in property acquired after revised 9 effective date, and security interest is perfected other than by filing under old 9, such action not being effective to perfect the security interest under revised 9; in such case the security interest in property acquired after revised 9 effective date is perfected for one year after revised 9 effective date; after lapse of one year, security interest becomes unperfected unless secured party takes action effective under revised 9 within one year of effective date; under 9-703(2) the security interest in the PED collateral is perfected also for only one year after revised 9 becomes effective.
EXAMPLE—SP has security interest in debtor's existing and after acquired instruments; the instruments are held by a bailee who is not an agent of or under the control of SP or debtor; SP perfects under old 9-305 by notifying bailee of SP's security interest; revised 9 takes effect and thereunder SP's perfection action is not effective; after revised 9 takes effect the debtor acquires instruments which it delivers to bailee; the security interest in the instruments acquired after revised 9 becomes effective remain perfected for one year from revised 9's effective date; thereafter, perfection lapses unless SP takes action effective under revised 9, e.g., bailee acknowledges it holds instruments for SP, or SP files a financing statement.

6. PED filing—9-705(2) & (3)

- Filing effective under revised 9, but ineffective under old 9—9-705(2)
- Where PED filing satisfies the perfection requirements of revised 9, but not the requirements of old 9, the security interest is perfected when revised 9 takes effect.

EXAMPLES—financing statement could be ineffective under the requirements of old 9 because, for example, the financing statement description is overly broad, or it is filed in the wrong jurisdiction under the choice of law rules of old 9-103; if revised 9 validates the financing statement’s broad description, or the jurisdiction is proper under revised 9’s choice of law rules, the security interest is perfected without further action when revised 9 becomes effective.

EXAMPLE—SP anticipates the effective date of revised 9 and files a financing statement under the requirements of revised 9, although the financing statement is not effective under old 9; the security interest is effective without further action when revised 9 becomes effective; SP typically also would make an effective filing under old 9.
• Filing effective under old 9, but ineffective under revised 9—9-705(3)

• Security interest is perfected by a PED filing which is effective to perfect the security interest under old 9; PED filing is not effective to perfect the security interest under revised 9; nevertheless security interest remains effective until earlier of remaining period of perfection under old 9, or June 30, 2006; this is an exception to the one year of perfection rule of 9-703(2)

EXAMPLE—SP takes a security interest in debtor's equipment in August 2000; SP perfects by filing financing statement in the Kentucky county clerk's office of the county of debtor's residence; revised 9 takes effect on July 1, 2001; under revised 9, financing statement in equipment is filed in secretary of state's office, thus filing is not effective under revised 9; security interest remains perfected regardless of lack of effective post-effective-date filing until earlier of normal lapse date under old 9 or June 30, 2006

PRACTICAL EFFECT—SP can do nothing and security interest perfected by PED filing remains perfected for both PED collateral and post-effective-date collateral

7. Continuation of perfection by filing—9-706 & 9-705(4)

• Security interest perfected by PED filing cannot be continued beyond lapse date by filing revised 9 continuation statement—9-705(4)

EXCEPTION—PED filing can be continued by timely filing a revised 9 continuation statement if PED filing was in the filing office designated by revised 9; the continuation statement and the PED financing statement must satisfy revised 9 requirements for an initial financing statement—9-705(4) & (6)

PRACTICAL EFFECT—exception is of little value to security interests perfected by filing in Kentucky because PED filing
typically is a county clerk's office filing and effective revised 9 filing is a secretary of state's office filing, thus effective filings would not be made in the same office; exception applicable to multi-state secured transactions where choice of law rules of both old 9 and revised 9 specify same jurisdiction and same office

- Continuing effectiveness of PED filing is accomplished by filing an initial financing statement "in lieu" of filing a continuation statement—9-706

- The "in lieu" statement is filed in the filing office designated by revised 9

- The "in lieu" statement can be filed any time prior to lapse of effectiveness of PED financing statement; this filing is not restricted to the normal six month window for filing continuation statements

- The "in lieu" statement continues the effectiveness of the PED financing statement for five years from the date of filing the "in lieu" statement, not five years from the normal lapse date of the PED filing

- The "in lieu" statement can continue the effectiveness of more than one PED filing against the same debtor provided the "in lieu" statement properly identifies all the affected filings

- The "in lieu" statement must: 1) satisfy the revised 9 requirements for an initial financing statement (part 5 of revised 9); 2) identify the PED filing by filing office, date of filing, and file numbers of the PED filing and most recent continuation statement (if any); and 3) indicate that the PED filing remains effective

EXAMPLE—SP perfects a security interest in Kentucky debtor's equipment by filing a PED financing statement in county of debtor's residence on August 5, 2000; revised 9 takes effect on July 1, 2001, and revised 9 specifies the proper filing office as the Kentucky secretary of state's office; on November 11, 2004, SP files, in the Kentucky secretary of
state's office, an initial financing statement (an “in lieu” statement) that also satisfies the requirements of 9-706(3) to continue the PED filing; SP's PED filing is continued for five years from November 11, 2004, and SP's priority date relates back to the original priority date.

8. Amendment of PED filing—9-707

- Amendment, under the revised 9 definition, includes any filings made to a financing statement after filing the initial financing statement, e.g., add or delete collateral, continue or terminate the financing statement, add or delete debtors/secured parties.

- Place of filing amendment—must file amendment in office and jurisdiction specified by revised 9 regardless of place of PED filing.

EXAMPLES—PED financing statement filed locally in Kentucky, post-revised 9-effective-date amendment can be filed only in Kentucky secretary of state's office; in multi-state secured transaction—PED filing made, for example, in Indiana under old 9’s choice of law rules; revised 9’s choice of law rules designate Kentucky as the proper jurisdiction; post-effective-date amendment can be filed only in Kentucky secretary of state’s office.

EXAMPLES—PED financing statement filed locally in Kentucky, post-revised 9-effective-date amendment can be filed only in Kentucky secretary of state's office; in multi-state secured transaction—PED filing made, for example, in Indiana under old 9’s choice of law rules; revised 9’s choice of law rules designate Kentucky as the proper jurisdiction; post-effective-date amendment can be filed only in Kentucky secretary of state’s office.

EXCEPTION—can terminate effectiveness, i.e., a termination statement, of PED filing in accordance with law of jurisdiction where PED filing is made—9-707(2) & (5); termination “exception” is not available if SP has filed a post-effective-date initial financing statement in office designated by revised 9; exception may not be available in Kentucky because revised 9 changes filing office from local to central.

- Method of amending—9-707(3)

- If the PED financing statement and the amendment are filed in the same office specified by revised 9, then amendment is only filing required; this method is not generally applicable in...
Kentucky since PED filing is local, and the post-effective-date amendment filing is central; possible in multi-state secured transactions where PED filing office is same as revised 9 filing office

- If the pre and post filing offices are not the same, file post-effective-date initial financing statement in office specified by revised 9, and therewith or thereafter, file amendment; two documents filed; the initial financing statement must also satisfy 9-706(3)—the information required to continue the effectiveness of the PED filing.

- If the pre and post filing offices are not the same, can file post-effective-date initial financing statement which provides the amended information in office specified by revised 9; one document filed; the initial financing statement must also satisfy 9-706(3)—the information required to continue the effectiveness of the PED filing.
I. Introduction

A. Transition. As of July 1, 2001, all transactions will become subject to new default rules.

B. Major Changes and Clarifications

1. Default Rules contained in Part 6
2. Statutory Distinction between Consumer and Commercial Transactions
3. Definitional Clarifications of Good Faith and Commercial Reasonableness
4. Definitional Clarification Regarding Parties
5. Notice Safe Harbor
6. Explanation of Deficiency

II. Commercial v. Consumer Transactions

A. Definition of Consumer Transactions.

9-102(24) defines "consumer transaction" as a "consumer transaction in which:
   (1) an individual incurs an obligation primarily for personal, family, or household purposes; and
   (2) a security interest in consumer goods secures the transaction."

9-102(23) defines "consumer goods" as "goods that are used or bought for use primarily for personal, family, or household purposes."
B. Importance

1. 10 day notice safe harbor does not apply to consumer transactions. R9-612 provides:

   (1) Except as otherwise provided in subsection (2) of this section, whether a notification is sent within a reasonable time is a question of fact.

   (2) In a transaction other than a consumer transaction, a notification of disposition sent after default and ten (10) days or more before the earliest time of disposition set forth in the notification is sent within a reasonable time before the disposition.

2. Separate Notice Requirements and Form. See Section V below.

3. Requirement of Explanation of Calculation of Surplus of Deficiency. See Section VI below.

4. Limitations on Strict Foreclosure. R 9-620(5)-(7) provide:

   (5) A secured party that has taken possession of collateral shall dispose of the collateral pursuant to KRS 355.9-610 within the time specified in subsection (6) of this section if:

      (a) Sixty percent (60%) of the cash price has been paid in the case of a purchase-money security interest in consumer goods; or

      (b) Sixty percent (60%) of the principal amount of the obligation secured has been paid in the case of a non-purchase-money security interest in consumer goods.

   (6) To comply with subsection (5) of this section, the secured party shall dispose of the collateral:

      (a) Within ninety (90) days after taking possession; or

      (b) Within any longer period to which the debtor and all secondary obligors have agreed in an agreement to that effect entered into and authenticated after default.

   (7) In a consumer transaction, a secured party may not accept
collateral in partial satisfaction of the obligation it secures.

5. Minimum Damage Provisions. R9-625(3), (5) and (6) provide:

(3) Except as otherwise provided in KRS 355.9-628:

(a) A person that, at the time of the failure, was a debtor, was an obligor, or held a security interest in or other lien on the collateral may recover damages under subsection (2) of this section for its loss; and

(b) If the collateral is consumer goods, a person that was a debtor or a secondary obligor at the time a secured party failed to comply with this part of this article may recover for that failure in any event an amount not less than the credit service charge plus ten percent (10%) of the principal amount of the obligation or the time-price differential plus ten percent (10%) of the cash price.

(5) In addition to any damages recoverable under subsection (2) of this section, the debtor, consumer obligor, or person named as a debtor in a filed record, as applicable, may recover five hundred dollars ($500) in each case from a person that:

(a) Fails to comply with KRS 355.9-208;

(b) Fails to comply with KRS 355.9-209;

(c) Files a record that the person is not entitled to file under KRS 355.9-509(1);

(d) Fails to cause the secured party of record to file or send a termination statement as required by KRS 355.9-513(1) or (3) of this Act;

(e) Fails to comply with KRS 355.9-616(2)(a) and whose failure is part of a pattern, or consistent with a practice, of noncompliance; or

(f) Fails to comply with KRS 355.9-616(2)(b).

(6) A debtor or consumer obligor may recover damages under subsection (2) of this section and, in addition, five hundred dollars
III. Definitions of Good Faith and Commercial Reasonableness

A. Good Faith

Current Article 9 uses the general UCC definition of good faith contained in 1-201(19). That section defines "good faith" as "honesty in fact in the conduct or transaction concerned."

R9-102(43) defines "good faith" as "honesty in fact and the observence of reasonable commercial standards of fair dealing." [emphasis added]

B. Commercial Reasonableness.

R9-627 provides some clarity to the definition of commercial reasonableness. That section provides:

355.9-627 Determination of whether conduct was commercially reasonable.

(1) The fact that a greater amount could have been obtained by a collection, enforcement, disposition, or acceptance at a different time or in a different method from that selected by the secured party is not of itself sufficient to preclude the secured party from establishing that the collection, enforcement, disposition, or acceptance was made in a commercially reasonable manner.
(2) A disposition of collateral is made in a commercially reasonable manner if the disposition is made:

(a) In the usual manner on any recognized market;
(b) At the price current in any recognized market at the time of the disposition; or
(c) Otherwise in conformity with reasonable commercial practices among dealers in the type of property that was the subject of the disposition.

(3) A collection, enforcement, disposition, or acceptance is commercially reasonable if it has been approved:

(a) In a judicial proceeding;
(b) By a bona fide creditors' committee;
(c) By a representative of creditors; or
(d) By an assignee for the benefit of creditors.

(4) Approval under subsection (3) of this section need not be obtained, and lack of approval does not mean that the collection, enforcement, disposition, or acceptance is not commercially reasonable.

IV. Definitions of Debtor, Obligor, and Secondary Obligor

A. Current Article 9 has created some uncertainty because the definition of "debtor" includes both the owner of the collateral and the person who owes the obligation, as the "context" requires.

B. R9-102 provides separate definitions for;

"debtor" — the person who owns the collateral;
"obligor" — the person who owes the debt; and
"secondary obligor" — a guarantor.

C. These definitions are most important when considering the parties entitled to notice and a commercially reasonable sale.

V. Notice Requirement. R9-614 provides clarity regarding the form that notice must take. Under R9-614 completing the following form provides sufficient information:
NOTICE OF OUR PLAN TO SELL PROPERTY

We have your ...... <describe collateral>, because you broke promises in our agreement.

<For a public disposition:>

We will sell ...... <describe collateral> at public sale. A sale could include a lease or license. The sale will be held as follows:

Date: ..............
Time: ..............
Place: ..............

You may attend the sale and bring bidders if you want.

<For a private disposition:>

We will sell ...... <describe collateral> at private sale sometime after ...... <date>. A sale could include a lease or license.

The money that we get from the sale (after paying our costs) will reduce the amount you owe. If we get less money than you owe, you ...... <will or will not, as applicable> still owe us the difference. If we get more money than you owe, you will get the extra money, unless we must pay it to someone else. You can get the property back at any time before we sell it by paying us the full amount you owe (not just the past due payments), including our expenses. To learn the exact amount you must pay, call us at ...... <telephone number>.

If you want us to explain to you in writing how we have figured the amount that you owe us, you may call us at ...... <telephone number> <or write us at ...... <secured party's address>> and request a written explanation. <We will charge you $. .... for the explanation if we sent you another written explanation of the amount you owe us within the last six (6) months.>

If you need more information about the sale call us at ...... <telephone number> <or write us at ...... <secured party's address>>.

We are sending this notice to the following other people who have an interest in ...... <describe collateral> or who owe money under your agreement:

......<Names of all other debtors and obligors, if any>"
R9-614 also provides:

(4) A notification in the form of subsection (3) of this section is sufficient, even if additional information appears at the end of the form.

(5) A notification in the form of subsection (3) of this section is sufficient, even if it includes errors in information not required by subsection (1) of this section, unless the error is misleading with respect to rights arising under this article.

(6) If a notification under this section is not in the form of subsection (3) of this section, law other than this article determines the effect of including information not required by subsection (1) of this section.

VI Explanation of Calculation of Surplus or Deficiency.

A. When a consumer requests an explanation after a disposition of collateral, R9-616 requires the secured creditor to respond within 14 days with an explanation of the method of calculation. The secured party must provide one explanation free of charge in any 6 month period. For additional explanations, the secured party may charge a fee of up to $25.00.

B. The explanation must include the following information:

(a) The aggregate amount of obligations secured by the security interest under which the disposition was made, and, if the amount reflects a rebate of unearned interest or credit service charge, an indication of that fact, calculated as of a specified date:

1. If the secured party takes or receives possession of the collateral after default, not more than thirty-five (35) days before the secured party takes or receives possession; or

2. If the secured party takes or receives possession of the collateral before default or does not take possession of the collateral, not more than thirty-five (35) days before the disposition;

(b) The amount of proceeds of the disposition;

(c) The aggregate amount of the obligations after deducting the amount of proceeds;
(d) The amount, in the aggregate or by type, and types of expenses, including expenses of retaking, holding, preparing for disposition, processing, and disposing of the collateral, and attorney’s fees secured by the collateral which are known to the secured party and relate to the current disposition;

(e) The amount, in the aggregate or by type, and types of credits, including rebates of interest or credit service charges, to which the obligor is known to be entitled and which are not reflected in the amount in paragraph (a) of this subsection; and

(f) The amount of the surplus or deficiency.

C. R9-616(4) provides:

A particular phrasing of the explanation is not required. An explanation complying substantially with the requirements of subsection (1) of this section is sufficient, even if it includes minor errors that are not seriously misleading.
HANDLING CASES WITH THE CHAPTER 7
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SECTION E (a)
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SECTION E(a)
I. PROPERTY OF THE ESTATE

A. Estate Property Defined

The commencement of a bankruptcy creates an estate, comprised of all property rights the debtor has in property of every kind and description, legal and equitable, wherever located and by whomever held, as of the date of filing. 11 USC §541. The definition of estate property is extremely broad, but the estate generally can have no greater interest in property than did the debtor at the time of filing. Property of the estate does however include property preserved, recovered or transferred back to the estate. 11 USC § 541(a)(4) and (5). Property of the estate may include consigned property, if no notice of the consignor’s interest is given. In re: Andaco, Inc., 226 BR 578 (Bankr. W.D. Ky. 1998).

1. Property Received Within Six Months of Petition

In addition to property rights held at the commencement of the case, property received by bequest or inheritance, property settlement or divorce decree, or through life insurance benefits within six (6) months of the petition is property of the estate. 11 USC § 541(a)(5).

2. Proceeds of Estate Property

Proceeds, product, offspring, rent or profits of estate property is estate property. This does not include earning from the debtor's services after the commencement of the case. Note that post-petition earnings are property of a Chapter 13 and Chapter 12 bankruptcy estate.

3. Property Not Part of the Estate

Some property is not held to be part of the bankruptcy estate. These specific, rarely seen exceptions involve property held in trust, expired leases of non-residential property, accreditation as an educational institution, certain interest in hydrocarbons and cash from the sale of certain money orders. Reference should be made to 11 USC § 541 (b) (1-5).

4. Effect of Restrictions on Transfer of Property Interest

The property of the debtor becomes property of the estate despite any agreed restriction on transfer, except for trust restrictions enforceable under state law. 11 USC §541(c)(1)(2).

B. Property Of Estate And The Chapter 7 Trustee, Generally

The Chapter 7 trustee has the duty of collecting and reducing to money the property of the estate, and is accountable for the property received. 11 USC § 704 (1)(2).

1. Property Exemptions

An individual may exempt property from the estate. 11 USC § 522. Kentucky has opted
for a state, rather than Federal exemption scheme. Exemptions are found in Chapter 427, and throughout the Kentucky Revised Statues, as well as in applicable Federal Statutes.

2. Objections to Exemptions

The trustee has thirty (30) days from the date of the first scheduled first meeting to object to a claim of exemption. Failure of the trustee to object within the time period will prevent the property from being administered, even if the claim of exemption is groundless. Talvory v. Freeland & Kronz, 503 US 638 (1992).

3. Abandonment of Property

A trustee may abandon property of the estate that is burdensome to the estate, or that is of inconsequential value and benefit. 11 USC § 554. Abandoned property reverts back to the debtor.

C. Reference To State Law

Property rights are determined by reference to the relevant state’s law. But once that determination is made, the federal bankruptcy law determines to what extent the debtor’s interest is property of the estate. In re Omegas Group, Inc., 16 F.3d 1443 (6th Cir. 1994); Bavel v. IRS, 911 F2d 1168 (6th Cir. 1990); Garrott v. Sons v. Union Planters National Bank of Memphis, 772 F2d 462 (8th Cir. 1985). State law must be applied in a manner consistent with federal bankruptcy law. Torres v. Eastlick, 767 F. 2d 1573 (9th Cir. 1985).

II. PREFERENCE LITIGATION

A. Introduction

Section 547 of the Bankruptcy Code, 11 U.S.C. §547, is one of the longer statues in the Bankruptcy Code. No statute so long is simple in either application or interpretation. Yet the premise of the preference statute is very simple. Preferences are transactions that benefit one creditor at the expense of others.

11 U.S.C. §547
(a) In this section—
(1) "inventory" means personal property leased or furnished, held for sale or lease, or to be furnished under a contract for service, raw materials, work in process, or materials used or consumed in a business, including farm products such as crops or livestock, held for sale or lease;
(2) "new value" means money or money’s worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the Trustee under any applicable law, including proceeds of such property, but does not include an obligation substituted for an existing obligation;
(3) "receivable" means right to payment, whether or not such right has been earned by performance; and
(4) a debt for a tax is incurred on the day when such tax is last payable without penalty, including any extension.
(b) Except as provided in subsection (c) of this section, the Trustee may avoid any transfer of an interest of the debtor in property—

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made—

(A) on or within 90 days before the date of the filing of the petition; or

(B) between 90 days and one year before the date of the filing of the petition, if such creditor at the time as such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if—

(A) the case were a case under Chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

(c) The Trustee may not avoid under this section a transfer—

(1) to the extent that such transfer was—

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

(B) in fact a substantially contemporaneous exchange;

(2) to the extent that such transfer was—

(A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;

(B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and

(C) made according to ordinary business terms;

(3) that creates a security interest in property acquired by the debtor—

(A) to the extent such security interest secures new value that was—

(i) given at or after the signing of a security agreement that contains a description of such property as collateral;

(ii) given by or on behalf of the secured party under such agreement;

(iii) given to enable the debtor to acquire such property; and

(iv) in fact by the debtor to acquire such property; and

(B) that is perfected on or before 20 days after the debtor receives possession of such property;

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—

(A) not secured by an otherwise unavoidable security interest; and

(B) on account of which new value the debtor did not make an
otherwise avoidable transfer to or for the benefit of such creditor;

(5) that creates a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfers to the transferee caused a reduction, as of the date of the filing of the petition and to the prejudice of other creditors holding unsecured claims, of any amount by which the debt secured by such security interest exceeded the value of all security interests for such debt on the later of—

(A) (i) with respect to a transfer to which subsection (b)(4)(A) of this section applies, 90 days before the date of the filing of the petition; or

(ii) with respect to a transfer to which subsection (b)(4)(B) of this section applies, one year before the date of the filing of the petition; or

(B) the date on which new value was first given under the security agreement creating such security interest;

(6) that is the fixing of a statutory lien that is not avoidable under section 545 of this title;

(7) to the extent such transfer was a bona fide payment of a debt to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a Court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement, but not to the extent that such debt—

(A) is assigned to another entity, voluntarily, by operation of law, or otherwise; or

(B) includes a liability designated as alimony, maintenance or support; or

(8) if, in a case filed by an individual debtor whose debts are primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than $600.00.

d) The Trustee may avoid a transfer of an interest in property of the debtor transferred to or for the benefit of a surety to secure reimbursement of such a surety that furnished a bond or other obligation to dissolve a judicial lien that would have been avoidable by the Trustee under subsection (b) of this section. The liability of such surety under such bond or obligation shall be discharged to the extent of the value of such property recovered by the Trustee or the amount paid to the Trustee.

e) (1) For the purpose of this section—

(A) a transfer of real property other than fixtures, but including the interest of a seller or purchaser under a contract for the sale of real property, is perfected when a bona fide purchaser of such property from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest that is superior to the interest of the transferee; and

(B) a transfer of a fixture or property other than real property is
perfected when a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee.

(2) For the purposes of this section, except as provided in paragraph (3) of this subsection, a transfer is made—

(A) at the time such transfer takes effect between the transferor and the transferee, if such transfer is perfected at, or within 10 days after, such time, except as provided in subsection (c)(3)(B);

(B) at the time such transfer is perfected, if such transfer is perfected after such 10 days; or

(C) immediately before the date of the filing of the petition, if such transfer is not perfected at the later of—

(i) the commencement of the case; or

(ii) 10 days after such transfer takes effect between the transferor and the transferee.

(3) For the purpose of this section, a transfer is not made until the debtor has acquired rights in the property transferred.

(f) For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition.

(g) For the purposes of this section, the Trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section, and the creditor or party in interest against whom recovery or avoidance is sought has the burden of proving the nonavoidability of a transfer under subsection (c) of this section.

B. Preferences – Purpose

The purpose of the preference statute allows a Trustee (or debtor in possession) to preserve the quality of distribution among unsecured creditors by preventing one creditor from enhancing his position at the expense of all other creditors on the eve of bankruptcy. In re IRFM, Inc., 52 F.3d 228 (9th Cir. 1995). Most importantly, the preference section facilitates an equal distribution of the debtor’s assets among creditors. In re Antweil, 931 F.2d 689, (9th Cir.) aff’d sub. nom., Barnhill V. Johnson, 503 U.S. 393, 118 L.ED 2d 39, 112 S.Ct. 1386 (1992).

C. Definitions

1. §547(a)

11 U.S.C. §547(a) defines the following terms:

a. Inventory

Inventory is defined as that personal property that is either leased or furnished, sold or delivered, including raw materials, crops or live stock and materials that are used or consumed in a business. Inventory is essentially the product that the debtor offers for sale leases or uses in the course of his business.

b. New Value

New value is defined as additional money, or new value of goods or services rendered, new
credit or release of property previously transferred to the debtor including proceeds of property that is used by the debtor, but does not include an obligation that is substituted for an already existing obligation. This definition, which creditors use as a defense under §547(c), requires a creditor to extend additional credit or material to a debtor rather than simply take the existing property of the debtor. The purpose of the new value exception encourages a creditor to continue to do business with a financially troubled debtor who might otherwise avoid bankruptcy. In re IRFM, Inc., 52 F.3d 228 (9th Cir. 1995).

c. Receivable

The term receivable means the right to payment whether or not that right has been earned by performance.

d. Taxes

Taxes are defined in terms of time under §547(a)(4). The parties must use the day that the tax is last payable without penalty, including any extension, rather than the day the tax is actually paid. Therefore, an income tax payment is due on April 15, unless an extension is granted. The tax is due on April 15, even if paid on March 15.

2. §547(b) - Elements of Preference

The elements constituting a preferential transfer are found at 11 U.S.C. §547(b). This straightforward section defines what a Trustee must assert and prove in order to avoid a preferential transfer. No transfer is void; it is simply voidable. If a Trustee fails to challenge a transaction, it remains valid. Clark v. Pure, 151 B.R. 75 (E.D. Pa.1993).

In order to avoid a transfer of an interest of the debtor, not necessarily title, the Trustee must assert and prove that the transfer:

1) benefits the creditor;
2) is payment on an antecedent debt;
3) made while the debtor is insolvent;
4) within 90 days of the filing of the bankruptcy, unless the transfer is to an insider, which calls for a one year reach back period, and
5) the result of the transfer allows the creditor to receive more than it would receive in a Chapter 7 distribution.


a. Transfer of Interest of Debtor

The first element of a preference requires that a transfer of an interest of the debtor must benefit the preferred creditor. What constitutes a transfer and when it is complete, is a matter of Federal Law. Barnhill v. Johnson, 503 U.S. 393, 118 L.Ed. 2d 39, 112 S.CT 1386 (1991). However, in the absence of Federal Law, transfer is defined by State law. Barnhill v. Johnson supra. The transfer of an interest of the debtor must benefit a creditor. In the absence of benefit, no
preference occurs.

b. Antecedent Debt

The debt must already have existed at the time that a transfer of property of the debtor occurs. What constitutes an antecedent debt has been the subject of some interesting cases. For example, a check returned for insufficient funds is a credit transaction. A subsequent payment by the debtor for a dishonored check is a payment on an antecedent debt. A check honored in the ordinary course is a cash transaction and not a payment on an antecedent debt. In re Car Renovators, 946 F.2d 780 (11th Cir. 1991), cert. denied sub. nom., Heart of Dixie Nissan v. Reynolds, 504 U.S. 913, 118 L.Ed. 2d 553, 112 S.Ct. 1949 (1992). Reducing future obligations to a present value and then obtaining cancellation of the debt for payment meets the statutory definition of an antecedent debt. In the case of In re Futuran, 76 F.3d 265 (9th Cir. 1996), a husband reduced his future maintenance obligations to a lump sum and paid that to his wife in exchange for cancellation of the debt. The Court characterized the transaction as payment of an antecedent debt.

c. Insolvency

Insolvency is defined in §101 of Title 11, the general definitions section. The presumption of insolvency generally favors the Trustee; in other words the debtor is presumed insolvent for a period of time. However, insolvency is rebuttable. 11 U.S.C. §101(32), defines insolvency as a balance sheet test. The Court will find the debtor insolvent if it determines the debtor’s liabilities exceed his assets. In re Bluegrass Ford-Mercury, Inc., 942 F.2d 381 (6th Cir. 1991). Insolvency is presumed for the ninety (90) days immediately prior to bankruptcy. The Trustee need put no proof into evidence on the issue of insolvency unless a creditor rebuts the presumption with evidence; or if the transfer of the interest of the debtor occurred outside the ninety (90) day period immediately prior to bankruptcy. The Trustee always bears the burden of persuasion to prove each element of a preferential transfer.

d. 90-Day Rule

Except with regard to transfers to insiders, the reach back period is ninety (90) days. The Trustee will review the period of the ninety (90) days immediately preceding the filing of the bankruptcy petition and determine whether transfers that have occurred in that time frame are preferential, with the knowledge that the debtor is presumed insolvent during those ninety (90) days. 11 U.S.C. §547(f). An affected creditor may challenge the presumption by competent evidence.

Weekends and holidays do not extend the preference period beyond ninety (90) calendar days. Unlike the holding of In re Butcher, 829 F.2d 596 (6th Cir. 1987), which held that the statute of limitation for filing a preference action was jurisdictional, the ninety (90) -day reach back period for preferences are deemed substantive rather than procedural. See In re Bergel, 185 B.R. 338 (9th Cir. B.A.P. 1995).

e. One Year Rule

With regard to transfers to insiders, as defined in §101(31) of the Bankruptcy Code, a Trustee may challenge transfers for one (1) year. The ninety (90) -day insolvency presumption still applies. The Trustee must prove insolvency in cases where the transfer occurs more than ninety (90) days prior to filing the bankruptcy. See In re Perry, 158 B.R. 694 (Bkrtcy. N.D. Oh. 1993). Even though the definition of "insiders" in §101(31) does not include the debtor's girlfriend, in certain
circumstances when a long term close relationship has been established, a girlfriend of a Chapter 7 debtor can be deemed an insider. See In re Levy, 185 B.R. 378 (Bkrtcy.S.D. FLA. 1995).

f. Liquidation Test

The last element that a Trustee must prove to establish a preferential transfer is called the liquidation analysis. Section 547(b)(5) sets forth a tri-partite test. The Trustee must show that the preferred creditor (1) received more than he would have received if the case were liquidated under Chapter 7; (2) if the transfer had not been made to the preferred creditor; and (3) that such creditor received payment of such debt to the extent provided by the provisions of Title II. The Trustee will generally prevail and carry his burden of persuasion if he proves that the transfer of an interest of the debtor that occurred prepetition would have been property of the bankruptcy estate upon filing of the bankruptcy petition if the transfer had not occurred. Therefore, the issue in these cases concerns whether the asset transferred would have been property of the bankruptcy estate.

A debtor’s payment prepetition of trust fund taxes does not constitute a transfer of property of the estate. Hence, the Internal Revenue Service did not receive more than it would receive in a Chapter 7 distribution. Biegerv. Internal Revenue Service, 496 U.S. 53, 110 L.Ed.2d 46, 110 S.Ct. 2258 (1991). Transfers of trust assets do not constitute preferential transfers. See In re Unicom Computer Corporation, 13 F.3d 321 (9th Cir. 1994).

Funds "ear marked" or clearly designated for the benefit of a party other than the debtor constitutes a transfer outside the scope of the preference section. Yet, a debtor who kites checks does not create an "earmarking" situation for the affected bank or creditor to utilize as a defense. See In re Montgomery, 983 F.2d 1389 (6th Cir. 1983).

Funds of the debtor held for safekeeping purposes only in an escrow account does constitute property of the estate. A payment of said funds prepetition can result in a voidable preferential transfer. In re Winters, 182 B.R. 26 (Bkrtcy. E.D.Ky. 1995).

However, when a general building contractor filed bankruptcy, and the owner paid the subcontractor directly to avoid the timely filing of a mechanics lien, a Court held that said transfer did not constitute a transfer of property of the estate, even though the payment reduced the general contractor’s interest. The payment to the subcontractor by the owner was held "ear marked". In re Steele Vest, Inc., 112 B.R. 852 (Bkrtcy. W.D.Ky. 1990).

Prepetition payments to fully secured creditors are not avoidable preferential transfers because a Trustee must pay in full a secured creditor if the Trustee sells the collateral. Thus, the liquidation test fails since that creditor received the same it would receive in a Chapter 7 liquidation. In re C-L Cartage Inc., 899 F.2d 1490 (6th Cir. 1990).

Normally, a Trustee need only offer as proof a mathematical analysis that reveals the preferred creditor benefited to a greater degree than its pro rata share of distribution of the claims actually filed in a Chapter 7 case. When a creditor receives a beneficial transfer prepetition, however received, he better his position over other unsecured creditors. Often, the only asset recovered in a case will be the preferred transfer.

The exceptions to the rule include two fact patterns. The first leaves the preferred creditor as the only creditor. The second pattern is the rare case in which the Trustee recovers other assets that allow the Trustee to pay other creditors more than the preferred creditor received.
The preferred creditor receives no distribution from the estate until it repays to the Trustee the value of the avoided transfer. 11 U.S.C. §502(d).

D. Defenses Of Creditors

11 U.S.C. §547(c) enumerates the defenses of a creditor to preference claims raised by the Trustee. These defenses supplement any claim that the Trustee has not met its burden in proving one of the elements of §547(b). Section 547(c) assumes that the transfers sought to be avoided have met the required elements of §547(b). In addition, section 547(c) allows for certain transfers and prohibits recovery by the Trustee for the benefit of all creditors. The enumerated defenses are as follows:

1. Contemporaneous Exchange for New Value

The Trustee may not avoid a transfer to a creditor that was (1) meant to be a transfer contemporaneous for new value; and (2) was in fact a substantially contemporaneous exchange. Many cases have discussed what constitutes a contemporaneous exchange.

A check given to a creditor at the time that services or goods are provided is in fact a contemporaneous exchange, so long as the drawer's bank honors the check. In re Transport Associates, Inc., 171 B.R. 232 (Bkrtcy. W.D. Ky 1994). Contrast the use of the phrase "date of transfer" between §547(b) and §547(c) as it applies to checks. The date of transfer of checks under §547(b) relates to the date the drawer's bank honors the check. Barnhill V. Johnson, supra. However, the date a creditor receives the check establishes the date of transfer pursuant to §547(c), so long as the drawer's bank subsequently honors the check. In re Transport Associates, Inc., supra.

New value requires the creditor to provide the debtor with some benefit after payment by the debtor. In re Lee, 179 B.R. 149 (9th Cir. BAP 1995). The purpose of the new value exception protects transfers that do not diminish the bankruptcy estate. In re Cocolat, Inc., 176 B.R. 540 (Bkrtcy N.D. CA. 1995). One test requires the Court to determine to what extent the debtor's estate was replenished by the creditor when it provided new services or products. In re Riggs, 129 B.R. 494 ( Bkrtcy. S.D. OH. 1991).


2. Ordinary Course

A Trustee cannot avoid transfers made by a debtor to a creditor in the ordinary course of business. 11 U.S.C. §547(c). To meet this exception, a creditor must show three elements. First, the debt must be incurred in the ordinary course of business as between the creditor and the debtor. Second, the payment of the debt must be made in the ordinary course as between the debtor and creditor. Third, the payment of the debt, in addition to being in the ordinary course between the parties, must also be in the ordinary course of the industry involved. The issue of which industry standard applies is an issue of factual proof. A tri-partite test has been adopted by several circuits. In re Midway Airlines, Inc., 69 F.3d. 792 (7th Cir. 1996); In re Rublin Industries, Inc., 78 F.3d 30 (2nd Cir. 1996); In re Fred Hawes Organization, Inc., 957 F.2d 239 (6th Cir. 1992).

The purpose of the exception allows parties who have enjoyed a steady business relationship to continue that relationship, even to the verge of the filing of the bankruptcy. The exception is not
available to a creditor who has engaged in only one transaction with the debtor. In re Winters, 182 B.R. 26 (Bkrtcy E.D. Ky. 1995).


Often times creditors couple the defense of ordinary course with the new value exception discussed supra.

E. Security Interests

The mere filing of a security interest can be an avoidable preference. This occurs particularly in cases in which the filing does not encompass an extension of credit for new value or a transfer in the ordinary course. To the extent that a security interest is filed outside the scope of the timely perfection scheme established by the Uniform Commercial Code, or within the time frame specified in §547(c)(3)B twenty (20) days after the debtor receives possession, the interest can be avoided by the Trustee even if the underlying debt is not preferential. Section 547(c) specifies that a creditor has twenty (20) days from the date of transfer of the debtor’s interest to perfect its lien on personality. The perfection then relates back to the date of transfer. When the transfers involve real estate, in the absence of any particular state statute on perfection, §547(e) applies. This section requires that perfection occur within ten (10) days after the transfer. A transfer is perfected when a good faith purchaser for value is put on notice that the interest of the transferee is superior to all others. This requires a filing. See In re Levy, 185 B.R. 378 (Bkrtcy. S.D. Fla. 1995). The transfer must include an interest of the debtor, but may be less than full title. In re Hedged Investments Associates, Inc., 163 B.R. 841 (Bkrtcy. D. Co. 1994). In cases of a garnishment in Kentucky, a transfer occurs on the day the garnishment lien was created, on the day of the filing of the garnishment, and not on the day the garnishment was paid. In re Clark, 171 B.R. 563 (Bkrtcy. W.D. Ky. 1994).

The essential rule on security interests provides that in the absence of any state statute, a creditor must perfect its lien on personality within twenty (20) days. Perfection then relates back. However, if real estate is involved, a recording must be made within ten (10) days of the date of the transfer. The waiver of a mechanic's lien right in exchange for a voluntary lien is still preferential under Kentucky law. A Court avoided as a preferential transfer the filing of a lien voluntarily given by the debtor in exchange for a waiver by the affected creditor of its mechanic’s lien right. In re Rexplore Drilling, Inc., 971 F.2d 1219 (6th Cir. 1992).

The primary tenant of this portion of §547(c) provides that a creditor will prevail so long as the creditor files timely. The Trustee will prevail if a creditor files late, even if the creditor has no specific knowledge of the financial plight of the debtor.

F. Accounts Receivable And Inventory

Accounts receivable and inventory are discussed in §547(c)(5). Liens on this type of property, the so-called floating liens, are not avoidable to the extent that the debtor’s inventory or accounts receivable have been replenished. A recorded financing statement and proof of supply of additional inventory to a debtor is sufficient to defeat a Trustee’s claim. A creditor does not receive
credit for financing a previous loan. In re Bluegrass Ford-Mercury, Inc., 942 F.2d 381 (6th Cir. 1991). Courts employ a net improvement and position test for floating inventory. Bankruptcy Courts look at the value of the inventory ninety (90) days before the filing of the bankruptcy and the value of the inventory on the date of the petition. To the extent that a Trustee proves more debt was paid by the debtor than inventory supplied by the creditor, the Trustee may recover the net improvement in the creditor's position in the ninety (90) days before the filing of the bankruptcy petition. In re Parker Steel Company, 149 B.R. 834 (Bkrtcy. N.D. Oh. 1992).

G. Statutory Liens

A Trustee may not be able to avoid statutory liens under §547. Hence, tax liens are nonavoidable. A Trustee cannot set aside a mechanic's lien timely filed in accordance with KRS 476, even if the mechanic's lien was filed within ninety (90) days before the filing of the bankruptcy petition.

H. Domestic Relations

To the extent that a debtor makes a transfer in good faith to a former spouse for alimony, child support, maintenance or pursuant to a valid separation agreement or divorce decree, the payments made by the debtor are not avoidable as a preference. 11 U.S.C. §547(c)(7). The exception does not apply to assignments of payments to another entity, voluntarily or by operation of law, nor does it apply to payments designated as alimony, child support or maintenance unless the payments are actually alimony, maintenance, or child support. However, a separation agreement that called for periodic payments, reduced to a lump sum by agreement of parties and paid prior to the filing of the bankruptcy, was deemed a preferential transfer even though the payment of future maintenance was canceled. In re Futoran, 76 F.3d 265 (9th Cir. 1996).

I. Consumer Minimum

In cases involving consumer debts, §547(c)(8) allows a creditor to defeat what would otherwise be a preferential transfer if the aggregate value of all of the property of the debtor that is affected by the transfer is less than $600.00. The purpose of this exception was to remove de minimis amounts collected by garnishments that occurred immediately preceding the filing of the bankruptcy. Some conflict exists regarding the term "aggregate value" and the amount of $600.00. One case in Kentucky in particular asserts that §547 will apply so long as the garnishment collected totals $600.00 or more in the aggregate that occurred within the ninety (90) days before the filing of the bankruptcy. In re Clark, 217 B.R. 89 (U.S. Dist. Ct. W.D. Ky. 1995).

J. Sureties

In the event that a debtor transfers property to a surety in order to secure reimbursement of a bond or makes other application in order to dissolve a judicial lien, such as a mechanic's lien, the transfer of property to secure that bond can be set aside as a preferential transfer. To the extent that the Trustee recovers property, the amount of the obligation insured by the surety can be reduced by the recovery made by the estate. See 11 U.S.C. §547(d).
K. Real Property Rules

A transfer of an interest in real estate occurs when the instrument is recorded. In re Levy, 185 B.R. 378 (Bkrtcy. S.D. Fla. 1995). If a creditor records a mortgage outside the ten (10) day limit of §547(e), the transfer of the interest of the debtor occurs when the mortgage is perfected, i.e. the date of the filing. The creditor also loses the new value and ordinary course exceptions as defenses. In re Moran, 188 B.R. 492 (Bkrtcy. E.D. NY. 1995). The same rules apply with regard to the filing of security interest on fixtures. Kentucky law requires that to perfect an interest in a fixture, a creditor must file a fixture filing in the County Clerk’s office. The transfer is not perfected until the filing occurs. Hence, Kentucky law applies the same rule with reference to fixture filings as it does to the filing of other interests in the real estate of the debtor, including mortgages. If an instrument is filed within ten (10) days, the transfer relates back and the defenses of §547(c) may apply.

L. Presumption Of Insolvency

11 U.S.C. §547(f) states that the debtor is presumed to be insolvent for the ninety (90) days immediately proceeding the filing of the petition. The presumption is rebuttable. The test for determining insolvency is called a balance sheet test. The balance sheet test requires a Court to find that the liabilities of the debtor exceed the assets of the debtor to hold that the debtor is insolvent. In re Bluegrass Ford-Mercury, Inc., 942 F.2d 381 (6th Cir. 1991). Outside of the ninety (90) day period, for insider transactions, the Trustee must prove insolvency as a necessary element under §547(b). See In re Perry, 158 B.R. 694 (Bkrtcy. N.D. Oh. 1993).

M. Burdens Of Proof

The Trustee bears the burden of proof by a preponderance of evidence to establish each and every element under §547(b). See In re U.S.A. Inns of Eureka Springs, Arkansas, Inc., 9 F.3d 680 (8th Cir. 1993). The burden of proof falls on a creditor to establish one of the exceptions under §547(c). See In re Fred Hawes Organization, Inc., 957 F.2d 239 (6th Cir. 1992).

N. Parties

Normally the Trustee brings any action under §547. The Trustee alone holds the avoiding power. The Trustee is specifically so authorized under the wording of the statute of §547(b) which states that "the Trustee may avoid any transfer and interest of the debtor in property". The debtor assumes the role of the Trustee in cases under Chapter 11. Pursuant to 11 U.S.C. §1107(a) the debtor-in-possession has all of the powers and standing of a Trustee to bring a preference action. A debtor may bring a preference action to the extent that it preserves an exemption which it holds specific in property. See 11 U.S.C. §522(g) and (h).

Additionally, in certain circumstances, an individual creditor may bring a preference action. A creditor has standing to do so if certain conditions are met. First, the creditor must show that a colorable claim exists which will benefit the estate. Second, the creditor must have demanded that the Trustee or the debtor-in-possession bring the action. Third, the fiduciary involved must have refused to bring the action. Fourth, the Court must find that the refusal to bring the action is unjustifiable in light of the statutory and fiduciary responsibilities placed upon the Trustee or debtor in possession. After a creditor satisfies the Bankruptcy Court by meeting these conditions, the burden of proof shifts to the Trustee or debtor in possession to rebut why the preference action
should not be brought. This type of issue arises more often in Chapter 11 than in Chapter 7 cases. See In re The Gibson Group, Inc., 66 F.3d 1436 (6th Cir. 1995).

O. Venue

Venue is governed by 28 U.S.C. §1409. Subsection (a) allows a Trustee to file a preference action in the Bankruptcy Court in which the case arose. The action can be brought regardless of where the defendant resides. The only limitation is set forth in 28 U.S.C. §1409(b), which limits the Trustee to bring an action for an amount less than $1,000.00 or a consumer debt of less than $5,000.00 only in the District Court in the district where the defendant resides. Controversies which do not exceed these amounts often place the defendant at a decided disadvantage where the defendant resides a substantial distance from the Court in which the bankruptcy case is filed. Venue often provides an effective weapon to the Trustee in obtaining a preference judgment equal to the merits of the action itself.

P. Statute Of Limitations

The statute of limitations applicable to actions under §547 of the Bankruptcy Code is governed by 11 U.S.C. §546(a). This Code section allows the Trustee the later of either two (2) years from the day the bankruptcy was filed or one (1) year after the appointment or election of the first Trustee under either Chapter 7 or 11 U.S.C. §1104, Chapter 12 or Chapter 13, if the appointment or election occurs before the expiration of two (2) years from the filing of the bankruptcy.

A preference action may not be commenced after the case is closed or dismissed. Hence, the period begins to run the day the bankruptcy case is filed. Be aware that the 6th Circuit has ruled in an often criticized case that the two (2) year statute of limitations is a jurisdictional prerequisite. In other words, the clerk's office is always open. Thus, Saturdays, Sundays and holidays do not extend the statute of limitations until the next working day. In re Butcher, 829 F.2d 596 (6th Cir. 1987).

III. FRAUDULENT CONVEYANCE LITIGATION

The Trustee can avoid fraudulent conveyances which occur within one (1) year of the filing of the bankruptcy petition. 11 U.S.C. §548 sets forth the terms and conditions under which a Trustee may avoid a transfer on the grounds of fraudulent conveyance. The purpose of the fraudulent conveyance statute is to enhance the pool of funds from which creditors can recover by setting aside gratuitous transfers made on the eve of the filing of the bankruptcy.

11 U.S.C. §548

§548 Fraudulent transfers and obligations.
(a) The Trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily—
(1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or
(2) (A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
(B) (i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(ii) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or

(iii) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

(b) The Trustee of a partnership debtor may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, to a general partner in the debtor, if the debtor was insolvent on the date such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation.

(c) Except to the extent that a transfer or obligation voidable under this section is voidable under section 544, 545, or 547 of this title, a transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.

(d) (1) For the purposes of this section, a transfer is made when such transfer is so perfected that a bona fide purchaser from the debtor against whom applicable law permits such transfer to be perfected cannot acquire an interest in the property transferred that is superior to the interest in such property of the transferee, but if such transfer is not so perfected before the commencement of the case, such transfer is made immediately before the date of the filing of the petition.

(2) In this section—

(A) "value" means property, or satisfaction or securing of a present antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor;

(B) a commodity broker, forward contract merchant, stockbroker, financial institution, or securities clearing agency that receives a margin payment, as defined in section 101, 741, or 761 of this title, or settlement payment, as defined in section 101 or 741 of this title, takes for value to the extent of such payment;

(C) a repo participant that receives a margin payment, as defined in section 741 or 761 of this title, or settlement payment, as defined in section 741 of this title, in connection with a repurchase agreement, takes for value to the extent of such payment; and

(D) a swap participant that receives a transfer in connection with a swap agreement takes for value to the extent of such
transfer.

A. Definitions Under §548

1. Transfer

Section 548(a) of the Bankruptcy Code allows a Trustee to avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is incurred either voluntarily or involuntarily within one (1) year of the filing of the bankruptcy. In determining what constitutes a transfer, the Trustee must first look to Federal law. Barnhill V. Johnson, 503 U.S. 393, 118 L.Ed 2d 39, 112 S.Ct. 1386 (1992). However, frequently federal law is silent on what constitutes a transfer. In that instance, the Trustee must look to the interest in property as defined by State law. In re FBN Food Services, Inc., 185 B.R. 265 (N.D. Ill. 1995). Courts will examine transfers of interests in real estate according to the date of recording of the controlling instrument. See In re Levy, 185 B.R. 378 (Bkrtcy. S.D. Florida 1995). The transfer must necessarily involve an interest of the debtor, but the debtor may hold less than full title. In re Hedged-Investments Associates, Inc., 163 B.R. 841 (Bkrtcy. D. Co. 1994). A foreclosure sale is an involuntary severance of the title of the debtor. Prior to 1994, the validity of a foreclosure sale of real estate for less than seventy percent of its value was open to question. See Durrett v. Washington National Insurance Company, 621 F.2d 201 (5th Cir. 1980). The so called Durrect Rule was abrogated at least with reference to real estate foreclosure sales in B.F.P. v. Resolution Trust Corporation, 128 U.S. 114 S.Ct 1757 (1994). The Supreme Court in B.F.P. held that, in the absence of evidence of collusion, the sale price derived from a foreclosure sale properly advertised and conducted pursuant to state law is reasonably equivalent value as a matter of law. As such, a valid foreclosure sale is sufficient to defeat a fraudulent conveyance action regardless of the price brought at the forced sale.

2. Incur Obligation

The transfer of an interest of the debtor encompasses more than simply the debtor transferring title. For example, a debtor who subjects property to a mortgage in favor of a relative within one (1) year of the filing of the bankruptcy has made a fraudulent conveyance. The issue of tithing, which is incurring an obligation in furtherance of worship in one's religion, has created much concern. A Chapter 7 Trustee recently attacked tithing and brought an action against the religious institution that received the contributions. In re Tessier, 190 B.R. 396 (Bkrtcy. D.Mont. 1995). However, while finding that tithing was a fraudulent conveyance as defined in §548 of the Bankruptcy Code, the Eighth Circuit recently held that recovery of religious contributions otherwise recoverable under §548 violated the Religious Freedom Restoration Act, 42 U.S.C. §2000b-b. In re Young, 82 F.3d 1407 (8th Cir. 1996).

3. Intent to Defraud

For purposes of 11 U.S.C. §548, the Trustee must prove either actual intent to defraud or constructive fraud. Actual fraud is found if the Trustee proves that the transfer of the interest of the debtor was made with actual intent to hinder, delay or defraud any entity to which the debtor was already obligated to or became obligated by the debtor within one (1) year of the filing of the bankruptcy. Actual harm is not an element necessary to prove a fraudulent conveyance. The Trustee only must show that the debtor acted with intent to hinder or delay creditors. In re Sherman, 67 F.3d 1348 (8th Cir. 1995). Even if the transfer was actually fraudulent as to creditors, if the requisite intent to defraud is not proven, the transfer will not be avoided under 11 U.S.C. §547(a)(1).
In re Vaughn, 244 B.R. 631 (Bankr. W.D. Ky. 2000).

a. Actual Fraud

Actual intent to defraud on the part of the debtor may be inferred from the badges of fraud in a subjective evaluation of the debtor’s intent. Badges of fraud that a Court may evaluate include threatened or actual litigation existing at the time of the transfer, the degree of the transfer of the interest of the debtor of the property, the state of the debtor’s finances at the time of the transfer, the special relationship held by the debtor with regard to the transferee and the retention of property by the debtor despite the transfer.

b. Constructive Fraud

The Trustee may also set aside transfers of interest of the debtor if the debtor received less than a reasonably equivalent value in exchange for the transfer or obligation and was either insolvent on that date or was rendered insolvent by such transfer or obligation. The phrase reasonably equivalent value does not require a finding that the debtor possessed actual intent to defraud. In re Young, 82 F.3d 1407 (8th Cir. 1996). The Trustee can avoid a transfer simply if the debtor received less than reasonably equivalent value. In re McDonnell, 934 F.2d 662 (5th Cir. 1991). The issue in reasonably equivalent value cases is normally whether a creditor paid sufficient consideration. For purposes of real estate foreclosure sales, the Supreme Court ruled that in the absence of collusion, and so long as the State statutes which prescribe the procedure for selling real estate and foreclosure were followed, the sales price was as a matter of law reasonably equivalent value. B.F.P. v. Resolution Trust Corporation, ___ U.S. ___, 128 L.Ed2d 556, 114 S.Ct. 1757 (1994). The current trend of cases avoids a specific numerical percentage or formula. Rather the Court must factor fair market value and the extent of the lack of interest between the parties and transaction. The closer or more special the relationship is between the parties, the less of an arms length transaction, the more scrutiny the Court renders the transfer to ensure that the creditor paid fair market value. See In re Morris Communications, NC, Inc., 914 F.2d 458 (4th Cir. 1990).

4. Insolvency

Insolvency is determined as of the time of the transfer using a so-called balance sheet test. In re Taubman, 160 B.R. 964 (Bkrtcy. S.D. Oh. 1993). The Trustee bears the burden of proof on the issue of insolvency. In re McConnell, 934 F.2d 662 (5th Cir. 1991). The Trustee also prevails in a fraudulent conveyance case if he shows that the result of the transaction or transfer of the debtor reveals that the debtor was unreasonably undercapitalized or that the debtor would be unable to pay his debts as they matured.

B. Partnership Transfers

If a partnership files bankruptcy, a Trustee is required to liquidate the assets of the partnership and then pursue the individual partners for the unpaid bills of the partnership. 11 U.S.C. §723. If the partnership files bankruptcy, the Trustee of the partnership may avoid transfers that have occurred with individual partners within one (1) year of the filing of the bankruptcy if the debtor partnership was either insolvent on the date of the transfer or became insolvent as a result of the transfer. The Trustee of the partnership debtor is not required to show any intent or that the transfer was for less than an reasonably equivalent value.
C. Rights Of Transferees

Initial transferees are those parties who receive property transferred in the fraudulent conveyance. The initial transferee, if the Trustee succeeds, loses the avoided conveyance, and the subject property is restored to its status prior to the transfer, subject to the Bankruptcy. A subsequent transferee who qualifies as a bonafide purchaser will be able to defeat a Trustee's claim under 11 U.S.C. §548, to the extent that the B.F.P. actually gave value in exchange for the transfer. See In re Coutee, 984 F.2d 138 (5th Cir. 1993). The transferee bears the burden of proof on the element of good faith, a basic prerequisite to being a B.F.P. U.S. v. Nordic Village, Inc., 503 U.S. 30, 117 L.Ed.2d 181, 112 S.Ct. 1011 (1992). To the extent that new value was paid by the transferee in an avoided transfer, the Trustee must reimburse the transferee. 11 U.S.C. §548(c).

D. Transfer

Section 548(d)(1) of the Bankruptcy Code defines the term "transfer" and its application in cases of fraudulent conveyance. Contrast the definition with section 547, the preference section, which fails to define the term "transfer". 11 U.S.C. 548(d)(1) defines "transfer" in terms of perfection of the conveyance by the creditor and notice to other parties of the change in character of the subject property.

The date of recording the instrument places all parties on notice of the transfer of the debtor's interest. That filing perfects the interest of the transferee. At that point in time, a B.F.P., a role the Trustee can assume pursuant to 11 U.S.C. §544(a)(3), cannot defeat the interest of the transferee.

If the transferee fails to perfect its interest until after the filing of the bankruptcy petition, section 548(d)(1) deems the perfection to have occurred on the day before the filing of the bankruptcy.

The date of transfer is the key date relating to the date of the bankruptcy petition, because the transfer must occur within one (1) year of filing of the bankruptcy petition. Thus, a Court held that the transfer of realty occurred on the day the girlfriend of the debtor recorded her deed, which occurred within one (1) year of the filing of her boyfriend's bankruptcy, notwithstanding the fact that the debtor executed the deed several years prior to the filing of the bankruptcy. In re Levy, 185 B.R. 371 (S.D. Fla. 1995).

A creditor perfects his lien on personalty normally by filing a UCC-1 although no filing is required for most consumer purchases.

E. Value Defined

11 U.S.C. §548(d)(2) defines value as property, or the securing of a present or antecedent debt of the debtor. Value does not include an unperformed promise to furnish support to the debtor or a relative of the debtor. The definition of value differs slightly for fraudulent conveyance purposes than for preferences or other Bankruptcy Code sections. Commodity brokers, stock brokers, and financial institutions, or other parties who deal with securities have special rules for dealing with margin payments or swap agreements. The securities party is entitled to the bonafide purchaser defense to the extent that he has taken payment or value to the extent of a margin or swap agreement.
F. Parties - Plaintiffs

As in preference actions, normally the Trustee or debtor in possession alone has standing to bring a fraudulent conveyance action. The statute plainly states that the Trustee is the party authorized to bring the action. The debtor is also authorized to bring a fraudulent conveyance action pursuant to 11 U.S.C. §522(g) or (h) to the extent that the debtor protects an exemption he claimed in his property. However, the debtor is not allowed to take advantage of the transfer of either a preference or a fraudulent conveyance action to the extent that a lien avoided is preserved for the benefit of the bankruptcy estate against the debtor. 11 U.S.C. §551. The debtor cannot take advantage through his exemptions when he previously agreed to subordinate his exempt interest in property to a creditor. The effect of lien preservation is that the Trustee replaces the avoided party as a secured creditor. The exemption of the debtor remains subordinate to the lien interest of the bankruptcy estate. The lien against the interest of the debtor remains.

The Sixth Circuit has also addressed whether an individual creditor has standing to bring a fraudulent conveyance action. In the case of In re The Gibson Group, Inc., 66 F.3d 1436 (6th Cir. 1995), the Court allowed a creditor to bring a §548 action since the creditor alleged a colorable claim that benefited the estate. The Court agreed with the analysis of the creditor that the fraudulent conveyance action benefited the estate. The Court must find that the creditor demanded that either the Trustee or the debtor in possession bring the fraudulent conveyance action and that the Trustee or debtor in possession refused to bring the action. The Court must find that the refusal of the Trustee or debtor in possession to bring the fraudulent conveyance action was unjustifiable in light of its statutory and fiduciary responsibilities. While the initial burden is on the individual creditor to show that it has met these elements, once established, the burden of proof shifts to the Trustee or debtor in possession to show why the fraudulent conveyance action should not be brought.

G. Venue

Venue is governed by 28 U.S.C. §1409. Venue normally lies in the Court in which the bankruptcy case is filed. In the event that the fraudulent conveyance action seeks to recover a money judgment of less than $1,000.00 or a consumer debt of less than $5,000.00, the action must be brought only in the District where the defendant resides.

H. Statute Of Limitations

Statute of limitations applicable to fraudulent conveyance actions are defined in 11 U.S.C. §546(a). This section allows an action to be brought either the later of two (2) years from the date the bankruptcy petition is filed, or one (1) year after the appointment of the first Trustee if such appointment occurs before the expiration of two (2) years after the case is originally filed. If the case is closed or dismissed, there is no standing to bring a fraudulent conveyance action.

I. State Law

11 U.S.C. §544(b) empowers a Trustee to utilize the state law fraudulent conveyance scheme. Kentucky Revised Statutes 378.010 allows for a reach back of five (5) years rather than the one (1) year of 11 U.S.C. §548. The Trustee under state law must establish that a debt existed on the date of transfer and that the transfer was made with intent to defraud creditors. KRS 378.010. A Trustee may also employ KRS 378.020 to set aside a transfer made by the debtor when he received no consideration rather than the standard of reasonably equivalent value pursuant to 11 U.S.C. §548.
A Trustee may utilize the state statutes because he possesses a five (5) year statute of limitations under KRS 413.120 rather than two (2) under 11 U.S.C. §546. Arguably, a Trustee can extend the five (5) year statute of limitations to seven (7) years. 11 U.S.C. §108(a) extends a statute of limitations if it otherwise expires before the end of two (2) years after the filing of the bankruptcy petition.

IV. "STRONG-ARM" POWERS OF A CHAPTER 7 TRUSTEE

A. General Analysis Of A Trustee’s Powers

Section 544(a) of the Bankruptcy Code, often referred to as the "strong-arm clause," provides the Trustee with the power and status of a hypothetical judicial lien creditor, a hypothetical bona fide purchaser, a creditor that extends credit at the time the bankruptcy case was commenced and an actual unsecured creditor. Although bankruptcy law confers upon the Trustee the rights of hypothetical creditors, the Trustee must look to relevant state law to determine what rights and remedies a creditor would have to avoid transfers of property. Section 544 of the Code confers no greater rights or powers on the Trustee than the applicable state law affords a creditor occupying the position assumed by the Trustee.

Since state law governs the powers of the Trustee under § 544, one necessary question is which state’s laws control. If the property of the estate is located in more than one jurisdiction or affected by contracts of more than one jurisdiction, the tendency of the courts is to utilize the law of the situs of the property at the commencement of the case. However, courts are not in consistent agreement regarding the manner in which the choice of law rules are applied.

B. Trustee’s Status As A Lien Creditor

1. § 544(a)

Section 544 confers upon the Trustee the rights of certain hypothetical creditors, specifically:

(1) a creditor that extends credit to the debtor at the time of the commencement of the case, and that obtains, at such time and with respect to such credit, a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien, whether or not such a creditor exists;

(2) a creditor that extends credit to the debtor at the time of the commencement of the case, and obtains, at such time and with respect to such time, whether or not such a creditor exists; or

(3) a bona fide purchaser of real property, other than fixtures, from the debtor, against whom applicable law permits such transfer to be perfected, that obtains the status of a bona fide purchaser at the time of the commencement of the case, whether or not such a purchaser exists [and has perfected such transfer].

The rights of these hypothetical creditors, and thus the Trustee, is dependent upon state law.

While, obviously, there is a variety of state statutory laws to apply, many of the actions brought by the Trustee will be based upon the Uniform Commercial Code. Section 9-301 specifies...
that "an unperfected security interest is subordinate to the rights of... a person who becomes a lien creditor before the security interest is perfected..." Therefore, in his/her position as a hypothetical lien creditor, the Trustee has rights superior to any creditor that is unperfected as of the date of filing for any of the number of reasons. For goods, the security interest must be perfected by the filing of a financing statement, pursuant U.C.C. § 9-302. The Trustee gains priority over any creditor that did not file a perfected security interest, whose filing has lapsed, who filed in the wrong location or in an inappropriate manner, who did not identify the security interest properly, or who failed to amend the filing to reflect subsequent changes.

Since the Trustee does not obtain rights greater than a lien creditor under § 544(a), creditors with a purchase money security interest perfected after the filing but in the time allowed by statute (twenty (20) days in Kentucky) are not subordinate to the interest of the Trustee. It is not a violation of the automatic stay for a creditor to file to perfect such a lien within twenty (20) days from the date the debtor received possession of the goods.

In addition to the filing requirements for holders of security interests in goods, the Uniform Commercial Code also sets forth certain notice provisions for a consignment seller under § 2-326(3). To the extent these notice requirements are not met, the Trustee may avoid the transfer and recover goods held on consignment.

Although the Uniform Commercial Code sets forth specific rights of the Trustee as to holders of security interests in goods of a hypothetical lien creditor, this status also provides the Trustee with power over creditors holding non-Code interests such as unrecorded real estate mortgages or conveyances.

As a hypothetical bona fide purchaser for real estate pursuant to § 544(a)(3), the Trustee holds rights greater than those of a hypothetical lien creditor. As well as the unrecorded interest that the Trustee could set aside as a hypothetical lien creditor, a hypothetical bona fide purchaser may avoid an unrecorded equitable interest, equitable claims under constructive or implied trust, or interest of a transferee claiming under recorded instruments with minor defects in form or content.

The status of a bona fide purchaser gives the Trustee some specific power of actions against the state government in Kentucky. Kentucky law provides that the state, county, city or other taxing districts shall have a lien on property assessed for taxes for five (5) years following the date when the taxes became delinquent. The lien may not be defeated by gift, devise, sale, alienation or other means except by sale to a bona fide purchaser.

Where the Commonwealth has seized property related to the trafficking in controlled substances, the seizure of said property may be set aside only by a subsequent bona fide purchaser.

2. § 544(b)

While the trustee is given the status of a hypothetical creditor under §544(a), regardless of the existence of any such creditor, §544(b) somewhat broadens the trustee’s standing further by providing,

The trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

For the trustee to avoid a transfer pursuant to this subsection there must exist an actual
creditor with an appropriate claim. This creditor must hold an allowed claim or one that is not
allowable only because of §502(e), which disallows certain claims by co-debtors or sureties. Once
it is established that there is such a creditor, the trustee acts not for the benefit of that creditor but
as trustee for the estate.

Under section 544(b), the Trustee is able to set aside fraudulent transfers or other voidable
transfers under state law. In a case out of the Eastern District of Kentucky, for example, the trustee
was able to utilize the Kentucky preferential transfer law, KRS §378.060, to set aside a transfer
between the debtor and a third party where the trustee may not have been able to show that the
transfer was a preference under 11 U.S.C. §547(b).10

Since the trustee’s rights to pursue a cause of action is derivative of a specific creditor, it
is generally accepted that any defenses, including estoppel or statute of limitations, good against the
creditor are good against the trustee.11 Therefore, where the creditor has taken some action prior to
the filing of the bankruptcy that would deem the transfer valid, the trustee will be foreclosed from
avoiding the transfer. When the statute of limitations has run before the filing of the bankruptcy,
the trustee is likewise prevented from avoiding the transfer.

When the statute of limitations has not run on the date filing of the petition, there is some
disagreement among the courts regarding whether to apply the state law statute or the limitation set
forth in §546(a) which provides a two (2) year limitation period for actions under §544. The view
that has been adopted by the Bankruptcy Courts in Kentucky is that if the statute of limitations had
not run on the date of filing, the trustee must bring the action to avoid the transfer within the two (2)
year period set forth in §546(a).12

C. Trustee’s Power to Avoid Statutory Liens

Section 545 of the Bankruptcy Code provides that the Trustee may avoid certain statutory
liens. Section 545 states as follows:

The Trustee may avoid the fixing of a statutory lien on property of the
debtor to the extent that such lien —

(1) First becomes effective against the debtor —

(A) when a case under this title concerning the debtor is
commenced;

(B) when an insolvency proceeding other than under this title
concerning the debtor is commenced;

(C) when a custodian is appointed or authorized to take
possession;

(D) when the debtor becomes insolvent;

(E) when the debtor’s financial condition fails to meet a
specified standard; or

(F) at the time of an execution against property of the debtor
levied at the instance of an entity other than the holder of
such statutory lien;

(2) is not perfected or enforceable at the time of the commencement

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of the case against a bona fide purchaser that purchases such property at the time of the commencement of the case, whether or not such a purchaser exists;

(3) is for rent; or

(4) is a lien of distress for rent.

Section 545 can be generally divided into three categories of statutory liens. First, those triggered by the insolvency of the debtor; second, those not valid against a bona fide purchaser; and third, a lien for rent.

The statutory liens referenced in § 545(1)(A)-(F), allows the Trustee to avoid any lien which arises solely because the debtor has become insolvent. "Insolvent" is a defined term under § 101 of the Code, which utilizes the traditional balance sheet definition of insolvency where the debtor is considered insolvent when his liabilities exceed his assets. This traditional definition of insolvency is modified by the Code by adding a provision that the debtor's non-exempt assets are excluded from calculation. However, since the applicable lien is a creature of state law, the state law definition of insolvency that applies will generally prevail in determining whether such a lien exists. It is possible, therefore, for the debtor to be insolvent for purposes of the Code but not insolvent under state law.

Section 545(2) provides the Trustee with the status of a hypothetical bona fide purchaser similar to § 544(a)(3). However, § 545(2) does not limit the Trustee to the position of a bona fide purchaser of real property.

The avoidability of a statutory lien under § 545(2) will typically turn on whether the creditor has taken the sufficient steps to perfect its interest under state law. Although most interests must be perfected at the time the case is filed, some interests may be perfected at a later date. Section 546(b) provides that the Trustee’s rights under § 545 are subject to any state law that permits perfection, post-filing, to relate back to a pre-filing date. For instance, in Kentucky, notice of a mechanic’s and materialman’s lien must be filed within a certain time of the work being performed. If the notice is filed within this time, the lien will relate back to the date that the service was performed. Therefore, under § 545, the Trustee cannot avoid a mechanic’s and materialman’s lien where the work was performed prior to filing but the creditor perfected its interest within the statutory time period although post-filing.

Much litigation under § 545(2) involves federal tax liens. The Internal Revenue Code creates a lien in favor of the United States on all property by a person liable to pay taxes upon the assessment that that tax is made. However, that same statute provides that the lien imposed upon assessment is not valid against "any purchaser, holder of a security interest, mechanic’s lien or judgment lien creditor, until notice thereof which meets the requirements of sub-section (f) has been filed by the secretary or his delegate." Therefore, to the extent the Internal Revenue Service has not filed the requisite notice, the Trustee in his position as hypothetical bona fide purchaser may avoid the lien in favor of the Internal Revenue Service.

D. Statute Of Limitations

Section 546(a) sets forth the statute of limitations applicable to the Trustee when taking an action to avoid a transfer or lien under §§ 544, 545, 547, 548, and 553. Under § 546, the Trustee may not commence an action after the earlier of:
Section 546(a) as described above, is as amended by the Bankruptcy Reform Act of 1994. Prior to the amendment, avoidance actions were barred after the earlier of two dates: two (2) years after the Trustee’s appointment, or the time the case was closed or dismissed.\(^{19}\) By amending the statute, the limitation period has generally been reduced to two (2) years from the entry of order for relief as opposed to two (2) years from the appointment of the Trustee. While an action may be brought one (1) year from the appointment or election of the Trustee, this provision does not take effect if the two (2) year time limit from the order of relief has expired. If no Trustee is appointed during the first two (2) years, the statute is not revived upon the appointment of a Trustee.

V. OTHER ISSUES RELATING TO TRUSTEE’S ADMINISTRATION OF THE BANKRUPTCY ESTATE

A. Post-Petition Transfers

In general, post-petition transfers are avoidable by the Trustee under § 549 if they are not authorized by the Court or by some provision of the Bankruptcy Code.\(^{20}\) Upon the filing of a Chapter 7 petition, the debtor is not authorized to sell or transfer property, or operate its business. Any entity taking title from a Chapter 7 debtor does so at his or her own peril. A Chapter 11, 12, or 13 debtor is authorized to continue operating its own business; therefore, in those cases a post-petition transfer will not be avoidable.

Two kinds of unauthorized post-petition transfers are, saved from avoidance under §549. First, until constructive knowledge of the bankruptcy is given by recordation of a copy of notice of the petition in the appropriate land records office, a good faith transferee of real estate who had no knowledge of the pending bankruptcy is protected to the extent he gave fair, equivalent value.\(^{21}\) Second, in the interim between the filing of an involuntary petition and the Order of Relief, referred to as the "gap period", a transferee is protected in any dealings with the debtor to the extent he gave value for the transfer.\(^{22}\) Finally, under §542(c), one who owes money to the debtor or holds property of the estate is not liable to the Trustee if, after bankruptcy, that person in good faith and without knowledge of the filing of the case pays the debtor or transfers the property to someone other than the transferee. The transferee will bear the burden of proof to establish a valid post-petition transfer.\(^{23}\) The Trustee must commence the adversary proceeding to avoid these transfers within two (2) years of the transfer or the time the case is closed or dismissed, whichever is earlier.\(^{24}\)

B. Trustee’s Power To Compel Turnover Of Property

Section 704 charges the Trustee with the responsibility to collect and liquidate property of the estate. The Bankruptcy Code, in two separate sections, gives the Trustee the power to compel turnover of property which is in the possession of third parties, including court-appointed custodians.
1. §542 Turnover of Property of the Estate

Section 542 requires any entity, other than a custodian, who comes into possession of property of the estate which "the Trustee may use, sell or lease under § 363" to surrender such property to the Trustee upon demand. If the third party refuses to surrender possession, the Trustee should commence an adversary proceeding to obtain an appropriate court order.

The property for which the Trustee can compel turnover is limited to property which the Trustee can "use, sell or lease under § 363." As a result, if the property is subject to a valid claim of set-off such as a bank account, the Trustee cannot compel the bank to surrender the proceeds of the account and defeat the bank’s right of set-off. If a creditor has a valid security interest in property and if the creditor has received relief from the automatic stay, the Trustee will not be entitled to turnover. In addition, property which is of "inconsequential value or benefit to the estate" cannot be compelled through turnover.25

If a Trustee commences an adversary proceeding, it will be the Trustee’s burden to prove: (a) possession and control of property by the entity; (b) that the property can be utilized by the estate under § 363; and (c) that the property’s value is more than inconsequential.26

This section will also authorize the Trustee to compel turnover of records and documents regarding the debtor’s property and financial affairs from the debtor’s attorney, accountants, or other third parties. This turnover is subject to any applicable privilege.27 The attorney/client privilege of a corporate debtor is held, however, by the Trustee who has the power to waive as to pre-petition communications.28

2. §543 Turnover of Property by Custodian

In addition to the powers of turnover set forth in § 542, the Trustee has the power to compel turnover of property from a "custodian." A "custodian" is defined by the Bankruptcy Code to mean:

(A) receiver or Trustee of any of the property of the debtor, appointed in a case or proceeding not under this title; (B) assignee under a general assignment for the benefit of the debtor’s creditors, or (C) Trustee receiver or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor’s creditors.

Once a custodian has knowledge of the bankruptcy, the custodian is prohibited from making any disbursements of property of the estate or take any action in the administration of that property except as may be necessary for its preservation.29 This statute affirmatively directs the custodian to deliver to the Trustee all of the property of the debtor and its proceeds and to provide the Trustee with an accounting of all the property which came into the custodian’s possession.30

The property which is to be turned over by the custodian is not limited, as in the case of §542, to property which the Trustee could use, sell, or lease as no such limitation exists in §543.

In the appropriate case, the Bankruptcy Court can allow the custodian to remain in possession of the property of the estate if it would be in the best interest of the creditors. Special circumstances may exist if the custodian had been charged with liquidating the property of the debtor and it would be in the best interest of the creditor for the custodian to continue with the liquidation process.
If a custodian is directed to turn over property of the estate, the Bankruptcy Court, after notice and hearing, is empowered to provide for the payment of the custodian’s expenses and fees. The Court can also provide for the payment of any third party or entity to which the custodian has become obligated.

C. Trustee’s Standing To Object To Or Revoke Discharge

Although seldom used, the Trustee has standing under the Code to oppose the grant of a discharge or within the time limits seek a revocation of that discharge. Section 727 outlines specific circumstances in which a debtor can be denied a discharge. For example, a discharge can be denied if the debtor has concealed, destroyed, mutilated, falsified or failed to keep or preserve books or records concerning his or her financial condition or business transactions, knowingly and fraudulently gave a false oath, failed to adequately explain loss of assets or deficiency of assets or with the intent to hinder, delay, or defraud a creditor, has transferred or concealed property within one year before the filing of the petition. Under certain circumstances, a Trustee or creditor may seek to revoke a discharge previously granted if the discharge was obtained through fraud or if the debtor acquired property of the estate and fraudulently failed to report the acquisition of the property or failed to surrender such property to the Trustee. The Trustee in that circumstance could file an adversary proceeding seeking the revocation of the discharge in the case of fraud within one (1) year after the discharge is granted, or in the circumstance in which property of the estate is acquired by the debtor which is not surrendered, one (1) year after the granting of the discharge or one (1) year after the date the case is closed whichever is later.

D. Operation Of The Debtor’s Business

In most Chapter 7 proceedings, upon the filing of the petition for relief, any business operations of the debtor must immediately cease, and the Trustee is charged to take possession of the business assets and begin liquidating those assets for future distribution to the creditors. In some limited circumstances, it may be in the best interest of the creditors for the debtor’s business to continue operating on at least a temporary basis. For example, it may be in the creditors’ interest for the Trustee to sell the business as a going concern as opposed to liquidating its individual assets. Section 721 authorizes the Trustee, with Court approval, "to operate the business of the debtor for a limited period." If the Court, after notice and opportunity for hearing, authorizes the temporary operation of the business, the Trustee may use, lease or sell property of the estate consistent with the requirements of §363, or obtain credit pursuant to the terms of §364. Like a debtor-in-possession in a reorganization proceeding, the Trustee is prohibited from using cash collateral without Court approval or creditor consent. Section 704(8) will require that the Trustee file periodic reports and summaries of the operation and provide those reports to the Court, the U.S. Trustee, and all governmental units responsible for the collection of taxes.

E. General Duties And Responsibilities Of A Trustee

Upon his or her appointment or election, the Trustee is charged with certain responsibilities to the creditors, the estate, and the Court. The Trustee will owe a fiduciary duty to the estate and the creditors in the performance of these duties. In order to fulfill this responsibility, the bankruptcy Trustee will have standing to bring certain causes of action and will have the power to avoid certain transfers. The Trustee is required to exercise due diligence and act in the best interest of the creditors. This section will examine the general responsibilities of a Trustee as set forth by §704 of the Code.
1. Control Property of the Estate

The Bankruptcy Code vests exclusive control of the property of the estate in the Trustee. Section 704(a) requires that the Trustee collect and reduce to money the property of the estate and to be accountable for the property received. The powers given the Trustee to avoid transfers and compel turnover of property are to be exercised to fulfill this duty. In addition, the Trustee should give notice to all banks, utility companies, landlords, and insurance companies issuing a policy with cash surrender value payable to the debtor.34

Once the property is collected, if it has value over and above the mortgages or security interests, and the debtors' exemptions, then the Trustee is to liquidate the property in a manner so as to produce the best dividend for the unsecured creditor. This sale typically will be conducted pursuant to §363 free and clear of all liens. If the property has no value to the unsecured creditors, the Trustee should abandon his interest. Upon abandonment, title to the property re-vests in the debtor.35

After his or her appointment, the Trustee is to file a physical inventory of the property of the debtor. This inventory is to be based upon the Trustee's review of the debtors' petition as well as the Trustee's own investigation.36 As the Trustee administers the estate, the Trustee is to maintain appropriate books and records showing all receipts and disbursements.37

Since the Trustee is vested with exclusive control of the property during the administration of the estate, the Trustee is also accountable for all property.38 To satisfy the Trustee's fiduciary duties, the Trustee may need to obtain insurance protecting the property and the estate from any loss or damage.

2. Insure Debtor's Performance of §521 Intentions

In 1984, the Bankruptcy Code was amended to require that the debtor file within thirty (30) days of the date of filing the petition a statement of his or her intent with respect to the retention or surrender of property. The debtor is required to specify whether the property is exempt, whether the debtor intends to redeem the property, or reaffirm the debt secured by such property. Within forty-five (45) days after the filing of the notice of intent, the debtor is directed to perform his or her intentions.39

Section 704(3) charges the Trustee with responsibility for insuring that the debtor performs his intentions concerning the retention or surrender of property. The Trustee can inquire of the debtor at the §341 meeting, but unfortunately in many cases the §341 meeting will be conducted prior to the expiration of the time period set forth in §521. It may be appropriate for the Trustee to continue the §341 first meeting of creditors in order to give the debtor the opportunity to complete his or her intentions, or for the Trustee to have follow-up contact with debtor's counsel.

3. Duty to Examine Debtor Concerning Knowledge of the Bankruptcy Proceedings

In the 1994 amendments to the Bankruptcy Code, §341 regarding the first meeting of the creditors was amended to require that the Trustee question the debtor to insure that the debtor understands:

(1) The potential consequences of seeking a discharge in bankruptcy, including the effects on credit histories;

(2) The debtors' ability to file a petition under a different chapter of this title;
(3) The effect of receiving a discharge of debts under this title;

(4) The effect of reaffirming a debt, including the debtors' knowledge of the provisions of §524(d) . . .

Section 524 regarding reaffirmation agreements was also amended so that a court hearing approving the reaffirmation agreement is no longer necessary if the debtor was represented by counsel in the known negotiation of the agreement. Since no court hearing will be held to approve the reaffirmation agreement, the Bankruptcy Code has charged the Trustee with responsibility to insure that the debtors understand the legal effect and consequences of a reaffirmation agreement and a default under that agreement as well as to insure that the debtor understands that the reaffirmation agreement is a voluntary agreement.

4. Duty to Investigate Financial Affairs of Debtor

In order to fulfill his or her fiduciary duties and to collect all the property of the estate available, the Trustee cannot rely solely upon the debtors' bankruptcy petition and schedule of assets and liabilities. The Trustee must perform his or her own independent investigation. This investigation can be performed informally through a review of the debtors' books and records. The Trustee will have the opportunity to question the debtor at the §341 first meeting of creditors. If a more extensive questioning is required, the Trustee is authorized to conduct such examinations pursuant to Rule 2004 which allows for an examination in a manner substantially equivalent to a civil discovery deposition. Rule 2004 is not limited to debtors. Under this Rule, the Court can order an examination of "any entity". This rule would allow the Trustee to depose the debtor, any creditor, any transferee of property, the accountant of the debtor or any other person who has knowledge concerning the assets, liabilities, or financial affairs and transactions of the debtors. As part of this examination, the debtor, or any party in interest, has the right to compel production of documents.

The debtor is charged with the duty to cooperate with the Trustee to enable the Trustee to perform his or her duties. Should the debtor fail to cooperate, such failure may be a basis to oppose the discharge of the debtor pursuant to §727.

5. Examination of Proof of Claims

In order to have an allowed claim for purposes of distribution of proceeds of the estate, a creditor, or some entity on behalf of the creditor, must file a proof of claim setting forth the nature of the claim, the amount of the debt, and appropriate documentation of the claim. Upon receipt of the proof of claims, and before making disbursements of the proceeds of the estate, the Trustee must examine each of the proof of claims and if appropriate, object to any improper claim. The objection should be in a form consistent with Bankruptcy Rule 3007.

6. Duty to Furnish Information

Section 704 imposes upon the Trustee the duty to "furnish such information concerning the estate and the estate's administration as is requested by a party in interest." Often the Trustee will receive requests for information from creditors or even the debtor concerning liquidation of assets, filing of claims, and more often, the likelihood of a distribution to the unsecured creditors. The Trustee should respond to these requests if the information is available to the Trustee. Certainly the Trustee is under no obligation to incur substantial expense on behalf of the estate in order to obtain information on behalf of a creditor.
The duty to provide information is limited to "a party in interest." The Trustee is therefore not obligated to provide information to the media.

7. Duty to File a Final Account

The Trustee is to either liquidate or abandon the property. Upon completion of the administration of all assets, §704(9) requires that the Trustee file a final report and an account of his or her administration of the assets. This report will set forth all property and monies received and disbursed by the Trustee. Upon approval by the Court of this final report, the Trustee will then disburse all final dividends to the unsecured creditors. Ninety (90) days after making the final disbursement, if any check is remaining unpaid, the Trustee will place a stop order on that check and pay over to the Bankruptcy Court clerk all unclaimed funds.41 At that time, the Trustee is required by Bankruptcy Rule 3011 to file a statement setting forth that he or she has complied with the provisions of § 347. Upon filing such report, the Court should discharge the Trustee from further service and obligation and release the Trustee's bond.

There appear to be three major approaches. First, the situs is the property, second is who buys the property at the time a lien came into existence, and third, a broad range of inquire with a substantial discretion in the reviewing court. In re Cuff, 54 Bankr. 424 (W.D. Mass. 1985). Where the property in question is real estate with a fixed situs, the first approach has been primarily used. Id. Where the property is highly mobile, the situs of the property at the time the lien arose has been primarily used. Where the assets in question are contract claims, the more flexible approach formulated under the Restatement of Conflicts of Laws, is available to the courts. Id. Where the parties to a contract have included a choice of law clause in the contract, this choice carries little weight with the court as the party to the action, the Trustee, would not have been a party to the contract and therefore, not subject to the clause. Ferrari v. Barclays Business Credit, Inc., In re Morris Tool, Inc., 108 Bankr. 384 (D. Mass. 1989).

U.C.C. 9-403.

U.C.C. 9-401.

U.C.C. 9-403.

U.C.C. 9-403.

Peck v. Trail, 251 Ky. 377, 65 S.W.2d 83 (1933).

KRS 134-420.

KRS 218A.450.


Id.

KRS 376.010.


Internal Revenue Code, §6321 and § 6322.
18 Internal Revenue Code, §6323.


20 §549(a)

21 §549(c); In re Allen, 816 F.2d 325 (7th Cir. 1987)

22 §549(b); Atwood v. Atwood, 124 B.R. 402 (Bankr. S.D. Ga. 1991)

23 Rule 6001

24 §549(d)

25 §542(a)


27 §542(c)


29 §543(a)

30 §543(b); Rule 6002(a)

31 §727(d)

32 §363(c)(2)

33 In re Rigdon, 795 F.2d 727 (9th Cir. 1986); In re Slack, 30 C.B.C.2d 1316 (Bankr. N.D. N.Y. 1994).

34 Bankruptcy Rule 2015(4)

35 §554; Rule 6007(a)

36 Rule 2015(a)(1)

37 Rule 2015(a)(2)

38 §704(2)

39 §521(2)(a)(b)

40 §521(3); Rule 4002(4)

41 §501; Rule 3001, 3002
HANDLING CASES WITH THE CHAPTER 7 BANKRUPTCY TRUSTEE
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**SECTION E(b)**
Introduction

The purpose of this discussion is to advise practitioners on methods and strategies regarding issues to address with the Chapter 7 panel Trustee appointed by the United States Trustee. The general theme of this discussion is to advise practitioners how to satisfy the demands of the panel Trustee without drawing a Motion to Dismiss or other sanctions. A working knowledge of the powers of the Trustee, particularly the strong arm powers, is necessary. Practitioners should refer to the Consumer Bankruptcy Practice in Kentucky: Chapter 7 Practice published by the University of Kentucky as a Monograph in 1996, Chapter 6, for a discussion of the powers of the Trustee. This author does not intend to restate all of those powers, although comments will be made when appropriate as to current practices and procedures.

Commencement of the Case

With the commencement of any Chapter 7 petition filed in the Eastern District of Kentucky, several matters arise at once that require the attention of Counsel. The first is the assignment of a case number. Contemporaneously with the assignment of the case number, the clerk appoints a Trustee on a random revolving basis from the list of panel Trustees, assigns a date for the meeting of creditors, and enters information onto the BANCAP system to issue what is called a "Order to Debtor". A copy of the Order to Debtor is attached for your review.
The Order to Debtor requires the Debtor to produce within ten (10) days various documents, which assists the Trustee in determination of whether an asset exists for liquidation or not. Please note that this Order is not issued in the Western District of Kentucky. No similar requirement exists in the Western District that compels Debtors to turnover documents.

The Debtors must produce within ten (10) days the following:

1. copies of deeds, mortgages or other interests in real estate;
2. copies of bank statements and cancelled checks;
3. copies of titles to motor vehicles, mobile homes, trailers or boats (registrations are not acceptable);
4. certificates of stocks, bonds, and keys to safety deposit boxes;
5. copies of the Debtors’ last filed state and federal income tax returns;
6. any other papers that pertain to ownership of property.

Failure to produce these documents on a timely basis will result in a Motion to Dismiss.

Pursuant to the Court's amended Standing Orders, which are available for review on the Court's website at www.kyeb.uscourts.gov, a copy of which is attached hereto, the Trustee has no discretion but to move to dismiss for failure to produce these documents.
Counsel is reminded to contact the individual Trustee to determine his or her individual requirements regarding the fulfillment of this Order. Some Trustees are more strict than others. However, the general practice is to produce these documents as soon as the identity of the Trustee is known.

Practice Tip

Except for exigent circumstances, Counsel should obtain all of the required documents prior to filing the petition. The one document that cannot be obtained in advance is the bank statement that shows accounts balances through the date of filing. However, other than that, Counsel should require the production of all necessary documents before filing the petition.

The Order to Debtor referenced herein also enjoins the Debtor from disposing of any property of the estate without the consent of the Trustee or Order of the Court. Frequently this author encounters situations where vehicles have been abandoned, turned over or allowed to be repossessed. Other collateral seems to disappear. The wiser approach is for Counsel to contact the Trustee to receive authorization for the intended course of action. The Debtor should not retain vehicles any longer than necessary, particularly if uninsured. However, to allow repossession of the vehicle without the Trustee's ability to inspect the title and verify that the lien is properly perfected, places the Debtor in the position of violating this order (as well as the relative creditor). In such cases, the property should not be turned over until a properly executed Order of Abandonment or Agreed Order Lifting Stay is executed.
The meeting of creditors is contained in the initial notice issued by the Bankruptcy Court to all creditors, parties of interest, the Debtor, attorney for the Debtor and the Trustee for the Debtor. The clerk also includes this information on the print out of the receipt that is returned to Counsel. Attendance at the meeting of creditors by Counsel and by Counsel's client is mandatory. If either should fail to attend the meeting of creditors, pursuant to the Court's latest standing Order, issued June 1, 2000, a copy of which is attached, the Trustee is directed to file a Motion to Dismiss.

If Counsel becomes aware that a conflict exists, a Motion to Continue, coupled with an Affidavit and a proposed Order, must be filed immediately. Notice of the Motion must be served upon all creditors and parties of interest. In addition to filing the Motion, contact the affected Trustee and try to obtain an agreed upon rescheduled date. This date can be included in your proposed Order so that certification of the Order is limited to one distribution instead of two.

Should a Motion to Continue not be necessary, Counsel and the Debtor should appear at the meeting of creditors at the time and place as scheduled. Ordinarily these hearings last only a few minutes. At the hearing, Counsel should be prepared to address each asset of the Debtor with the Trustee. While the meeting is conducted by the Trustee, who shall address questions to the Debtors, Counsel should be familiar with the assets of the Debtor and be prepared to discuss these with the Trustee.
Of a particular interest to any Trustee is any pending litigation, any pending claim or any other matter that is contingent. Other matters of interest include any inheritance, lottery winnings, lien perfection issues, and equity available to the Debtor.

To the extent that Counsel is informed that any potential asset may be subject to administration, the better practice is to inform the Trustee of the status of that asset prior to the meeting of creditors. This information will allow the Trustee to focus on the matters that need to be administered. In addition, Counsel should inform the Debtor that resolution of the personal injury or the contingent matter will rest with the Trustee and that the Debtor has no authority to adjudicate, settle or otherwise dispose of any contingent claim. The Debtor’s remedy is limited to objection to any proposed solution made by the Trustee and to properly schedule exemptions of said claims.

An interesting development over the last several years has been the redemption of assets by Debtors in favor of either the estate or a perfected secured creditor. Companies have been formed whose primary purpose is to finance Debtors who have filed bankruptcy to allow those Debtors to either retain property that is listed in the bankruptcy or finance the acquisition of the new assets following the petition. To the extent that this issue may be appropriate, Counsel is urged to discuss this matter with the Debtor and with the Trustee prior to the meeting of creditors, if possible. For example, if the Debtor presents a title which Counsel knows lists an unperfected lien or lists a lien that is avoidable because it is preferential, an inquiry into the Debtor’s desire to retain that item is necessary before the meeting of creditors. When the meeting of creditors occurs, the Trustee can be informed of the Debtor’s intent to redeem.
It is this author's opinion that redemption pursuant to 11 U.S.C. § 722 includes property of the estate. The Debtor is required to pay the fair market value of the tangible personal property intended for personal family or household use by paying "the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien". Nothing in this section prohibits that the holder of such lien would be the Trustee in Bankruptcy. The Trustee stands in the shoes of an unperfected secured creditor pursuant to 11 U.S.C. § 551, which allows the preservation of the lien avoided by the trustee in favor of the estate as against the Debtor. Thus, should redemption be desired, an inquiry into the ability of the Debtor to redeem must be made prior to the meeting of creditors. Otherwise, the Debtors stand an excellent chance of having the asset, particularly a vehicle, removed from their possession and sold at auction or by other appropriate means by the Trustee.

In sum, the meeting of creditors is the vehicle used by the Trustee to refine what assets of the estate need to be liquidated. Counsel for the Debtor should use the meeting of creditors as an opportunity to refine that process for the Trustee. By assisting the Trustee, Counsel can also facilitate the wishes of the Debtor by appropriately seeking alternatives. If the Debtor is aware that an asset is subject to liquidation before the meeting of creditors, the Debtor has been properly informed and is not surprised to learn that a valuable asset is to be turned over at the meeting of creditors. A surprised Debtor makes for an unhappy Counsel. Full disclosure of all possibilities to the Debtor prior to the meeting of creditors will confirm the confidence the Debtor has placed in Counsel. Disclosure of assets to be liquidated to the Trustee prior to the meeting.
of creditors will engender good faith with the Trustee and allow for a better recovery for both the estate and the Debtor.

The Difficult Debtor/Issues of Discharge

In the Eastern District, the Court entertains Motions to Dismiss for the failure of Debtors to produce necessary documents or attend necessary hearings. Necessary hearings not only include the meeting of creditors but properly scheduled Rule 2004 examinations. Debtors can also be compelled to provide testimony in adversary proceedings. The Debtor has a continuing duty to cooperate with the Trustee. 11 U.S.C. § 521.

On rare occasions, the Debtor does not either fully cooperate with the Trustee. Instead of full disclosure, the Debtor attempts to conceal assets, delay production of documents or fail to provide full disclosure of transfers that apply prior to the filing of the bankruptcy. Both the Trustee and creditors have available as a sanction a complaint that objects to the discharge of the Debtor. Unlike nondischargeability issues under § 532 of the Code, dischargeability issues fall under 11 U.S.C. § 727. Once filed, a case cannot be settled without full disclosure to creditors and the Court.

Trustees are increasingly becoming more litigious in the area of discharge. Trustees particularly rely on 11 U.S.C. § 727(d), which required the Court to revoke a discharge if a discharge was obtained through the fraud of the Debtor and the Trustee did not become aware of the fraud until after the discharge had been granted; the Debtor acquired property that was
property of the estate and failed knowingly and fraudulently to report the acquisition or entitlement of such property or refused to deliver said property to the Trustee or the Debtor has refused to obey a lawful order of the Court. The Debtor’s discharge can also be revoked if one transferred, removed, mutilated or concealed property of the estate or what could have been property of the estate within one(1) year before the filing of the petition and failed to disclose it or if the Debtor lied, made false oath or attempted to bribe the Trustee. The conduct of the Debtor includes not only an examination of conduct after the filing of the petition, but also before the filing of the petition.

Recently the Sixth Circuit Court of Appeals adopted the “continuous concealment doctrine”. This doctrine provides that should the Debtor conceal assets more than one (1) year prior to the filing of the petition, but exercises dominion over said asset into the one (1) year before the filing of the bankruptcy and the Debtor fails to disclose either the transfer or the exercise of control, then the Debtor’s discharge can be revoked for failure to disclose and for making a false oath by signing the petition. In Re: Keeney, 200 Fed. App. 0341P, (filed September 26, 2000). A copy of the opinion is attached for your review.

Counsel does not normally participate in such conduct with the Debtor. To do so invites potential criminal sanctions. In such situations, Counsel needs to walk a fine line between properly advising one’s client, maintaining confidences under the Code of Professional Responsibility and not participating in a fraud upon the Court and reporting such fraud to the appropriate authorities, including the Trustee and the United States Trustee.
Practice Tips

Advise one’s client in writing to make full disclosure of all assets, transfers, or potential assets prior to the filing of the petition and prior to the meeting of creditors. At least advise your client that a fraudulent conveyance action should not be coupled with a discharge revocation action. Advise the Debtor of the powers of the Trustee’s “strong arm” powers pursuant to § 544-553 of the Bankruptcy Code.

Duties After Meeting of Creditors

The Debtor’s duty to cooperate with the Trustee extends until the close of the case. Therefore, Counsel needs to maintain contact with the Trustee in the event that any asset needs to be administered. Counsel particularly needs to be vigilant in the assertion of appropriate exemptions. If a Trustee undertakes the prosecution of a personal injury claim that belong to the Debtor and then seeks to settle the matter, Counsel needs to review the proposed settlement with the Debtor to ensure that the Debtor’s interest are properly represented. The Debtors are allowed exemptions which are fully delineated in KRS 427.150. Pain and suffering has been adjudicated to be excluded from the exemption as stated in KRS 427.150. The Trustee is required to furnish information concerning the estate to a party in interest. 11 U.S.C. § 704(7). Thus, Counsel should maintain contact with the Trustee to determine the status of the pending litigation, should the Debtor believe that a viable exemption exists. Maintain with the
Trustee that an exemption by the Debtor is claimed and that any resolution of the case, short of jury findings, that settles the case strictly along the lines of pain and suffering will be opposed. The same admonition to creditors and creditor’s Counsels exists with regard to Debtors and Debtors Counsel in these actions. Vigilance is essential.

The same vigilance applies to activities that must be undertaken by the Debtor after the filing of the petition that cannot be produced by the meeting of creditors. Examples of these type of activities include preparing the filing tax returns, receiving and properly disbursing tax refunds or other activities that simply could not be performed by the meeting of creditors. Counsel should advise Debtors not to cash tax refund checks until cleared by the Trustee. Maintain contact by Counsel between the Debtors and the Trustee will ensure that no inappropriate actions will be filed, such as a complaint to revoke the discharge.

Dealings With the Trustee in Representation of Creditors

Creditors has one disadvantage in a bankruptcy in that, except for the rare instance of an involuntary petition, creditors do not select the place of filing. Counsel who represents creditors are not under the same statutory requirements to cooperate with the Trustee that the Debtor and Debtors Counsel have. However, even in adversary situations, the more sensible approach by creditor’s Counsel should be to communicate and to cooperate with the Trustee.

Creditors Counsel normally have contact with the Trustee in the following situations:

1. Relief matters;
2. lien avoidance matters;
3. sale of secured assets; and
4. representation of unsecured creditors.

Regardless of the type of proceeding, Counsel will find that cooperation with the Trustee will produce a more effective administration of the case, result in a more efficient distribution of funds to creditors and enable Counsel to make speedier dispositions of assets that are secured in favor of their client's.

Relief Matters

In the Eastern District of Kentucky, relief from stay can be obtained by Motion in one of two ways. The first is by noticing the Motion on a fifteen (15) day opportunity notice. If another party in interest wishes to object to the Motion for Relief, then the matter will be set for motion docket. The alternative is to notice it for a date certain. Motion dockets are conducted on a regular basis in the Eastern District of Kentucky and are set forth in Local Bankruptcy Rule 9014-1. Counsel is urged to review any changes to the date and times on the Court’s web page at www.kyeb.uscourts.gov. Recently, Judge Howard changed the motion hour for the Covington division from the first Tuesday of the month to the second Tuesday of the month to accommodate his new duties as a member of the Bankruptcy Appellate Panel.

On relief matters, Counsel must attach a copy of the proof of claim to the Motion for Relief. The Motion must also set forth the basis by which relief should be granted, including the recording information that is pertinent to the asset that ought to be released from the
bankruptcy. Unlike some jurisdictions, a request for an abandonment of the property may be included in the Motion for Relief.

An alternative to filing the Motion is to seek an Agreed Order with Counsel for the Debtor and the Trustee. The same information must be disclosed. Counsel must provide to the Trustee the documentation that shows the perfection of the lien on the asset in question. Often times, Counsel attaches a copy of a mortgage or other instrument which does not contain the recording information. Trustee’s review, proofs of claims, Motions for Relief and other documents for information that shows clearly that the lien of the punitive secured creditor is perfected in a timely manner and is not otherwise avoidable under the Trustee’s strong arm powers.

Absent such information, the Trustee should object to the Motion for Relief or refuse to sign the proposed Agreed Order. Providing such information the first instance provides a smoother, more efficient administration of the estate and allows Counsel to seek liquidation of the asset on behalf of the secured creditor on a speedier and more efficient basis. An Order must accompany the Motion for Relief.

Lien Avoidance Matters

The most important aspect of representation of a creditor by Counsel when a Trustee seeks to avoid a lien is to accurately assess the merits of the Trustee’s position. To litigate simply to stall for time frequently costs creditors substantial dividends. The cost of litigation is borne by the estate and therefore decreases the amount of funds available for distribution, not
to mention the time spent litigating causes delays in which distribution can occur. If Counsel concludes that the Trustee’s position is sound and no basis exists to defeat the proposed lien avoidance, the best representation is to concede and to facilitate a liquidation of the asset so that Counsel’s client can receive a greater dividend. While the creditor will suffer a loss, for it is a rare case in which a lien avoidance matter results in a 100% dividend, the accurate assessment of a Trustee’s case at the beginning of a case will allow the creditor to recover the maximum amount possible. Of course, if Counsel concludes that the Trustee’s action is not warranted, defense of the litigation is proper, even if the result is adverse to Counsel’s client in the end. Most Trustees are cognizant of the cost of litigation, the time expended in litigation and have already performed a cost benefit analysis before undertaking the proposed litigation. Most Trustees are normally considerate of settlement in these matters because the goal is to return funds to creditors as quickly as possible.

If Counsel has determined that viable defenses exists to the Trustee’s proposed action, the information that establishes the defense should be provided to the Trustee as soon as practicable. Most Trustee’s are aware of the potential defenses to any action. Providing the documentation or offering testimony, that supports the defenses will quickly frame the issues. Counsel should be aware of the intent by the Bankruptcy Court in the Eastern District of Kentucky to bring matters to trial in an expeditious manner. Therefore, no time exists by which to delay discovery. On the contrary, if discovery needs to be undertaken, do so at once. The burden of proof does rest with the Trustee. Normally, the key witness for the Trustee will be the Debtor. If not the Debtor, it is documentation provided to the Debtor that forms that basis
of the complaint. The Debtor is required to cooperate with the Trustee. Therefore, if his testimony is necessary, do not hesitate to take his deposition. The trial procedures in the Eastern District require all Counsel to enter into stipulations to refine the issues to be heard by the Court. Normally in lien avoidance actions, the litigation centers on one element. For example, frequently in preference litigation, the issue is an industry standard to determine whether the payment was made on an antecedent debt. Focus on the issues that benefit your client's the most. If the Trustee cannot prevail on all of the elements, the Trustee fails to meet the burden of proof. If Counsel can convince the Trustee that the elements cannot be met, the dismissal of the action should be obtained.

**Liquidation Analysis**

Whether Counsel represents a creditor who holds a lien or is simply unsecured, Counsel for creditors need to perform a liquidation analysis of the Debtor's assets. If the creditor represented is a lien creditor, the focus would be limited to the asset that is encumbered. Normally, the liquidation analysis for representing a secured creditor goes hand-in-hand with whether Counsel should prepare a Motion for Relief from Stay or seek and Agreed Order lifting the stay. Simply put, the Trustee undergoes a mathematical analysis. The Trustee must deduct the administrative costs from any hypothetical sale. The administrative costs include the Trustee's commission, which is set forth in 11 U.S.C. § 326, any professional fee, such as auctioneer, real estate commission, attorney's fees, any tax costs as a result of the sale,
particularly any capital gains tax and any other costs that the Trustee must consider before performing the sale. In addition to the administrative costs, the Trustee must consider distribution to co-owners, if applicable, and, of course, the amount owed to the lien holders. Interest continues to accrue on the valid liens that encumber the asset. In addition to all of these factors, the Trustee must also consider applicable exemptions, particularly homestead exemptions in real estate sales. After all of these costs are deducted and a benefit remains to the estate to sell the property, it is in the interest of the secured creditor to facilitate a sale as well as the Trustee. After all, the secured creditor will be paid in full from the sale of the asset. If the creditor becomes convinced that a sale will not in fact pay all of these costs, then Counsel should employ the relief from stay mechanisms.

If Counsel represents an unsecured creditor, Counsel should ask one’s client to what extent that client may have knowledge of assets of the Debtor that can be liquidated. It is in the unsecured creditors interest to find assets that can be liquidated. Unsecured creditors, of course, only get paid a dividend from assets that are liquidated. Otherwise, the case becomes a no asset case and the client receives nothing. Counsel can determine quickly what assets of the Debtor hold potential value for the estate, and brings these matters to the attention of the Trustee. Counsel can assist the Trustee to make sure that creditors receive a substantial dividend. The services of Counsel in this area are limited to support for the trustee. However, a Trustee normally sells assets only after parties bring the value of those assets to the Trustee’s attention. Many times Debtors understate or simply don’t appreciate the value of property that they own. Thus, if Counsel or Counsel’s client holds knowledge of the value of certain assets,
even if the Debtor does not agree with that assessment, the Trustee may be able to realize a dividend to that creditor when otherwise the Trustee would be prepared to file a report of no distribution. The vigilant creditor is normally the creditor who gets paid. When representing an unsecured creditor, Counsel must file proofs of claims to preserve the right of the creditor to receive a dividend.

Conclusion

When Counsel must engage with a Chapter 7 Trustee, two attributes most often work for the benefit of all concerned. Those attributes are cooperation and disclosure to the Trustee. In order for the bankruptcy system to work at its best, the system must be efficient. It is the duty of Counsel to facilitate and perform those necessary tasks to make the system work more efficiently. It is in the interest of all concerned, the Debtors, Trustee, and creditors, that the system work efficiently. The faster the system works, the faster Debtors leave the bankruptcy system and place this unpleasant chapter behind their lives. The faster the system works, the faster the creditors get paid and realize the full extent of their loss or recovery. Of course, the faster the system works, the faster the trustee gets paid as well. But more importantly, and efficient bankruptcy system brings credibility and respectability to what is now a meck maligned system.

This author does not advocate that one should abandon a client when one disagrees with the Trustee. However, focusing on the area of disagreement, rather than litigating everything,
can only be in everybody’s interest. The shorter the litigation, the lower the costs. The lower the costs represents a higher dividend to creditors. A lower litigation cost, also can result in more favorable, negotiated settlements for the Debtor or the creditor. Failure to communicate with the Trustee results in Motions to Dismiss with regard to the Debtors, more extensive litigation with regard to creditors, greater administration costs and lower dividends to everyone. The only person who makes more money when a lack of cooperation and the communication exists is the Trustee’s Counsel. Practice in the Eastern District of Kentucky requires cooperation and disclosure of information. Debtor’s must timely disclose assets and documentation supporting those assets. Creditors must disclose documents that prove perfection of liens. Litigants are required to engage in meaningful stipulations and settlement discussions. Failure by one party to engage in a cooperative course can and probably will adversely impact that litigant. Candor before the Bankruptcy Court is a virtue and is normally not penalized. The required cooperation is perhaps the principal fundamental difference between litigating in the Bankruptcy Court and litigating in any other Court.
UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

In re: MILTON KEENEY,
    Debtor.

MILTON W. KEENEY,
    Appellant,

v.

MARY JEAN SMITH,
    Appellee.

Appeal from the United States District Court
for the Eastern District of Kentucky at London.
No. 98-00556—Jennifer B. Coffman, District Judge.

Argued: June 15, 2000
Decided and Filed: September 26, 2000

Before: KRUPANSKY, NORRIS, and SUHRHEINRICH,
Circuit Judges.
In re Keeney

No. 99-5949

COUNSEL


OPINION

ALAN E. NORRIS, Circuit Judge. Milton W. Keeney, debtor in this bankruptcy action, appeals from the order of the bankruptcy court denying his petition for discharge in bankruptcy. The denial was based upon the court's finding that he had concealed property interests and made a false oath.

We affirm the order.

I.

In 1971, Appellee, Mary Jean Smith, obtained a judgment against Keeney for injuries she sustained in a car accident. Smith has been unable to collect on this judgment.

In 1982, a tract of real property was purchased in the names of Keeney's parents, Winfred and Ruth Keeney. They mortgaged this property to Mutual Federal Savings and Loan ("Mutual Federal"). Keeney and his then-wife, Barbara Keeney, lived on the property for about a year, and paid his parents no rent. Keeney or K-Bar Trailer Manufacturing ("K-Bar") made all of the mortgage payments for the property.

In 1985 Keeney executed a note for $89,960 to Mutual Federal secured by a new mortgage from Keeney's parents on the property, as well as all of K-Bar's inventory, fixtures and equipment. Keeney or K-Bar made all the payments on this note and mortgage. This property was eventually transferred by his parents for the sum of $15,000, which was paid to Mutual Federal.

Keeney placed the winning bid for a second piece of real estate in 1983, which was purchased in his parents' names for the sum of $61,700. Of that sum, $52,000 was borrowed from Mutual Federal. Keeney or K-Bar paid $9,255 down for this property from K-Bar's checking account, and thereafter Keeney paid $52,455 from K-Bar's checking account for the balance due on the purchase price. Keeney and his wife moved onto this property at about the time it was conveyed to his parents and lived there until the time of their separation in 1994 or 1995. Keeney continues to live there. Keeney or K-Bar paid for improvements on this property and made all the mortgage payments. Keeney does not pay rent to his parents for his use of the property.

The record in this case indicates that the debtor had property titled in his parents' names while retaining a beneficial interest in the property. The bankruptcy court denied Keeney discharge in bankruptcy under 11 U.S.C. § 727(a)(2)(A), finding that he had continuously concealed this beneficial interest in the property.

The record contains evidence that Keeney had no economic interest in the property, and that he had no intention of retaining possession of the property.

We affirm the order.
In examining the defendant's intent, the Court notes that these transfers took place while a judgment was pending against him in favor of the plaintiff. The defendant listed none of these property interests on his schedules when he filed his bankruptcy case. The district court relied upon the continuing concealment doctrine to conclude that Keeney had concealed property in violation of 11 U.S.C. § 727(a)(2)(A). The court noted that Keeney produced only self-serving affidavits from himself and his parents stating that he had no interest in the property, and that no explanation was given for placing property that Keeney purchased and used into his parents' names. The district court concluded that Keeney had made a false oath in violation of 11 U.S.C. § 727(a)(4)(A) by failing to disclose his interests in the property to the bankruptcy court.


Keeney first argues that the bankruptcy and district courts erred in applying the continuing concealment doctrine to find that he had concealed property in violation of 11 U.S.C. § 727(a)(2)(A) by failing to disclose his interests in two properties to the bankruptcy court. The section encompasses two elements: 1) a disposition of property, such as concealment, and 2) a subjective intent on the debtor's part to hinder, delay or defraud a creditor through the act disposing of the property.

In Hughes v. Lawson (In re Lawson), 122 F.3d 1237, 1240 (9th Cir. 1997), the court determined that Keeney had concealed his beneficial interest in the two properties by placing them in his parents' names, with the requisite intent to defraud. Keeney argues that he had no interest in the property. A beneficial interest of ownership in the property can be inferred, however, from Keeney's payment for and use of the properties, including his rent-free residence on each and payment of all mortgage obligations. As noted by the district court, no explanation was provided as to why the properties were titled in the parents' names, with the result that the district court found Keeney had concealed his beneficial interest in the properties by placing them in his parents' names.

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the facts of this case, the bankruptcy court did not commit clear error in its determination that Keeney held a beneficial interest in the properties. The requisite intent to hinder, delay, or defraud was also permissibly inferred by the bankruptcy court in this case. See In re Snyder, 152 F.3d 596, 601 (7th Cir. 1998) (citation omitted) (a debtor's intent 'may be inferred from the circumstances surrounding the objectionable conduct').

Keeney next argues that even if he holds a beneficial interest in the subject properties, this court should not recognize the continuous concealment doctrine to bring the violation within the requirements of section 727(a)(2)(A). That statute specifies that both elements (the act of concealment and requisite intent) must occur within a year before the bankruptcy petition is filed. 11 U.S.C. § 727(a)(2)(A) (1993). The bankruptcy and district courts relied upon a continuing concealment to bring the transfers of property in this case, all performed over one year before filing, within the statute. "Under the 'continuing concealment' doctrine, a transfer made and recorded more than one year prior to the petition for bankruptcy may serve as evidence of the requirement of section 727(a)(2)(A) if the debtor retains a secret benefit of ownership in the transferred property within the year prior to filing."

Hughes, 122 F.3d at 1240; see also Rosen v. Bezner, 996 F.2d 1527, 1531 (3d Cir. 1993) (describing the doctrine by stating that "a concealment will be found to exist during the year before bankruptcy even if the initial act of concealment took place before this one year period as long as the debtor allowed the property to remain concealed into the critical year"). In Hughes, the Court of Appeals for the Ninth Circuit found a continuing concealment where a debtor retained an interest in her house after transferring it to her mother, because the debtor had lived in the house and subordinated her mother's deed of trust in order to obtain a loan. Friedell v. Kauffman (In re Kauffman), 675 F.2d 127, 128 (7th Cir. 1981) (per curiam), the court found that a debtor held a beneficial interest in a house where the debtor lived in the house, made mortgage payments, and used the house as collateral for a homeequity line of credit. In this case, the facts of the case, the bankruptcy court did not commit clear error in its determination that Keeney held a beneficial interest in the house that had been transferred to his mother. Keeney next argues that even if he holds a beneficial interest in the house, the court erred in not finding that the house was transferred to his mother for less than a reasonable consideration. See § 704(a)(2)(A)(iv). The Court of Appeals for the Ninth Circuit found a continuing concealment where a debtor retained an interest in his house after transferring it to his mother, because the debtor had lived in the house and subordinated his mother's deed of trust in order to obtain a loan. Friedell v. Kauffman (In re Kauffman), 675 F.2d 127, 128 (7th Cir. 1981) (per curiam), the court found that a debtor held a beneficial interest in a house where the debtor lived in the house, made mortgage payments, and used the house as collateral for a homeequity line of credit. In this case, the facts of the case, the bankruptcy court did not commit clear error in its determination that Keeney held a beneficial interest in the house that had been transferred to his mother.
In re Keeney

Keeney points out that this court has never been presented with a case concerning continuing concealment, and urges us not to adopt the doctrine. Alternatively, he cites Rosell, supra, to support his argument that the doctrine's application is not proper in this case.

In Rosen, however, the Court of Appeals for the Third Circuit reversed the bankruptcy court's denial of discharge because there was a material issue of fact on the intent element, so that the case was not proper for summary judgment disposition. Rosen, 996 F.2d at 1532.

Application of the continuing concealment doctrine is proper under the facts of this case, and we join those having adopted the doctrine.

Keeney also notes that under Kentucky law, Smith cannot recover the subject property because the statute of limitations has run. See Ky. Rev. Stat. Ann. §§ 413.120, 413.130 (Banks-Baldwin 1998). He argues that even if a violation of section 727(a)(2)(A) can otherwise be shown, that fact is irrelevant because Smith is too late to reach the property.

This argument fails. "Concealment or transfer under § 727(a)(2) may occur even if no creditors are harmed by it. 'Proof of harm is not a required element of a cause of action under Section 727 ....'" Peterson v. Scoll (In re Scott), 172 F.3d 959, 968 (7th Cir. 1999) (citation omitted).

B.

In addition to relying upon a violation of section 727(a)(2)(A), the bankruptcy and district courts also based the denial of discharge on Keeney's making of a false oath when he omitted his beneficial interest in the properties from his benefit schedules filed with the bankruptcy court, in violation of section 727(a)(4)(A).

§ 727(a)(4)(A) provides:

[a] The court shall grant the debtor a discharge, unless—

(a) the debtor knowingly and fraudulently, in or in connection with the case—

(1) made a false oath or account; . . .

In order to deny a debtor discharge under this section, a plaintiff must prove by a preponderance of the evidence that:

1) the debtor made a statement under oath; 2) the statement was false; 3) the debtor knew the statement was false; 4) the debtor made the statement with fraudulent intent; and 5) the statement related materially to the bankruptcy case.

Whether a debtor has made a false oath under section 727(a)(4)(A) is a question of fact. See Williamson v. Fireman's Fund Ins. Co., 828 F.2d 249, 251 (4th Cir. 1987). "Complete financial disclosure is a prerequisite to the privilege of discharge." Peterson, 172 F.3d at 967. The Court of Appeals for the Seventh Circuit has explained that intent to defraud "involves a material representation that you know to be false, or, what amounts to the same thing, an omission that you know will create an erroneous impression." In re Chav, 150 F.3d 726, 728 (7th Cir. 1998). A reckless disregard as to whether a representation is true will also satisfy the intent requirement. See Williamsoll, 828 F.2d at 252 (citation omitted). However, a debtor is entitled to discharge on Keeney's making of a false oath only if it is determined that the required proof of intent exists.

Keeney argues that because he has no interest in the subject property, he could not have made a false oath concerning it. As explained in the previous section, there was no error in the finding that Keeney held a beneficial interest in the property. By omitting this interest from his benefit schedules he made a false oath.
Keeney claims that even if he did make a false oath, it was not done knowingly, and that the bankruptcy court failed to find the intent element. Although the court was brief, it did find that Keeney had the requisite intent when not listing his interest in the property in his schedules. The bankruptcy court did not clearly err in inferring from the circumstances of this case that Keeney knowingly (or at least with reckless disregard) omitted his interest in the property with an intent to defraud. Keeney held a substantial beneficial interest in the properties, and the facts of this case make the bankruptcy court's inference of intent entirely proper. Accordingly denial of discharge under section 727(a)(4)(A) was proper.

III.

For the foregoing reasons, the denial of discharge is affirmed.
CHAPTER 7 ORDER TO DEBTOR

The above-named debtor shall within 10 days from the date of this order turn over to the trustee, whose name and address appear above, the following documents:

1. All books, records of account, bank books, bank statements and cancelled checks for the 6 months preceding bankruptcy (the last bank statement must show the amount on deposit on the date of bankruptcy);

2. The original or a certified copy of the deed or contract under which the debtor holds title to or any interest in real estate, and certified copies of all recorded mortgages, liens, or encumbrances upon said real estate (these documents may be obtained from the office of the county court clerk of the county in which the real estate is located);

3. Title papers to any motor vehicles, mobile homes, trailers or boats (if original papers have been lost, duplicates must be obtained from the office of the county court clerk of the county in which the vehicles are registered);

4. Certificates of stock, bonds and keys to any safety deposit boxes;

5. Contracts of life or burial insurance;

6. Copies of the debtor's last state and federal income tax returns;

7. Contracts or title papers pertaining to any property of the debtor; and

8. Copies of all notes, security agreements, loan disclosure statements and other documents relating to loan transactions to which the debtor is a party.

Except for surrender of the aforementioned documents to the trustee, the debtor is restrained and enjoined from transferring, abandoning, releasing to creditors, or in any way disposing of property of the estate until further order of the court.

Failure to timely comply with this order will result in the filing of a motion to dismiss the case.

Counsel for the debtor is responsible for seeing that the debtor complies with this order.

Dated: 10/23/00

By the court -

William S. Howard
U.S. Bankruptcy Judge
United States Bankruptcy Court  
Eastern District of Kentucky  
Notice*Notice*Notice

The Court has instructed the Trustees that 341 meetings are not to be continued unless they have an Order sustaining a Motion to Continue. If they do not have an Order sustaining a Motion to Continue, they are directed to file the attached Motion to Dismiss. Any Motion to Continue the 341 meeting must be accompanied by an Affidavit of the person so requesting (debtor or counsel) and must be served upon the Trustee, the U.S. Trustee and all creditors listed on the matrix of the debtor(s). (See suggested form Motion and Order below.) Note the changes in the §341 Notice and Order to the Debtor for cases filed after June 1, 2000.

We are going to reduce the time it takes to enter a Chapter 7 discharge from 120 days to 60 days. We have already reduced the time to 110 days and will be reducing the time by 10 days each month. In November 2000, discharges will be entered 60 days after the 341 meeting, absent a complaint being filed objecting to discharge.

We will no longer sustain a Motion to Withhold a Chapter 7 Discharge for failure to file tax returns, failure to turn over tax refunds, failure to turn over other assets, etc. The Trustees are instructed to file a Motion to Dismiss.

The Chapter 13 Trustee is instructed to file a Motion to Dismiss if the debtor is two (2) monthly or three (3) biweekly or five (5) weekly payments in arrears. All Motions to Dismiss will be heard by the court.

From the FYI Department:

a) The court will no longer accept Agreed Orders of Nondischargeability. An adversary proceeding must be filed.

b) Multiple, unrelated defendants in adversary proceedings will be dismissed. Separate causes of action require separate adversary proceedings even if conduct is similar and defendants are represented.

c) The court will discourage extensions of time to file Complaints to Determine Dischargeability of Debt and will be reluctant to approve Agreed Orders extending time.

d) For Judge Howard's adversaries - the trial will be set approximately 60 days after the pre-trial.

e) Beginning in October, 2000, trustee-held Chapter 13 confirmation hearings will be scheduled approximately 30 days after the 341 meeting. A confirmation hearing continued for any reason will be scheduled approximately 30 days after the trustee's confirmation hearing and will be conducted by the court.

f) The Chapter 13 Trustee is drafting a standardized Chapter 13 Plan to be used in


11/14/2000
Notice regarding Rules for U.S. Bankruptcy Court, E.D.Ky.

This District. It is expected to be distributed on or about June 1, 2000, and will be required after July 1, 2000. A new local rule will be issued. A copy of the Plan will be added to the Court’s website.

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF KENTUCKY

Division

In re:

Case No. ______________

Debtor(s)

MOTION TO DISMISS CH. 7 CASE

The trustee asks the Court to dismiss this case because

[ ] the debtor(s) did not appear at the §341 First Meeting of Creditors.
[ ] the attorney for the debtor(s) did not appear at the §341 First Meeting of Creditors.
[ ] the debtor(s) did not timely provide the documents required by the Court’s Order to Debtor.

DATE: ______________

Trustee

NOTICE

This motion to dismiss will be brought on for hearing at ________ on __________, 20___, United States Bankruptcy Court ______________________________________.

CERTIFICATION

This is to certify that the above motion was served upon the debtor(s), counsel for the debtor(s), the U.S. Trustee and all creditors listed on the debtor’s matrix on this the _____ day of

11/14/2000

E(b) - 28
MOTION TO DISMISS CH. 13 CASE

The trustee asks the Court to dismiss this case because

[ ] the debtor(s) did not appear at the §341 First Meeting of Creditors.
[ ] the attorney for the debtor(s) did not appear at the §341 First Meeting of Creditors.
[ ] the debtor(s) did not timely provide the documents required by the Court's Order to Debtor.

DATE: ____________________________

Trustee

11/14/2000
NOTICE

This motion to dismiss will be brought on for hearing at ________ on ________, 20__, United States Bankruptcy Court ____________________________.

CERTIFICATION

This is to certify that the above motion was served on the parties listed below on this the _____ day of ________, 20__.

_____________________
Trustee

_____________________
UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF KENTUCKY

___________ Division

In re:

Case No. ____________

Debtor(s)

MOTION TO CONTINUE

Comes now counsel for the above-captioned debtor(s) and moves the Court for an order continuing the scheduled §341 First Meeting of Creditors. An affidavit in support of said
motion is attached.

DATE: ____________

Counsel for Debtor(s)

CERTIFICATION

This is to certify that the above motion was served upon the trustee, the U.S. Trustee, and all creditors listed on the debtor's matrix on this the ___ date of ____, 20__.

Counsel for Debtor(s)

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF KENTUCKY

Division

In re:

Case No. ____________

Debtor(s)

ORDER

Upon the timely-filed motion of the debtor(s) to continue the §341 First Meeting of Creditors and the Court having reviewed the record and being otherwise properly and sufficiently advised,
IT IS HEREBY ORDERED that the §341 First Meeting of Creditors be and same is hereby continued to a date and time to be set by the trustee.

DATED: ____________

JUDGE

Copy to: Trustee

Attorney for Debtor(s)

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF KENTUCKY

Division

In re:

Case No. ______________

Debtor(s)

ORDER

The trustee having moved the Court to dismiss the within case and same having come on for hearing and the Court having reviewed the record and being otherwise properly and sufficiently advised,

IT IS ORDERED that the above-captioned case should be and hereby is DISMISSED.

DATED: ____________

11/14/2000

E(b) - 32
JUDGE

Copy to:

Debtor(s)
Counsel for the Debtor(s)
Trustee

Notice to all creditors and parties in interest

Return to main menu

Please let us know any questions about these procedures.
LIQUIDATION OF ASSETS ON THE INTERNET BY TRUSTEES AND CREDITORS

Alan C. Stout
Stout Law Office
Marion, Kentucky

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SECTION E(e)
I. OVERVIEW

"Change, before you have to."-Jack Welch, CEO, General Electric.

Under the terms of Bankruptcy Code Section 363 (11 U.S.C. 363), the trustee "after notice and a hearing" may use, sell, or lease, other than in the ordinary course of business, property of the estate.

Under Rule 6004 of the Federal Rules of Bankruptcy Procedure ("FRBP"), notice to be provided in conformity with Rule 2002 of the FRBP. Rule 6004(f) recognizes that a sale not in the ordinary course of business can be by private sale or public auction. It also indicates that "unless it is impracticable, an itemized statement of the property sold, the name of each purchaser, and the price received for each item for a lot or for the property as a whole if sold in bulk shall be filed on completion of a sale." FRBP 6004(f).

The Internet provides a unique opportunity for bankruptcy trustees to liquidate assets of bankruptcy estates. This is particularly true with assets which were previously difficult to market and eventually abandoned by the Trustee. Subjecting bankruptcy assets to sale before a worldwide market also may increase the value of the assets to be sold. An awareness of the opportunities the internet brings to the liquidation arena can be beneficial to debtors’ counsel, creditors’ counsel and all members of the insolvency community. Any party having an interest in maximizing value to the estate should benefit. For example, thru maximizing value to the estate, the liquidation analysis in chapter 11 and chapter 13 venues may be impacted, thereby increasing the dividend to unsecured creditors.

Advantages of internet liquidation of assets include:
1. Market for hard to sell assets, specialty items or items not suited for locale;
2. Market for highly specialized assets (i.e., target marketing or automatic notification service);
3. Can assist in obtaining abandonment of assets (some courts have actually required proof of web exposure for abandonment of certain types of assets-ND NY & SDCA);
4. Less expensive;
5. Administrative ease;

II. CONSIDERATIONS ON WHETHER OR NOT TO USE INTERNET
marketing of a specific asset is - what methodology to utilize?

Generally, there are three options for utilization of the Internet for liquidation of assets by Trustees:

- Asset Listing Service: Utilizes a traditional sale (i.e., public auction through auctioneer or private sale through listing of assets through broker). The Internet is used to market the asset only (i.e., through a listing service such as napt.com or bankruptcysales.com); or
- Online Auction Service: Use the Internet for the actual auction through an Internet auctioneer or asset disposition service (i.e., ebay.com, bid4assets.com or bankruptcymarket.com).
- Simulcast Auctions: Hybrid auction where traditional auction on-site is combined with internet auction

The methodology utilized will depend on the type of asset, location, and market appeal of a specific asset.

See, generally Lawyers Weekly USA, September 20, 1999, attached as Exhibit A.

III. TYPES OF ASSETS SUCCESSFULLY MARKETED ON INTERNET

Types of bankruptcy assets that have been successfully marketed on the Internet include:

- Vehicles
- Time shares
- Inventory
- Art
- Jewelry
- Real estate (particularly commercial leases-everything from shopping centers to office buildings to convenience stores)
- Commercial paper (notes, judgments)
- Restaurant equipment - In re: Mama's Original Foods, Inc., 234 BR 500 (S.D.Calif., 1999), the Court held that where a chapter 7 trustee held restaurant equipment and there was no "recognized market" for such assets, the trustee was required to advertise the assets on the internet and by newspapers.
- Partnerships or corporate ownership interests

Note, the internet is actually becoming the "recognized market" for certain technology-based assets. However, disposition of these assets create a new range of issues. Some of these assets are:

- Intellectual properties-An obvious market for intellectual property includes businesses which might actually have a use for the property. However, in some cases businesses may have a use for the intellectual property for "offensive" or "defensive" purposes. In the offensive market, the purchaser would acquire the right to prosecute potential patent infringement litigation against companies which may have infringed on the rights of the patent. In the defensive setting, the
acquiring company could maintain potential suits against new entrants into a particular industry. Many times new entrants into a particular manufacturing industry are vulnerable to infringement litigation.

- Customer lists, financial information, credit card numbers, etc. However, this may create public access v privacy concerns, see USTP-Privacy Study-Comments and Summary, available at: http://www.usdoj.gov/ust/privacy/comments-elements.htm for a summary of the public comments received by the U.S. Department of Justice "Study on Financial Privacy and Bankruptcy" (Original deadline -Sept. 8, 2000 extended to Sept. 22, 2000)


- Domain names
- Preference & Fraud claims- The Ninth Circuit recently held that preference & fraud claims in a bankruptcy case can be sold. In re: Duckor, Spralding & Metzger v. Baum Trust (In re P.R.T.C., Inc.), 177 F3d 774 (9th Cir., 1999).

- Bankruptcy claims - A market has developed over the internet for the sale of bankruptcy claims of all types.

IV. A "SAMPLING" OF WEBSITES AVAILABLE FOR LIQUIDATION OF ASSETS BY TRUSTEES

A. nabt.com - Created in 1997 by the National Association of Bankruptcy Trustees (NABT) as a FREE service to Chapter 7 Trustee membership - The website includes NABT member listings; provides e-mail list service features to members and NABT Board; Library and links to other bankruptcy related sites; legislative updates and other information about organization in addition to asset sale postings by NABT trustee members. There are approximately 1200 Chapter 7 trustees nationwide - of which, over 900 are members of NABT. This site provides listing for:

  - Upcoming bankruptcy sales
  - Bankruptcy assets listed for sale

Provides basic information on sales and contact information regarding the sales of assets by Chapter 7 Trustees.

  - Approximately 260 assets listed as of November 1, 2000
  - Approximately 100,000 hits per month

B. bankruptcysales.com-NABT and American Bankruptcy Institute (ABI) have completed formation of a joint Internet Committee to form bankruptcysales.com. This a new site for noticing of Chapter 7, 11, and 13 bankruptcy sales of assets which will serve as a listing service and will have links to auction sites. This service will be available to the entire insolvency community for liquidation of assets. As these materials are prepared, bankruptcysales.com is scheduled to go on-line on November 20, 2000.
• Heavy marketing
• Launched on November 15, 1999 designed specifically for sale of government, bankruptcy, foreclosed assets, and financial instruments
• Various bankruptcy pleadings available on line (application to employ, declaration, report of sale)
C. bankruptcymarket.com - online auction service and posting service
   Approximately 41 assets listed as of September 4, 2000
D. liquidation.com - online marketplace for business surplus inventory
E. ebay.com - The premier auction website. Over 2 million items and over 1 million users at any given time
F. fairmarket.com - Specializes in sale of large volumes of retail related items
G. tradeout.com - Surplus items and business to business items

V. ISSUES WITH INTERNET LIQUIDATION OF ASSETS

• Court approval of employment of auctioneers as professionals - 11 USC §327(a) and §328(a) FRBP 6004(a)
• Bonding and insurance
• Turnover of proceeds
• Security concerns
• Auctioneer’s report
• U S Trustee concerns
• Auctioneer fee applications and commissions generally - guidelines contained in Trustee’s handbook (See Handbook for Chapter 7 Trustees, Chapter 8, section m-6), effective January 1, 1998. No specific rules on internet auctions are in place at this time. However, it is contemplated that new rules will be included in handbook revisions.
• Shipping, packaging, and order processing

VI. ACTUAL SALE RESULTS

A. Atlantic Rancher Case
B. nabt.com
C. bid4assets.com
Bankruptcy Trustees Are Using the Internet to Sell Debtors’ Property

By Sylvia Hsieh

Bankruptcy trustees have a new tool for selling debtors’ property – Internet auctions.

It’s already been used successfully in at least one bankruptcy case, and trustees are predicting this could be the wave of the future. It can net a wider audience and better prices, as well as saving on administrative costs, many trustees say.

“This is the hottest, fastest-growing, most innovative area in bankruptcy liquidation in 50 years,” says Lawrence Friedman of Southfield, Mich., vice president of the National Association of Bankruptcy Trustees.

Instead of hiring an auctioneer, taking out newspaper ads or holding a traditional sale, trustees can post property on the Web and let the bidding begin!

However, most lawyers agree that a number of wrinkles in the process have to be ironed out before on-line auctions fully catch on.

Going Once, Going Twice...

Chapter 7 trustees say this new tool will allow consumers around the world to bid for property and ultimately put more money in creditors’ pockets.

“This will increase bankruptcy sales because it enlarges our market. Anybody can click a button and see what’s being sold. This opens it up to anybody to get into the bidding process,” says Eugene Crane of Chicago, a Chapter 7 trustee.

Online bidding is ideal for office equipment, cars, commercial real estate, jewelry, and other inventory, as well as intangibles such as notes, judgments or partnership interests, experts say.

In fact, debtors’ lawyers may want to start advising their clients that some items that used to be routinely abandoned may suddenly be up for sale.

“A time share or an interest in a condo is a classic example where it becomes cost-prohibitive to run ads in all the local newspapers. But if you put it on the Internet, it’s easier to find a buyer,” says Dan Goldberg of Houston, president of the Commercial Law League of America.

Friedman, who has sold several time-shares over the Internet this year, agrees. “Trustees never used to sell time-shares. Now, we’re turning dollars out of nothing.”

Other items appropriate for online auctioning include out-of-state property or property that doesn’t fit the local market.

“You won’t get anything for a fur coat in Arizona in August, but put it on the Web and someone back East might be more interested,” says David Birdsell, a Mesa, Ariz., Chapter 7 trustee.

Some trustees expect this new tool to work in both consumer and business bankruptcies.

But others say that consumer debtors’ property may be too personalized to sell over the Internet.

“A sofa at the debtor’s house can be sold at a garage sale or flea market. And the shipping cost for smaller items like a refrigerator may weigh against buying from outside the locale,” says Neal Batson of Atlanta, who represents creditors.

Small and medium-size businesses are better candidates for Internet auctions, he says.

How It Works

The idea is so novel that trustees are still experimenting with how online auctions will work.

A number of auction websites catering specifically to bankruptcy estates are beginning to pop up, notes Friedman.
And the National Association of Bankruptcy Trustees (NABT) has been experimenting with posting items for sale on its website, hoping to attract consumers as well as liquidation specialists.

A recent sampling of those listings includes a jewelry store’s inventory, vacant land in Arkansas, an assisted living facility in Florida, a debtor’s 1,100+ compact disc collection, and a $948 annuity payment from an estate.

The organization is now considering linking to an auction site that will handle online bidding, says Friedman.

Trustees can try to sell directly to consumers by posting items on auction websites, such as eBay, Yahoo!, or Amazon.com.

But the problem with those sites is that the trustee would have to front the costs and the Internet provider would have to sign court documents to be appointed as an auctioneer—something providers have so far shown little interest in doing, notes Birdsell.

In Massachusetts, a website provider recently set up an auction directly on the debtor’s home page, using pictures of the items and product descriptions scanned directly from the debtor’s catalogue.

The trustee is still responsible for the sales, but instead of taking out newspaper ads in the local paper, he or she scans digital pictures and uploads product descriptions onto a server.

The trustee may also have to “pick and choose” which items to put up for auction and set the reserve prices, says Boston attorney John Aquino, the Chapter 7 trustee in the Massachusetts case.

This is particularly true where there is a large inventory of similar items that are being auctioned directly to retail consumers online, he adds.

In addition, there are a variety of different auctioning methods that can be used, depending on the type of property being sold, says Warren Agin of Boston, who represents creditors and trustees.

The Upside

Trustees who have attempted to sell property online say they get higher bids because of the wider exposure.

Although the exact cost is unknown, most trustees predict that Internet auctions will be cheaper than traditional auctions.

A Recent Online Auction

When the outdoor-clothing catalogue company Atlantic Rancher filed for bankruptcy, it had about $3 million in inventory.

The highest offer from bulk liquidators was 15% of cost.

“When I looked at the quality of the products, I knew there had to be a better way to realize more for the creditors,” says John Aquino of Boston, the Chapter 7 trustee in the case.

The auction was so successful that Aquino has since sold two plants for a traditional sale, and the judge approved a motion to expand the Internet auction for another 60 days.

The website company created an auction site on Atlantic Rancher’s homepage, featuring a link to the auction catalogue and selling them about Internet auctions.

“We’re receiving bids that we otherwise never would have gotten. We’re selling at about 75% of retail prices. Normally, the highest offer you get in liquidation is 30 to 40 percent of cost,” says Hawes.

The auction was so successful that Aquino has since sold two plants for a traditional sale, and the judge approved a motion to expand the Internet auction for another 60 days.

The website company created an auction site on Atlantic Rancher’s homepage, featuring a link to the auction catalogue and selling them about Internet auctions.
"A lot of Internet auctions operate on a small listing fee and percentage compared to what you would pay an auctioneer," says Agin.

The provider in the Massachusetts case, Fairmarket Inc., waived the set-up costs in exchange for 10 percent of the auction sales.

Another company, Bid4Assets.com in Washington, will launch its website next month. It plans to charge 6-8 percent of sales, depending on the size of the assets, according to Tom Kohn, the company's CEO. Trustees who aren't NABT members will be charged a listing fee, and the company will also charge a fee for scanning photos, blueprints or other documents, he says.

But Birdsell predicts that as more companies begin providing this service, the cost will drop to 3-5% of sales, compared to the 10% that is paid to a traditional auctioneer.

The result is that debtors may lose more property if trustees can put items on the auction block so cheaply, experts say.

Because trustees can set the reserve price, they can post an item for sale and withdraw it if nobody bids above that price, without risking major advertising or listing fees, says Agin.

"If the asset is marginal, I might put it on the Internet with a reserve price and see if I get a bite," he says.

The Wrinkles

Since online auctioning of bankruptcy property is still so new, lawyers say there are a lot of kinks to work out before this type of sale becomes accepted.

The area is going to have to be monitored and fleshed out over time," says Chris Marshall, the U.S. Trustee in Boston, who adds that his office is watching the Massachusetts case to "see the results and what issues it raises."

Trustees who are used to doing things a certain way may be slow to convert to such a novel and unpredictable process.

In addition, any type of sale must be approved by the court, and Internet auctions are a totally new territory for judges.

"I question whether a judge would approve an Internet auction because of notice to the creditors. Lots of people don't have computers and wouldn't search for it," says Alexander Knopfler, a Chapter 7 trustee in Chicago.

But most trustees predict they'll get little objection from creditors, who will benefit from the sales.

Another issue is that the Internet auction provider will have to be familiar with the different procedural requirements for each jurisdiction, says Birdsell.

"It's very complicated because there are so many different variations. The auction companies would have to jump through whatever hoops are required before they get paid their commission. They would have to understand that the trustee can't just write out a check," he says.

In some jurisdictions, the auctioneer must post a bond, and it's unclear whether this will apply to Internet companies.

A trustee would also have to ask the court to waive any local requirement that an auctioneer attend the sale since this would be "impossible" over the Internet, says Marshall.

Some jurisdictions require post-sale confirmation by the court.

This could be a problem if the buyer has to travel to attend a hearing, he notes.

The potential for fraud in online bidding is another problem, given the recent tale of a 13-year-old who bid up to $3 million on eBay for a Corvette, property in Florida and a Van Gogh painting.

One solution would be to give passwords only to bidders who put up a deposit.

"That way if you get involved in bidding, you're pretty sure you're bidding against other real bidders," says Schorling.

But for large assets, many consumers may not have the available limit on their credit cards for such a big deposit, he notes.
Sifting the Dot-Com Rubble

Md. Auctioneer Set to Sell Assets Of Failed Firms

By ROB GARRETTSON
Washington Post Staff Writer

Though she didn’t gain the international headlines garnered by Internet failure Boo.com, the story of entrepreneur Andria McClellan is well known throughout the Washington technology community.

Her business, Civiczone.com, which offered Web links between citizens and local governments, fell into bankruptcy in May when funds ran short.

But the final chapter of Civiczone’s story won’t be written until later this month, when its remaining assets will be auctioned to pay off the company’s creditors.

Out of the ashes of one local dotcom flame-out, another local dotcom hopes to build a profitable business.

Bid4Assets.com of Silver Spring is the online auctioneer for the Civiczone bankruptcy sale, and the eight-month-old company is gearing up for what it expects to be a wave of Internet failures, restructurings and consolidations.

Founded by a pair of businessmen who grew up across the street from each other in Silver Spring, Bid4Assets is a Web-based auction site designed to bring together sellers and buyers of assets such as real estate, financial instruments, luxury goods and other items typically disposed of in bankruptcies or seized by government agencies.

Among the assets featured on Bid4Assets was the former presidential yacht USS Sequoia, which sold for an undisclosed amount in excess of $1 million, according to Tom Kohn, the company’s chief executive.

Among the happy customers is Warren E. Agin, a bankruptcy lawyer at Swigart & Agin in Boston and author of a book on Internet bankruptcy. Acting as a liquidation counsel, Agin used Bid4Assets to get $28,000 for the domain name planetrock.com.

“It’s really a great business model they have down there,” Agin said.

Unlike other popular general-purpose auction sites such as eBay, or mass online merchants such as Amazon.com, Bid4Assets site handles property that requires more due diligence to buy or sell than used CDs, consumer electronics or other household merchandise do.

For sellers, Bid4Assets provides services such as pre-qualifying buyers, including checking their credit, or accepting deposits required of bidders on high-priced assets. The company also actively promotes its inventory with collectors and other likely buyers, which a bankruptcy trustee or a government agency that has seized an asset is unlikely to do.

Bid4Assets also helps buyers by offering, online inspection of crucial documents, such as deeds, title records and inspection certificates.

Bill Kasting, left, chief operating officer of Bid4Assets.com, and CEO Tom Kohn with a backhoe, one of the many things their company auctions off.

“It’s a win-win situation all around,” McClellan said. “We bankrupt company will likely garner more dollars for its assets and be able to pay off more creditors, and folks that are in the market for distressed assets will have more efficient means of viewing many more’ assets. And certainly the trustees win, because it eases their pain significantly.”

Though online auctions offer efficiency for most types of bankruptcies, there are particular advantages for Internet businesses forced to liquidate assets, McClellan said.

“The bankruptcy process and the court system in general has been around for decades and isn’t really geared toward the efficient sale of intellectual property and assets from dot-com enterprises. [Online auctions] provide a very efficient means of gaining some value from those assets.”

Privacy advocates are concerned, however, about the auctioning of customer lists and other personal information gathered by Web sites, particularly when those that buy this information haven’t disclosed how they will handle it.

Though the privacy issues surrounding failed dot-coms are still cloudy, online bankruptcy auction sites such as Bid4Assets can help avoid problems, according to Richard Tillon, a bankruptcy lawyer at Greenberg Traurig in New York.

“Any buyer who wants to buy databases has to be concerned about the cost of litigating the privacy issue, which can be incredibly high if you’re fighting with 50 states and the FTC,” he said. “Buyers understand clearly that they have to bend over backwards to comply with existing policy statements and maybe even go beyond them.”

By making those privacy statements available online for buyers to inspect, Bid4Assets will help potential buyers judge the value of information — assets and sidestep privacy concerns before they bid on them, he added.

Bid4Assets was launched in November of last year, after one of the founders, Norman Understein, had shivered through an outdoor auction of a $5 million property in Baltimore. There had to be a better way, he and co-founder Rick Zitelman figured.

The company has listed more than $1 billion of assets for sale in the past six months, according to Kohn, a veteran of America Online Inc., FreeLoader.com and most recently USA Today Online.

Though Civiczone.com will be the first failed dot-com that Bid4Assets has liquidated, it won’t be the last, Kohn predicted.

“When we started this business, Internet companies could really do no wrong, and we’re just now beginning to feel the effects of the market correction in April,” he said. “And it’s taking this long because the bankruptcy process takes so long.”

Civiczone.com, filed for Chapter 7 liquidation in Alexandria on May 31, listing assets of between $100,001 and $500,000 and liabilities of between $500,000 and $1 million. Its assets headed for auction include some custom-developed Web software and about 100 domain names, plus computers, printers and office equipment. The auction will close at 3:00 p.m. on Aug. 24, 2000.

“Bid4Assets is the natural extension of the life cycle of a dot-com,” Civiczone’s McClellan observed. “I can’t imagining doing this any other way.”
Firms auction off assets on-line

By William Glanz
THE WASHINGTON TIMES

On-line businesses that sell the assets of bankrupt companies are springing up to convert others' hard times into revenue. They have customer lists full of failed enterprises.

Bid4Assets.com, a Silver Spring company, is selling everything from domain names of failed dotcoms to unpaid debt to tangible assets like buildings and art.

"We don't get personal enjoyment out of others' failures. We're just trying to run a business," said Thomas Kohn, chief executive of the privately held company.

They aren't the only ones.

Cambridge, Mass.-based Bankruptcy Exchange and Auction Market Inc. debuted its Web site last week.

"Traditional auctions are very parochial, and we're changing that," Bankruptcy Exchange and Auction Market President Jack Pascal said.

New York-based Ereorg.com will begin Web auctions in August of distressed loans.

The assets of failed companies - everything from furniture and computers to unpaid debt - reached an estimated $250 billion last year alone, according to Bid4Assets.

The sale and purchase of most of those items is done at traditional auctions, Mr. Pascal said.

But auctions are inefficient because they attract a regional audience and few people bid on the assets companies are forced to liquidate, the emerging Web auction companies argue.

On the Web, the potential audience is larger. The bigger the audience, the greater the chance an asset will be purchased, on-line auctioneers say. More potential buyers also makes bidding more vigorous and can boost the purchase price.

That makes on-line auctions valuable to creditors, because Web deals can help creditors of failed companies recoup more money than they would recover at traditional auctions, Boston-based bankruptcy lawyer Warren Agin said.

The sites that market assets of bankrupt companies aren't specializing in nickel-and-dime trinkets. On Ebay.com, the world's largest on-line marketplace, the average transaction amounts to $40. On Bid4Assets, it amounts to $25,000.

Last month, an auction on Bid4Assets resulted in the sale of the former presidential yacht USS Sequoia, used from the Harding administration in the 1920s forward, until President Carter sold it in 1977.

Even with a strong economy, 17-month old Bid4Assets already has listed $1 billion worth of assets.

NorshipCo, a Norfolk-based shipbuilder and dry-docking company, repossessed the 104-foot yacht after its owners, Presidential Yacht Sequoia Foundation, based in Alexandria, failed to pay the $3 million it cost to renovate the vessel.

NorshipCo sold the ship for an undisclosed price - but more than $1 million - in a sealed bid auction to Sequoia LLC, a group of Texas investors.

Bid4Assets, started with $5 million in capital, makes money by collecting a fee of up to 8 percent for each item sold on its Web site.

Even with a strong economy, 17-month old Bid4Assets already has listed $1 billion worth of assets on its Web site already.

If the economy slows and companies begin failing, business at Bid4Assets, Ereorg.com and Bankruptcy Exchange and Auction Market could flourish.

"We're definitely countercyclical," Bid4Assets Vice President of Development David Marchick said.

With more Internet companies failing, Web auction sites selling assets of bankrupt companies expect more business.

Dot-com companies used to simply close their doors, Mr. Agin said.

Now they are taking advantage of Chapter 11 bankruptcy to sell off assets, reorganize and reopen for business.

"We've not seen that before. They're doing it now because they realize they do have assets," Mr. Agin said.

The intangible assets of dotcoms - domain names, patents, copyrights and trademarks - are potentially the most valuable assets, Mr. Agin said.

"When it comes to selling a domain name, the Internet is a natural. If you try to think of another way other than the Internet to sell a domain name, your mind just goes blank," he said.

Mr. Agin sold a domain name www.planetrock.com - owned by bankrupt Massachusetts-based Internet company WebSecure at, an on-line auction on Bid4Assets for $28,000 to a London-based radio group.

If the deep well of venture capital available to dot-coms dries up, the failure rate of the Internet companies will surge, Mr. Marchick predicts.

So will business for the companies swooping in to sell their asset on-line.

"We didn't think about [dot-com failures] when we started, but we're starting to get calls and we've shifted resources to handle it," Mr. Marchick said.

Thomas Kohn, Bid4Assets.com CEO, displays a toy with the auction site's logo at its Silver Spring offices.
ADVERSARY PROCEEDINGS TO DETERMINE DISCHARGEABILITY OF DEBTS AND TO CHALLENGE DEBTOR'S DISCHARGE

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SECTION F
# Adversary Proceedings to Determine Dischargeability of Debts and to Challenge Debtor’s Discharge

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SECTION F
ADVERSARY PROCEEDINGS TO DETERMINE
DISCHARGEABILITY OF DEBTS AND TO
CHALLENGE DEBTOR’S DISCHARGE

Thomas L. Canary, Jr.
Updated by Ann E. Samani

I. INTRODUCTION AND SCOPE

The scope of this chapter is limited to the most common examples of cases filed to challenge
the dischargeability of a specific debt or to challenge the debtor’s discharge, generally. This subject
is frequently addressed in multi-day seminars and this chapter is but a brief glimpse at the intricacies
involved in the litigation of these type cases. For those interested in a more replete examination of
this topic, the author recommends The Fraud Book by William R. Mapother, Creditors Law Center,
1989 and 1993 Supplement. For information concerning that treatise, contact Creditor Law Center
at (502) 587-5451.

II. BANKRUPTCY TERMINOLOGY AND CONCEPTS

Before reviewing the specific cases and statutes involved in this area of the law, it is
important for the reader to understand some of the basic terminology used by judges and
practitioners.

There is a vast difference between attempting to hold a debt nondischargeable and seeking
a denial of the debtor’s discharge. The first is specific and the second is general.

A. Non-Dischargeable Debt

A "non-dischargeable debt" is one where a creditor seeks to have an individual debt
excepted from the discharge provisions of the Bankruptcy Code. This is done by filing an Adversary
Proceeding pursuant to §523 of the Bankruptcy Code.

For the purposes of this chapter, the following provisions of §523 will be examined:

- §523(a)(2)(A) - Debts incurred through false pretenses, false
  misrepresentations or actual fraud;
- §523(a)(2)(B) - Debts incurred through the use of false financial
  statements;
- §523(a)(5) and (15) - Obligations incident to a divorce;
- §523(a)(6) - Situations where a debtor’s collateral is converted by
  the debtor; and
- §523(a)(8) - Student loans.

In each one of these situations, other than cases predicated upon §523(a)(5), an Adversary
Proceeding must be filed.

B. Denial Of Debtor’s Discharge

When a creditor seeks to have the debtor’s discharge denied in its entirety, that Adversary
Proceeding must be based upon 11 U.S.C. §727(a) and (c). If a creditor is successful, then he would
deprive the debtor of the ultimate relief sought in a Chapter 7 proceeding, that is, relief from all of
his debts. Obviously, this is an extreme result, and this issue will be discussed at length later at IV below.

C. Adversary Proceedings

Adversary Proceedings are the Complaint filed by a creditor in the Bankruptcy Court seeking to hold a debt nondischargeable or seeking to deny generally the debtor’s discharge. Such Adversary Complaints must be filed within sixty (60) days from the date originally set for the first meeting of creditors. This is mandated by Bankruptcy Rules 4004 and 4007.

Note that this is sixty (60) days from the date first set for the meeting of creditors. In other words, if the meeting of creditors is continued, the sixty (60) days is calculated from the original date, not the continued date. Peerless Ins. Co. v. Miller (In re Miller), 228 B.R. 399 (B.A.P. 6th Cir. 1999)

This sixty (60) day deadline is absolute. If an individual files on the 61st day, the Complaint will be dismissed.

Note, however, the Courts are generally liberal about granting an extension of that time period. Such extensions are authorized under Bankruptcy Rules 9006(b), 4004(b) and 4007(c). The Motion for Extension must be filed prior to the expiration of the original sixty (60) day deadline. The Motion should be accompanied by some reason for the extension of time. Generally accepted grounds for such a Motion are the need for additional time to conduct discovery to see whether a Complaint is warranted, availability of records from the debtor or from the creditor, and the unwillingness of a debtor to submit himself to an examination pursuant to Bankruptcy Rule 2004, etc.

While Courts are generally liberal about granting a first extension, practitioners should have ample reason for requesting a second extension. One such example would be if a potential nondischargeability case is settled via the use of a Reaffirmation Agreement.

D. Reaffirmation Of Debts

11 U.S.C. §524(c) is the Bankruptcy Code section which allows for the reaffirmation of debts in Chapter 7 proceedings. 11 U.S.C. §524(c)(4) allows the debtor the later of the sixty (60) days from the filing of the Reaffirmation Agreement with the Bankruptcy Court, or the entry of the Discharge Order, to rescind the Reaffirmation Agreement. An unweary creditor’s attorney could fall into the following trap.

Remember, one has only sixty (60) days from the original date set for the first meeting of creditors to file an Adversary Complaint. If the potential nondischargeability case is settled via a Reaffirmation Agreement, the debtor would have, at a minimum, sixty (60) days from the entry of the Reaffirmation Agreement with the Court to rescind that Reaffirmation Agreement.

Say for example the Reaffirmation Agreement used to settle the potential nondischargeability case is filed with the Court on the 45th day after the first date originally set for the meeting of creditors. The creditor would have fifteen (15) days to file the Adversary Complaint. The debtor would have forty-five (45) days after the expiration of the creditor’s time to file the nondischargeability suit to rescind the Reaffirmation Agreement. The debtor could agree to reaffirm, allow the nondischargeability deadline to run, and then rescind the Reaffirmation Agreement. If there is collateral involved, the lien survives the bankruptcy and the creditor could seek return of the collateral. However, if the potential nondischargeability suit were based upon
credit card fraud or some other unsecured type of credit, then this author would suggest placing your malpractice carrier on notice.

E. Procedure In Adversary Proceedings

The initiation of an Adversary Proceeding is largely governed by Bankruptcy Rule 7001. It is very similar to civil actions filed in State or Federal Court. The filing fee for an Adversary Proceeding is currently $150.00. Bankruptcy Rule 7003, like Federal Rule of Civil Procedure 3, states that an Adversary Proceeding is commenced by the filing of the Complaint with the Court. Like Federal Rule of Civil Procedure 4, Bankruptcy Rule 7004 dictates the rules on summonses and service of those summonses. This author would recommend that a practitioner new to this area review Official Form 160 on the proper caption for a Adversary Proceeding and Official Form B250, the summons form used by the Bankruptcy Court.

For those practicing in the Western District of Kentucky, a reading of LBR (W.D. Ky.) 8 would be advisable. This is found in the Kentucky Rules of Court, Federal, published by West Publishing Company.

Practitioners will also find that most of the Federal Rules of Civil Procedure are incorporated into the Bankruptcy Rules many times without change. The author would commit to your reading the Advisory Committee notes to Bankruptcy Rule 7001 which gives a "conversion table" for many of the Federal Rules of Civil Procedure to the Bankruptcy Rules.

After the initial filing of the case, it proceeds forward like a regular civil action. The Judges in both the Eastern and Western Districts of Kentucky have standard pretrial Orders that will issue soon after the initiation of the Adversary Complaint. Practitioners would be well-advised to adhere to the requirements and deadlines of those pretrial Orders to the "tee". While one would think this would go without saying, the author has seen many an Adversary Proceeding dismissed (recalcitrant creditors counsel) and Judgment entered (dilatory debtor's counsel) for failure to adhere to these deadlines.

The burden of proof in an Adversary Proceeding is by a preponderance of the evidence. This is made clear in the case of Grogan v. Garner, 111 S.Ct. 654 (1991). This standard was also reiterated in the case of In re McLaren, 983 F.2d 56 (6th Cir. 1993).

Likewise, the burden of persuasion is on the plaintiff. See Bankruptcy Rule 4005.

III. Bankruptcy Code §523 - Non-Dischargeability

A. §523(a)(2)(A) - False Pretense, False Representation or Actual Fraud

11 USC Section 523(a)(2)(A) provides as follows:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt —

(2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained, by —

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition.
Any practitioner preparing a Complaint to be filed under §523(a)(2)(A) must read the case of In re Ward, 857 F.2d 1082 (6th Cir. 1988). The Ward court found that a creditor had to prove four elements to be successful in an action under this Code provision.

1. The debtor knowingly made false statements to the creditor, and
2. These representations (false statements) were made with the intent to deceive the creditor, and
3. The financial institution reasonably relied upon these representations, and
4. This reliance was the proximate cause of the creditor's loss.

The creditor must prove all four of these factors in order to make its case. For guidance, the author would recommend as reading the cases of In re Martin, 761 F.2d 1163 (6th Cir. 1985), and In re Parkey, 790 F.2d 490 (6th Cir. 1986).

The most difficult of these four factors to prove is element number 3, "reasonable reliance". Fortunately, a recent case from the United States Supreme Court appears to have lessened this standard.

In the case of Field v. Mans, 116 S.Ct. 437 (1995) the Supreme Court of the United States held that the creditor must show, only, that it "justifiably relied" on the false representations made by the debtor.

Unfortunately, "justifiable reliance" was not succinctly defined by the Supreme Court in its opinion. The theory, and thus the definition, was extrapolated from the Restatement (2nd) of Torts (1976). The Court made it clear that the debtor's conduct need not conform to a "community standard" of a "reasonable man". In fact, at page 444 of the Field decision, the Supreme Court quoted from Prosser's Law of Torts (1978), §108 at 717. This is as close to a definition of "justifiable reliance" as can be found in the opinion:

An individual standard of the plaintiff's own capacity and the knowledge which he has, or which may fairly be charged against him from the facts within his observation in the light of his individual case.

In other words, these matters will be examined on a case-by-case basis. The debtor's conduct will not be measured against some hypothetical "reasonable man". The debtor's conduct will be adjudged by examining his background, education and life experiences to determine whether he knew or should have known that his statements were false and would be relied upon by the financial institution in order to make its credit decision.

This Supreme Court decision will make litigation of these type cases very fact-intensive. Was it reasonable for a creditor to rely upon the statements made by an adult with an 8th-grade education as to whether he had pledged certain pieces of personal property on other loans? Is it reasonable for a creditor to expect an individual with a college degree in finance and 12 years' experience in his own business to be able to discern between collateral actually belonging to him versus to his corporation? Should a creditor be able to rely on statements made by a debtor as to his annual income without verification from his employer? It is this author's opinion that these are the issues that will have to be examined by the Court in light of the ruling in Field v. Mans, supra.

The Sixth Circuit has also provided some guidance in cases that fall under §523(a)(2)(A). A case can be made under this section by showing that the debtor was "grossly reckless" in providing the information to the creditor. In the case of In re Phillips, 804 F.2d 930 (6th Cir. 1986), the debtor provided the creditor a very misleading deed. The Sixth Circuit found that this "statement" was so grossly reckless that it rose to the level of fraud that §523(a)(2)(A) was drafted to remedy.

Likewise, the fraud of one partner can be imputed to another. See In re Ledford, 970 F.2d 1556 (6th Cir. 1992).

In re Rembert, 141 F.3d 277 (6th Cir. 1998) declared that the debtor who used a credit card is only representing at most an intent to repay, not the ability to repay. Thus the proper inquiry is what the debtor's subjective intent was after considering all of the circumstances surrounding the situation. Here a gambler (hourly wage factory inspector for 28 years) who had previously obtained a second mortgage on her home to pay her credit card debts and continued to gamble was found to lack the subjective intent to defraud. Note that two credit card issuers went to the 6th Circuit for two debts totaling $11,623.48.

In re Shartz, 221 B.R. 397 (B.A.P. 6th Cir. 1998) followed Rembert and indicated that the court was not going to overturn the decision of the bankruptcy court when the debtor, who was laid off ran up $12,500 in debt while attempting to get a job, had not made any luxury purchases and had not attempted a "one last hurrah" at the creditors expense. The decision affirmed that the creditor had failed to meet the burden of proof. Pro se Debtor.

In re Francis, 226 B.R. 385 (B.A.P. 6th Cir. 1998) states that a general release in prepetition settlement agreement does not release a §523(a)(2)(A) nondischargeability claim.

Many times, a creditor will initiate a civil action in state or federal court to redress damages incurred by it due to false representation or actual fraud on the defendant's part. The reaction to a judgment favorable to the creditor is the filing of a bankruptcy petition. The Sixth Circuit case of In re Batie, 995 F.2d 85 (6th Cir. 1993) addresses this. If the issue of fraud is properly determined in the civil action, then the debtor could be collaterally estopped from relitigating this case in the bankruptcy arena. A creditor can plead its civil judgment as collateral estoppel against the debtor in the adversary proceeding filed under §523.

Likewise, there are several cases decided by the Bankruptcy Court for the Western District of Kentucky in this area. A debtor's sale of stock that he did not own led to an adverse decision for the debtor in the case of In re Pallo, 65 B.R. 101 (W.D. Ky. 1986). See also the cases of In re Sustarich, 73 B.R. 731 (W.D. Ky. 1983); In re Tabers, 28 B.R. 679 (W.D. Ky. 1983); In re Donald, 26 B.R. 521 (W.D. Ky. 1983); and In re Fox, 13 B.R. 827 (W.D. Ky. 1982).

Note also, that a future promise to turn over a tax return is not a "false representation" or "false pretense". In re Roeder, 61 B.R. 179 (W.D. Ky. 1986). Likewise, a promise to pay and give creditor a lien on a replacement vehicle in the future also does not arise to the level of a nondischargeable debt. In re Todd, 34 B.R. 633 (W.D. Ky. 1983). In both of these cases, note that it was a future promise that was determined not to give rise to a complaint under §523(a)(2)(A).

Two cases from the Eastern District of Kentucky also shed some light on this area of the law. In the case of In re O'Bryan, 190 B.R. 290 (E.D.Ky. 1995), Judge Howard discusses the use of collateral estoppel from a judgment rendered in a state or federal civil action. This case also offers an excellent discussion of the dischargeability of punitive damages. Likewise, see In re
Parriman, 190 B.R. 88 (E.D.Ky. 1995), specifically discussing collateral estoppel from a state court judgment.

B. §523(a)(2)(C) – Luxury Goods

11 USC Section 523(a)(2)(C) provides as follows:

(a) A discharge under section 727, 1141, 1228(a), 1228(b) or 1328(b) of this title does not discharge an individual debtor from any debt —(C) for purposes of subparagraph (A) of this paragraph, consumer debts owed to a single creditor and aggregating more than $1075 for "luxury goods or services" incurred by an individual debtor on or within sixty (60) days before the order for relief under this title (11 USCS Sections 101 et seq.), or cash advances aggregating more than $1,075 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within sixty (60) days before the order for relief under this title (11 USCS Sections 101 et seq.), are presumed to be nondischargeable; "luxury goods or services" do not include goods or services reasonably acquired for the support or maintenance of the debtor or a dependent of the debtor; an extension of consumer credit under an open end credit plan is to be defined for purposes of this subparagraph as it is defined in the Consumer Credit Protection Act.

1. Presumption Periods

Many people have a basic misunderstanding of 11 U.S.C. §523(a)(2)(C). Some creditors feel that if they have a debt that falls within the parameters set forth in this subsection of the Bankruptcy Code that the debt is per se nondischargeable. This is a fatal error.

Specifically, this subsection of the Bankruptcy Code states that consumer debts to a single creditor aggregating more than $1,075 for a "luxury" goods or services obtained within sixty (60) days of the filing of the bankruptcy, or cash advances exceeding $1,075 taken on a consumer credit or open-end plan within sixty (60) days of the filing of the Bankruptcy are presumed to be nondischargeable. This does not absolve a creditor from having to file an Adversary Proceeding in order to determine the dischargeability of this debt. The presumption merely shifts the burden to the debtor to prove why the debt should not be discharged.

11 U.S.C. §523(a)(2)(C) also defines luxury goods and services. These are goods and services not reasonably required for the support or maintenance of the debtor or the debtor’s dependents. Such examples would be lavish vacations, a gambling binge, mink coats, travel trailers, etc.

C. §523(a)(2)(B) – Use Of A False Statement In Writing

11 USC Section 523(a)(2)(B) provides as follows:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt
for money, property, services or an extension, renewal or refinancing of credit, to the extent by –

(B) use of a statement in writing — 

(i) that is materially false; 
(ii) respecting the debtor's or an insider's financial condition; 
(iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and 
(iv) that the debtor caused to be made or published with intent to deceive.

In order to maintain an action under this provision of the Bankruptcy Code, a creditor must prove five (5) elements:

1. The statement must be in writing,
2. It must be materially false,
3. Respecting a debtor's or insider's financial condition, 
4. Upon which the creditor extending the credit reasonably relied, and 
5. Published by the debtor with the intent to deceive.

Note the material difference now between the cases filed under §523(a)(2)(A) and §523(a)(2)(B). Under §523(a)(2)(A), a creditor can show "justifiable reliance". Cases filed under §523(a)(2)(B) must show "reasonable reliance", which is, in the author's opinion, a higher standard.

Note also that the statement in writing must be materially false. In other words, had the written statement been properly completed, would the creditor have still made the loan to the debtor?

Proof of this element is often difficult. Hopefully, the financial institution has well-written lending policies. Many times, those lending policies dictate certain debt-to-income ratios which must be met before the loan is to be made. Ideally, a creditor could show that if debts omitted from a financial statement had been properly listed, then the ratios would have been exceeded and the loan not made. The author would submit that the creditor has gone a long way towards meeting this burden of proof.

Additionally, was the reliance by the creditor "reasonable"? In other words, did the creditor have another means by which to secure the information omitted from the financial statement?

It is common, almost to the point of being required, that a creditor show that it ran a credit bureau report or Dun & Bradstreet report prior to the extension of credit to an individual. Of course, the credit bureau report must be run at the time of the taking of the application, or soon thereafter, but before the decision to loan the money has been made.

If the debts omitted from the application appear on the credit bureau report, then the creditor's case will not be persuasive. The Court could hold that creditor had another means to ascertain this information, and it is "reasonable" to expect creditor to do so.
However, creditors would be surprised at the number of financial institutions that do not report to the credit bureau. If the debts were not listed on the application and did not appear on the credit bureau report, then the creditor has gone a long way toward proving this necessary element.

The most difficult of these elements to prove is "intent to deceive". Any requirement to prove such a "state of mind" makes these cases difficult to prosecute. Such intent must be shown by circumstantial evidence, as it is rare that a debtor will ever admit that he meant to deceive the creditor.

Many times, the false statement comes in the nature of grossly understating living expenses or grossly overstating income. As concerns the living expenses, it is very important for a creditor to conduct the proper discovery to ascertain whether the debtor purposefully understated living expenses in order to meet minimum requirements of the creditor in order to make the loan.

Remember, each debtor must file a Schedule I and J with their petition. Schedule I lists the debtors' income and Schedule J lists their expenditures. A creditor would be well-advised to review the Schedule J with the debtors to see if their living expenses have changed greatly from the time they made application for credit.

Additionally, see if such a budget were taken at the time of the application for the loan. Compare the two and try to ascertain the nature of any significant differences.

Also examine the Schedule I very closely. Has the debtor suddenly claimed a number of exemptions in order to artificially create a large tax refund at the end of the year? Is there overtime or other income that appeared on the debtor's original application that do not appear on the Schedule J? Did the debtor's income depend largely upon commissions and that was not revealed in the application? Does the application reveal a second source of income not listed on the Schedule I?

One point of inquiry from the Court will be whether a creditor attempted to verify a debtor's employment. In other words, did they ask for a pay stub or contact the debtor's payroll department upon application for credit? If a creditor simply took the word of a debtor, then the reasonable reliance requirement may not have been met.


Like §523(a)(2)(A), the burden of proof is the preponderance of the evidence. See the Grogan and McLaren cases cited above. There are a number of cases from the Sixth Circuit which provide examples of what types of false writings have been determined actionable: Coman v. Phillips, 804 F.2d 930 (6th Cir. 1986) [false representation of acreage in deed held reasonable so debt discharged], But see, Knoxville Teachers Credit Union v. Parkey, 790 F.2d 490 (6th Cir. 1986) [misrepresentation of liabilities grossly reckless and debt determined to be nondischargeable].

"Extension of credit" includes a fraudulently obtained promise to forbear collection. As a result an otherwise dischargeable debt can become nondischargeable even though the creditor did not suffer any damage as a result of the forbearance. In re Campbell, 159 F.3d 963 (6th Cir. 1998).

The case of In re Woollums, 979 F.2d 71 (6th Cir. 1992) is also very instructive. There, an incomplete, unsigned and erroneous financial statement was submitted to a creditor. Later, when the debtor filed bankruptcy, the creditor moved to hold the debt nondischargeable pursuant to
The bankruptcy court ruled against the debtor, but the district court reversed. The district court found that there was no way that any competent financial institution could reasonably rely upon such a poorly-completed financial statement. The standard to be applied is to safeguard against a creditor acting in bad faith. In other words, it would not be fair for a creditor, on one hand, to accept so deficient a financial statement and then use the same financial statement as grounds for holding the debt nondischargeable. Creditors have to play by the rules. The Sixth Circuit reinstated the bankruptcy court decision denying dischargeability to the two loans. It determined that reasonable reliance should not allow the court to undertake subjective evaluation and judgment of a lender's policies and practices.

Another interesting case is that of In re Martin, 761 F.2d 1163 (6th Cir. 1985). Generally, 11 U.S.C. §506(b) will allow a creditor to recover reasonable fees (attorney fees) and costs provided that the creditor is oversecured. The value of its collateral must exceed the debt.

However, the Sixth Circuit found that the creditor was entitled to an award of attorney fees based on its contract only. Here, the contract called for the recovery of attorney fees in the collection of a debt. It was this clause that the Court focused on, not simply §506. The Court allowed for the recovery of the attorney fees despite creditor's undersecured status. Creditors should use this case when filing any case under §523 for the proposition that it should be allowed to collect its attorney fees.

In the Eastern District of Kentucky there appears to be only one case on the court's web site which discusses §523(a)(2)(B). It is Judge Lee's 1990 decision in In re Snyder, Adv. No. 84-0151 (Bankr. E. D. Ky. 1990). The debtor prevailed when the creditor was unable to meet the burden of proof as to reliance and intent to deceive.

There are a litany of cases decided under §523(a)(2)(B) from the Western District of Kentucky. Note that the holding in some of the cases from the Western District of Kentucky could now be different since the standard of proof has changed. Prior to the Grogan case, the standard of proof was clear and convincing. It would be interesting to try to determine whether the holdings in any of these cases would have changed under the new preponderance of the evidence standard.

In the case of In re Rosel, 63 B.R. 603 (W.D. Ky. 1986), a debtor understated his debts by $20,000 and overstated his income by $21,000. Additionally, his assets were overstated by $20,000 for a total of $61,000. In reviewing the case, the Court found that the reliance on this statement by the creditor was so outrageous that the reliance was not deemed to be "reasonable". The debt was discharged.

In the case of In re Bridges, 51 B.R. 85 (W.D. Ky. 1985), a creditor was denied the relief it sought in its Adversary Complaint because it failed to verify the information in the written statement (application). This is a lesson well taught and the author would refer the reader to the discussion of this subject above.

Where a bank was actually aware of the debtor's financial condition, reliance on a financial statement was not reasonable. See In re Duncan, 35 B.R. 323 (W.D. Ky. 1983). Likewise, see In re Whitehouse, 26 B.R. 239 (W.D. Ky. 1982) to again show how a bank failed to show reasonable reliance. The author would also refer the reader to the case of In re Perez, 52 B.R. 824 (W.D. Ky. 1985) and In re Peterson, 49 B.R. 1 (W.D. Ky. 1984).
While not a case out of the Western District or Sixth Circuit, recommended reading would be the case of In re Rickey, 8 B.R. 860 (M.D. Fl. 1981). As stated above, "intent to deceive" is probably the most difficult element to prove when trying to make a case under §523(a)(2)(B). The Rickey Court held that intent can be shown by:

1. False statement made by the debtor with actual knowledge it was false,
2. Made with reckless indifference to the truth,
3. Made by the debtor without checking sources readily available to him,
4. Made without reasonable grounds to believe it was true.

This sentiment is echoed in the Knoxville Teachers Credit Union v. Parkey case, supra.

D. Unjustified 523(a)(2) Claims

Creditors should not loosely file cases under §523(a)(2). §523(d) does allow a consumer debtor to petition the Court for costs and reasonable attorney fees from a creditor if that creditor files an action under §523(a)(2) and loses. To do so, the Court must show that the creditor’s position was not substantially justified unless special circumstances exist that would make the award unjust. See In re Carmen, 723 F.2d 16 (6th Cir. 1983).

This is why the author advocates taking a Bankruptcy Rule 2004 exam prior to the filing of a suit. The evidence adduced at that examination will determine whether your lawsuit is viable. As long as the creditor feels, after that examination, that its position would be substantially justified, an award under §523(d) should not be forthcoming. Unless such an examination is performed or deposition taken, a creditor may find the insult of defeat compounded by the injury of an award of attorney fees and costs against it.

E. §523(a)(6) Willful And Malicious Injury [Conversion; Assault and Battery; Breach of Contract]

11 USC Section 523(a)(6) provides as follows:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt —

(6) for willful and malicious injury by the debtor to another entity or to the property of another entity.

A cause of action under this Bankruptcy Code section usually entails the debtor’s conversion of property given as collateral on a creditor’s loan. A small primer on secured transactions (Article 9 of the Uniform Commercial Code) is appropriate at this juncture.

Remember that perfection of a security interest is a notice provision only. In other words, the security interest is still valid as between the creditor and the debtor. Lack of perfection affects third parties only. A Trustee in bankruptcy, a bona fide purchaser for value or an intervening lien creditor may have rights superior to the unperfected lien creditor. However, the creditor’s rights are still superior to the debtor’s. This lack of perfection does not invalidate this separate contract (a security agreement) between the debtor and creditor that the property will stand as collateral for the loan.
If a debtor sells a creditor's collateral in derogation of a security agreement, what is the measure of damages? The answer in the Western District of Kentucky seems to be the value of the property so converted. See In re Thomas, 36 B.R. 851 (W.D. Ky. 1984) [value of automobile converted]; and In re Stevens, 26 B.R. 389 (W.D. Ky. 1983) [sum for which property was sold].

However, there is another case holding that the entire amount of the debt, not just the value of the collateral converted, is the measure of damages. See Birmingham Trust Nat'l Bank v. Case, 755 F.2d 1474 (11th Cir. 1985). Since the Birmingham Trust case was decided after these two cases from the Western District, the issue of the measure of damages may need to be revisited.

In order to sustain a case under §523(a)(6), a creditor must prove that the injury was both "willful" and "malicious". Willful has been defined as deliberate and intentional. See In re Thomas, supra at 853; Wheeler v. Laundani, 783 F.2d 610 (6th Cir. 1986); and In re Bex, 143 B.R. 835 (E.D. Ky. 1992).

Kawaauhau v. Geiger, 523 U.S. 57, 118 S.Ct. 974, 140 L. Ed 2d 90 (1998) has changed the landscape for "willful and malicious" because the proof must establish that the actor "desires to cause the consequences of his act, or ... believes that the consequences are substantially certain to result from it." In Geiger the court held that a medical malpractice judgment based upon negligent or reckless conduct could not be the basis for a §523(a)(6) nondischargeable debt. The Eighth Circuit held that the debtor cannot just intend to do the act but must also intend the consequences of the act and the Supreme Court affirmed.


The ability to sustain a case under §523(a)(6) is very fact-intensive. For instance, in In re Hawkins, supra, the Court found no malice since the debtor gave the creditor $188 of the $300 actually received for the sale of the car. The debt was allowed to be discharged.

The most recent Sixth Circuit case is that of In re Markowitz, 190 F.3d 455 (6th Cir. 1999). Neither the jury verdict for legal malpractice nor the state court’s refusal to submit a special interrogatory has collateral estoppel effect. Plaintiff obtained a prepetition legal malpractice judgment against the debtor for negligence. Collateral estoppel is applicable if "(1) the law of collateral estoppel in the state in which the issue was litigated would preclude relitigation of such issue, and (2) the issue was fully and fairly litigated in state court." Michigan law uses collateral estoppel when "the prior proceeding culminated in a valid, final judgment and the issue was actually litigated and necessarily determined... An issue is actually litigated if it is put into issue by the pleadings, submitted to the trier of fact and determined by the trier of fact... The jury verdict did not actually decide the issue of willful and malicious injury; it was not actually litigated." (Emphasis added). The more important use of Markowitz is its new definition of "willful and malicious" taken from Geiger, supra, to require "the actor desires to cause consequences of his act, or ... believes that the consequences are substantially certain to result from it". The court declared that Perkins v. Scharffe, 817 F.2d 455 (6th Cir. 1987) was overruled by the Supreme Court in Kawaauhau v. Geiger, 523 U.S. 57, 118 S.Ct. 974, 140 L.Ed2d 90 (1998). The court sent back a judgment against an attorney as not establishing willful and malicious injury even though the attorney had admitted that he knew that failure to file an answer would result in a default judgment.

However, in Abbo v. Rossi, McCrerey & Assoc. (In re Abbo), 168 F.3d (6th Cir. 1999) the court found that a malicious prosecution judgment established "willful and malicious" injury for
§523(a)(6). The jury verdict had required a finding that the defendant had acted "maliciously".

Spring Works, Inc. v. Sarff (In re Sarff), 242 B.R. 620 (B.A.P. 6th Cir. 2000) held that a state court judgment for breach of covenant not to compete, breach of contract, breach of duty of loyalty, misappropriation of trade secrets and intentional interference with business relations is nondischargeable under 523(a)(6). The debtor was found guilty of intending to cause injury by taking customers from former employer. Reliance on advice of counsel can be a defense to 523(a)(6) action but the reliance must be reasonable. Continuing to violate an injunction on advice of counsel, did not allow an escape for the debtor.

In re Crump, 247 B.R. 1 (Bankr. W.D. Ky. 2000) granted debtor relief because his failure to remit proceeds generated from the sale of crop in which creditor had a security interest did not establish any intent to cause injury to the creditor. Instead, the court found that the debtor's use of the funds in the farming operation constituted his attempt to keep the business going so the debt could be repaid.

In the case of In re Cline, 52 B.R. 301 (W.D. Ky. 1985), the creditor was found to have expressly or impliedly consented to the sale of the livestock. Since the creditor was charged with this knowledge, there could be no malice since the creditor could not show that the debtor intended to do harm. This debt was allowed to be discharged. For other cases involving cattle, see In re Brame, 23 B.R. 196 (W.D. Ky. 1982), and In re Vance, 43 B.R. 99 (W.D. Ky. 1984).

In re Duncan, 30 B.R. 754 (W.D. Ky. 1983) dealt with another livestock situation. There, a creditor's loan was secured by a corn crop. The debtor used this corn to feed hogs which stood as security for another creditor's loan. The Court allowed this debt to be discharged because the debtor received no pecuniary gain from the "conversion".

The author questions the holding that there was no "pecuniary gain" since the hogs had obviously been "improved" by the use of the feed and the eventual sale of the hogs. Perhaps that may lead to some suit between the respective secured creditors under a quantum meruit theory of law. Perhaps the creditor who had the security interest in the corn could sustain such a suit against the debtor. Reliance upon §523(a)(6) should not be blind. Common law theories such as quantum meruit are valid in these instances.

An adjudication of such willful and malicious injury by the debtor to another entity or to the property of another entity may have been litigated previously and decided in state court. The party prevailing in state court may be able to plead collateral estoppel to any adversary proceeding filed in the Bankruptcy Court. See In re Stillwell, 96 B.R. 102 (W.D. Ky. 1988), and In re Davis, 23 B.R. 633 (W.D. Ky. 1982), both dealing with civil rights judgments.

There is also a line of cases dealing with assault and battery. See In re Kirby, 167 B.R. 91 (E.D. Ky. 1994) [no collateral estoppel effect given to default judgment entered in state court] See also, Spillman v. Harley, 572 F.2d 224 (6th Cir. 1981); In re Bishop, 55 B.R. 687 (W.D. Ky. 1985) [damage sustained by a creditor after being struck in head with hammer by debtor held nondischargeable. See the cases cited at page 688 of that decision]; In re Beach, 39 B.R. 56 (W.D. Ky. 1984) [damages sustained by a waitress shot in bar fight held nondischargeable. See footnote 1 at page 56 of that decision for other cases]; In re Thompson, 39 B.R. 270 (W.D. Ky. 1984) [since no punitive damages were awarded in state court, the Court did not allow collateral estoppel and allowed the debt to be discharged]. Compare In re Cooney, 8 B.R. 76 (W.D. Ky. 1980) [where debt held nondischargeable with no award of punitive damages].

The case of In re Daniels, 130 B.R. 239 (E.D. Ky. 1991) dealt with a reclamation obligation.
There, the Court held that obligations requiring an expenditure of money by the creditor were dischargeable. However, damages occasioned by illegal surface coal mining activities were nondischargeable.

The case of *In re Druen*, 121 B.R. 509 (W.D. Ky. 1990) deals with the issue of lapsed automobile insurance. There, the Court held that while a knowing failure to secure automobile insurance could be determined willful, it was not malicious so the debt was allowed to be discharged. For those of you with under age drivers, you can rest easy knowing that if your insurance lapses or is not in effect and your child causes injury to a third party, you can file bankruptcy and the injured party cannot use §523(a)(6) to attempt to declare the debt nondischargeable as to you. *In re Bex*, 143 B.R. 835 (Bankr. E.D. Ky. 1992).

However, the author would remind the reader that any damages resulting from death or personal injury caused by the debtor's operation of a motor vehicle while intoxicated gives rise to a cause of action under §523(a)(9). Unlike causes of action under §523(a)(6), causes of action under (a)(9) are per se nondischargeable. *See also, In re Bex*, 143 B.R. 835 (E.D. Ky. 1992) which again found that lack of insurance did not rise to the level of being willful so the debt was allowed to be discharged.

For miscellaneous other causes of action under §523(a)(6), *see In re Smith*, 95 B.R. 473 (W.D. Ky. 1988) [state court jury instruction focused on a "wanton and reckless", not "willful and malicious" standard]; *In re Howard*, 946 F.2d 1226 (6th Cir. 1991) [since guarantor personally participated in conversion, debt held nondischargeable] and *In re Stevens*, 26 B.R. 389 (W.D. Ky. 1983) [sale of musical instruments].

The key in any case filed under §523(a)(6) is to focus on the direction given in the cases cited above to establish that the injury is "willful and malicious". Bringing your cause of action within the ambit of these definitions is critical.


"... for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, ... not for compensation of actual pecuniary loss, other than tax penalty ...."

*In re Maxwell*, 229 B.R. 400 (Bankr. W.D. Ky. 1998) held costs incurred for debtor's incarceration are nondischargeable under §523(a)(7).

*In re Ray*, 240 B.R. 260 (Bankr. W.D. Ky. 1999) held restitution adjudged as condition for probation would be nondischargeable under §523(a)(7) even though payable to the victim in amount of damages suffered by the victim ($1800 property damage on charge of wanton endangerment). Court said that *Kelly v. Robinson*, 479 U.S. 36 (1986) mandates that "any condition a state criminal court imposes as part of a criminal sentence" is nondischargeable under 523 (a)(7).

G. §523(a)(8) - Student Loans

11 USC Section 523(a)(8) provides as follows:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt

(8) for an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit or made under any program
funded in whole or in part by a governmental unit or a nonprofit institution, or for an obligation to repay funds received as an educational benefit, scholarship or stipend, unless excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents.

Note: Effective for all cases filed after October 8, 1998, there is no longer a period of time after which the debt can be discharged. For cases filed before October 8, 1998, a student loan could be discharged if consolidated loan first became due more than seven years before filing of bankruptcy. Debtor argued 7 year period should run from date on which original loan matured. Rudnicki v. Southern College of Optometry (In re Rudnicki), 28 B.R. 179 (B.A.P. 6th Cir. 1999)

Unlike the other causes of action discussed to this point, this is an Adversary Proceeding filed by the debtor seeking to discharge a student loan. Unless the debtor moves to have the student loan debt declared dischargeable, it is per se nondischargeable.

Since it is the debtor seeking the relief in the Adversary Proceeding, the burden of proof here is on the debtor. See B.R. 4005. The standard of the burden of proof is by the preponderance of the evidence. See Grogan v. Garner, supra.

In order to sustain his burden of proof, the debtor must show that requiring the debtor to pay this obligation will impose an undue hardship on the debtor or the debtor's dependents.

Note also that the debtor must show that this is an educational loan (a) insured or guaranteed by a governmental unit, or (b) made under a program funded by a governmental unit or nonprofit institution. The definition of nonprofit institution is a subject of discussion when it comes to credit unions.

There was an apparent split of authority over whether a credit union was a "nonprofit organization" and thus whether student loans made by it would enjoy the protection of §523(a)(8). The case of In re Roberts, 149 B.R. 547 (C.D. Ill. 1993) found credit unions to be nonprofit organizations. Two other cases that should be examined are the In re Sinclair-Ganos, 133 B.R. 382 (Bankr. W.D. Mich. 1991) and In re Simmons, 1995 B.R. 624 (Bankr. E.D. Va. 1994), which are both cited in the Roberts opinion.

Coming to the same holding, i.e., student loans made by credit unions enjoy the protections under §523(a)(8), but by a different means, is the case of TJ Federal Credit Union v. Delbonis, 72 F.2d 921 (1st Cir. 1995). Here, the Court found not that the credit union was a nonprofit organization, but was a governmental unit. Note that this holding applies to federal credit unions, only.

Given the apparent split in the Circuits on the issue of what constitutes a "nonprofit organization", the author surmises that this battle will rage on.


The seminal case on student loans from the Western District of Kentucky is In re Berthiaume, 138 B.R. 516 (W.D. Ky. 1992). The Berthiaume Court examined the dischargeability of a student loan under a tripartite test: (1) the mechanical test, (2) the good faith test, and (3) the policy test.

The mechanical test examines whether the debtor's financial resources in the foreseeable future are sufficient to allow the debtor to live at a subsistence level while repaying the student loan.
Pursuant to Berthiaume, the foreseeable future is 10 years. The debtor must show that his financial condition will not improve over the next 10 years in order to allow some small payment to the creditor.

"Subsistence level" is usually equated with the poverty level. Poverty level statistics for a given year can be obtained in the Federal Register. For current figures, you may contact the Federal Information Center at (800) 688-9889 or try the Department of Health and Human Services at (202) 690-6141.

The "good faith test" examines whether the debtor has made a bona fide attempt to find a good-paying job, maximize financial resources and minimize expenses. This should be a point of inquiry by a student loan creditor at the discovery level, both in the form of a Request for Production of Documents and questions to be asked at a Rule 2004 exam or a deposition. The debtor should be examined concerning the Schedules I and J filed with the petition concerning income and expenses. Debtor should also produce copies of any resumes, letters, letters of rejection from potential employers, etc. to sustain the debtor's burden of proof under this test.

Lastly, the "policy test" examines whether the debtor's motivation in filing the bankruptcy was the type of abuse that §523(a)(8)(B) was enacted to prevent. Some of the questions that will be asked by the Court are:

(a) How much time expired between the date the loan was taken and the bankruptcy filed?
(b) How much time expired between when the debtor graduated from school and the bankruptcy was filed?
(c) What percentage of overall debt does the educational loan comprise?
(d) What sort of degree did the debtor get?
(e) What benefit did the debtor derive from the education?

While not specifically made a part of the statute, there seems to be a judicial sentiment that the debtor must have received some benefit from the education. That benefit would include not only the education that the debtor received, i.e., did it make the debtor more employable, but also what assistance the school rendered in helping the debtor find employment.

The author has been involved in several Adversary Proceedings dealing with "trade schools". In those cases where the "trade school" did nothing to make the debtor more employable, nor provided any assistance in order to help the debtor secure employment, the author's "batting average" has been less than enviable.

The "hardship" that must be endured by the debtor is not the "garden variety hardship" or "unpleasantness". Berthiaume at 521. In other words, the Court will require the debtors to "tighten up the purse strings" before they will be afforded the relief sought under §523(a)(8). An examination of the debtor's present financial condition and potential future employability is a requirement for litigation under this Code section. The Berthiaume court did find that while the husband failed to meet the test, his wife's health problems were sufficient to allow her student loans to be discharged.

The case of In re Cheesman, 25 F.3d 356 (6th Cir. 1994), cert. denied, 513 U.S 1081, 115 S.Ct. 731, 130 L.Ed. 2d 634 (1995) allows the Court to be imaginative in crafting its relief. Here,
the Sixth Circuit affirmed the lower Court’s decision to defer final ruling on the dischargeability of the debt for 18 months. This was done to see if the debtor’s circumstances would change and whether undue hardships still existed. It exercised the Court’s equitable powers under §105(a) of the Bankruptcy Code in order to shape this relief.

The latitude evinced by the Sixth Circuit allows the parties to be imaginative in any settlement negotiations. Deferment of payments, "stepped up payments" in recognition of potential increases in income, judicial reexamination of the debtor’s financial condition, etc., are all tools to be used in crafting a settlement of cases filed under §523(a)(8). Options allowed in the following cases:

1. Wait 18 months or 2 years and require the debtor to advise of change of circumstances before the court will rule on the adversary. In re Cheesman, supra.


4. Each loan considered separately for §523(a)(8) purposes. Therefore, bankruptcy court can discharge two loans and declare one loan nondischargeable. In re Andresen, 232 B.R. 127 (B.A.P. 8th Cir. 1999).

5. In re Hornsby, 144 F.3d 433 (6th Cir. 1998) said debtors not entitled to discharge but §105 would allow bankruptcy court to consider some amount less than full amount to be declared dischargeable. Debtors had not minimized expenses, were above poverty level, had $200 per month surplus income, and had never paid the first penny on the $30,000.00 student loans.

H. §523(a)(5) And (15) – Obligations Incident To A Divorce

11 USC Section 523(a)(5) provides as follows:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt —

(5) to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement, but not to the extent that —

(A) such debt is assigned to another entity, voluntarily, by operation of law, or otherwise (other than debts assigned pursuant to section
408(a)(3) of the Social Security Act, or any such
debt which has been assigned to the Federal
Government or to a State or any political
subdivision of such State); or

(B) such debt includes a liability designated as
alimony, maintenance, or support, unless such
liability is actually in the nature of alimony,
maintenance, or support.

In addition, 11 USC Section 523(a)(15) provides as follows:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b)
of this title does not discharge an individual debtor from any debt
— (15) not of the kind described in paragraph (5) that is incurred
by the debtor in the course of a divorce or separation or in
connection with a separation agreement, divorce decree or other
order of a court of record, a determination made in accordance
with State or territorial law by a governmental unit unless —

(A) the debtor does not have the ability to pay such debt from
income or property of the debtor not reasonably necessary
to be expended for the maintenance or support of the
debtor or a dependent of the debtor and, if the debtor is
engaged in a business, for the payment of expenditures
necessary for the continuation, preservation, and operation
of such business; or

(B) discharging such debt would result in a benefit to the
debtor that outweighs the detrimental consequences to a
spouse, former spouse, or child of the debtor.

Code. The Bankruptcy Courts in Kentucky have not been spared from the furor that this section has
caused. For an exhaustive examination of both §523(a)(5) and (a)(15), the author recommends the
excellent article authored by C.R. (Chip) Bowles, former law clerk to the Honorable Judge Henry
Dickinson, Bankruptcy Judge for the Western District of Kentucky. Mr. Bowles analyzes this
situation in his usual replete style and would answer many of the questions merely raised by this
article. It can be found in 34 U.L.J. Fam. L. 521 (1996).

If an obligation incident to a divorce falls under the mantle of §523(a)(5), it is deemed
automatically nondischargeable, that is, no Adversary Proceeding has to be filed. Included in that
genre of obligations are debts to a spouse, former spouse or child of a debtor for:

(a) Alimony to,

(b) Maintenance for,

(c) Support of such spouse or child,

(d) In connection with a Separation Agreement, Divorce Decree or
other Order of a Court of record, or

(e) A Property Settlement Agreement.
Excepted from this group of automatically nondischargeable debts are any debts to the extent that:

(a) The debt is assigned to another entity, voluntarily, by the operation of law or otherwise [unless it is a debt assigned under the Social Security Act, §408(a)(3)] or any debt assigned to the federal government, state or any political subdivision of the state.

In other words, the debt actually has to be in the nature of alimony, maintenance or support. A practice tip to remember when the state comes to collect for medical expenses incurred for the mother and child. In re Lambdin, Adv. 97-6035 (Bankr. E.D. Ky. 1998) held that if the parent was not married to the mother, the state can only collect as a nondischargeable debt the amount of medical expenses incurred for the child and the DNA testing to determine paternity. The mother’s medical expenses are dischargeable. The reader should examine the cases of Fitzgerald v. Fitzgerald, 9 F.3d 517 (6th Cir. 1993) and Long v. Calhoun, 715 F.2d 1103 (6th Cir. 1983) for the tests used to determine whether the debt is in the nature of alimony, maintenance or support.

The author would note that the Calhoun decision does represent the minority view by allowing a Bankruptcy Court to inquire into the party’s changed financial conditions. Other courts, including the Second, Eighth and Eleventh Circuits, have specifically rejected the Calhoun analysis. See Forsdick v. Turgeon, 812 F.2d 801 (2nd Cir. 1987); In re Draper, 7790 F.2d 52 (8th Cir. 1986); and In re Harrell, 754 F.2d 902 (11th Cir. 1985).

Calhoun was further explicated by the holding of the case of In re Fitzgerald, 9 F.3d 517 (6th Cir. 1993). At page 520 of its decision, the Court held that:

The applicability of Calhoun, especially the second step’s "present needs" inquiry, to support obligations other than assumptions of debt have been the source of some confusion in the lower courts of this circuit.

This comment is especially pertinent since the author of the Fitzgerald decision was also the author of the Calhoun decision. Specifically, Judge Kennedy stated, again at page 520 of the decision, that:

The writer regrets that it [Calhoun] has been applied more broadly than intended. Fortunately, a majority of courts in other circuits have rejected the "present needs" test when applied to alimony or child support.

Indeed, this seems to overrule that portion of Calhoun that will go behind the divorce decree. Instead, the Court now seems to focus on the intent of the parties at the time of the divorce, and does not focus on the "present needs" at the time of the filing of the bankruptcy. The "present needs" test has been criticized on many grounds opining that it permits undue federal interference with a state Court’s domestic authority.

Additionally, it has been held that the "present needs" analysis punishes a non-debtor’s spouse who has struggled to become self-supporting. It would result in the discharge of an overwhelming high number of support obligations simply because a non-bankrupt, ex-spouse has become self-reliant by the time of the filing of the bankruptcy petition. At page 521 of the decision, Judge Kennedy states:

Calhoun was not intended to intrude into the state’s traditional authority
over domestic relations and the risk of injustice to the non-debtor spouse or children.

With that being said, the state of the law in the Sixth Circuit is, generally, that if the divorce decree specifically states that the award was for alimony, maintenance or support, the Court should not go behind that finding to challenge the intent of the parties at the time of the filing of the divorce decree. With all that being said, how does that impact §523(a)(15)?

Section 523(a)(15) of the Bankruptcy Code provides that the debtor will not be allowed to discharge debts of the kind described in §523(a)(5) incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other Order of the Court of record unless the debtor can show one of the following:

a. The debtor does not have the ability to pay the debt from income or property of the debtor not reasonably necessary to be expended for the maintenance or support of the debtor or dependent of the debtor. If the debtor is engaged in business, then the debtor must show that paying these debts would endanger the continuation, preservation or operation of such business; or

b. discharging the debt would result in a benefit to the debtor that outweighs the detrimental consequences to the spouse, former spouse or child of the debtor.

1. Case Law: §§523(a)(5) and (15)

In re Sorah, 163 F.3d 397 (6th Cir. 1998) found that a "label such alimony, support or maintenance in the decree or agreement" is one of three "traditional state law indices" which produce a "conclusive presumption" of support and shift the burden of proof.

In re Molino, 225 B.R. 904 (B.A.P. 6th Cir. 1998) "If debtor's standard of living will fall materially below the creditor's standard of living if the debt is not discharged, then the debt should be discharged". Eleven nonexclusive factors to consider. (They are same as in Smither, infra) Ability to pay considers debtor's prior, current and future prospects as well as debtor's voluntary removal of self from the job market or purposeful underemployment. Fact intensive and balance of factors required. Debtor had $48,000 annual income before divorce, now claiming income of $50 to $90 per week. Former spouse paid $22,434 to creditors which was subject to hold harmless clause and debtor could repay over several years on manageable terms. Note the burden of proof that the debt fits §523(a)(15) is on the creditor. But the burden of proof to establish the defenses to dischargeability are on the debtor.

In the case of In re Smither, 194 B.R. 102 (Bankr. W.D. Ky. 1996), Judge Dickinson held that a debtor's obligation to pay his ex-wife's attorney fees was nondischargeable under §523(a)(15) as being in the nature of support. Additionally, the Court held that the equalization of the debtor's marital property obligation was also nondischargeable. Any decision under §523(a)(15) is extremely fact-specific, and the author would refer the reader to this opinion for the details surrounding the Court's holding. Debtor has ability to pay if he can pay "all or a material part ... within a reasonable amount of time." The eleven non-exclusive factors he considered were:

1. Amount of debt, including payment terms
2. Current income of the debtor, objecting creditor and their respective spouses
3. Current expenses of debtor, objecting creditor and their respective spouses
4. Current assets, including exempt assets of the debtor, objecting creditor, and their respective spouses
5. Current liabilities, excluding those discharged by debtor’s bankruptcy, of the debtor, objecting creditor and their respective spouses
6. Health, job skills, training, age and education of the debtor, objecting creditor and their respective spouses
7. Dependents of the debtor, objecting creditor, and their spouses, their ages and any special needs which they may have
8. Any changes in the financial conditions of the debtor and the objecting creditor which may have occurred since the entry of the divorce decree
9. Amount of debt which has been or will be discharged in the bankruptcy
10. Whether creditor is eligible for relief under the Bankruptcy Code

Judge Dickinson’s analysis has been approved in the unpublished decision of the Sixth Circuit, In re Patterson, 132 F.3d 33 (6th Cir. 1997) and in the BAP decision in Molino, supra.

For those in the Eastern District of Kentucky, the Hon. Judge William S. Howard has rendered an opinion in In re Owens, 191 B.R. 669 (Bankr. E.D. Ky., 1996). Here, the Court held that the debtor was required to continue making payments on a loan for a motor vehicle driven by the former spouse as discharging the same would result in a benefit to the debtor that would outweigh the detrimental consequences to the spouse.

Note however that the court held that a debtor’s obligation under a property settlement agreement to pay debts on a note did not come within the discharge exception given the absence of hold-harmless language. This sentiment is common amongst other Courts in examining the situation of the hold-harmless language. See also, In re Richardson, 212 B.R. 842 (Bankr. E.D. Ky. 1997) where court found that debt to debtor’s ex-spouse’s mother was dischargeable because there was no hold harmless language.

It is interesting to note that in determining whether the debtor had the ability to pay debts owed to his ex-spouse, the Court in Owens would not consider payments being made by the debtor on a note secured by the residence of the debtor’s mother. The Court held that these payments were not reasonably necessary to be expended for maintenance or support of the debtor or debtor’s dependent and therefore could not be considered in determining whether the debtor lacked the ability
to pay such debts from his own income or property. Attorneys filing §523(a)(15) cases in the Eastern District of Kentucky are advised to read In re Owens as the Court’s analysis under the case is very complete and well-written.

In re Milburn, 218 B.R. 862 (Bankr. W.D. Ky. 1998) provides an example of how not to litigate in state court and expect to come to bankruptcy court and re-litigate. If the ex-spouse attempts to litigate in state court over a debt that the debtor believes was discharged, the debtor must immediately remove the matter to the bankruptcy court.

A very recent decision, In re Romer, 254 B.R. 207 (Bankr. N.D. Ohio 2000), determined that the ability to pay would not include consideration of the funds the debtor was spending to support his live in girlfriend nor the funds he was spending on his adult children.

In a decision by a district court, In re Cameron, 243 B.R. 117 (M.D.Ala. 1999), the court determined that the bankruptcy judge should not consider the IRS guidelines for expenses in determining ability to pay, but instead should use the actual expenses, to the extent they were reasonably necessary and make that determination as of the time of trial. The court suggested the chapter 13 "disposable income" analysis would work well in this context.

I. The Automatic Stay And §523 Judgment Collection

One last aside. The Sixth Circuit held in the case of In re Embry, 10 F 3d 401 (6th Cir. 1993) that it is not necessary for a creditor to seek relief from the §362 Automatic Stay to pursue collection of a judgment entered in a nondischargeability suit pursuant to §523. A determination by the court that the debt is nondischargeable terminates the stay as to that particular debt. This allows a creditor to begin collection actions immediately.

IV. 11 U.S.C. §727 - DENIAL OF DISCHARGE

11 USC Section 727(a) provides as follows:

(a) The court shall grant the debtor a discharge, unless —

(1) the debtor is not an individual;

(2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title [11 USCA Sections 101 et seq.], has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed —

(A) property of the debtor, within one year before the date of the filing of the petition; or

(B) property of the estate, after the date of the filing of the petition;

(3) the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information,
including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case;

(4) the debtor knowingly and fraudulently, in connection with the case —

(A) made a false oath or account;
(B) presented or used a false claim;
(C) gave, offered, received, or attempted to obtain money, property, or advantage, or a promise of money, property, or advantage, for acting or forbearing to act; or
(D) withheld from an officer of the estate entitled to possession under this title [11 USCS Sections 101 et seq.], any recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs;

(5) the debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities;

(6) the debtor has refused, in the case —

(A) to obey any lawful order of the court, other than an order to respond to a material question or to testify;
(B) on the ground of privilege against self-incrimination, to respond to a material question approved by the court or to testify, after the debtor has been granted immunity with respect to the matter concerning which such privilege was invoked; or
(C) on a ground other than the properly invoked privilege against self-incrimination, to respond to a material question approved by the court or to testify;

(7) the debtor has committed any act specified in paragraph (2), (3), (4), (5), or (6) of this subsection, on or within one year before the date of the filing of the petition, or during the case, in connection with another case, under this title [11 USCA Sections 101 et seq.] or under the Bankruptcy Act, concerning an insider;

(8) the debtor has been granted a discharge under this section, under section 1141 of this title [11 USCS Section 1141],
or under section 14, 371, or 476 of the Bankruptcy Act, in a case commenced within six years before the date of the filing of the petition;

(9) the debtor has been granted a discharge under section 1228 or 1328 of this title or under 660 or 661 of the Bankruptcy Act [11 USCS Sections 1060, 1061], in a case commenced within six years before the date of the filing of the petition, unless payments under the plan in such case totaled at least —

(A) 100 percent of the allowed unsecured claims in such case; or

(B) (i) 70 percent of such claims; and
(ii) the plan was proposed by the debtor in good faith, and was the debtor's best effort; or

(10) the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter.
11 USCS Sections 701 et seq.

An Adversary Proceeding seeking to deny the debtor's discharge must be distinguished from an attempt to dismiss the debtor's bankruptcy petition, in its entirety, under §707. Dismissals under §707 cannot be at the request or suggestion of a creditor. 11 U.S.C. §707(5). Additionally, the legal grounds for these two Code provisions are quite different.

Dismissal of the case is like the petition was never filed at all. Denial of the debtor's discharge, while not dismissing the case, robs the debtor of the ultimate relief that he sought, that is, relief from his non-reaffirmed obligations.

Likewise, an Adversary Proceeding filed under §727 of the Bankruptcy Code is different from an Adversary Proceeding filed under §523. Remember, an Adversary Proceeding filed under §523 seeks to except an individual debt from discharge. Cases filed under §727 seek to deny discharge of all debts, and therefore is a case to the benefit of all creditors.

Also, unlike cases under §523, cases under §727 cannot be settled easily. If the debtor is guilty of actions that give rise to a complaint under §727, then the discharge should be denied and no single creditor should be allowed to capitalize on that knowledge. Bankr. R. 7041 provides judicial oversight for the plaintiff's dismissal of a complaint to deny the discharge. There must be notice to the U.S. Trustee and the chapter 7 trustee and the court can condition a dismissal on such terms and conditions as it deems proper. Those terms do not deny the court the ability to allow compromises of claims made in an adversary proceeding to deny the debtor's discharge but they do allow additional judicial oversight to prevent "sale of the discharge". In these circumstances, the courts have allowed other creditors to pursue the denial of the discharge if the creditor who brought the action is no longer interested in pursuing it. The lesson is do not file an Adversary Proceeding under §727 unless you are willing to take it all the way through trial and that you have a case that falls in one of the 10 enumerated grounds for denying discharge under §727(a).
To improperly use a discharge complaint to coerce a settlement on a §523 claim could be considered in violation of 18 U.S.C. §152. It is a bankruptcy crime to knowingly and fraudulently give, offer, receive, attempt to obtain any money or property, remuneration, compensation, reward, advantage or promise thereof for acting or forbearing to act in any case under title 11.

A. Case Law: §727

Despite the rarity of §727 actions, there is some case law authority to give the practitioner guidance in the event that a creditor wishes to pursue this avenue of relief. In re Adams, 31 F.3d 389 (6th Cir. 1994) involved a transfer of accounts receivable which served as collateral for a creditor's loan. The debtor transferred the accounts receivable into a corporation's operating account rather than into the creditor's dominion account. The monies were then used to pay other suppliers.

The Court denied discharge since the debtor attempted to defraud a creditor by transferring property of the debtor within one year before the date of the filing of a bankruptcy petition. If it had been done postpetition, it would also qualify for denial of discharge under §727(a)(2)(B).

The Adams case also stands for the proposition that the standard of proof of §727 actions is by a preponderance of the evidence.

In re Keeney, 227 F.3d 679 (6th Cir. 2000) is a case of Judge Howard's from the Eastern District in which the debtor purchased property over many years and titled it in his parents' names. He was attempting to avoid payment of a personal injury judgment. Although the debtor made the purchases outside the relevant statutes of limitation the court used the "continuing concealment" doctrine to find that the concealment continued into the one year limit set by 727(a)(2)(A). His discharge was denied under both 727(a)(2)(A) and 727(a)(4). Note that the creditor whose judgment was being hindered was no longer collectible because the statute of limitations had expired. The Sixth Circuit expressly adopted the "continuing concealment" doctrine and noted that denial of discharge does not require proof of harm. Complete financial disclosure is required by the Bankruptcy Code to obtain the discharge.

Interesting reading is the case of In re Krohn, 886 F.2d 123 (6th Cir. 1989). Here, the Court actually dismissed a case where the Court found that the debtor had sufficient future income. The Sixth Circuit opined that the petitioner's seeking relief under the Bankruptcy Code was an abuse of the "fresh start" theory that permeates the Bankruptcy Code. The lavish lifestyle and other excesses evidenced by the debtor postpetition further demonstrated the abuse that §727 was initiated to deter.

Examples from the Western District of Kentucky under §727(a)(2) are In re Terrell, 114 B.R. 907 (W.D. Ky. 1989) [ex-husband's transfer of vehicles to then-girlfriend {now wife} held insufficient to deny discharge. NOTE: that the Court used the clear and convincing standard. See In re Adams, supra; In re Yokley, 61 B.R. 198 (W.D. Ky. 1986) [four large withdrawals of money within three months of filing held to be transfer of property of the debtor with an intent to defraud the creditor]; In re Lineberry, 55 B.R. 510 (W.D. Ky. 1985) [debtor's failure to list one investment account insufficient to deny discharge when debtor's ex-wife admitted she was aware of the account. This case also examines §727(a)(3), (4) and (5)]; In re Hargis, 50 B.R. 698 (W.D. Ky. 1985) [debtor concealed that his wife was a partner in partnership and the wife held partnership assets. Discharge denied. See also, 44 B.R. 225 (W.D. Ky. 1984)].

Section 727(a)(3) requires the debtor to keep and preserve records from which his financial affairs can be understood. In re Scott, 172 F.3d 959 (7th Cir. 1999) involved a debtor with 435 boxes
of documents which "effectively concealed" the financial maze created by the debtor’s interrelated entities. The Code places the burden on the debtor to create books and records accurately documenting his business affairs. In re Strbac, 235 B.R. 896 (B.A.P. 6th Cir. 1999) denied debtor’s discharge on summary judgment because debtor owned two unincorporated businesses whose records he "kept in his head". No tax returns were provided, and not one piece of paper relating to financial activities. Case by case analysis considering debtor’s occupation, financial structure, education, experience, sophistication and any other factors which should be considered in the interest of justice.

Section 727(a)(4)(A) requires no knowing and fraudulent false oaths. In re Hamo, 233 B.R. 718 (B.A.P. 6th Cir. 1999) Debtor discharge denied when he did not reveal that he was president of a company that bought and sold nine pieces of real estate including 1 just 2 days before bankruptcy; did not list $50,000 personal injury claim, and did not disclose $62,304.00 judgment against another company. Standard requires proof of:

1. Debtor made a statement under oath
2. Statement was false
3. Statement related materially to the bankruptcy case (fact is material if it concerns discovery of assets, business dealings or existence or disposition of property)
4. Debtor knew statement was false
5. Debtor made statement with fraudulent intent. Intent determined from course of conduct of debtor.

Another detailed case discussing the requirements of §727(a)(4)(A) is In re Schultz, 2000 WL 575505 (Bankr. N.D. Oh.). See also In re Keeney, 227 F.3d 679 (6th Cir. 2000).

The other options for §727(a)(4) include the knowing and fraudulent withholding of recorded information from the trustee, presenting or using a false claim or giving offering, receiving, or attempting to obtain money, property or advantage or a promise of money, property or advantage, for acting or forbearing to act.

Quite commonly, the debtor cannot explain a loss of assets. This falls under §727(a)(5) of the Bankruptcy Code. Example of cases litigated under that section are as follows: In re Dolin, 799 F.2d 251 (6th Cir. 1986) [debtor testified that the loss of assets were due to his expenditures for cocaine and gambling addictions. Held: insufficient to overcome presumption and discharge denied. This case also addresses §727(a)(3) concerning failure to keep records]; In re Yokley, 61 B.R. 198 (W.D. Ky. 1986) [debtor was unable to document what two large withdrawals within three months of the filing of the bankruptcy petition were used for. Held: discharge denied]; In re Schermer, 59 B.R. 924 (W.D. Ky. 1986) [the debtor was unable to explain the disappearance of $26,000 in cash, inventories and receivables within two months of the filing of the bankruptcy petition. Held: discharge denied].

The trustee is most likely to use §727(a)(6) "failure to comply with a lawful order of the court" to obtain assets which were to be turned over and then when the asset is not provided, the discharge is denied.
Section 727(a)(7) permits denial of the discharge when the debtor has committed any act specified in paragraph (2), (3), (4), (5), or (6) of this subsection, on or within one year before the date of the filing of the petition, or during the case, in connection with another case, under this title [11 USCA Sections 101 et seq.] or under the Bankruptcy Act, concerning an insider. That is helpful when the debtor as a corporate officer has not complied with the standards in the corporate case and then files a personal bankruptcy. See In re Adams, 31 F.3d 389 (6th Cir. 1994). In re Dolin, 799 F.3d 251 (6th Cir. 1986). In re Barman, 237 B.R. 342 (Bankr. E. D. Mich. 1999).

Seeking a denial of the debtor’s discharge under §727 is an all-or-nothing proposition. Given the severity of the relief requested, creditors should seek this as a last resort and only when they are willing to commit the resources necessary to take a case of this type all the way through litigation.

V. PRACTICE TIPS

Listed below are some practice tips used by the author’s firm found to be very successful in litigation under §523 and §727. The tips are in no particular order and are simply offered as an aid to the practitioner.

A. Rule 2004 Exams

Bankruptcy Code 2004 allows you to examine the debtor much like the taking of a deposition. As had been suggested in this chapter, this exam should be performed prior to the filing of an Adversary Proceeding or a complaint seeking to deny the debtor’s discharge. Not only will this allow the creditor to evaluate the case, but may insulate a creditor from an attorney’s fee demand under §523(d).

Bankruptcy Rule 7030 and Federal Rule of Civil Procedure 30(b)(4) allow for the taking of a deposition or Rule 2004 exam by non-stenographic means. This author takes the 2004 exams by video tape. This can be done by agreement or Order of the Court. The only expense involved is the cost of the tape and an initial investment of portable video equipment.

The author has found that this procedure provides the creditor’s counsel with a psychological advantage. It is suggested that the television being used as the monitor be positioned so that the debtor can see himself. Many psychological studies have found that a person is much less likely to lie if they can see their own face. The debtor is then caught within the conflict of watching himself lie or tell the truth. This psychological pressure often results in more truthful testimony.

Conduct a deposition or examination as if it will have to be transcribed. Many courts are not set up to play video. Even if they are, some judges may not be willing to use them. Additionally, opposing counsel may request a transcription of the testimony for use at trial. Using tape to impeach a witness can be cumbersome.

Make sure that all objections are properly preserved for the record. It is also suggested that the practitioner have a backup source in the form of an audio tape. That way, if the videotape were somehow destroyed prior to the transcription being made, there would be a record of the exam.

Practitioners are advised to observe all of the usual strictures of a deposition such as the swearing-in of the witness, identification of the parties and the like. This is often explicated in the
Order to take the 2004 exam itself.

B. The Subpoena Duces Tecum

In taking a Rule 2004 exam or deposition, the use of a *subpoena duces tecum* is highly recommended. Items to request under the subpoena are discussed below.

1. Checking and Savings Account Records

First, ask for checking and savings account statements and canceled checks for the last 12 to 24 months, looking for preferential or fraudulent transfers. These transfers could be to family, friends, business partners, relatives, creditors, or simply unexplained transfers of money.

The practitioner should also check for extravagant expenditures, especially postpetition. This can be very valuable in a case filed under §523(a)(8) where the debtor is claiming an undue hardship. If the debtor is able to afford luxuries postpetition, then it is unlikely that he or she will be able to convince the Court that the payment of the student loan obligation will work an undue hardship.

If the case was filed under §523(a)(2)(A), the checking account could show that the debtor was using cash advances to support a luxurious lifestyle or simply to pay other creditors. It is amazing how often debtors will take multiple cash advances very shortly before the filing of the bankruptcy petition and deposit that money into the checking account. Possession of these checks and bank statements could show the flow of those funds.

A review of the checking and savings account records can also provide evidence of possible conversion. If collateral was sold, many times the proceeds from the sale will be placed into one of these accounts. Review of the records reveals where the money went, and what it was used for.

Other proceeds, such as insurance proceeds not turned over to a creditor find their way into these accounts. If they were transferred to third parties for "safekeeping" or used for something other than car repairs, the checking account may prove to be the key in a case.

Many times, such proceeds are used to purchase other exemptible assets. Equivalent to "bankruptcy planning for the indigent", such evidence can be used to show fraudulent intent and may convince the Court to impress an equitable lien on the property. A transcript of the deposition or copy of the tape given to the Trustee may give rise to a fraudulent transfer action under §548 of the Bankruptcy Code or a preferential transfer under §547.

2. Policies of Property Insurance and Riders

This practitioner often requests policies of property insurance and riders on homeowners' insurance policies. Quite often, this reveals valuable assets either not scheduled or undervalued on the debtor's schedule.

Most homeowners' insurance policies do not cover items such as jewelry, antiques, furs, oriental rugs or the like. They are often covered by separate riders. Many times this will provide the "persuasion" needed to convince the debtors that they should settle the case.

C. Use of Written Discovery

If the practitioner has already filed an Adversary Proceeding and is preparing to take a
deposition in the matter, the use of written discovery should be considered. Responses to written discovery provides a background to the case and will aid in formulating questions to be asked at the upcoming deposition. Similarly, the use of Requests For Production will often provide materials to review in advance of the deposition. Finally, documents and written responses received in response to written discovery may lead to a request for additional and different documents at the deposition via the subpoena duces tecum.

The use of written discovery will many times yield facts unknown to even the debtor's counsel. Providing evidence to the debtor's counsel that his or her client has not been forthcoming may provide an avenue for potential settlement of the matter.

D. Settlement Document

If an Adversary Proceeding has been filed, this author often enters into an Agreed Judgment.

The Judgment should declare that the debt is not discharged. Be specific as to what Bankruptcy Code section led to the Judgment as this may have an impact if the debtor files for relief under the Bankruptcy Code at a future date. This could be considered res judicata or collateral estoppel in state court proceedings as well.

The creditor should also seek a personal judgment against the debtor for the monies due and owing. If the debtor later defaults, the Agreed Judgment could be "localized" by filing suit on the judgment in state or federal court and initiating proceedings supplemental to collect the debt.

If an Adversary Proceeding has not been filed, the creditor should use a combination of a Reaffirmation Agreement and Agreed Order extending time to file a nondischargeability suit.

Recall that the debtor has sixty (60) days from the filing of the Reaffirmation Agreement with the Court, or entry of the Discharge Order within which to rescind the Reaffirmation Agreement. The creditor should get an extension of time past that last day so that he does not fall into the "Catch-22" previously described in this chapter.

There are certain disadvantages of not filing an Adversary Proceeding and getting an Agreed Judgment. The Reaffirmation Agreement does not carry the weight of a Judgment. If a debtor reaffirms and then defaults on the Reaffirmation Agreement, it will be necessary to file suit. The basis of the lawsuit will not be the original contract, but the Reaffirmation Agreement. Localizing and collecting on a Judgment is much different than on a Reaffirmation Agreement.

Additionally, with the Reaffirmation Agreement, the creditor does not have a personal judgment. This is why the creditor would have to sue on the Reaffirmation Agreement. One cannot immediately move to execute on the Reaffirmation Agreement and it has no res judicata or collateral estoppel effect.

Obviously, there are some advantages to entering into a Reaffirmation Agreement and extension of time over an Agreed Judgment. It is usually quicker. The Reaffirmation Agreement and Agreed Order can often be negotiated at the first meeting of creditors and the case can be over within a few short days.

Secondly, there is less expense involved in negotiating the Reaffirmation Agreement. You do not have the initial outlay of $150 for the court costs, nor the associated attorney time in the
litigation of the case.

The Reaffirmation Agreement does "revive" the creditor's debt. That is, the debt survives discharge and can be collected postpetition. Much like an Agreed Judgment, the terms of repayment can be spelled-out in the Reaffirmation Agreement.

VI. CONCLUSION

This has been only a brief examination of common Adversary Proceedings filed both for the discharge of an individual debt and Adversary Proceedings seeking to deny the debtor's discharge. Each case must turn on its own facts and a rereading of the Bankruptcy Code is always suggested prior to the filing of any Adversary Proceeding.
REPRESENTING DEBTORS IN CHAPTER 13 CASES

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SECTION G
# REPRESENTING DEBTORS IN CHAPTER 13 CASES

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VI. CHAPTER 13 ISSUES - 2000

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A. WHY CHAPTER 13? WHEN TO CONSIDER CHAPTER 13 AS AN ALTERNATIVE TO CHAPTER 7

1. Definition. A Chapter 13 case is one of several remedies available to individual debtors who have a regular income and a limited amount of debt.

2. Alternatives. An individual debtor may file a Chapter 7 liquidation, Chapter 11 reorganization, a Chapter 12 farmer’s plan or a Chapter 13 wage earner’s plan.

3. Purpose of Chapter 13. The debtor is obligated to propose a wage earner plan that proposes payments out of the debtor’s future earnings to a Chapter 13 Trustee who will in turn pay those payments to the debtor’s creditors in the order of priority fixed either by the plan, the Code or the Court, thus paying the creditors either in full or in part.

4. Reason for Filing a Chapter 13. If the debtor has assets that would otherwise be lost in a Chapter 7 liquidation bankruptcy, he should file a Chapter 13 if he has future earnings sufficient to pay the creditors more than what they would receive in a Chapter 7 over a period not to exceed sixty months.

5. Lower Cost. A Chapter 13 case is far simpler, less costly and less time consuming than a Chapter 11 case. Different from a Chapter 11 case, a Chapter 13 may
be filed only by the debtor and the plan is approved by the Court without a vote by the creditors if it meets the statutory criteria. Chapter 13 creditors neither may defeat a plan by voting, nor can they propose their own plan. See In the Matter of Workman, 108 B.R. 826 (Bkrtcy. Ga. 1989) and Memphis Bank & Trust v. Whitman, 692 F.2d 427 (6th Cir. 1982).

6. **Broader Discharge Provisions.** Chapter 13 cases also provide a discharge far broader than that available under either Chapter 7 or 11. Under Chapter 13, all debts are discharged except for certain long-term debts; taxes; certain educational loans; debts for death or injury caused while operating a motor vehicle while intoxicated; and criminal restitution awards. Most importantly, the remaining debts which are nondischargeable under Code §523(a) are dischargeable in a Chapter 13. See also, Code §1322(b)(2).

7. **Major Drawbacks to Chapter 13.** The major "drawback" to a Chapter 13 is that a debtor must commit all of his disposable income in plan payments for the plan to be confirmed. This requirement (along with certain other restrictions discussed hereinafter) is the principal limitation on this type of relief under the Code.

B. **REQUIREMENTS OF CHAPTER 13 PLAN - ELIGIBILITY, FEASIBILITY AND GOOD FAITH.**

1. **Debt Eligibility.** Only an individual who has secured debts at the time of filing of $250,000 or less and unsecured debts of $750,000 can file a Chapter 13. The debts must be non-contingent and liquidated to count. Code §109(e) also requires a Chapter 13 debtor to be an individual, not a corporation or partnership.
2. **Good Faith.** Code §1325(a)(3) requires that the plan be filed in good faith with intent to pay off or pay down the debtor's creditors. Although "good faith" is not specifically defined in the Code, courts have interpreted it to mean the ability of the debtor to achieve a confirmed plan.

3. **Feasibility.** Code §1325 authorizes the Court to confirm a plan only if (a) it complies with the provisions of the Code; (b) all fees required by the Code or by the plan to be paid before confirmation have been paid; (c) it is proposed in good faith and not by any means forbidden by law; (d) the value of property to be distributed under the plan on payments are not less than the amounts that would be paid on such claim if the debtor were liquidated under Chapter 7; (e) as to each allowed secured claim provided for by the plan, either the holder of such claim has accepted the plan; the plan provides that the holder of such claim retain the lien securing such claim; the value of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or the debtor surrenders the property securing such claim to such holder; and (f) the debtor will be able to make all payments under the plan and to comply with the plan terms.

4. **Limitations on Confirmation.** If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless the value of the property to be distributed under the plan is not less than the amount of such claim; or the plan provides that all the debtor's projected "disposable income" to be received in the payback period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.
For purposes of Code §1325, "disposable income" means the debtor’s income that is not reasonably necessary for the maintenance or support of the debtor or a dependent of the debtor; and if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation and operation of such business.

C. **HOW TO COMPUTE AND PLAN - PAYING OFF THE CREDITORS.**

1. **Mandatory Provisions of the Plan.** Code §1322(a) sets forth certain provisions of the plan that are mandatory and must be included in the plan.

   (a) **Submission of the debtor’s income to the Trustee.** The plan must provide that all of the debtor’s income or a portion of the debtor’s income necessary to fund the plan must be paid to the Chapter 13 Trustee.

   (b) **Pay all priority claims in full.** The plan must provide for payment in full of all priority claims defined as such under Code §507, such as administrative expenses, taxes, attorneys’ fees and other similar expenses as described therein.

   (c) **Equal treatment for each particular class.** If the plan contains provisions classifying the claims, all claims within each particular class must receive equal treatment.

   (d) **Imposition of mandatory rules under local provisions.** Each judicial district may have its own local rules which may contain other mandatory provisions within that district.

2. **Permissive Provisions of the Plan.** Code § 1322(b) provides that there are certain provisions which may permissively be included in the plan.
(a) Designate classes of unsecured claims. The plan may designate classes of unsecured claims or other classes of claims so long as all the unsecured classes receive equal treatment under the plan and equal treatment within each class. Public Fin. Corp. v. Freeman, 712 F.2d 219 (5th Cir. 1983).

(b) Modify the rights of secured claimants. The plan may modify the rights of the holders of secured claims from the original lending terms or by a write-down under Code §506 to the fair market value of the collateral, except that a claim secured only by the debtor's principal residence may not be modified in any manner. Nobleman v. Amer. Savings Bank, 113 S. Ct. 2106 (1993).

(c) Cure or waive any default. The plan may cure or waive any default. The cure of any default, however, must be provided for in the plan and must be accomplished within a reasonable period of time. "Reasonable" is determined by the Court under the circumstances of the individual case.

(d) Concurrrently pay secured and unsecured creditors. This plan may provide payments to secured and unsecured debts concurrently, even though it would normally provide for payments in the order of the priorities set forth in either the plan or the Code.

(e) Cure defaults on long-term debts. The plan may cure defaults on long-term debts that would otherwise survive the plan term and reinstate provisions of the creditor's debt instruments if those defaults are cured within a "reasonable" time.

(f) Provide for payment of post-petition claims. The plan may contain provisions for the payment of post-petition claims.
(g) Assume, reject or assign executory contracts or unexpired leases. The plan may make provisions for the assumption, rejection or assignment of executory contracts or unexpired leases, subject to the limitations contained in Code §365. In re Ford, 159 B.R. 90 (Bkrtcy. Wash. 1993).

(h) Provide for payment of all or part of claims from property of the estate or property of the debtor. The plan may contain provisions for the payment of all or part of the various claims from either the property of the estate or property of the debtor and can also propose payments made by a third party entity.

(i) Provide for the vesting of property of the estate. The plan may provide for the vesting of property of the estate, either at confirmation or a later time, either in the debtor or another entity. If there is no provision made for the vesting of the property, then the vesting would be controlled by Code §1327(b) which revests the debtor’s assets in the debtor upon confirmation of the plan.

(j) Other provisions not inconsistent with the title. The plan may include any other provision not inconsistent with the Code. Such authorization gives the debtor a wide latitude in formulating plan terms and tailoring those terms to suit the debtor’s individual needs and requirements.

3. Classification of Claims. A plan may contain classes of creditors, some of which or all of which may be paid concurrently pursuant to the terms of the plan, or they may be paid in the order of priority as fixed either in the plan or as provided for in Code §503 and §507.
(a) Administrative claims. The plan may set up a separate class for administrative claims or administrative expenses. The Code describes an "administrative expense" in Code §503(b)(1)(A) as including "the actual common necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case." One such administrative expense would be court costs and the Chapter 13 Trustee's commissions.

(b) Professional fee claims. The plan may also contain a provision for the separate payment of attorneys' fees or other fees incurred by professionals, such as auctioneers, accountants, realtors or engineers as a Code §503(b)(2) expense. Under Code §503(b)(2), compensation and reimbursement may be awarded under Code §330(a)(1) which defines compensation for officers of the Court. Under Code §330(a)(1), the Court may "award to a trustee, an examiner or a professional person employed under §327... (A) reasonable compensation for actual, necessary services rendered by the ... professional person, or attorney and by any paraprofessional person employed by any such person; and (B) reimbursement for actual, necessary expenses." See In re Busy Beaver Building Centers, Inc., 19 F.3d 833 (3rd Cir. 1993). At the time of the filing of the petition, the debtor's attorney of record becomes a "professional person" for purposes of allowance of compensation under the limitations set forth in Code §330.

Many Bankruptcy Courts have placed limitations on Chapter 13 attorneys' fees, limiting them either to a routine case fee or an extraordinary case fee, the former of which is normally a flat fee and the latter of which is a fee allowed by the Court upon
the presentation of the attorney's affidavit containing his time charges and actual expenses incurred. In both cases, an order must be entered allowing the compensation and ordering that the compensation be paid pursuant to the treatment of that particular class set forth in the plan.

Due to the advent of bankruptcy clinics, many courts including Kentucky's have limited attorneys' fees to $600-$750 for "run-of-the-mill garden variety" Chapter 13 cases. If the attorney desires a higher fee allowance, then the attorney must file a fee application, with adequate notice, containing itemized time charges, and obtain court approval for the fee.

(c) Tax claims. Code §503(b)(1)(B) requires the allowance of "any tax" (i) incurred by the estate or any "fine, penalty or reduction in credit relating to a tax, after application, a hearing and entry of an order." Even though taxes are normally non-dischargeable in bankruptcy under Code §523(a), Code §1328(a) provides that a tax claim is discharged at the end of the term of the plan, but Code §1322(a) requires provisions that the tax claims be paid in full as a condition precedent to confirmation. If the debtor defaults later in the plan and obtains what is known as "hardship discharge" under Code §1328(b), then such a discharge would not discharge taxes. This means that the debtor must provide for payment in full of the taxes and successfully complete the plan to obtain the discharge of his taxes.

(d) Cured claims. A cured claims class may be provided for in the plan if its treatment provisions are reasonable and such provisions cure the default within a reasonable time. The cure may be for either a real or personal property claim in
arrears, requiring payments to bring the claim into conformity with the original lending terms. Failure to cure would give the secured creditor a right to relief from the stay and the curing under the plan would preclude the Court from granting such relief. The usual method used by the debtors in their plans is to classify the cure claims and then provide that early distribution payments go to them from the Chapter 13 Trustee until such time as the claims have been brought current. The plan may also contain provisions that the current payments be made by the debtor outside of the Chapter 13 case directly to the creditor.

(e) **Secured claims.** A Chapter 13 plan may make provisions for the payment of a secured claim either through the plan or outside of the plan. If there are mortgage, automobile, or other consumer property installment payments that are owed by the debtor, those payments may be scheduled to be paid outside of the plan and kept current by the debtor to preclude any default caused by delay of payments from the Chapter 13 Trustee to the secured creditor. The debtor’s plan may otherwise provide that payments be made to the Chapter 13 Trustee who in turn would make the payments to the secured creditor. If a secured creditor’s claim is written-down to the value of the collateral pursuant to Code §506(a), the payment normally would be made directly to the trustee who in turn would pay the secured claim to the extent of the fixed value of the collateral and the secured creditor’s deficiency would become a part of the unsecured creditors’ class and treated as such in that class. *Memphis Bank v. Whitman,* supra. Value is either fixed by the plan or, if contested by the creditor, determined by the Court at a valuation. Many courts are hearing valuation on cross-affidavits, with only cross-
examination of the appraisers at the scheduled hearings.

(f) **Unsecured claims.** Unsecured claims are normally treated in one class and provisions are made for payment either (A) in full of that class, or (B) of a percentage of the total of the claims in that class, or (C) of a specific amount to be paid to the creditors in that class regardless of the total amount of the aggregate claims, i.e., a pool plan. Payment in full would be determined by taking the total amount of the unsecured creditors and dividing it by the length of the plan and the resulting sum would approximately equate to the monthly payment to be paid by the debtor either directly or by wage deductions payable by the debtor’s employer to the Chapter 13 Trustee. A percentage payment would propose a certain percentage payback of the total allowed claims in the unsecured creditors class, which method can create problems in determining the exact amount of the monthly payment. A pool plan provides that a certain amount of money paid to the Chapter 13 Trustee over the life of the plan term would go to the unsecured creditors, regardless of what the total aggregate class debt amount would be. The debtor would not care what the total amount of the aggregate unsecured creditors’ debts were because he would be paying only a specific sum for the plan duration. Trustee’s fees would be added to all of these types of plans to obtain the exact payment.

(g) **Insider claims.** An "insider" is defined by Code §101(31)(A) as a relative of the debtor but this definition is not inclusive because other persons, even if they are not relatives, may have such a close relationship to the debtor that they could be deemed insiders. Insider debt may be one of two kinds of debts: one that is payable as part of the unsecured creditors’ class or one which is subject to grounds for objection
for inclusion in the unsecured creditors' class. Creditors will object to including an insider in an unsecured creditors' class if the insider has taken steps that would give the insider an advantage that other creditors would not have had, for example, the insider continued making loans to the debtor knowing that the debtor was insolvent and/or bankrupt for the purpose of the watering down the unsecured creditors' class.

Notwithstanding the Code §1322(b)(1) prohibition that the classification of unsecured claims may not discriminate unfairly against any class so designated, the plan may propose a different treatment for a co-obligor's consumer debt if that individual is liable on such consumer debt with the debtor. This means that a claim arising from a personal guarantee by a relative may be treated differently without violating the prohibition against unfair discrimination. The non-bankrupt co-debtor is protected by the debtor's automatic stay, but only to the extent of the amount of the debt being paid through the plan.

Several courts require the debtor to treat all unsecured claims, insiders and others, in one class for the first 36-month term under the plan. Since the Code mandates all disposable income to be used to finance the plan for the first 36-month term, then the debtor would be free to pledge his disposable income in any way he pleases for the final 24 months of the term.

4. Modification of Secured Debt. Code §1322(b)(2) authorizes the debtor to file a plan that will "modify the rights of holders of secured claims,..."

(a) Definition of secured claims. Code §506(a) provides that "an allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to set off under §553 of this title, is a secured claim to the
extent of the value of such creditor's interest the estate's interest in such property... and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim." To allow a secured claim in a Chapter 13, the Court must determine the value of the asset secured by the lien thereon, which value amount becomes the secured claim, and subtract that value from the total claim; the resultant figure is the allowed amount of the unsecured claim. In re 680 Fifth Avenue Associates, 156 B.R. 1010 (Bkrtcy. N.Y. 1993). Often the allowance of secured claims is reached by negotiated agreement with the secured creditor, otherwise the Court must determine the amount of the allowed claim at a valuation hearing. See (e), supra.

(b) Reduction of secured claim to value. The debtor may write down or reduce the secured creditor's claim to an allowed amount equal to the value of the collateral under Code §506(a). Once the valuation of the collateral is determined, the claim amount is written down to the fair value of the collateral and allowed as a secured claim in that amount, then the remaining debt or the deficiency becomes an unsecured claim and may be treated in the unsecured creditors' class. If, however, the secured creditor's collateral is valued greater than the debt, then the secured creditor is entitled to payment in full pursuant to its debt instrument terms and the plan, otherwise such failure would justify the Court in granting relief from the automatic stay. If the debtor's plan reduces the secured creditor's claim to the value of the collateral, the debtor nevertheless must pay the creditor the present day value or interest on the debt to obtain confirmation.
(c) **Exception to the real estate residence.** Notwithstanding Code §1322(b)(2) that authorizes modification of secured claims, this section contains an exception, described as "other than a claim secured only by a security interest in real property that is the debtor's principal residence,...," which effectively prohibits the modification of the debtor's residence's mortgage. Code §1322(c) provides that, notwithstanding Code §1322(b)(2) and applicable non-bankruptcy law, any default with respect to or that gave rise to a lien on the debtor's residence may be cured at any time up to such time as when the residence is sold in a foreclosure sale and if the case is one where the last payment on the original payment schedule is due before the date in which the final payment under the plan term is due, the plan may provide for the payment of the claim as modified to a later date beyond the duration of the plan. This means the debtor can extend the final mortgage payments to the end of the term or beyond it.

The prohibition against modification of the claim against the residence, however, is mandatory, but if the Court determines that the secured creditor's claim is not secured "only" by a security interest in real property, i.e., is also secured by other collateral, then such a partially secured claim can be treated and modified under the plan. Although the debtor may modify the rights of the secured creditor, such modifications must be confined to the limitations or parameters of Code §1325(a) which mandate that the holder of the allowed secured claim has either accepted the plan, or the plan provides that the holders such claim retain it's underlying lien and the value of the property to be distributed under the plan on account of such claim is not less than the amount of the allowed claim, or the collateral must be surrendered to the secured creditor.

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There is a split among the circuits as to whether the claim can be bifurcated into two separate classes. Some courts: prohibit bifurcation and some allow bifurcation. Compare *Lomas Mtge USA v. Wiese*, 980 F.2d 1279 (9th Cir. 1992) with *Nobleman v. American Savings Bank*, 113 S. Ct. 2106 (1993).

(d) **Avoidance of lien on consumer property.** The debtor either by motion or as part of his plan may use Code §522(f)(1) to avoid the fixing of a lien or interest on the debtor’s property to such an extent that such a lien impairs an exemption which the debtor would have been entitled to if such lien were a judicial lien or a non-possessory, non-purchase money security interest in household goods, furnishings, wearing apparel, appliances, books, animals, crops, musical instruments or jewelry that are held primarily for personal, family or household use by the debtor or a dependant of the debtor, and implements, professional books or tools of the trade of the debtor or the trade of a dependent of the debtor, or professionally prescribed health aids for the debtor or a dependant of the debtor. A judicial lien that secures a debt to a spouse, former spouse or child of the debtor for alimony to, maintenance for support of such spouse or child in connection with a separation agreement, divorce decree or other order of a court of record, if such debt has not been assigned to another entity either voluntarily or by operation of law, cannot be set aside. For purposes of determining how the lien and the dollar values may be avoided, reference should be made to the formula set forth in Code §522(f)(2)(A).
5. **Length of Plan.**

   (a) **Minimum and maximum terms.** A Chapter 13 plan may be any length of time not to exceed 60 months calculated from the date the payments commence. Code §1322(d). Since filing a Chapter 13 is limited to an individual with regular income, this normally indicates that the debtor is a wage earner receiving a regular paycheck. Thus a Chapter 13 plan would normally propose the payment of a certain amount of money out of each paycheck, either paid voluntarily to the Chapter 13 Trustee or by a payroll deduction order from his paycheck. Nothing, however, precludes a plan from providing that the Chapter 13 payment be made irregularly or quarterly or even semi-annually or annually, depending on the type of income received by the debtor. The plan payment term therefore may be tailored to fit the debtor's individual needs. The court cannot confirm a plan that will take longer than 60 months to be administered.

   (b) **Calculation of payback amount.** In formulating the plan, the debtor's counsel will normally require the debtor to prepare a precise monthly budget. He would deduct the total of living expenses from the net take-home pay and the remaining amount of money available would be the debtor's disposable income. The disposable income would then be the amount of the Chapter 13 payment. That amount then would be multiplied by 36 to 60 months to determine the maximum payment that the debtor is capable of making, and then the total would be compared to the floor or minimum payment required for purposes of confirmation. There is no requirement that the debtor pay all indebtedness in full; rather, the test is that the debtor must pay to the creditors an amount equal to what they would receive in case of a Chapter 7 liquidation.
That figure, derived from a Chapter 7 analysis of the debtor's assets and liabilities, would determine the floor. The maximum is determined by the debtor's disposable income, determined to be the best effort that the debtor can make in paying the most to his creditors. Add to the payables any allowable attorneys' fees, other professional fees, Court costs and the Chapter 13 Trustee's commissions and expenses, usually 8% - 9½% of the payable amount, and the payback sum is determined.

6. Dischargeability Considerations. At the end of every successful Chapter 13, a discharge of any remaining unpaid indebtedness is ordered by the Court. Dischargeability of a Chapter 13 debtor is treated in Code §1328 at the end of a term. This discharge is different from the discharge that is normally entered in a Chapter 7 bankruptcy case.

(a) Dischargeability in Chapter 7. Under Code §523, certain debts in a Chapter 7 bankruptcy are not dischargeable in bankruptcy. These debts include taxes, a debt incurred by fraud, a debt not listed in the petition; a debt incurred by fraud or defalcation while acting in a fiduciary capacity, embezzlement or larceny; a debt due a spouse, former spouse or child of the debtor for alimony to, maintenance for support of such spouse or child in connection with the separation agreement, divorce decree or other determination made under law by governmental unit; a debt for a fine, penalty or forfeiture payable to or for the benefit governmental unit; a debt incurred for an educational benefit or loan made, insured or guaranteed by a governmental unit; a debt incurred for death or personal injury caused by the debtor's operation of a motor vehicle while being intoxicated from using alcohol, drug or another substance; a debt that was
or could have been listed or scheduled by the debtor in a prior bankruptcy case under which he waived his discharge; a debt provided for any final judgment, reviewable order or consent order or decree entered in a United States or State Court issued by a Federal depository institution's regulatory agency rising from any act of fraud or defalcation while acting in a fiduciary capacity committed with respect to a depository institution or insured credit union; a debt incurred for malicious or reckless failure to fulfill a commitment by the debtor to a Federal depository institution's regulatory agency to maintain capital of that institution; a debt incurred for the payment of an order of restitution issued under the criminal code; a debt incurred to pay a tax to the United States that would otherwise be non-dischargeable; and a debt incurred for a property settlement division or separation agreement or divorce decree relating to property unless the debtor does not have the ability to pay or discharging such debt would result in a benefit to the debtor that outweighs the detrimental consequences to a spouse, former spouse or child of the debtor. All other debts, except these, are dischargeable in a Chapter 7, but some would otherwise be dischargeable in a completed Chapter 13 plan.

(b) Super-Dischargeability in Chapter 13. Code §1328 provides two types of discharges, both of which have some super-dischargeability consequences that are different from the discharge in a Chapter 7. At the successful completion of all payments under the plan, unless the Court approves a written waiver of discharge executed by the debtor after the bankruptcy has been filed, the Court grants a discharge of all debts provided for in the plan or disallowed under the plan, except for debts that are provided in the plan to survive the discharge where the last payment is due after the
date of which the final payment of the plan is due; for restitution or a criminal fine in a sentence on the debtor's conviction of the crime; and debts due a spouse, former spouse or child of the debtor for alimony, maintenance or support; debts due for an educational benefit or loan made by an insured or guaranteed by a governmental unit; and debts incurred by death or personal injury caused by the debtor's operation of a motor vehicle when the debtor was intoxicated from using alcohol, a drug, or another substance. This means that debts incurred by fraud and debts due for taxes and the other exceptions listed in Code §523(a) are otherwise dischargeable if the Court confirms and the debtor completes the plan. Note that taxes are required to be provided for in full. Code §1328(a) provides that "the Court shall grant the debtor a discharge of all debts provided for by the plan ...," even though said debts are not paid in full. The conditioned limitation is that the debtor has to complete the payments under the plan.

(c) Hardship Discharge of claims in Chapter 13. Code §1328(b) provides for a second kind of discharge in a Chapter 13, known as the hardship discharge. The Court may grant a discharge to the debtor under this section even though he has not completed the payments under the plan if the debtor's failure to complete such payments was due to circumstances for which the debtor should be justly held accountable and the debtor has paid to the creditors upon the date of the discharge or the application therefor a sum equal to what the creditors would have received if the debtor had filed a Chapter 7 bankruptcy on the original filing date; and if a modification of the plan to provide for other payment terms is not practicable. This discharge will discharge this debtor from all unsecured debts provided in the plan, except debts that were
scheduled to be paid beyond the payment date last due under the plan and excepts all of the Code §523(a) debts from the discharge. This means that tax debts, fraud debts and all of the non-dischargeable debts specified in Code §523 would not be discharged under the Code §1328(b) discharge, but could be discharged under a Code §1328(a) discharge.

(d) Mandatory payments in full. To obtain the right to the Code §1328(a) discharge, the plan payments must be paid in full in conformity with Code §1322(a) for the debtor to be entitled to the discharge. Since Code §1322(a) contains mandatory provisions for the payment of certain debts, i.e., all claims entitled to a priority under Code §507, then for the debtor to obtain the super-discharge under §1328(a), all payments proposed by the plan, must be paid in full.

(e) Treatment of Domestic Relations Claims. A line of cases has developed that give to the debtor the right to create separate classes with separate provisions for debts due for alimony, maintenance, or child support. See In re Gianakas, 917 F.2d 759 (3d Cir. 1990). There is a split of authority as to whether such classifications can properly be included in a plan, although the majority interpretation of most courts is that separate classification can be made. The limitation, however, is that the plan payments must not unfairly discriminate against another class of creditors, and if a former spouse, entitled to alimony, maintenance or support, is preferred over other creditors, then probably the plan itself is not confirmable under Code §1322(a). The October, 1995 amendments added Code §523(a)15, giving non-dischargeability status to debts incurred for property division arising out of divorce decrees and property settlements. A debtor would therefore normally attempt to either include the former
spouse in a separate class for special treatment or alternatively include the spouse as an unsecured creditor in the unsecured creditors' pool and avail himself of the Code §1328(a) discharge. The hardship discharge under 1328(b), however, would not discharge any spousal debts remaining unpaid at the time of the termination of the plan.

(f) Effect of Confirmation. Notwithstanding the discharge that is entered under Code §1328 after the completion of the plan, the confirmation of the plan itself has consequences that are beneficial to the debtor. First, the provisions of the confirmed plan bind not only the debtor but each creditor, whether or not the claim of such creditor is provided for by the plan and whether or not such creditor has objected to, has accepted or has rejected the plan. Secondly, except as otherwise provided in the plan or the order confirming the plan, once the plan is confirmed all of the property of the estate is vested in the debtor, and under Code §1327(c), the vesting of said property in the debtor is free and clear of any claim or interest of the debtor provided for by the plan. This means that once the plan is confirmed, any property that was property of the estate for purposes of determining the minimum payment due the unsecured creditors is thereafter free of any creditor's claims and may be disposed of by the debtor in any manner chosen by him. The disposal of the property, however, does not eliminate the debtor's obligation to make the plan payments, but any conversion of a Chapter 7 would revert back to the date of the bankruptcy action when the order of relief was entered and thereby bind the debtor to the Chapter 7 Trustee for the value of the property of the estate that existed at the time of the filing of the Chapter 13 since converted to a Chapter 7. If the debtor has disposed of the property, the debtor may not be able to raise the
cash necessary to satisfy the Chapter 7 Trustee and thereby could forfeit his discharge.

7. **Leases and Executory Contracts.** Unexpired leases and executory contracts may either assumed, rejected or assumed and assigned either by motion during the pendency of a Chapter 13 or pursuant to the terms of a confirmed Chapter 13 plan as authorized by Code §365.

(a) **Assumption.** Under Code §365(b)(1)(C), if there is an unexpired lease or an executory contract, the debtor has the option to assume such lease or contract if he either cures or provides adequate assurance that he will promptly cure any pre-existing default; compensates or provides adequate assurance that he will compensate the party to the contract for any actual pecuniary loss resulting from such default and "provides adequate assurance of future performance under such contract or lease." An example would be that if the debtor is a party to an automobile lease, he may, either by motion or pursuant to the plan, assume that lease and provide for a separate classification for the curing of any arrearage due by providing for early payments to such creditor and continuing to make the monthly lease payments outside of the plan. Even though the creditor may oppose the assumption of such lease or unexpired contract, so long as the debtor meets the conditions set forth in Code §365(a), then the Court should approve the assumption.

(b) **Rejection.** The debtor may, either by motion or as a part of the terms of the plan, reject any unexpired lease or executory contract. Any rejection again, like an assumption, must be approved by the Court and the rejection of a lease or contract will probably result in damage to the rejected party. That damage then becomes
an unsecured claim presumed to have been in existence as of the date of the filing of the
bankruptcy.

(c) Assignment. Code §365(f) also authorizes the assumption and the assignment of an unexpired lease or executory contract. If, for example, an automobile lease has value, the debtor may assume the contract, cure the default and comply with the provisions of Code §365(b)(1)(A),(B) and (C), and then under Code §365(f)(2), the debtor may assign the executory contract or unexpired lease, but only if he gives adequate assurance of future performance by the assignee of such contract or lease. The latter requirement applies even if there has not been a default in such contract or lease.

8. Mortgage on Debtor's Principal Residence. The plan may make various provisions relating to the debtor's residence.

(a) Treatment in Plan. Upon the filing of the bankruptcy, if the debtor owns his real estate residence, whether with or without a mortgage thereon or with or without equity, various treatments may be made with respect to the residence debt. As discussed before, if the plan attempts to modify a secured creditor's claim, one of the Code limitations is that modification cannot be made as to the debtor's principal residence. This means that if there is a mortgage, the mortgage must be reaffirmed by the debtor as a part of the plan, any arrearages cured and paid according to the terms thereunder or the debtor will be subject to the lifting of the stay.

(b) Use of state exemption statute. If the debtor's real estate residence is unencumbered, then the debtor may use the state exemption statute of $5,000 per person or a total of $10,000 for a married couple (and may use the general
exemption of $1,000 for each debtor) against the residence for purposes of lowering the total amount of equity that would otherwise result in calculating the minimum or floor payments due under the Chapter 13 plan. Thus, if married debtors owned a residence valued at $25,000, the debtor could use their $10,000 real estate residence exemption to reduce the net equity to the creditors to $15,000 to establish the floor or minimum payments for purposes of the plan. As noted above, the disposable income test would determine the maximum amount but the floor would be the amount used for purposes of determining the Code §1328(b) confirmation or hardship discharge requirements later.

(c) Abandonment of an asset. If the debtor's residence is fully encumbered and the debtor is unable to either make plan payments or to cure any arrearage for purposes of preventing the lifting of the stay, then the debtor may abandon the asset. The abandonment of the asset simply means that the Bankruptcy Court jurisdiction is ended upon the entry of the Court's order approving the abandonment and the stay, if thereafter lifted, would enable the secured creditor to file a foreclosure suit, force a sale and receive the proceeds from the sale for application on its mortgage debt. Any deficiency would become an unsecured claim and would be treated by the plan's unsecured creditors' provisions. Abandonment is determined by a debtor when there is an inability to pay the mortgage payments through the terms of the plan and there is no significant equity that needs to be preserved by the debtors in retaining the asset.

(d) Putting the Plan Together. A sample plan, usually fitting for most debtors, is attached hereto as Exhibit 1. and references in this section shall be made to said Exhibit.
(1) **Steps for Formulating Plan.** The debtor's attorney, using the information obtained from the debtor as set forth in the previous section, would perform the following:

(a) Calculate the debtor's budget
(b) Determine the floor payments by doing a Chapter 7 Liquidation Analysis
(c) Calculate the debtor's "best effort" or "disposed income",
(d) Determine the length of the plan,
(e) Create the creditor's classifications,
(f) Obtain debtor's authorization to proceed, and
(g) Obtain debtor's signature on plan.

(2) **Service of Plan.** The plan should be filed contemporaneously with the filing of the Petition and Schedules, but can be filed within 15 days thereafter, or even longer if approved by the Court. All creditors, the standing Chapter 13 Trustee and all known attorneys representing creditors must be served. The debtor's attorney is required to file in court his certificate of service of the plan.

(3) **Confirmation Hearing.** The proposed plan is argued before the court at the Confirmation Hearing. The Chapter 13 Trustee will have filed his recommendations and comments and any creditor will have filed their objections to the plan. The court, after hearing arguments will either confirm, order amendments to the plan or refuse to confirm. If confirmation cannot be obtained, the debtor can either dismiss the Chapter 13 or convert to Chapter 7; the court cannot order involuntary
conversion.

D. POST CONFIRMATION DEFAULT.

1. Effect of Default. If a debtor fails to comply with the provisions of his plan, he may obtain a modification of the plan, convert to Chapter 7 or dismiss the Chapter 13.

2. Modification of the Plan. Code §1329 allows the debtor to modify his plan by either increasing or reducing his plan payments, extending or reducing the time for such payments or by altering the terms of distribution to the creditors. Modifications have to be approved by the Court, but the limitations and conditions applicable to confirmation of the original plan still apply to the approval of the modified plan. Code §1329(b)(1).

3. Dismissal or Conversion. Under Code §1307, the debtor may voluntarily elect to convert to a Chapter 7 (or to a Chapter 11 or 12), but only if the debtor so elects to be converted. The case can be dismissed by the Court for unreasonable delay that is prejudicial to the creditors, non-payment of fees, failure to file a timely plan, denial of confirmation of the proposed plan, material default of a plan term, revocation of the confirmation order, or failure to file timely such information required to be delivered to the trustee. The above list is merely illustrative; the reason for dismissal must be "for cause" as determined by the Court.

E. POST-PETITION DEBT.

1. No New Debt Intended. The purpose of the Chapter 13 pay-back is to pay off old debt, not to incur new debt. Any new debt that is incurred would be
legally binding on the debtor, but because his income has been submitted to the exclusive jurisdiction of the Bankruptcy Court, a post-petition creditor cannot garnish or attach the debtor’s income being used to fund the plan. The creditor must wait until the plan is either completed or the debtor’s case is dismissed. If there is a conversion to Chapter 7, however, the post-petition-incurred debt is includable in the debt pool and is dischargeable through the Chapter 7.

2. **Tax Debts.** Code §1305(a)(1) provides that if post-petition tax debts are incurred, the taxing unit may file a proof of claim and seek payment through the Chapter 13. The Bankruptcy Rules provide that if the taxing unit fails to file a proof of claim, the debtor can file one for the taxing unit so it will be paid under the plan.

3. **Consumer Debts.** Code §1305(a)(2) provides that if consumer debts are incurred after the Chapter 13 case if filed, the creditor may file a proof of claim and seek payment through the Chapter 13. If, however, the consumer creditor "knew or should have known" that prior approval by the trustee of the debtor’s incurring the obligation was practicable but was not obtained, its proof of claim will be disallowed under Code §1305(c).

4. **Non-discharge of Post-petition Debt.** If the debtor incurs post-petition debt without obtaining the trustee’s permission and such permission time was practicable, then under Code §1328(d), that post-petition debt would not be included in the debtor’s discharge at the completion of the Chapter 13, but would survive the bankruptcy as a non-dischargeable debt.
UNITED STATES BANKRUPTCY COURT
Eastern District of Kentucky
LEXINGTON DIVISION

In re: sample

Case No. ____________________________
Chapter 13

CHAPTER 13 PLAN

NOTICE

THIS PLAN CONTAINS EVIDENTIARY MATTER WHICH, IF NOT CONTROVERTED, MAY BE ACCEPTED BY THE COURT AS TRUE. CREDITORS CANNOT VOTE ON THIS PLAN BUT MAY OBJECT TO ITS CONFIRMATION PURSUANT TO BANKRUPTCY CODE § 1324, AND LOCAL RULES. ABSENT ANY SUCH OBJECTION, THE COURT MAY CONFIRM THIS PLAN AND ACCEPT THE VALUATION AND ALLEGATIONS CONTAINED HEREIN.

The Debtor(s) above named hereby proposes the following plan.

1. Debts. All debts are provided for by this Plan. Only creditors holding claims duly proved and allowed shall be entitled to payments from the Trustee. (See Notice of Filing for Bar Date.) Trustee shall not file a claim on behalf of any creditor.

2. Payments. As of the date of this Plan, the debtor has paid $0.00 to the Trustee. Debtor and/or any entity from whom the income shall pay to the Trustee the sum of $0.00 Monthly, commencing ________________, for 60 months for total of $0.00 or until such amounts are paid that will afford payment of all allowed and proven claims in the amounts payable under this Plan.

3. Plan Payments. The Trustee, from available funds, shall make payments to creditors in the following amounts and order. All dates for beginning of payments are estimates only and may be adjusted by the Trustee as necessary to carry out the terms of this plan.

A. DEBTOR'S ATTORNEY

<table>
<thead>
<tr>
<th>FEE</th>
<th>PAID TO BALANCE DUE</th>
<th>---- PAYMENT SCHEDULE ----</th>
<th>TOTAL PAYMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>NONE</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

B. Mortgage Arrears. (Regular monthly payments to be made by Debtor and to start on the first due date after date of filing petition.)

<table>
<thead>
<tr>
<th>CREDITOR</th>
<th>RATE</th>
<th>ARREARS</th>
<th>---- PAYMENT SCHEDULE ----</th>
<th>TOTAL PAYMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>NONE</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

C. Secured Claims. (A creditor’s secured claim shall be the net amount due as of date of filing or the value of the collateral to which creditor’s lien attaches, whichever is less. Interest shall be allowed at contract rate or 12.00% APR whichever is less. Creditor shall retain its lien until the allowed secured portion of the claim is fully paid.)

<table>
<thead>
<tr>
<th>CREDITOR &amp; COLLATERAL</th>
<th>RATE</th>
<th>CLAIM</th>
<th>---- PAYMENT SCHEDULE ----</th>
<th>TOTAL PAYMENTS</th>
</tr>
</thead>
</table>

i. Secured Claims - Paid in full

| NONE | | |

ii. Secured Claims - Cure default only

| NONE | | |

D. Priority Claims. (Unsecured claims entitled to priority under 11 U.S.C. § 507 shall be paid in full as follows.)

<table>
<thead>
<tr>
<th>CREDITOR</th>
<th>PRIORITY CLAIM</th>
<th>---- PAYMENT SCHEDULE ----</th>
<th>TOTAL PAYMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>NONE</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

E. Separate Class of Unsecured Claims. (May include co-signed debts as provided for by 11 U.S.C. § 1301, including interest at contract rate.)

<table>
<thead>
<tr>
<th>CREDITOR &amp; CLASSIFICATION</th>
<th>RATE</th>
<th>UNSECURED CLAIM</th>
<th>---- PAYMENT SCHEDULE ----</th>
<th>TOTAL PAYMENTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>NONE</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
F. Unsecured Creditors. (All other creditors not scheduled above are deemed unsecured without priority and shall be paid pro rata from funds remaining after payment of the above scheduled claims. Debtor estimates the unsecured claims to total $0.00, and proposes to provide at least $0.00, which will pay in full said creditors claims, or in no event, provide a composition percentage of less than 0%. (Funds Provided/Unsecured Claims)

G. Lien Avoidance. (Debtor intends to file a motion, pursuant to Bankruptcy Rule 4003(d) to avoid all nonpossessory, nonpurchase money security interests and judicial liens as provided by 11 U.S.C. §522(f), and the plan herein provides for payment of such liens as general unsecured claims only. Any creditors claim or portion thereof not listed in paragraph C. above is to be treated as unsecured and, unless objected to, such unsecured status, for purposes of this plan, will be binding upon confirmation, but the lien shall survive unless avoided.

H. Leases and Contracts. The Debtor hereby assumes the following unexpired leases and executory contracts, and rejects all others.

<table>
<thead>
<tr>
<th>NAME OF CREDITOR</th>
<th>DESCRIPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>NONE</td>
</tr>
</tbody>
</table>

I. Miscellaneous Provisions.

NONE

4. Secured Claims - Paid directly by debtor(s). The following creditors' claims are fully secured, shall be paid directly by the debtors, and shall receive no payments under paragraph 3 above:

<table>
<thead>
<tr>
<th>CREDITOR</th>
<th>COLLATERAL</th>
<th>MARKET VALUE</th>
<th>AMOUNT OF CLAIM</th>
</tr>
</thead>
<tbody>
<tr>
<td>NONE</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

5. Future Income. Debtor(s) submits all future earnings or other future income to such supervision and control of the Trustee as is necessary for the execution of this Plan.

6. Standing Trustee Percentage Fee. Pursuant to 28 U.S.C. §586(e)(B), the Attorney General, after consultation with the United States Trustee, sets a percentage fee not to exceed ten percent of payments made to creditors by the Trustee under the terms of this Plan.
SUMMARY AND ANALYSIS OF PLAN PAYMENTS TO BE MADE BY TRUSTEE

A. Total debt provided under the Plan and administrative expenses

1. Attorney Fees 0.00
2. Mortgage Arrears 0.00
3. Secured Claims 0.00
4. Priority Claims 0.00
5. Separate Class of Unsecured Claims 0.00
6. All other unsecured Creditors 0.00

Total payments to above Creditors 0.00
Trustee percentage 0.00
* Total Debtor payments to the Plan 0.00

* Total payments must equal total of payments set forth in paragraph 2 on page 1 of this Plan.

B. Reconciliation with Chapter 7

1. Interest of unsecured creditors if Chapter 7 filed
   a. Total property of debtor 0.00
   b. Property securing debt 0.00
   c. Exempt property 0.00
   d. Priority unsecured claims 0.00
   e. Funds for Chapter 7 distribution (est.) 0.00

2. Percent of unsecured, nonpriority claims paid under Plan 0%

3. Percent of unsecured, nonpriority claims paid if Chapter 7 filed (est.) 0%

Attorney for Debtor(s):

Bar no.

BUNCH & BROCK
271 WEST SHORT STREET, SUITE 805
P.O. BOX 2086
LEXINGTON KY 40588-2086
(606)254-5522

Signed: sample, Debtor

Chapter 13 Plan - Page 3 of 3 G - 29
WORKING WITH THE CHAPTER 13 TRUSTEE’S OFFICE

Beverly M. Burden  
Chapter 13 Trustee  
U.S. Bankruptcy Court  
Eastern District of Kentucky  
Lexington, Kentucky

and

William W. Lawrence  
Attorney at Law  
Chapter 13 Trustee  
U.S. Bankruptcy Court  
Western District of Kentucky  
Louisville, Kentucky

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## WORKING WITH THE CHAPTER 13 TRUSTEE'S OFFICE

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D. Chapter 13 Delinquency Procedures

E. Chapter 13 Payment Suspension

F. Claims in Chapter 13 Cases

G. Application to Incur Debt

H. www.13network.com

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SECTION H
WORKING WITH THE CHAPTER 13 TRUSTEE'S OFFICE IN THE EASTERN DISTRICT OF KENTUCKY

BEVERLY M. BURDEN
CHAPTER 13 TRUSTEE

MAILING ADDRESS: PO Box 2204
Lexington KY 40588

PAYMENT ADDRESS: Chapter 13 Trustee, EDKY
PO Box 1766
Memphis TN 38101-1766

LOCATION: 100 East Vine Street
Suite 500
Lexington KY 40507

TELEPHONE: 859-233-1527

FAX: 859-255-3143

E-MAIL ADDRESS (FOR GENERAL INQUIRIES): questions@ch13edky.com

WEBSITE: www.ch13edky.com

CASE INFO. AVAILABLE FOR AUTHORIZED USERS AT: www.13network.com
Local Rules and Forms of the United States Bankruptcy Court for the Eastern District of Kentucky
Effective May 1, 1997

Note: These Rules were amended by Standing Orders dated January 1, 1998, November 1, 1998, July 1, 1999, December 29, 1999, and August 1, 2000. All these are reproduced at the end of this page. Please refer to those amendments as well as to the text of the Rules.

Note also that a new unofficial form of Reaffirmation Agreement has been issued by the Administrative Office of the Courts.

Also, effective February 15, 1999, motions for relief in Judge Howard's cases must be noticed for hearing in the division to which the case is assigned. Except where an order allowing a hearing in a different division is obtained prior to the filing of a motion for relief, no relief motions shall be noticed for hearing on Lexington motion days other than cases in the Lexington division.

HONORABLE WILLIAM S. HOWARD, CHIEF JUDGE
HONORABLE JOE LEE, JUDGE

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9. Motion to Redeem Property

REvised by STAnding COurT ORDr

of AUGust 1, 2000

H - 3
LOCAL RULES

section 327 or 1103 of title 11 must have attached thereto a copy of the order of retention or authorization.

Supplemental fee applications shall, in the same manner as original fee applications, contain all the information required by Rule 2016 of the Federal Rules of Bankruptcy Procedure.

RULE 3001-1. CLAIMS AND EQUITY SECURITY INTERESTS - GENERAL

Each proof of claim, with supporting documents evidencing the claim and the perfection of a security interest, if any, shall be submitted in duplicate, one original copy, complete with supporting documents, for the court case file, and one conformed copy, complete with supporting documents, for the trustee's case file. The original copy, which must bear the original signature of the claimant, shall be retained by the clerk in the court case file. The conformed copy, which may bear a photocopy of the claimant's signature, but which otherwise shall be complete in all respects with supporting documents, shall be forwarded by the clerk to the trustee.

The trustee shall examine and object to any defective or insufficiently documented claim, if any useful purpose would be served thereby.

Upon request, the Clerk of Court shall provide claimants with instructions for filing proofs of claim.

The requirements for filing in duplicate and documenting proofs of claim apply with equal force to any proof of an equity security interest in a debtor corporation.

RULE 3002-1. CLAIM - PROOF OF BY CREDITOR HOLDING A SECURED CLAIM IN CHAPTER 13 CASE

A proof of claim in conformity with Local Rule 3001-1 by or on behalf of a creditor, including a creditor holding a secured claim, other than a claim secured by an interest in real estate, must be filed in a chapter 13 case before the debtor or trustee may make payments to such creditor in accordance with the plan. Proof of a secured claim filed after the expiration of the time fixed by Rule 3002(c) of the Federal Rules of Bankruptcy Procedure for filing claims shall be allowed only to the extent of the value of the collateral securing the claim.

RULE 3003-1. CLAIMS - CHAPTER 11 CASE

Unless the court for cause shown orders otherwise, the cutoff date for filing unscheduled claims or claims scheduled as disputed, contingent, or unliquidated in a chapter 11 case shall be the date of the order approving the disclosure statement.

RULE 3009-1. DIVIDENDS - CHAPTER 7 ASSET CASES - DEADLINE FOR AMENDING CLAIMS

When estate funds are available in a chapter 7 case for payment of a dividend to creditors holding allowed unsecured claims, the deadline for filing an amended claim for any deficiency remaining after the liquidation of collateral or for requesting an extension of time within which to file an amended
LOCAL RULES

claim shall be the date of the final hearing on applications for compensation or, in divisions other than the Lexington division, if applications for compensation are filed on a notice and opportunity basis, such deadline shall be the last date for objecting to such applications for compensation in accordance with the notice. No dividend shall be paid on an amended claim filed after that date by a creditor who did not timely request an extension of time within which to amend the claim.

RULE 3015-1. CHAPTER 13 - PLAN - SERVICE OF PLAN

(a) Form of Plan. A chapter 13 plan shall conform substantially to Form No. 2 with such alterations as may be appropriate to suit the circumstances. Revised by Standing Court Order Dated 8/1/2000

(b) Service of Plan. Concurrently with the filing of the plan the debtor or the debtor's attorney shall cause a copy of the plan to be served by first class mail upon all creditors of the debtor and other parties in interest. The debtor or the debtor's attorney shall file with the plan a certificate of service in the form prescribed by Form No. 3 certifying that a copy of the plan has been served by first class mail upon all creditors of the debtor and parties in interest.

RULE 3015-2. CHAPTER 13 - AMENDMENTS TO PLANS - SERVICE OF PLAN

A modified chapter 13 plan shall be served upon all creditors and parties in interest and shall be accompanied by a certificate of service in the same manner as the original plan. The modified plan and the order confirming a modified plan shall identify the plan as the First, Second, etc. Modified Plan Dated __________.

RULE 3015-3. CHAPTER 13 - CONFIRMATION

(a)(1) Objections to Confirmation. An objection to confirmation of a chapter 13 plan is governed by Rule 9014 of the Federal Rules of Bankruptcy Procedure. Such objection shall be filed with the court not later than 10 days prior to the hearing on confirmation of the plan, shall be served upon the debtor, the attorney for the debtor and the chapter 13 trustee, and shall be noticed for hearing at the hearing on confirmation of the plan. An objection by a creditor to the recommendation of the chapter 13 trustee as to the allowed amount of the secured claim of such creditor may be presented at the hearing on confirmation of the plan. Revised by Standing Order of 8/1/00

(2) Hearing on Confirmation. The court shall rule on confirmation of a chapter 13 plan after hearing on notice to the debtor, the attorney for the debtor, and all creditors, including creditors holding secured claims, and any creditor who has timely filed an objection to confirmation of the plan. Notice of the hearing on confirmation of a chapter 13 plan may be combined with the notice of the meeting of creditors given pursuant to Rule 2002 of the Federal Rules of Bankruptcy Procedure. If no objection is timely filed, the court, without hearing evidence, may find that the plan has been proposed in good faith and not by any means forbidden by law.

(b) Order of Confirmation. The order of confirmation of a chapter 13 plan shall conform substantially to Form No. 4 and a copy of the order shall be served promptly upon the debtor or the attorney for the debtor, the chapter 13 trustee, and any creditor who timely filed an objection to confirmation of the plan. Revised by Standing Order of 8/1/00.
STANDING ORDER

Effective August 1, 2000, Local Rules 3015-1(a), 3015-3(a)(1) and 3015-3(b) [E.D. Ky. LBR 3015-1(a), E.D. Ky. LBR 3015-3(a)(1) and E.D. Ky. LBR 3015-(b)] are hereby amended to read as follows:

RULE 3015-1. CHAPTER 13 - PLAN - SERVICE OF PLAN

(a) **Form of Plan.** A chapter 13 plan shall conform to Form No. 2 as revised 08/01/00.

RULE 3015-3. CHAPTER 13 - CONFIRMATION

(a)(1) **Objections to Confirmation.** An objection to confirmation of a chapter 13 plan is governed by Rule 9014 of the Federal Rules of Bankruptcy Procedure. In cases pending in all divisions except Lexington, such objection to confirmation, for any reason, including valuation, shall be filed with the court and served upon the debtor, the attorney for the debtor and the chapter 13 trustee at or prior to the date first set for the meeting of creditors and in cases pending in the Lexington division within ten (10) days after the date first set for the meeting of creditors. The objection to confirmation shall be noticed for hearing at the hearing on confirmation of the plan.

(b) **Order of Confirmation.** The order of confirmation of a chapter 13 plan shall conform substantially to Form No. 4 as revised 08/01/00 and a copy of the order shall be served promptly upon the debtor or the attorney for the debtor, the chapter 13 trustee, and any creditor who timely filed an objection to confirmation of the plan.

Dated: 7/27/00

BY THE COURT

WILLIAM S. HOWARD
CHIEF JUDGE
I. PROPOSED PLAN PAYMENTS AND DURATION OF THE PLAN.

A. Plan Payments. The Debtor submits all or such portion of Debtor’s future earnings or other income as is necessary for the execution of the plan to the control of the Trustee. 11 U.S.C. § 1322(a)(1).

1. The Debtor shall pay to the Trustee out of Debtor’s future earnings or other income (check one):
   - [ ] the sum of $_____ each _____.
   - [ ] the monthly step plan payments set forth below:

     | $     | from | through |
     |-------|------|---------|

2. The Debtor shall also pay to the Trustee periodic payments as follows:

<table>
<thead>
<tr>
<th>Amount of Each Payment</th>
<th>Frequency of Payment</th>
<th>Payment Due Date</th>
<th>Source of Periodic Payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>$</td>
<td>estimated or actual</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

B. Duration (Pool Plan Only). The duration of the plan shall be ____ months. (If blank, the duration of the plan shall be sixty (60) months).

C. Total Amount to be Paid (Pool Plan Only). The Debtor shall pay a “pool” amount of $_____ to the Trustee to complete payments under the plan (pool amount equals monthly payments times duration plus additional periodic payments).

D. Method of Payment. Plan payments shall be made to the Trustee by (check one):

   - [ ] Payroll Deduction: (specify [ ] H or [ ] W in joint case)
     Employer Name:
     Address:
     and
     Phone Number:

   OR

   - [ ] Direct payments by the Debtor. However, Payroll Deductions will start if the Debtor does not make payments when due.
II. TREATMENT OF ADMINISTRATIVE EXPENSES.

A. Attorney’s Fee. An attorney’s fee for Debtor’s counsel will be requested by separate application and shall be paid as allowed by the Court. It is estimated that the amount of the attorney’s fee to be paid through the plan is $_____. Unless otherwise ordered, the attorney’s fee will be paid before creditors receive payments.

B. Trustee’s Fee. The percentage fee payable to the Trustee shall be paid before or at the time of each payment to creditors and other claimants.

C. Other Administrative Expenses. All other expenses entitled to administrative priority under 11 U.S.C. § 507(a)(1) shall be paid before creditors are paid.

III. TREATMENT OF SECURED CLAIMS.

A. Secured Claims To Be Paid Inside the Plan.

1. Unless otherwise provided in the plan or ordered by the Court, each of the following secured claims, if allowed, shall be paid inside the plan, on a pro rata basis with all other allowed secured claims, to the extent of the proposed secured value or the amount of the claim, whichever is less. Any remaining portion of the claim shall be treated as a general unsecured claim.

<table>
<thead>
<tr>
<th>Secured Creditor</th>
<th>Collateral Description</th>
<th>Estimated Amount of Claim</th>
<th>Proposed Secured Value</th>
<th>Proposed Interest Rate*</th>
</tr>
</thead>
</table>

* If blank, the interest rate shall be the contract rate.

2. The holder of any allowed secured claim provided for by the plan shall retain a lien until the allowed secured portion of the claim is fully paid.

3. Secured claims shall be paid after administrative claims are paid and before all other priority claims are paid.

B. Mortgages, Leases, and Other Debts To Be Paid Outside the Plan.

1. Payments Outside the Plan by Debtor. The Debtor shall pay the following claims, except any prepetition arrearage, outside the plan by making payments directly to the creditors. The claims of such creditors shall be paid pursuant to the underlying contracts.

<table>
<thead>
<tr>
<th>Secured Creditor</th>
<th>Collateral Description</th>
<th>Maturity Date of Note</th>
<th>Estimated Amount of Arrearages</th>
<th>Interest Rate on Arrearage*</th>
</tr>
</thead>
</table>

* If blank, the interest rate shall be the contract rate.

2. Payments Outside the Plan by Third Party. The following claims shall be paid outside the plan by a non-filing third party making payments directly to the creditor. The claims of such creditors shall be paid pursuant to the underlying contracts.

<table>
<thead>
<tr>
<th>Secured Creditor</th>
<th>Collateral Description</th>
<th>Name of Party to Make Payments</th>
<th>Relationship to Debtor</th>
</tr>
</thead>
</table>
C. Prepetition Arrearages To Be Paid Inside the Plan. Unless Section VII of the Plan ("Special Provisions") specifically provides otherwise, any claim filed by a creditor for prepetition arrearages on a debt to be paid outside the plan shall be treated as a secured claim to be paid inside the plan concurrently with all other allowed secured claims. If no interest rate is specified, interest shall be paid at the contract rate.

D. Surrender of Property. The Debtor surrenders the following property. Upon confirmation the automatic stay is terminated as to the collateral being surrendered. No distributions shall be made to the secured creditor until such time as an amended claim for the deficiency is filed by the creditor. Any allowed claim for a deficiency shall be treated as a general unsecured claim.

<table>
<thead>
<tr>
<th>Secured Creditor</th>
<th>Collateral Description</th>
</tr>
</thead>
</table>

E. Avoidance of Liens under 11 U.S.C. § 522(f). The liens of the following creditors are avoided under 11 U.S.C. § 522(f). The allowed claims of such creditors shall be treated as general unsecured claims.

<table>
<thead>
<tr>
<th>Secured Creditor</th>
<th>Collateral Description</th>
</tr>
</thead>
</table>

F. All Other Secured Claims. Any creditor filing a claim as secured that is not otherwise provided for by this plan or Court order shall be treated as a claim secured to the extent of the value of the collateral set forth in the proof of claim, to be paid inside the plan with interest at the contract rate.

G. Orders Granting Relief From Stay. If at any time during the life of the plan an order terminating the automatic stay is entered, no further distributions shall be made to the secured creditor obtaining stay relief until such time as such creditor files an amended claim. Any allowed claim for a deficiency shall be treated as a general unsecured claim.

IV. TREATMENT OF PRIORITY CLAIMS.

Priority Claims To Be Paid Inside the Plan. The following claims are entitled to priority under 11 U.S.C. § 507 and shall be paid inside the plan in full, in deferred cash payments, after administrative claims and secured claims are paid and before unsecured non-priority claims are paid. (Claims entitled to administrative priority are paid pursuant to Section II of the plan).

<table>
<thead>
<tr>
<th>Creditor Holding Priority Claim</th>
<th>Description of Claim</th>
<th>Estimated Amount of Claim</th>
</tr>
</thead>
</table>

V. TREATMENT OF UNSECURED CLAIMS.

A. Estimated Amount of Unsecured Debt (from Schedule F): ___

B. General Unsecured Claims.

1. The claims of creditors holding allowed unsecured claims shall be paid pro-rata over the period of the plan after payment of administrative, secured and priority claims.

2. General unsecured claims shall be paid (check one):

- [ ] In full;
- [ ] To the extent of ____ cents on the dollar ("fixed percentage plan")*;
- [ ] To the greatest extent possible from payments to be made by the Debtor ("pool plan").

* A fixed percentage plan shall be treated as a 36-month pool plan if unsecured creditors will receive more.
3. No interest accruing after the date of the filing of the petition shall be paid on the claims of creditors holding unsecured claims.

C. Co-Signed Debts To Be Paid in Full. The following creditors holding unsecured claims for which a non-filing debtor is also liable shall be paid in full, without interest, concurrently with other unsecured creditors.

<table>
<thead>
<tr>
<th>Creditor</th>
<th>Description of Claim</th>
<th>Co-Signer</th>
<th>Relationship to Debtor</th>
</tr>
</thead>
</table>

VI. REJECTION OF LEASES AND EXECUTORY CONTRACTS.

The Debtor hereby rejects the following leases and executory contracts and will surrender the leased property.

<table>
<thead>
<tr>
<th>Creditor</th>
<th>Description of Leased Property or Nature of Contract</th>
</tr>
</thead>
</table>

VII. SPECIAL PROVISIONS.

The Debtor proposes the following special provisions.

DATED: __________________________

DEBTOR

DEBTOR

ATTORNEY FOR DEBTOR
ORDER CONFIRMING CHAPTER 13 PLAN
DATED

A plan under chapter 13 having been filed and served by the debtor on all creditors, and it appearing that
the plan meets the requirements for confirmation, IT IS ORDERED:

The plan is confirmed.

The trustee shall serve copies of this order on the persons named below.

Dated:

By the court –

Bankruptcy Judge

Copies to be served by the chapter 13 trustee on:
Chapter 13 Trustee  
Eastern District of Kentucky

Chapter 13 § 341 Meeting Procedures  
effective June 1, 2000

Attendance by debtors: The court has instructed the trustee that 341 meetings are not to be continued unless the trustee has an order sustaining a motion to continue the meeting. If the trustee does not have an order sustaining a motion to continue the 341 meeting, the trustee is required to file a motion to dismiss. Any motion to continue the 341 meeting must be accompanied by an affidavit of the person so requesting (debtor or counsel) and must be served on the trustee, the U.S. Trustee, and all creditors listed on the debtor’s mailing matrix.

In the event an emergency prevents the debtor from attending the 341 meeting and counsel is thereby unable to obtain an order continuing the 341 meeting prior to the meeting, it is advisable for counsel to file the motion to continue, accompanied by the requisite affidavit, and notice it for hearing at the same time as the trustee’s motion to dismiss. The court generally does not consider “I couldn’t get off work” to be a sufficient reason to avoid dismissal.

If a debtor is incapacitated and physically unable to attend the 341 meeting even at a later date, a motion requesting that the debtor be permitted to undergo the 341 examination by interrogatories should be filed.

Attendance by counsel for debtor: Failure of an attorney to appear or to make advance arrangements for a colleague to appear in his/her behalf could result in the filing of a motion to dismiss. The trustee does not object to another attorney volunteering at the 341 to fill in for the absent attorney so that the debtors do not suffer as a result of the attorney’s failure to appear. However, unless the absent attorney subsequently files a motion to excuse the attorney’s absence and an affidavit in support thereof, the trustee will likely object to counsel’s fees.

Production of documents: When a bankruptcy petition is filed, an Order to Debtor is issued by the court within a day and is served on the debtor immediately. The Order requires the debtor to send to the trustee within 10 days of the Order (which usually means 10 or 11 days after the petition is filed) the following documents:

- a copy of all deeds, land contracts, etc.
- a copy of recorded mortgages, liens, etc.
- a copy of certificates of title for cars, mobile homes, 4-wheelers, boats, trailers, motor homes, motorcycles, campers, motor homes, etc.
- a copy of the last state and federal income tax returns
- a copy of paycheck stubs for the preceding month

The Order provides that “Counsel for the debtor is responsible for seeing that the debtor complies with this order.”

The Order further provides that “Failure to timely comply with this order will result in the filing of a motion to dismiss the within case.”
Although some attorneys have their clients send the documents to the trustee directly, most attorneys collect the documents from their client and forward copies to the trustee. The trustee prefers the latter practice and is especially appreciative when the documents are accompanied by a checklist showing what is included. No matter how the documents are transmitted to the trustee, the debtor’s name and case number must be identified either on each document or in a cover sheet affixed to the documents.

In the past debtors were directed to bring documents to the 341 meeting. Because of the fast-track confirmation procedure, it is imperative that documents be provided as ordered.

Please note that the chapter 13 trustee does not need bank statements, pleadings in foreclosure actions, proof of insurance, contracts for the purchase of personal property, and other documents other than those required to be produced by the Order to Debtor. The trustee will request additional documents on an as-needed basis.

**Examination of debtor:** The trustee will swear in the debtor. Counsel for the debtor will then ask a series of questions as prescribed by the trustee, and the trustee will also ask a series of questions as appropriate and necessary. Any creditors in attendance will also be given an opportunity to ask questions. If necessary, the trustee may continue the 341 if additional time is needed to complete the examination.

Counsel should advise their clients immediately preceding the examination to speak up, to answer all questions “yes” or “no” rather than by head-nodding or “uh-huh”, and that both debtors must answer all questions in a joint case.

**Payments:** The trustee will not accept plan payments at the 341 meeting (or at any hearing). All payments must be mailed to the trustee’s lockbox address.

In all divisions but Lexington, by the time of the 341 meeting, the debtor should have made the first payment due under the plan. In some instances if the plan was filed subsequent to the petition, the first payment might not yet be due. The trustee will verify this, and the debtor will be expected to know when the first payment is due. Please refer to the “Chapter 13 Delinquency Procedure” for further information.
**PAYMENT INFORMATION**

CHAPTER 13 BANKRUPTCY
EASTERN DISTRICT OF KENTUCKY
(606) 233-1527
BEVERLY M. BURDEN, TRUSTEE

**DEBTOR NAME**

**CASE #**

***PAYMENTS***

1. **Monthly** payments to the Trustee are: 

2. Your first payment is due on or before: 

3. Mail your personal check or money order to:

   Chapter 13 Trustee, EDKY
   P. O. Box 1766
   Memphis, TN 38101-1766

4. Write your CASE NUMBER AND NAME on every check, money order or cashier's check.

5. **DO NOT SEND CASH OR POST DATED CHECKS !!!**

6. Office hours are from 9:00 AM to 4:00 PM weekdays.

***PAYROLL DEDUCTION***

Call us with the exact NAME and ADDRESS of your Employer IF you want your Chapter 13 payments taken directly from your paycheck. Payroll Deductions should begin within a week or two. Check with your employer if they do not! You will get a copy of the Order when your employer does. (We **cannot** set up payments to be sent directly from your checking or savings account.)

Yellow or Golden Rod
1. The Trustee's office advises Bankruptcy Court whether or not your Chapter 13 plan should be approved. We also handle the money to pay your creditors (people you owe) after Court approves or "confirms" your plan.

        Payments will not be made to your creditors until your case is confirmed by the Court

2. We mail a report of your case to you every three months. CHECK THIS REPORT CAREFULLY. All your creditors that filed a claim will be listed on the report. If you disagree with any of the amounts given to us by your creditors, call your attorney immediately to file an objection to the claim.

3. You must get the permission of the Trustee and Bankruptcy Court before selling, giving away or getting rid of any of your property or possessions while in bankruptcy. (This permission needs to be in the form of a written Order).

4. Do not buy anything on credit without the permission of the Trustee and the Court.

5. Do not make any direct payments to creditors without court approval. (This may not apply to your house or car payments). Ask your attorney if you are supposed to make any direct payments "outside the plan."

6. Give us: Your NEW address and phone number if you move.
           Your NEW employer's name and address if it changes.

        Give: Bankruptcy Court your NEW address also (606-233-2608).

7. You must pay your regular home mortgage payments on time. Call your attorney if your mortgage company does not accept your payment.

8. Call your attorney with any questions about your Chapter 13 plan.
Chapter 13 Trustee’s Office Payment Schedule

Please use this check-list to help you keep track of the Chapter 13 payments you have made.

Day of Month Payments are Due: XX

| January-01 | September-02 | May-04 |
| February-01 | October-02 | June-04 |
| March-01 | November-02 | July-04 |
| April-01 | December-02 | August-04 |
| May-01 | January-03 | September-04 |
| June-01 | February-03 | October-04 |
| July-01 | March-03 | November-04 |
| August-01 | April-03 | December-04 |
| September-01 | May-03 | January-05 |
| October-01 | June-03 | February-05 |
| November-01 | July-03 | March-05 |
| December-01 | August-03 | April-05 |
| January-02 | September-03 | May-05 |
| February-02 | October-03 | June-05 |
| March-02 | November-03 | July-05 |
| April-02 | December-03 | August-05 |
| May-02 | January-04 | September-05 |
| June-02 | February-04 | October-05 |
| July-02 | March-04 | November-05 |
| August-02 | April-04 | December-05 |

Some plans are set up for less than 60 payments. Please check your plan to see how many months you need to pay and how much your payments are.

Attached are labels printed with your name and case number. Please place these labels in the “note” or “memo” section of every check or money order you send to ensure that your payment is posted to your case.

Send payments to:
CHAPTER 13 TRUSTEE, EKY
PO BOX 1766
MEMPHIS TN 38101-1766

We are also enclosing labels with this address for your convenience.

We will not accept payments at our Lexington office or at any court hearing.
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Memphis, TN 38101-1766

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P. O. Box 1766
Memphis, TN 38101-1766

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PAYROLL DEDUCTION INFORMATION

IF you would like your Chapter 13 Bankruptcy payments to be deducted from your paycheck by your employer, please provide us with the following information:

Your Chapter 13 Case Number ____________________________
Payroll Deduction is for:

______________________________________________________
(Your Name)
Name and Address of Your Employer:
(Where your payroll actually comes from)

______________________________________________________
______________________________________________________
Phone Number and Person to Contact at Payroll Office:

How Do You Get Paid: (Circle one below)
Weekly    Bi-Weekly    Semi-Monthly    Monthly
(every 2 weeks) (15th, 30th)

The Trustee's Office will send a Court Order to your Employer. It should take a week or two for payments to begin. (CONTINUE MAKING YOUR REGULAR PAYMENTS TO THE TRUSTEE UNTIL YOU SEE IT HAS STARTED COMING OUT OF YOUR PAYCHECK!)

MAIL THIS FORM TO: PDO CLERK
CHAPTER 13 TRUSTEE'S OFFICE
(859) 233-1527 P. O. Box 2204
Lexington, KY 40588-2204

"A payroll deduction order can only be started by a signed Court Order by the Judge and can only be stopped by a signed Court Order by the Judge."
CHAPTER 13 ORDER TO DEBTOR

The debtor shall send the following documents to the trustee, whose name and address appear above, within 10 days from the date of this order. The debtor's name and case number must be identified on each document or in a cover letter affixed to the documents:

1. A copy of all deeds or contracts under which the debtor holds title to or any interest in real estate (copies may be obtained from the office of the county court clerk of the county in which the real estate is located);

2. A copy of all recorded mortgages, liens, or encumbrances on all real estate in which the debtor holds an interest (copies may be obtained from the office of the county court clerk of the county in which the real estate is located);

3. A copy of all Certificates of Title on which the debtor's name appears as owner individually or jointly of any motor vehicles, mobile homes, trailers, boats, motor homes, campers, motorcycles, or all-terrain vehicles (do not send originals)(if original titles have been lost, duplicates must be obtained from the office of the county court clerk of the county in which the vehicles are registered);

4. A copy of the debtor's last state and federal income tax returns (do not send originals);

5. A copy of paycheck stubs or equivalent documents issued by the debtor's employer showing gross earnings and all deductions for the month ended just before the filing of the case.

The debtor is restrained and enjoined from selling, transferring, abandoning, releasing to creditors, or in any way disposing of property until further orders of the court.

Failure to timely comply with this order will result in the filing of a motion to dismiss the within case.

Counsel for the debtor is responsible for seeing that the debtor complies with this order.

Dated:

By the court -

U.S. Bankruptcy Judge

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MESSAGE TO CHAPTER 13 DEBTORS ABOUT TODAY'S MEETING OF CREDITORS

Today you are attending the "341 Meeting" or a "Meeting of Creditors." Someone from the Chapter 13 Trustee's Office presides at the meeting. This meeting is tape recorded. You will be asked to take an oath that everything you say is true and correct to the best of your knowledge. You will be asked questions about your bankruptcy case. Your testimony is under penalty of perjury.

• Please speak up so that your voice can be heard on the tape.

• Please answer the questions "yes" or "no" instead of "uh-huh" or nodding your head.

• If you have filed a joint petition with your spouse, both of you need to answer every question.

• If you do not understand a question, please say so.

• Please feel free to explain your answers.

• Remember, you must answer all questions truthfully and completely.
QUESTIONNAIRE FOR CHAPTER 13 CREDITOR MEETINGS

Please state your name and social security number for the record.

[SHOW DEBTOR A COPY OF PAGE 2 OF PETITION] Is this your signature?

In the paperwork you filed with the Bankruptcy Court, did you list everything that you own?

Did you list everyone that you owe money to?

Is all the information contained in the petition and schedules true and correct to the best of your knowledge?

Has anything changed since you filed your bankruptcy?

Are there any corrections or additions you need to make?

Have you ever filed bankruptcy before?
[IF YES]: When?

Have you made your first chapter 13 payment yet?

[IF A DEBTOR IS EMPLOYED]: Are there any deductions from your paycheck for:
retirement/401k
profit sharing
stock purchase plan
Christmas club or vacation account
credit union or other savings
child support
garnishment
car payment or other debt
QUESTIONS TO BE ASKED BY TRUSTEE (as appropriate or necessary)

Can you afford $___ per month for your chapter 13 payment?

Do you receive overtime on a regular basis?

Do you receive (or have you in the past received) bonuses? How often? How much?

Do you expect your income to change within the next 3-5 years as a result of retirement, loss of child support or maintenance, change in disability status, loss of unemployment payments or workers' comp payments, or other reason?

Do you have any claims, pending lawsuits, or potential lawsuits against anyone? [IF YES]: Describe the nature of the claim or lawsuit. State the name of any attorney you have consulted about the lawsuit.

If you own real estate, how much do you think it would sell for today?

Child support: paid:____ received:____
for how many children
how much $
how long
current?

Notes:
UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF KENTUCKY

Division

In re:

Case No. ________________

Debtor(s)

MOTION TO DISMISS CH. 13 CASE

The trustee asks the Court to dismiss this case because

[ ] the debtor(s) did not appear at the §341 First Meeting of Creditors.

[ ] the attorney for the debtor(s) did not appear at the §341 First Meeting of Creditors.

[ ] the debtor(s) did not timely provide the documents required by the Court's Order to Debtor.

DATE: ____________

___________________________
Trustee

NOTICE

This motion to dismiss will be brought on for hearing at _________ on _________
____, 20__, United States Bankruptcy Court _________________________________.

CERTIFICATION

This is to certify that the above motion was served on the parties listed below on this the
_____ day of __________, 20__.

___________________________
Trustee
UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF KENTUCKY

Division

In re: 

Case No. 

Debtor(s)

MOTION TO CONTINUE

Comes now counsel for the above-captioned debtor(s) and moves the Court for an order continuing the scheduled §341 First Meeting of Creditors. An affidavit in support of said motion is attached.

DATE: 

Counsel for Debtor(s)

CERTIFICATION

This is to certify that the above motion was served upon the trustee, the U.S. Trustee, and all creditors listed on the debtor’s matrix on this the ____ date of ______, 20___.

Counsel for Debtor(s)
In re: 

Debtor(s)

ORDER

Upon the timely-filed motion of the debtor(s) to continue the §341 First Meeting of Creditors and the Court having reviewed the record and being otherwise properly and sufficiently advised,

IT IS HEREBY ORDERED that the §341 First Meeting of Creditors be and same is hereby continued to a date and time to be set by the trustee.

DATED: ________________

JUDGE

Copy to: Trustee

Attorney for Debtor(s)
Chapter 13 Trustee  
Eastern District Of Kentucky

▶ Chapter 13 Confirmation Procedure ◀  
effective August 1, 2000

Chapter 13 Plan: A standardized plan has been adopted for this district for all chapter 13 cases filed on or after August 1, 2000. See Form #2 of Local Rules.

The standardized plan is the centerpiece of the revised chapter 13 confirmation and delinquency procedures. It will:

- facilitate the review of the plan for feasibility
- offer consistency in the language of common plan provisions while retaining the flexibility needed to address debtors’ special circumstances
- eliminate common reasons for defective plan notices and pre-confirmation plan amendments
- provide secured creditors with early information about how their claims are to be treated, which in turn means an early bar date for filing objections to confirmation can be set
- speed up confirmation so that some plans can be confirmed immediately following the 341 meeting of creditors, and most plans should be confirmable within 30 days after the 341
- enable more accurate tracking of plan payment requirements as compared to payments actually made

The plan is presently available as a Microsoft Word 2000 template or in WordPerfect 8 from the Chapter 13 Trustee or the Bankruptcy Court. Please visit www.kyeb.uscourts.gov or www.13network.com/lexhome.htm; www.ch13edky.com is under construction and will be operational soon. Instructions for using the standardized plan explain the reasons for including certain provisions, and point out variances between current practice and the standardized plan.

With the use of a standardized plan, the time-frame needed for confirmation can be abbreviated. The first confirmation hearing will be about 30 days after the 341 meeting, and the second confirmation hearing, which will be conducted by the court, will take place approximately 30 days after the first confirmation hearing. Previously, the 341 meeting and confirmation hearings were scheduled 60 days apart.

Defective Plan Notice: The Trustee will notify debtor’s counsel if there are problems preventing plan confirmation by serving on debtor’s counsel a Defective Plan Notice (“orange sheet”). The Defective Plan Notice may be amended and supplemented prior to confirmation as necessary.

Creditors’ Objections to Confirmation: Any creditor objecting to the treatment of its claim in the chapter 13 plan must file with the Court and serve on the Trustee an objection on or before the date and time first set for the Meeting of Creditors in Divisions other than Lexington. In Lexington Division cases, creditors’ objections must be filed
with the Court and served on the Trustee within ten (10) days following the Meeting of Creditors. Creditors and creditors’ counsel should be aware that in the absence of an objection, the value of their collateral is established by the debtor’s plan. The Trustee in this district does not make an independent determination of the value of property subject to liens.

If an objection to confirmation is filed, the Court will schedule an evidentiary hearing to be conducted approximately 60 days following the Meeting of Creditors. This evidentiary hearing and second confirmation hearing will be conducted by the Court at the same time.

341 Meeting of Creditors: If no objections to confirmation have been timely filed, and if the Trustee has not served on debtor’s counsel a Defective Plan Notice and does not intend to serve a Defective Plan Notice following the 341 meeting, the Trustee will tender to the Court an order confirming the chapter 13 plan.

First Confirmation Hearing: The notice of the confirmation hearing is combined with the notice of the meeting of creditors that is sent to all creditors. The first confirmation hearing is conducted by the Trustee’s office about 30 days following the meeting of creditors. The debtor is not required to attend the confirmation hearing; however, the debtor’s presence may be beneficial to the parties depending on the nature of the objections to the plan.

If the Trustee has served a Defective Plan Notice on counsel for the debtor, or if a creditor has filed an objection to confirmation and the objection is unresolved, or if a motion for relief from stay has been filed, debtor’s counsel is required to attend the first confirmation hearing. At that hearing any problems that can be resolved by the parties should be resolved, and the appropriate amendments, agreed orders and other needed documentation should be filed within 15 days thereafter to allow for confirmation.

The confirmation hearing will be continued for approximately 30 days and will be scheduled for hearing on the Court’s docket. The Trustee is instructed not to continue the confirmation hearing to the Trustee’s docket for any reason, and not to continue the confirmation hearing for a longer period than the approximately 30-40 days until the next date on which the court will conduct hearings in the division in which the case is pending.

If there are no unresolved objections to confirmation from the Trustee or any creditor, counsel for the debtor is not required to attend the hearing. The Trustee’s office will give notice of cases which can be confirmed without a hearing (the “short-list”) to the Court and to the appropriate counsel for the debtors no later than approximately 5 days prior to the date of the first confirmation hearing. The Trustee will tender to the Court an order confirming the plan.

The Trustee will not file a Trustee’s Report and Recommendation prior to the first confirmation hearing. The TR&R is not needed to advise debtors’ counsel of whether the plan is confirmable; the Defective Plan Notice will serve that purpose. And the TR&R is no longer needed to advise secured creditors of how their claims are to be treated under the plan; the standardized plan serves that purpose.

Second Confirmation Hearing and Valuation Hearing: Problems addressed in the Defective Plan Notice must be cured within 15 days after the first confirmation hearing in order to obtain a favorable recommendation from the Trustee as to confirmation. The
Trustee will file a Trustee's Report and Recommendation approximately 7 to 10 days prior to the second confirmation hearing. If the Trustee recommends confirmation of the plan and objections to confirmation have been resolved by agreed order or otherwise, the Trustee's office will tender to the Court an order confirming the plan. The Trustee's office will give notice of cases which can be confirmed without a hearing (the "short-list") to the Court and to the appropriate counsel for the debtors approximately 5 days prior to the date of the confirmation hearing so that the cases can be removed from the Court's docket.

The confirmation hearing in cases which are not "short-listed" will be conducted by the Court. The Court does not require attendance of the debtors at confirmation hearings which it conducts. In addition, any valuation hearing or other hearing on a creditor's objection to confirmation will be conducted by the Court at the same time as the second confirmation hearing.

At the second confirmation hearing, the Court will not take any papers for filing such as last minute agreed orders, last minute amended plans, etc. The Court will consider only what has been properly and timely filed in time for all parties to react to it.

Motion to Continue Confirmation Hearing: If a debtor has special problems such as tax claims that require more time to address, debtor's counsel should file a motion to continue the second confirmation hearing and set forth in the motion the reasons for the requested continuance and a proposed time frame needed to resolve the issues. The motion to continue must be noticed for hearing no later than the date of the second confirmation hearing. The Court may, upon request of the Trustee or of any secured creditor, direct counsel for the debtor to tender agreed orders of adequate protection so that payments can be made to secured creditors during the extended period needed for confirmation.

Payment Delinquencies at Time of Confirmation: No case will be confirmed unless the debtors are substantially current in payments, both to the Trustee and to secured creditors. If the debtors have not made any payments within 40 days after the plan is filed, the Trustee will file a motion to dismiss the case which will be heard by the Court in lieu of the first confirmation hearing. Cases in which the debtors are not substantially current in payments at the second confirmation hearing will be dismissed at that hearing. The failure of debtors to be substantially current in payments is not a valid reason for requesting that the second confirmation hearing be continued.

Notice of Allowance of Claims: After the bar date for filing proofs of claims by governmental units, the Trustee will file with the Court and serve on debtor, debtor's counsel, and all creditors a Notice of Allowance of Claims, which will set forth how the Trustee's office has set up all filed claims for payment. By the time this Notice is served, disbursements on claims filed as secured will have commenced. It is advisable that debtor's counsel review all claims filed as secured so that disbursements will not be made on claims which were filed as secured but which the debtor believes are unsecured. See Standardized Plan Instructions, Section III.F, for more information. Parties will have 10 days in which to object to the Notice of Allowance of Claims. In the absence of objections, the claims will be deemed allowed.
Chapter 13 Trustee
Eastern District Of Kentucky

> Standardized Plan Instructions <

effective August 1, 2000

Section I.A.1. Step Plan Payments:

Generally the plan will call for payments of $X for X months. However, for a variety of reasons, debtors’ payments may need to vary during the life of the plan. In those instances, the monthly step payment schedule should be used. Examples:

- income is expected to increase (anticipated job promotion; car loan is almost paid in full).
- income is expected to decrease (loss of child support when child turns 18).
- plan payments will increase for a period of time to cure a delinquency.
- income fluctuates seasonally.
- ***plan payments need to be amended (pre-confirmation) or modified (post-confirmation).***

The use of a step payment schedule is a significant change in local practice and is required for the trustee’s new delinquency program. Consider the following example:

*Debtor’s plan calls for payments of $100 per month for 60 months. Debtor makes two payments (total paid in: $200). Debtor’s plan then must be amended (pre-confirmation) to increase payments to $200 per month. The amended plan looks just like the original plan except it now says “Debtor will pay $200 per month for 60 months.” The trustee’s new system will show payments are due from month 1 through month 60 at $200 per month for a total pool amount of $12,000. When the plan is confirmed, the debtor will be behind $200, because in month 1 and 2 he paid only $100 per month, not $200 per month. The correct way to show the amended payments is using the step payment plan: month 1-2: $100; month 3-60: $200; total pool: $11,800. Another option, which is rarely feasible, is for the debtor to catch up the past due amount so that the pool amount remains $12,000.*

The importance of using the step payment schedule cannot be emphasized enough. It is the key to the trustee’s delinquency program, and along with the total pool amount (Section I.C.) will accurately track the balance remaining to be paid in to the plan at any given time.

Section I.A.2. Periodic Plan Payments:

In addition to making regular payments, the debtor may also need to make periodic payments, for example, quarterly bonuses or annual tax refunds; or one-time lump-sum payments, for example, proceeds from the sale of real estate or non-exempt proceeds from a personal injury action. (See also Section VII).
Estimated Payments: If the debtor must pay the entire bonus or tax refund or sales proceeds or whatever into the plan but the amounts of those payments are unknown, the amount to be received should be estimated so that a dollar amount can be used in evaluating feasibility of the plan. If the amount of the payment is less than estimated, the debtor will not be delinquent.

Actual Payments: On the other hand, if the debtor knows she must pay, for example, $1,000 of her tax refund every year into the plan in order to make the plan work, that payment should be identified as “actual.” If the debtor fails to make the entire actual payment, she becomes delinquent, and arrangements must be made to cure the delinquency.

Section I.C. Total Amount To Be Paid (Pool Plan Only):

The plan must specify the total amount to be paid over the duration of a pool plan. A separate “pool plan calculator” is available to use with the monthly step payment schedule. The pool plan calculator allows the user to input specific dates, and it will calculate the number of months.

The amount of the pool is important if a subsequent plan modification is needed to cure plan delinquencies. Also, having a fixed pool amount will help debtors and debtors’ counsel quickly determine how much remains due under the plan (pool amount minus total paid in equals payoff amount).

Section I.D. Method of Payment:

If the debtor is employed, a request for a Payroll Deduction Order (PDO) may be made in the plan. The trustee will process the PDO so that payments can commence within 30 days. Because a debtor’s chances of succeeding in chapter 13 are greater when plan payments are payroll-deducted, the trustee strongly recommends payments by PDO.

Section III. Treatment of Secured Claims:

Every secured claim listed in Schedule D must be itemized in the plan. This is a significant change in local practice. Many plans used by debtors’ attorneys do not identify the value of collateral in the plan. Instead, reference must be made to the Schedules. The standardized plan requires that all information, including value of collateral, must be set forth in the plan.

Section III is the most likely place to identify how a secured claim will be treated. However, the debtor may want to treat all or part of the claim in a manner not addressed in Section III. For example, a third party may be paying the mortgage arrearage outside the plan. Section VII should be used if Section III does not fit the debtor’s needs.

If a secured claim is listed in Schedule D (Creditors Holding Secured Claims) and is not specifically addressed in Section III or Section VII of the plan, by default the claim will be paid inside the plan at the contract rate of interest. If the contract rate is greater than the present market rate of interest, the trustee will object to payment of contract rate, confirmation will be
delayed, and an amended plan will be necessary. See Section III.F. Do not omit from the plan any secured creditor listed in Schedule D.

Section III.A. Secured Claims to be Paid Inside the Plan:

The name of the creditor, collateral description, amount of claim, and proposed secured value come straight from Schedule D (Creditors Holding Secured Claims). Of course, if for example the debtor owes ABC Credit Union on a car and on a boat and wants to pay the car inside the plan and surrender the boat, separate values need to be placed on each item of collateral in the plan itself.

An interest rate must be specified for each claim to be paid inside the plan. If the interest rate field is blank for any creditor, the default interest rate in the plan is the contract rate. If the contract rate is higher than the current market rate of interest, the trustee will object to payment of contract rate, confirmation will be delayed, and an amended plan will be necessary. Do not leave the interest rate field blank on any row in this section.

Section III.B.1. Payments “OSEA” – Outside Except Arrearages:

By default, any claim to be paid outside the plan will be treated as being “outside except arrearages,” and the arrearage claim will be treated inside the plan (see Section III.C.). The monthly payment on an OSEA debt must be reflected in Schedule J (Current Expenditures of Individual Debtors) (the budget).

The plan also asks for the date on which the note matures. If the note will be fully paid during the life of the plan, plan payments must increase at that time. Asking for the maturity date of the note will serve as a reminder to use the step payment schedule (See Section I.A.1.).

It is important to identify “OSEA” claims because of the effect of such claims on feasibility issues. If, for example, a mortgage debt is listed in Schedule D (Creditors Holding Secured Claims) and the plan does not specify it is to be paid outside the plan, it will be treated as a secured claim to be paid inside the plan. See Section III.F.; see also 11 U.S.C. § 1326(c) (unless the plan provides otherwise, “the trustee shall make payments to creditors under the plan”). That of course will make the plan not feasible. This is a common reason for Defective Plan Notices.

If the debtor believes there is an arrearage on a debt to be paid outside the plan, put the estimated amount of the arrearage and the interest rate at which the arrearage claim should be paid in this section. If no interest is to be paid, insert 0%. If the debtor does not believe a prepetition arrearage is owed, insert an interest rate – even 0% if appropriate - anyway. See Section III.C.

Section III.B.2. Payments “OSTP” – Outside by Third Party:

List claims that someone other than the debtor will pay. The name of the third party and the relationship of that person to the debtor is also required.
It is important to distinguish OSTP claims from OSEA claims. Frequently a plan will state only that the debt is to be paid outside the plan without reference to the fact that it is to be paid by someone other than the debtors. The trustee will object to the plan if that outside payment is not listed on Schedule J (Current Expenditures of Individual Debtors) and will question whether the debtor can afford both the chapter 13 payment and the outside payment. Or it may be that a boat or extra car is to be paid by the debtor’s parents, for example, but that fact is not disclosed in the plan. The trustee will object to the debtor keeping unnecessary property, and confirmation is delayed while an amendment to the plan is prepared.

Section III.C. Arrearages:

Frequently the debtor does not believe he is in arrears, yet the proof of claim filed by the creditor has an arrearage amount listed. In the past, this caused problems because the plan did not specify how that arrearage claim should be paid, and a Defective Plan Notice was sent so that the plan could be amended.

The standardized plan provides that by default any arrearage claim will be paid inside the plan as a secured debt. That means it will be paid concurrently with all other secured debts. The plan also specifies that interest on the arrearage claim will be paid at the contract rate unless the plan specifies otherwise. Once again, if the contract rate is higher than the market rate of interest, the trustee will object. That is why it is important to state an interest rate that will be paid on any arrearage claim that might be filed by a creditor listed in Section III.B.1., even if the debtor does not believe an arrearage is due.

Arrearage claims can be treated differently. For example, if the arrearage is to be cured by the debtor’s parents when they assume the debtor’s mortgage payment, Section VII can so specify, and the arrearage claim will be set up as OSTP.

Section III.D. Surrender of Property:

Specify the property which the debtor intends to surrender to the secured creditor. Include any collateral repossessed prepetition if the debtor does not wish to regain possession and the collateral had not been sold by the creditor as of the date of the filing of the petition. This information is necessary so that when the claim is filed, the trustee will not make disbursements on the claim as a secured claim.

This section also provides that the automatic stay will be deemed terminated upon confirmation of the plan as to property surrendered pursuant to this section of the plan. This is a new practice. Furthermore, this section reminds secured creditors that they need to file an amended proof of claim for any deficiency remaining after the collateral is sold. See also Section III.G.

Section III.E. Avoidance of Liens Under 11 U.S.C. § 522(f). This paragraph reflects current practice that liens can be avoided under section 522(f) in the plan itself.
Section III.F. All Other Secured Claims:

This paragraph provides a default treatment of secured claims and is required in the standardized plan. There are three primary situations this default paragraph is intended to address. Section III.F makes a significant change from current practice with respect to the second and third situations.

The first reason for the default paragraph is to make sure every claim listed in Schedule D (Creditors Holding Secured Claims) is treated in the plan. Frequently a claim listed in Schedule D is not addressed anywhere in a plan. The trustee must send a Defective Plan Notice because the treatment of a particular claim was not specified, and the plan must be amended before it can be confirmed. If a secured claim is listed in Schedule D and is not specifically addressed in Section III or Section VII of the plan, by default the claim will be paid inside the plan at the contract rate of interest. In many instances this will correct the oversight. However, if the contract rate is greater than the present market rate of interest, the trustee will object to payment at contract rate, confirmation will be delayed, and an amended plan will be necessary. It is important to include in the plan every claim listed in Schedule D.

The second scenario occurs when a secured creditor listed in Schedule D has multiple items of collateral, including property that the debtor does not list as owning. Perhaps the collateral was repossessed pre-petition and the debtor does not want to regain possession. Or it may be that the collateral is in the possession of the debtor’s former spouse in accordance with the pre-petition property settlement agreement. In current practice the trustee makes an assumption that such claims are unsecured as to the debtor. The standardized plan will treat such claims as secured to the extent of the value of the collateral set forth in the creditor’s proof of claim unless the plan provides otherwise. It is important that the plan specifically address those claims (“to be surrendered”; “OSTP”; etc.) so that the default provision does not apply.

The third situation involves a discrepancy between the plan or schedules and the proof of claim. For example, the debtor schedules a claim as unsecured (or forgets to list the creditor at all), but the creditor files a proof of claim as secured. In the past the trustee has treated these claims as unsecured. The standardized plan will treat such claims as if secured to the extent of the value of the collateral as set forth in the creditor’s proof of claim, to be paid inside the plan with interest at the contract rate. The debtor or the trustee can always object to the claim if appropriate, and the claim will be paid only to the extent it is allowed. The drawback to applying Section III.F in this third situation is that if the contract rate of interest is higher than the current market rate, the trustee will object to confirmation, or may require the debtor to modify the plan.

While debtor and debtor’s counsel have control over the first two scenarios and can take steps to prevent the default paragraph from being applied, they may not be able to prevent the third situation. For example, a creditor may file a proof of claim as secured under the mistaken belief that it holds a security interest. This happens on occasion. On the other hand, the situation often occurs when the debtor did not provide to counsel all the necessary documentation to enable counsel to determine that a particular claim is secured.
Debtor’s counsel will need to review claims carefully to make sure an unsecured claim is not set up to be paid as a secured claim. There are two alternatives for debtor’s counsel. First, Section VII can provide that if any claim is scheduled as unsecured but the creditor files a proof of claim as secured, the claim will be treated as an unsecured claim. Second, the plan can be amended or modified as necessary to address the particular claim (“to be surrendered”; “OSTP”; 522(f); etc.).

Debtor’s counsel will need to be especially vigilant with respect to creditors claiming nonpossessory, non-purchase money security interests in household goods that can be avoided under 11 U.S.C. § 522(f) so that an appropriate amendment to the plan or an objection to the claim or a motion to avoid the lien can be filed.

It is important to remember that the trustee will no longer presumptively treat certain claims as unsecured if the proof of claim indicates it is a secured claim. Instead, such claims will be treated as specified in the proof of claim absent some instruction in the plan to the contrary.

Section III.G. Orders Granting Relief From Stay: Upon entry of an order granting relief from stay, the trustee will not make any further disbursements to the secured creditor obtaining stay relief until the creditor files an amended claim for any deficiency. This provision reflects current practice. The purpose of putting it in the plan is to negate the need for the trustee to file a memorandum of understanding as to each order terminating the automatic stay.

Section IV. Treatment of Priority Claims:

All priority claims listed on Schedule E (Creditors Holding Priority Claims) must be listed in Section IV or in Section VII of the plan. Otherwise a Defective Plan Notice will be sent.

Section V.A. Estimated Amount of Unsecured Debt (from Schedule F):

The purpose of requesting the total dollar figure of unsecured debts from Schedule F (Creditors Holding Unsecured Nonpriority Claims) in the plan is to facilitate the evaluation of feasibility and the liquidation test. General unsecured claims do not need to be itemized in the plan.

Section V.B. General Unsecured Claims:

There are three ways unsecured claims can be treated: paid in full, paid X% (the “fixed percentage plan”), or paid to the greatest extent possible from the “pool” of funds paid in by the debtor (the “pool plan”).

Generally speaking, the fixed percentage plan is an anomaly, but it is still used by several attorneys. One of two problems frequently arise in fixed percentage plans. The first problem arises when it will take fewer than 36 months to pay X%. This might occur when, for example, several unsecured creditors did not file proofs of claims, or claims were filed but disallowed as tardy. The debtor is required to pay all of his disposable income into the plan for at least 36
months (unless unsecured debts are paid in full). In the past, either a Defective Plan Notice required the debtor to amend the plan, or the trustee filed a plan modification after confirmation to convert the fixed percentage plan into a 36-month pool plan. The standardized plan will now automatically change a deficient fixed percentage plan into a 36-month pool plan.

The second problem with fixed percentage plans is at the other end of the spectrum. The problem arises when it will take more than 60 months to pay the fixed percentage. The trustee will continue to send Defective Plan Notices in these instances because the plan is not feasible. The use of a pool plan will usually prevent this type of defect, but it will be up to debtor’s counsel to file amendments to cure any plan that exceeds 60 months.

The fixed percentage plan is strongly discouraged, but is permitted, with a standard proviso now that it will automatically convert to a 36-month pool plan if it is determined that the plan will pay the fixed percentage in fewer than 36 months. The pool plan is preferable.

Section V.C. Co-Signed Debts to be Paid in Full:

The debtor may not want to pay in full every debt listed on Schedule H (Co-Debtors), so the plan should specify which co-signed debts are to be paid in full.

Section VII. Special Provisions:

If the debtor’s intended treatment of a claim will not fit anywhere else in the plan, it should be addressed here in Section VII. Also, there may be additional provisions needed to address situations such as the sale of real estate or the addition of personal injury proceeds to the plan. The trustee’s office has prepared draft Addenda to address these situations which will provide guidelines as to what information is necessary to evaluate these special circumstances. “Business” chapter 13 cases may also require special attention in Section VII.
ADDENDUM No.

ADDITION OF NON-EXEMPT PROCEEDS
TO THE PLAN PAYMENTS
(Lawsuits for Personal Injury, Breach of Contract, etc.)

1. The Debtor(s) have certain causes of action identified below. Upon confirmation of the plan, said causes of action shall revest in the Debtor for prosecution during the pendency of the case. Upon receipt of an offer to compromise any cause of action, the Debtor(s) shall notice all parties in interest, creditors, the Trustee and the Court by providing appropriate notice and sufficient opportunity to object to the proposed compromise.

Description of Cause(s) of Action

2. Any non-exempt recovery arising from the aforementioned causes of action exercised by the Debtor(s), net of Court costs and attorney fees and cost, shall be paid to the Trustee for the benefit of the bankruptcy estate and disbursed as follows:

(a) First, to administrative claimants and costs whose efforts and actions resulted in recovery benefiting the estate;
(b) Second, to unsecured and undersecured creditors pro-rata pursuant to the priorities set forth in 11 U.S.C. Sec 726;
(c) Third, to the secured creditors, pro-rata; and
(d) Fourth, after payment of all remaining claims, administrative costs and expenses of the estate, the balance shall be refunded to the Debtor(s).

3. Any non-exempt recovery by the Debtor(s) shall be paid to the Trustee in addition to the plan payments and shall not alter or reduce the periodic payments due under the plan, nor shall the duration of the plan be shortened, except to the extent said recovery shall result in payment in full to all creditors and administrative costs.
1. The Debtor(s) are proposing to sell certain real property commonly known as ____________________________ ("Property"). Debtor(s) attaches herewith copy of the proposed Listing Agreement setting forth the asking price and terms of the sale offer. Upon receipt of a bona fide offer to purchase, the Debtor(s) shall notice all parties in interest, creditors, the Trustee and the Court by providing appropriate notice and sufficient opportunity to object to the proposed sale.

2. Debtor(s) shall cause the Property to be listed with ____________________________ ("Realtor") for ____ months. Should the Property fail to receive a written offer to purchase, Debtor(s) shall then offer the Property for sale to the highest and best bidder at public auction within ____ months after expiration of the aforementioned listing period.

3. Upon confirmation of the plan, the Realtor shall be approved to offer the Property for sale and to receive compensation as set forth in the attached Listing Agreement upon closing the sale.

4. Any non-exempt proceeds received from aforementioned sale of property net of commissions, fees and costs of sale, shall be paid to the Trustee for the benefit of the bankruptcy estate and disbursed as follows:
   (a) First, to administrative claimants and costs whose efforts and actions resulted in the sale benefiting the estate;
   (b) Second, to unsecured and undersecured creditors pro-rata pursuant to the priorities set forth in 11 U.S.C. Sec 726;
   (c) Third, to the secured creditors, pro-rata; and
   (d) Fourth, after payment of all remaining claims, administrative costs and expenses of the estate, the balance shall be refunded to the Debtor(s).

5. The non-exempt proceeds shall be paid to the Trustee in addition to the plan payments and shall not alter or reduce the periodic payments due under the plan, nor shall the duration of the plan be shortened, except to the extent said recovery shall result in payment in full to all creditors and administrative costs.
UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF KENTUCKY
DIVISION

IN RE:

DEBTOR(S) CASE NO.:

Defective Plan Notice

This plan will not be recommended for confirmation for the following reasons:

☐ Is the regular monthly Mortgage Payment to be paid inside or outside the plan?

☐ Is the Mortgage Arrearage to be paid inside or outside the plan?

☐ Is this plan a pool or percentage plan?

☐ The Trustee interprets the pool amount to be $__________________.

☐ The plan goes over 60 months.

☐ Secured and/or priority creditors will not be paid in full.

☐ The plan doesn’t provide an adequate percentage to be paid to unsecured creditors.

☐ Plans lasting less than 36 months must pay unsecured creditors 100%.

☐ The plan should not specify the amount of monthly payment to be made by the Trustee to any creditor.

☐ The plan lists conflicting interest rates.

☐ The plan should not forbid the Chapter 13 Trustee from filing claims on behalf of any creditor.

☐ The plan proposes to pay undersecured creditors outside the plan. ________________________________

☐ The liquidation test is not met. See attachment.

☐ The plan should specify that non-exempt proceeds from tort claims will be paid to the Trustee in addition to regular plan payments.

☐ The budget contains questionable expenses as follows:__________________________________________

☐ Expenses are included on the budget for debts that are to be paid by the Trustee.

☐ The plan proposed does not comply with the standardized plan required to be used with all cases filed after 08/01/00.

☐ Other: ______________________________________________________________________________________

Dated: 11/16/00

Beverly M. Burden, Trustee
P.O. Box 2204
Lexington, KY 40588-2204

To: Attorney for the Debtor

The dreaded orange sheet!
**PLAN WAS FILED 4/27/99**  
**POOL PLAN CALCULATOR**

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**Total Months:** 61

**Total Pool:** $18,900.00  
(Stated In Plan)

**NOTE:** How dates are input based on the actual due dates of payments.
### POOL PLAN CALCULATOR

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**Total Months:** 48

**Total Pool:** $11,880.00
## POOL PLAN CALCULATOR

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**Total Months:** 63

**Total Pool:** $36,000.00

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Casa # 
Name: 

[Signature]

---
Chapter 13 Trustee
Eastern District of Kentucky

Chapter 13 Delinquency Procedures
effective November 1, 2000

SUMMARY:
- first payment is due 30 days after plan is filed
- plan will be confirmed only if all payments are current
- plan arrearages must be cured, usually with double payments
- probation order means automatic dismissal if a single payment is 7 days late
- payroll deduction order will not cover payments to cure plan arrearage
- plan modification may be necessary to cure arrearages in older cases
- debtor’s attorney must be more active in delinquent cases
- do not have debtors call the trustee’s office about a motion to dismiss

Pre-Confirmation:
The debtor is required to commence making the payments proposed by a plan within 30 days after the plan is filed. 11 U.S.C. § 1326(a)(1). The plan must be filed within 15 days after the petition is filed. Fed. R. Bankr. P. 3015(b). The preferred practice given the fast track procedures on confirmation is to file the plan with the petition and schedules. When the plan is received, the trustee sends to the debtor a letter on bright yellow- or goldenrod-colored paper containing payment information. This is the only notice the debtors receive from the trustee about the amount and due date of their payments.

If the trustee’s office has not received and posted the debtor’s first payment within 35 days after the petition date, the trustee will send a letter to the debtor and debtor’s attorney, and if the debtor is employed, a payroll deduction order will be entered immediately. We wait 35 days because of the time it takes for checks to be mailed to the trustee’s lockbox in Memphis, Tennessee, and the resulting 2-day delay for the payment to be posted to the debtor’s chapter 13 account. In addition, at the 341 the debtor will be instructed to make the first payment immediately. If the first payment is not made forthwith, or if a payroll deduction order is not possible, and certainly if the debtor misses a second payment, a motion to dismiss will be filed.

Sometimes there is a delay between the time a payroll deduction order is requested and when monies begin to be deducted from the debtor’s paycheck. If a payment is due before the payroll deduction order has been effectuated, the debtor needs to make at least a partial payment directly on or before the payment due date and be prepared to pay the balance of the payment due by the end of the month if the payroll deduction still has not come out of the debtor’s check. That way the debtor has made a full monthly payment in the first month.
The trustee in the Eastern District of Kentucky does not accept payments at the 341 meeting or at any hearing. All payments must be mailed to the trustee’s lockbox address: Chapter 13 Trustee EKY, PO Box 1766, Memphis TN 38101-1766.

Because of the new fast-track confirmation procedures, it will be rare that a case will be confirmed if even one payment has been missed. The debtor needs to establish a willingness and an ability to make payments for the plan to be confirmed.

Post-Confirmation:

Until June of 2000, the trustee had some flexibility in working with debtors to arrange for them to catch up on missed payments. When in June of this year the judges began to preside over the trustee’s motions to dismiss, the trustee was instructed that motions to dismiss could be withdrawn only if the trustee had received payments sufficient to bring the debtor completely current in payments prior to the hearing.

Also, in the past, motions to dismiss were generated when the debtor missed consecutive payments. A skipped payment here and there did not usually trigger the filing of a motion to dismiss. Now, however, the judges have instructed the trustee to file motions to dismiss in every case in which the dollar amount of the total delinquency during the life of the case is the equivalent of two or more monthly payments, three or more bi-weekly payments, or five or more weekly payments. The purpose of doing this is twofold. One, by detecting a delinquent case early (i.e., when the debtor has missed only two payments), there is an increased likelihood the debtor can cure the plan arrearage and remain in chapter 13. The greater the delinquency, the harder it is (and the longer it takes) to catch up. Two, dealing with delinquencies immediately will decrease the chance that the plan will not complete within 60 months. If a debtor who missed two payments can double up on payments for two months, the duration of the plan is not affected. The judges have now taken a hard-line approach on cases that exceed 60 months and will dismiss a case that is in its 61st month.

The trustee is still in the process of adopting a new delinquency program that will be able to determine a delinquent case based on the money paid in to date compared to what should have been paid in to date. Cases in which the debtor has recently missed two payments will continue to be the subject of motions to dismiss. The court has prescribed several acceptable ways of curing plan arrearages in these cases, which are discussed below. However, this revised program will also generate motions to dismiss in cases in which the debtors are presently current but have missed payments in the past. No longer will the court permit these missed payments to be tacked on at the end of the plan in 60-month cases. This holds true with suspended payments as well. Instead, debtor and debtor’s counsel will have to take action to eliminate the past arrearage. In the coming months there will be an increased number of motions to dismiss filed, especially in older cases, even though the debtor is presently current in payments. And because the trustee is no longer able to work out payment plans with a delinquent debtor, debtor’s counsel must assume a more active role in addressing plan arrearages than in the past. Any proposal to cure plan arrearages must be approved by the court.

At the request of the judges, all motions to dismiss will soon disclose the amount of the plan arrearage and the equivalent number of months it would take to cure the arrearage. In
addition, we will provide to debtors a printout showing the payments we have received. Counsel has access to the receipt history via the 13network.com website.

"Present Delinquencies". We will use this term to describe cases in which the debtor has missed two or more monthly payments in the past twelve months. Please note that for purposes of filing a motion to dismiss, it does not matter when the delinquency occurred; only the dollar amount of the delinquency in relation to the monthly payment due is relevant. However, from the perspective of the trustee (and debtor's counsel), the age of the arrearage may have some bearing on how it should be addressed, as discussed below.

The methods of curing arrearages as prescribed by the court are well-suited to cases with recent delinquencies. The court generally permits the debtor to cure an arrearage comprising up to 4 (sometimes 5) months' worth of payments. The court generally requires that plan arrearages be cured within a relatively short period of time, and the cure must start reasonably soon after the hearing. We tried last year using tax refunds to cure arrearages, and the result was an abysmal failure. Consequently, that is no longer an option. Most frequently the judges require double payments or a payment and a half to be made until current, with extra payments to start on the next due date following the date of the hearing. Sometimes, based on representations of debtors that they can become current right away (a frequent response to the court's question "how soon can you get caught up?" of a debtor who is fearful that the case will be dismissed), the judge will grant them a brief period (generally not exceeding 30 days) in which to bring payments completely current. Your clients might be well-advised to offer double payments, and if they are able to be current in 30 days (without skipping a mortgage payment), great; if not, they still have a chance to get caught up. There are no brownie points given for curing a plan arrearage in 10 days versus 4 months.

It is important to note that payroll deduction orders will not be amended to capture the extra payments required to cure plan arrearages. Besides the fact that it would impose an administrative burden on my office, in my view the debtors should have to expend some effort to make the missed payments themselves. Therefore, debtors whose payments are made via payroll deduction need to know how much to pay each month, how long to make the extra payments, and where to send the payments. We will not calculate this for debtors or counsel, but by providing the amount of the arrearage and the receipt history with the motion to dismiss, we have given the debtor and counsel the information they need to figure it out.

Regardless of how the arrearage will be cured, a probation order is sure to be issued. The probation order is effective for one year. During the next twelve months, if any single payment is received by the trustee more than 7 days after the due date, the trustee must file a notice of noncompliance and tender an order of dismissal, which will be entered immediately without further hearing or opportunity to cure. It is the ultimate "drop-dead" order. Whether it will have any bearing on eligibility issues if a subsequent case is filed within 180 days after the order of dismissal is entered is an open question right now.

Prior Delinquencies. In the coming months there will be an increased number of motions to dismiss filed, especially in older cases, even though the debtor is presently current in payments. It is the trustee's intention to notify counsel by letter of cases in which missed or suspended payments are likely to cause a plan to exceed 60 months as measured from the date of confirmation and give you sufficient opportunity to resolve the matter before a motion to dismiss the case is filed. If you have older cases that are at risk of being dismissed because of prior
unaddressed delinquencies, or because delinquencies and suspensions will cause the plan to exceed 60 months, you have several options. Please note that the methods of curing plan arrearages prescribed by the court and discussed above will not work if the arrearage is substantial (e.g., more than 5 months’ worth of payments). The judges have made clear that it is too late to catch up a substantial delinquency by making double payments; those cases are being dismissed. Consequently, other options should be considered.

You might want to file a plan modification to keep the case from being dismissed. You can increase the debtors’ monthly payments so that they still pay in the total “pool” amount within 60 months. That would have no adverse effect on creditors, so you would only need to notice the trustee. In fact, that can easily be done by agreed order signed by the debtor (and counsel) and the trustee.

However, sometimes the debtors can’t afford to increase their payments and may in fact need to reduce their payments. In those instances you might want to modify the plan to reduce the total “pool” amount being paid into the plan. The plan modification may also provide for a decrease in monthly payments, depending on the debtors’ present financial condition. You might be able to wipe out a delinquency by modifying the plan to “total paid in as of x date plus $x per month for the remaining x months of the plan”. This would require notice to all creditors, and an amended Schedule I and J must be filed in support of reduced payments.

Remember that any modified plan still has to be feasible, and the debtor still must satisfy the liquidation test, so a plan modification may not work in all cases. You can use the claims information and the summary information in the “debt breakdown” section from the 13network.com website to assist you in your evaluation of the feasibility of a plan modification. Don’t forget to include in your calculations an estimate of the amount of the supplemental fee to which you will likely be entitled (upon application and order approving) for your efforts in keeping your client in chapter 13.

Of course the other available options are to convert the case to a chapter 7 case or to allow the chapter 13 case to be dismissed and consider whether the debtor would benefit from refiling. Regardless of which route you choose, all proposals to cure plan delinquencies are subject to court scrutiny and approval, and there is no guarantee that the trustee’s agreement to the proposal will ensure it will be approved by the court.

Because the trustee can no longer work with debtors to arrange for them to catch up on missed payments, please do not tell your clients to call my office. There is nothing we can do. I have instructed my staff to inform debtors who call about a motion to dismiss that they need to call their attorneys. Also, we will soon be sending a letter to debtors along with the motion to dismiss advising them to call their attorneys.

This is a significant change from past practice, but it is necessary given the emphasis the court is now placing on the 60-month limit. We need to consider not only a debtor’s monthly payments, but also the total “pool” amount to be paid into the plan and the time it will take for a debtor to complete payments under the pool plan in light of missed and suspended payments.
## Fix Delinquency by Adjusting Payments

**Plan Payments were $100/month for 60 months.**

<table>
<thead>
<tr>
<th>Next Pmt. Due Date</th>
<th>Final Payment Date</th>
<th>Total of Months Remaining</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 1, 2001</td>
<td>December 31, 2002</td>
<td>24</td>
</tr>
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</table>

<table>
<thead>
<tr>
<th>Plan Base</th>
<th>Total Paid Into Plan</th>
<th>Pool Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>6,000</td>
<td>3,200</td>
<td>$2,800.00</td>
</tr>
</tbody>
</table>

**Modification Needed**

**New Pmt. Amount to Cure Delinquency**

$116.67

### OR

## Fix Delinquency Calculator by Adjusting Pool Amount

<table>
<thead>
<tr>
<th>Paid to Date</th>
<th>Total of Months Remaining</th>
<th>Modification Needed</th>
</tr>
</thead>
<tbody>
<tr>
<td>$3,200.00</td>
<td>24</td>
<td></td>
</tr>
</tbody>
</table>

**Monthly Payment Amount**

$75.00

**New Pool Amount**

$5,000.00

**Case Number:**

**Name:**

* = USER INPUT
Case Summary
Dear Chapter 13 Debtor:

The Chapter 13 Trustee’s office has filed a Motion to Dismiss your bankruptcy case because you have fallen behind on your plan payments to the Trustee.

This motion to dismiss does not mean that your case will automatically be dismissed. You might have several options to keep your bankruptcy case from being thrown out.

I urge you to contact your bankruptcy attorney as soon as possible. Your attorney can advise you on your options. For example, you might be able to file a new plan to change your payments. Or you might be able to bring your plan current by making extra payments. You might even decide that chapter 13 no longer works for you. Only you and your attorney can decide what is best for you.

The Trustee’s office cannot cancel or withdraw this motion to dismiss, so please do not call this office asking that we do so. Do plan to attend the hearing on the date and time listed on the motion. But first contact your attorney.

Yours truly,

Beverly M. Burden
Chapter 13 Trustee

cc: Debtor’s Counsel
![](image)

<table>
<thead>
<tr>
<th>Date</th>
<th>Code</th>
<th>Batch</th>
<th>Source</th>
<th>Credit</th>
<th>Claim ID</th>
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<td>0000 A7</td>
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**Totals**

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<tbody>
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<td>Less</td>
<td></td>
</tr>
<tr>
<td>Net</td>
<td>4,680.00</td>
</tr>
</tbody>
</table>

**DATE RECEIVED**

**MONEY ORDER RECEIPT NUMBER**

**CHECK NUMBER**
PROBATION NOTICE

The court has placed you on probation in your chapter 13 case. For the next year, if any single payment is 7 days (or more) late, your case will automatically be dismissed. The trustee must receive and post your payment within the 7-day grace period.
Chapter 13 Trustee  
Eastern District of Kentucky  

Chapter 13 Payment Suspension  
effective November 1, 2000

The trustee generally does not object to requests that plan payments be suspended for a period not to exceed 90 days where the motion shows cause to suspend the payments. In the past, suspended payments have been tacked on to the end of the plan. However, with the court’s emphasis on the 60-month limit for plan durations, that may not be possible, and other arrangements must be made for the debtor to make up the suspended payments. If the plan was confirmed as a 55-month plan (for example) rather than a 60-month plan, the trustee would not object to payments continuing past the 55th month until the suspended payments are completed, provided the plan does not thereby last longer than 60 months.

It is the position of the court that if the debtor is delinquent at the time the motion to suspend payments is filed, the missed payments are to be counted in the suspended period. In other words, the debtor cannot miss two payments, ask for a 3-month suspension, and thereby avoid making payments for 5 months.

The trustee would prefer that the order granting the suspension of plan payments specify the months in which payments will not be made rather than requesting a vague “60-day” or “90-day” suspension. Also, the order should specify how the debtor will make up the suspended payments. The attached order should be used as a guideline (and can be modified as necessary).

There may be times when the suspension is due to a significant change in the debtor’s financial condition (e.g., loss of employment) such that the debtor is unable at the time of the suspension to project whether and how suspended payments can be caught up. In that instance the debtor may want to wait until the suspension is over, s/he has resumed payments, and then propose a cure for the suspended payments. This delayed proposal should be filed within 30 days after the date on which plan payments resume. The debtor must resume payments at the current monthly payment until a subsequent plan modification is confirmed. A plan modification will require notice to all creditors, and an amended Schedule I and J must be filed in support of the modification. In the alternative, an agreed order signed by the trustee and requiring the debtor to make additional payments until the suspended payments are caught up will not require notice to creditors as they are not adversely affected.

If a payroll deduction order is in effect, counsel for the debtor, not the trustee, is responsible for serving the debtor’s employer. Also, when payments are to resume, the debtor is responsible for making payments if the employer does not resume the payroll deduction.
IN RE: 

DEBTOR(S) 

ORDER SUSPENDING PAYMENTS 

This matter having come on for hearing on the debtor's motion to suspend plan payments, IT IS ORDERED:

1. The debtor's plan payments are suspended for the following month(s) [please specify]: ________, 20__. 

2. The debtor shall resume payments in the month of ________, 20__.

3. [if applicable] The Payroll Deduction Order is also suspended for the months specified.

4. The debtor shall make up the suspended payments by:
   - [ ] increasing payments to $_____ per month for the remaining duration of the plan, which shall not exceed 60 months;
   - [ ] making [double] payments when payments resume for ______ months, provided that if a payroll deduction order is in effect, the debtor shall make the extra payments to the trustee directly and not through payroll deduction;
   - [ ] making a lump sum payment in the amount of $______ on or before ________, 20__. 
   - [ ] filing a motion to modify the plan, which motion shall be filed within 30 days after the date on which payments are to resume; OR
   - [ ] other (describe) ____________________

5. [if applicable] Counsel for the debtor shall serve this order on the employer if a Payroll Deduction Order is in effect.

Dated: ________________________________

By the court - ________________________________

Bankruptcy Judge

H - 56
Chapter 13 Trustee
Eastern District of Kentucky

Claims in Chapter 13 Cases

"under construction"

see Defective Claim Letter, Objection to Claim, attached.
August 24, 1999

To Creditor

Re: [Redacted]
SSN: [Redacted]
Account No. [Redacted]
Chapter 13 Bankruptcy Case No. [Redacted]

Dear Sir or Madam:

This office serves as the Trustee in the above referenced Chapter 13 case. As Trustee, we must object to claims that are lacking adequate documentation. Your claim in the amount of $13,974.27 is not supported by a statement of account that correlates with the amount of your claim. The statement of account can take the form of a ledger card or computer printout. Regardless, your statement must clearly demonstrate how you arrived at the amount of your claim.

Please provide us with adequate documentation along with a copy of this letter and mail to: Chapter 13 Trustee, P.O. Box 204, Lexington, KY 40588-2204. If we do not receive the requested documents within thirty days, we have no choice other than to object to your claim in its entirety.

If you have any questions or comments, please do not hesitate to contact us.

Yours truly,

Chapter 13 Office
Accounting Department
NOTICE AND OPPORTUNITY FOR HEARING AND OBJECTION TO CLAIM

TO: DEBTOR'S COUNSEL.  CREDITOR.

NOTICE OF HEARING

Notice is hereby given of this Objection to Claim. Unless a Response and Request for Hearing, stating grounds for opposing the Objection is filed within thirty (30) days of service of this Notice, an Order will be tendered sustaining the Objection and the matter will be submitted to the Court for decision. No hearing will be held unless a timely request for hearing is filed. Notice is further given that the attached order sustaining this objection is being tendered herewith.

CERTIFICATE OF SERVICE

It is hereby certified that a true copy of the foregoing was mailed on this the 13th day of October 1997, to the persons and addresses indicated above.

OBJECTION TO CLAIM

The Trustee objects to the claim of filed as claim number 0009 in the amount of $13,974.27 on the grounds that the claim was defective when filed and was never amended.

Beverly M. Burden, Trustee
P.O. Box 2204
Lexington, KY 40588-2204
see attached forms
Dear Practitioner:

We have received an inquiry from one of your clients regarding the possibility of incurring additional debt and/or re-financing a mortgage for the purpose of paying out their Chapter 13 case. We have asked your client to contact you directly for assistance with this matter.

Enclosed is the information you and your client need: an application to incur additional debt, an order, a creditor’s commitment, and instructions. In addition, amended Schedules I and J (the budget) must accompany the application. Please retain this packet as a master copy and use it when any of your clients desire to incur additional debt, or refinance existing debt, while their Chapter 13 case is open. These forms are also available on our website at www.ch13edky.com.

Also enclosed is our policy on obtaining payoff balances. Please review this policy and share it with your clients. It is especially important to note that we will not provide payoff balances to prospective lenders. We will provide the information only to the debtors or their attorneys.

Yours truly,
Chapter 13 Trustee
November 20, 2000

VIRGIL JACKSON and SANDRA JANE FRYMAN
#1, BOX 164
BERRY KY 41003

Re: Chapter 13 Bankruptcy
Case Number: 5-00-1332

1) The approximate balance of your Chapter 13 case is $

2) This balance is an ESTIMATE ONLY.

3) If you intend to either refinance your home, or borrow funds, in order to pay out your Chapter 13 case, you are REQUIRED to obtain an order from the U. S. Bankruptcy Court before doing so. Contact your attorney for information about this process.

4) The exact payoff will not be determined until your case has audited.

5) An estimate of your balance will only be provided once every sixty (60) days.

6) If you prefer to make your future requests by e-mail, you may send your request to erogers@ch13edky.com.

Thank you,

Erin Rogers
1. Fill out, sign and date the application.

2. File an amended schedule I and J with the U. S. Bankruptcy Court and provide a copy to the Trustee’s office with your completed application.

3. Have your attorney approve and sign the application also.

4. Have the lending institution complete their part of the application.

5. The Chapter 13 Trustee’s office reviews the application and then, if approved, forwards it to Bankruptcy Court for approval. It takes approximately 2-3 weeks to process the application. (The Trustee's office has no control over the length of time required for Court to review the application).

6. Call your Attorney if you have any questions or need help in filling out this application.

7. The Trustee's office will not give specific information about your Chapter 13 case to any lending institution. We will mail a print out of your case to you if requested. You may share this information with any potential creditor.

8. We only send one payoff letter to your Attorney, if you intend to pay off your case. This amount will be mailed to you only after we have audited your case.

   *** Only COMPLETED APPLICATIONS will receive an audit ***

9. You must provide a written estimate if your application to incur debt is for home or vehicle repairs.

Return the completed application to:
UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF KENTUCKY

RE: CASE NO.

DEBTOR(S)

APPLICATION TO INCUR ADDITIONAL DEBT

The Debtor hereby applies to the Court for approval of additional debt to be repaid by way of direct installment payments.

The additional debt is as follows:

PURCHASE PRICE: ______________________

(If this debt does not involve a purchase, skip down to "TOTAL AMOUNT OF DEBT").

DOWN PAYMENT: ______________________

TRADE-IN: ______________________ (if applicable)

TOTAL AMOUNT OF DEBT: ______________________

MONTHLY INSTALLMENT: ______________________

PURPOSE OF DEBT: ______________________

NAME OF CREDITOR: ______________________

SECURITY: (Describe) ______________________

The debt is for property or services necessary for the Debtor(s) performance under the plan.

The Debtor(s) will be able to make the payments on the new debt as well as maintain payments under the plan. Attached is a current income and expense budget form. The Trustee has reviewed the budget and believes it is a fair account of the Debtor(s) current financial situation.

Previous application to incur additional debt? ______________________

Dated: ______________________

Debtor ______________________

Attorney for Debtor(s) ______________________

Debtor ______________________

Chapter 13 Trustee ______________________
CREDITOR'S COMMITMENT

It is hereby acknowledged that ________________________________
(Name of Borrower)

has applied to ________________________________ for credit as follows:
(Lender)

PURCHASE PRICE: ________________________________
(If the new debt does not involve a purchase, skip down to "TOTAL NEW DEBT").

DOWN PAYMENT: ________________________________

TRADE-IN: ________________________________
(If Applicable)

TOTAL NEW DEBT: ________________________________

MONTHLY INSTALLMENT: ________________________________

SECURITY: (DESCRIBE) ________________________________

INTEREST RATE ON LOAN: ________________________________

It is understood that the applicant is in an active Chapter 13 case in the Bankruptcy
Court for the Eastern District of Kentucky.

Approval of the credit extension is hereby granted subject only to the approval of said
Bankruptcy Court which the Borrower undertakes full responsibility to obtain.

DATE: ________________________________

BY: ________________________________
(LENDER'S SIGNATURE AND TITLE)
ORDER APPROVING ADDITIONAL DEBT

The debtor(s) have applied to the Court for approval of debt (after filing Chapter 13). The Trustee has no objection to such additional debt and feels that the additional debt should not interfere with the performance of the plan.

IT IS HEREBY ORDERED that the Court approves the application of the above Debtor(s) to incur additional debt in an amount not to exceed ______________________ for the purpose of ____________________________________________________________

________________________________________
The parties agree and it is so Ordered that such additional debt shall not be affected by any Chapter 13 discharge entered in this case. The Chapter 13 Trustee shall not be responsible for administering this additional debt.

This the _________ day of ____________________, 19 ___.

BANKRUPTCY JUDGE

Approve Entry:

Attorney for the Debtor

Chapter 13 Trustee
# Log-in Screen

## 13 Network Home - Microsoft Internet Explorer

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<th>Back</th>
<th>Forward</th>
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<th>Refresh</th>
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<th>Favorites</th>
<th>Mail</th>
<th>Print</th>
<th>Edit</th>
<th>Size</th>
</tr>
</thead>
</table>

- **Address**: http://www.13network.com/

- **Links**: Customize Links, Free Hotmail, Windows, Personal Files

<table>
<thead>
<tr>
<th>State</th>
<th>Names and Locations</th>
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**WWW.13NETWORK.COM**
User Log-in

Beverly M. Burden
Chapter 13 Trustee
Eastern District of Kentucky

Office Hours: 8:00 am - 4:00 pm EST
Mailing Address: Chapter 13 Trustee EDKY
PO Box 2204
Lexington, KY 40568
Payment Address: Chapter 13 Trustee, EDKY
PO Box 1766
Lexington, KY 40568

Authorized Users Log-In
Chapter 13 Inquiry
Other Links
To obtain a user ID and password click here
Web Access Agreement

Chapter 13 Inquiry

Please enter your User ID and Password.
Click on the Submit button when done.

User Id: __________________________
Password: _________________________

Submit  Reset  Cancel

Important: Users accessing this information must have the proper consensus of the Chapter 13 trustee.
Search for Case Number

13network.com

List all cases in order by

Case Number

or

List cases where

Case Number

Equals

!13Network Login - Microsoft Internet Explorer

File Edit View Favorites Tools Help

Back Forward Stop Refresh Home Favorites Mail Print Edit Size

Address http://206.160.143.105/exloginfrm.htm

Links Customize Links Free Hotmail Windows Personal Files

CHASE

THE RIGHT RELATIONSHIP IS EVERYTHING.

Chase Bankruptcy Information Systems, Inc.

Case Query

Case Number: "2341339 order by Case Number"

Click on the case number to view detail information.

Case Number  Debtor 1 Last Name  Debtor 1 First Name  Debtor 2 Last Name  Debtor 2 First Name


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**Case Information**

**13network.com**

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<tr>
<th>Case</th>
<th>First Name</th>
<th>Last Name</th>
<th>Address 1</th>
<th>Address 2</th>
<th>Address 3</th>
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<th>A/K/A</th>
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**Attorney Information**

**13network.com**

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<tr>
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<th>Fee in Plan</th>
<th>Initial Amount</th>
<th>Initial Paid</th>
<th>Attorney's Percentage</th>
<th>Regular Payment Amount</th>
<th>Months between Payments</th>
<th>Arrears Amount</th>
<th>Paid to Date</th>
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Date Information

13network.com

Case
- Date Entered: [Date]
- Date Petition Filed: [Date]
- Date Plan Filed: [Date]
- 341 Meeting Date: [Date]
- 341 Meeting Time: [Time]
- Confirmation Hearing Date: [Date]
- Confirmation Hearing Time: [Time]

Attorney

Dates
- Paid Out Letter

Plan Payments

13network.com

Debtor 1
- Employer
- Pay Ded Amt: $133.85
- Pay Ded Freq: Bi-WEEKLY
- Dir Pay Amt: $0.00

Debtor 2
- Employer
- Pay Ded Amt
- Pay Ded Freq
- Dir Pay Amt

Summary

Claims

### Receipts Screen

**Case Inquiry - Microsoft Internet Explorer**

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**13network.com**

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**Case Inquiry - Microsoft Internet Explorer**

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**H - 76**
Debt Breakdown

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Claims Register

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<td>ROUTE 3</td>
<td>Submitted</td>
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<td>BROOKSVILLE KY 41004-0000</td>
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Website Access Agreement

This Agreement is made and entered into by and between the Office of the Trustee, Beverly M. Burden, Chapter 13 Standing Trustee (hereinafter referred to as a TRUSTEE), AND

INDIVIDUAL USER NAME: ____________________________

AND

COMPANY/FIRM NAME: ____________________________

Both the INDIVIDUAL USER AND COMPANY/FIRM are liable under this Agreement and may only access cases in which they are a creditor or debtor.

The Trustee is a duly appointed Chapter 13 Standing Trustee for the Eastern District of Kentucky, vested with the duties as set forth in U.S.C. Section 1302(b), including the duty to furnish information concerning debtors' estates and the administration of these estates. The Trustee maintains records and files in computerized form. The Trustee permits approved Internet Access to the User for the purpose of viewing and inspecting files of debtors for selected information regarding receipts and disbursements of funds.

The User desires Internet access to view and inspect these selected files.

THEREFORE, in consideration of the mutual promises and covenants contained in this agreement and the satisfactory performance of all conditions stated, the Parties agree that:

1. INTERNET ACCESS TO RECORDS - The User shall be given Internet Access to, and the Trustee shall provide that access to selected records and data maintained by the Trustee.

2. LIMITATIONS ON ACCESS AND USE - User hereby acknowledges and agrees to Internet Access.

PURPOSE - Shall be for the sole purpose of viewing and inspecting the selected data and records under the control and custody of the Trustee, and User shall neither make nor attempt to make any data entry changes or modification to any record or data.

USE - Is provided solely for the use of User in User's business. User hereby expressly agrees that it will not use nor allow the use of records, data or information obtained through the Internet Access for the purpose of solicitation or any other use or practice not specifically permitted by this Agreement.

MANNER - Will be accessed and used by User only in the manner expressly authorized and permitted by the Trustee. User agrees that it will neither use nor permit use of the Website in any manner or for any purpose which is not authorized by the Trustee or which is unlawful or which is likely to cause damage or disrepair to the equipment, software, records or Website of the Trustee.

3. CUSTODY AND CONTROL OF RECORDS - User hereby expressly acknowledges and agrees that the records and data for which access is provided under this Agreement are and shall remain records under the control and custody of the Trustee, and access is provided only under the direct supervision of the Trustee, pursuant to the terms of this Agreement and all reasonable and necessary rules and procedures adopted by the Trustee.

User, further, expressly acknowledges and agrees that while accessing, viewing and using the Trustee's selected records, the User shall be under the same duties, responsibilities, and obligations as the Trustee to protect and carefully keep and preserve the records, subject to the same penalties for any violation of those duties and obligations.

4. CONDITIONS FOR USE AND ACCESS

A. EQUIPMENT AND CONNECTIONS - The User shall obtain and supply, at its sole cost, all equipment, including computer, peripherals, modems, software and connections and shall be responsible for and pay any and all other fees or costs necessary to implement this Agreement.

5. TERM OF AGREEMENT - This Agreement shall continue until such time as it is terminated pursuant to the provision in the following subsection.

http://www.13network.com/lexWAA.htm
6. TERMINATION – This Agreement may be terminated by either the Trustee or by the User, at any time, for any reason whatsoever, without notice.

7. INDEMNIFICATION – User shall and hereby agrees to indemnify the Trustee for, and to hold Trustee harmless from any claims, demands, suits, damages or costs, of any kind, arising out of or relating to use and access provided under this Agreement, caused or claimed to be caused by any act or failure of Trustee.

8. ASSIGNMENT OR SUBCONTRACT – This agreement shall not be assigned nor shall any use or access provided under this Agreement be subcontracted, co-opted or allowed to any other person, firm or other legal entity without the express written consent of the Trustee, and such consent may be conditioned upon such terms and conditions as the Trustee may require.

9. ENTIRE AGREEMENT – This Agreement, together with any rules or procedures adopted by the Trustee shall constitute the entire Agreement between the parties, and User hereby expressly acknowledges that it is not relying upon any other representations or agreements not expressed in writing as a part of this Agreement. This Agreement may not be amended or modified, except in writing, and signed by all parties.

10. DISCLAIMERS AND LIMITATIONS OF LIABILITY:

A. NO WARRANTIES – The Trustee hereby expressly disclaims any express or implied warranties of the software program, computer equipment or computer, and User hereby expressly assumes all risk related to the use and access provided under this Agreement.

B. NO REPRESENTATIONS CONCERNING ACCURACY OR COMPLETENESS OF RECORDS – The Trustee hereby expressly disclaims any representation or assurance concerning the accuracy, completeness or substantive nature of any data to which access is being provided and User hereby acknowledges this disclaimer and waives any claim or reliance upon such representations or assurances.

C. NO LIABILITY FOR ERRORS OR FAILURES – The Trustee shall not be liable in any manner under this Agreement for any error, inaccuracy or incomplete information contained in the records for which access is provided, and User hereby expressly releases the Trustee from any claim, demand or suit arising from or as a result of any such error, inaccuracy or incomplete information.

Further, the Trustee shall not be liable in any manner under this Agreement for any failure, malfunction or other delay, inconvenience, or inability of the computer system, software or equipment, and User hereby expressly releases the Trustee from any claim, demand, or suit arising from or as a result of any such failure, malfunction, delay, inconvenience or inability of the system software or equipment.

D. NO WARRANTY AS TO CURRENT DATA OR INFORMATION – The data and information available in the Trustee's records is as current as possible, depending on work flow, work needs, holidays, weekends, restraints on the Trustee, and any elements or factors outside the control of the Trustee.

Payoff balances are only approximated due to the aforementioned conditions, recent receipts or disbursements, claim changes, court orders or accruing interest. Exact pay off amounts should be obtained through the Trustee's Office by specific written request.

E. ADMISSIBILITY AS EVIDENCE – The Trustee makes no representation that the data and information available by accessing the Trustee's Website will be admissible in Court as a Hearsay exception pursuant to Rule 803 of the Federal Rules of Evidence.

User shall forward an original of this signed and dated Agreement to the attention of Danatia Coulter. Upon receipt, and approval by Trustee, Trustee will promptly sign and return a copy of this Agreement to User along with a user-id and password.

11. Corporations/Companies: Firms, and/or any parties or individual using the assigned user-id and password are liable under this agreement.

Print or type all information.

Enter Company Name: ____________________________________________

Enter User Name: _______________________________________________

Title: __________________________________________________________

Address: _________________________________________________________

City, State Zip: _________________________________________________

Phone/Fax Number: _____________________________________________

http://www.13network.com/lexWAA.htm
Signature of User: 

Print Name: 

Date: 

Mail with self-addressed, stamped envelope to: 

User ID Request
Chapter 13 Trustee
PO Box 2204
Lexington, KY 40588

Or fax to: (859)255-3143

Office of The Trustee
Beverly M. Burden
By: __________________________

Beverly M. Burden
Chapter 13 Standing Trustee

Date: __________________________

Internet Website: www.13network.com

Chapter 13 Use Only

User I.D.: __________________

User password: __________________
CHAPTER 13 ORIENTATION

Beverly M. Burden, Trustee
Eastern District of Kentucky

100 East Vine Street, Suite 500
Community Trust Building
P. O. Box 2204
Lexington, Kentucky 40588-2204
<table>
<thead>
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<th>TABLE OF CONTENTS</th>
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<td>Payroll Deductions</td>
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<td>Monthly Payment Chart</td>
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<td>Stopping Payroll Deductions</td>
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<td>Returned Checks</td>
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<td>Extra Payments</td>
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<td>Outside Payments</td>
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<td>Length of Chapter 13 Plan</td>
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<td>Three Major Reporting Agencies</td>
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<td>Definitions of General Bankruptcy Terms</td>
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<td>Where Your Money Goes</td>
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<td>Reasons for Filing Bankruptcy</td>
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Introduction

This booklet will help to answer some of the most common questions or problems arising from being in Chapter 13 Bankruptcy. Please refer to this handbook often as a reference guide. If you need more information with a particular problem, feel free to call the office.

Calling the Office

Office hours are from 9:00 AM until 4:00 PM Monday through Friday. The phone number is (859) 233-1527. A staff of 12 is well qualified to answer your questions. The receptionist can direct your call to the proper person.

Have a question about your payments?

Call: 233-1527 (See below list for extension numbers)

- Covington cases - Ext. 101
- Corbin cases - Ext. 101
- Frankfort cases - Ext. 105
- Pikeville cases - Ext. 105
- Lexington cases - Ext. 106
- Ashland cases - Ext. 111

Payments

Chapter 13 is commonly called the Wage Earner's Plan. It involves payment of debt to your creditors and allows your property to be protected from creditors. You may be able to complete your plan early if you are able to increase the amount of money you pay or if some creditors do not file a claim in your case. Plans usually last 3-5 years but should never exceed 5 years in length.

Generally, you pay us and we pay your creditors, according to your plan. We make payments to your creditors once a month. We pay all secured creditors first, then priority creditors and finally, unsecured creditors.
Direct Payments

You should have received a "Payment Information" letter with exact details about your particular case, such as due date each month and payment amount. You must remain current on all payments. You may pay by personal check, money order or cashier's check - made payable to the Chapter 13 Trustee. Write your case number on all payments.

If you fall behind or become "delinquent" in your payments, one or more of your creditors could file for a "relief from the automatic stay" on your case. This means a creditor can get the Court's permission to repossess your property. Call your attorney if you receive a motion for relief from stay. Your attorney can tell you what your options are.

Payroll Deductions

Call the office IF you would like your Chapter 13 payments taken straight from your paycheck. Ask for the Case Manager for your case. We need your employer's exact name and address (where your payroll comes from). This Payroll Deduction Order (PDO) is signed by the Judge and can only be stopped by a court order signed by the Judge. This deduction must stay in place as long as you are in bankruptcy or as long as you work for this employer. It usually takes 1-2 weeks to get the deduction started from your paycheck. Continue mailing your payments to Memphis until you see it has started coming out of your check.

If you change jobs often, the Trustee may not let you use payroll deduction.
If you are paid every week or twice a month, your payment to the Trustee will be divided up and taken out of each paycheck.

See the following chart to see how payments are determined.

**IF YOUR MONTHLY PAYMENTS ARE $500.00/MONTH:**

| Weekly amount would be: | Multiply $500.00  
|-------------------------|--------------------
|                          | x 12 (months)      |
|                          | divide by 52 (weeks per year) |
|                          | $115.38 weekly     |

| Bi-Weekly amount would be: | Multiply $500.00  
|---------------------------|--------------------
|                           | x 12 (months)     |
|                           | divide by 26 (pay periods per year) |
|                           | $230.77 bi-weekly |

| Semi-Monthly amount would be: | $500.00  
|-------------------------------|--------------------
|                              | divide by 2 (pay periods per mo) |
|                              | $250.00 semi-monthly |
Stopping Payroll Deductions

When your case is paid in full, the Trustee's office will send your employer written notice to stop your payroll deductions. Please be patient and allow a little time for deductions to stop coming out of your check.

Anything extra paid to the Trustee will be sent back to you the following month.

Returned Checks

Memphis will send a personal check back through the bank one time only if it comes back marked "insufficient or non-sufficient funds". If it doesn't clear a second time, we will send you a letter notifying you that your check has been returned. You will need to send another check to Memphis immediately. Two NSF checks mean that you will no longer be allowed to pay by personal check. After that, you would need to pay by money orders or cashier's checks only.

Extra Payments

Extra payments are certainly allowed, and even encouraged, if you are able to do so. You do need to keep making your regular monthly payments even if you have paid "extra" on your case. Your plan calls for a disbursement (payment) to be sent to your creditors each month!

Outside Payments

Your payments are governed by law once you have filed Chapter 13 bankruptcy. You cannot pick and choose which particular creditor you would like to pay ahead of others or which creditor you might like to pay directly, "on the side." You are responsible for paying all normal living expenses that come due after you file bankruptcy. Your mortgage is usually paid directly by you also. Make sure you know which creditors you must pay directly and which will be paid through your Chapter 13 case.
Length of Ch. 13 Plan

Most plans last 3 - 5 years. It is rare that a plan will last the exact number of months it was originally scheduled. Sometimes, a creditor will file a claim for a larger amount than you thought you owed, or interest rates might be changed. You may have even forgotten to list a debt in your petition. All these things will lengthen the time it takes to pay off your case.

On the other hand, sometimes one or more creditors may not file a proof of claim with the Court. This could possibly shorten the time to pay off your case. Therefore, the length of your plan can change over the 3 - 5 year period.

Case Summaries

The Trustee will mail a print-out of your case semi-annually, in January and July.

This is a summary of your creditors who are being paid by the Trustee's office, based on your plan and claims filed by creditors. Please look this over carefully for any errors. If you object to a claim that has been filed in your case because, for example, the amount is wrong or you do not owe that creditor at all, you need to call your attorney to file an objection with the Court. DO NOT CALL THE TRUSTEE'S OFFICE.

Your case summary also lists payments you have made to the Trustee for this particular six month period. If you believe you have made a payment that is not on this report, call the Trustee's office and ask to speak to the Controller.
IMPORTANT NOTE:
The Trustee's office can only change a claim when, and if, the creditor files a new claim with the Court.

Claims Filed by Creditors

Money you send to the Trustee's office goes toward the Trustee's fees, any additional attorney's fees and the people you owe (your creditors). Creditors generally have 90 days from your first date set for the Meeting of Creditors to file a claim with the Court. The Trustee can only pay those creditors who filed a claim with Bankruptcy Court. The Trustee cannot pay a creditor who did not file a claim with the Court. Sometimes, you need to make sure a certain creditor files a claim. Call your attorney to help you get a claim filed if a creditor that you listed on your petition does not appear on your summary.

Payments to Creditors

Generally, creditors have 3 types of debts or claims:

- **Secured Creditors:**
  Have claims against property that has been pledged as collateral such as a home, car or furniture.

- **Priority Creditors:**
  Have claims for taxes, past due child support, attorney's fees or Chapter 13 fees. These claims are unsecured.

- **Unsecured Creditors:**
  Are owed debts that have no collateral such as credit cards, medical expenses, signature loans, etc.

All your secured debts are paid first, then priority, and finally unsecured debts. Unsecured debts are not always paid in full, depending on your plan.
Co-Signed Debts

Chapter 13 usually protects a co-signer or guarantor on your debts from collection activity by a creditor. This protection lasts only as long as you remain in bankruptcy. Creditors should not call your co-signers and try to get payments from them. Call your attorney if this happens.

Permission for Credit

If you need to repair a furnace, replace a broken-down car, or borrow money for any reason while you are in bankruptcy, you must get the Trustee's written approval and a court order. The Trustee has forms that you and the lender must fill out and sign. Your attorney must also sign the forms. These forms are called an "Application to Incur Debt."

The Trustee generally will not approve the application unless you are facing an emergency situation or unusual circumstances.

Selling Your Property

Similar rules apply here as they do for obtaining new debt. You cannot sell, give away or trade any of your property without the Court's permission while in bankruptcy. Call your attorney to discuss any special circumstances.
Income Taxes

The Court requires you to file an income tax return each year in a timely manner. Returns are handled by the IRS Special Procedures Staff and are processed manually, causing a delay of your refund. Tax refunds are generally sent directly to you. The Trustee will sometimes require you to sign an Agreed Order to send us money from your tax refund the following year, if you fall behind in your plan payments. If an IRS tax claim has been filed in your Chapter 13 case, the IRS will probably withhold any refund and apply it toward the debt you owe them.

Completion/Dismissal of Your Ch. 13 Plan

Completion

Successful completion of your Chapter 13 case means everything was set up and paid according to your plan. An Order of Discharge will be sent to you from Washington D.C. when your case is paid out.

Dismissal

An "Order of Dismissal" is sent when you have failed to follow one or more of the conditions of your approved plan. Falling behind on your payments is a major reason most cases are dismissed. You are no longer under the protection of the Court and creditors are free to start collecting payments, foreclose on or repossess your property. Your unsecured creditors are also free to obtain judgments against you or to garnish your wages. The IRS can take over your wages and/or bank accounts until your tax debts are paid in full.
Non-Discharged Debts

There are some debts you may owe that may not be discharged or closed out at the end of your bankruptcy case unless they have been paid in full through your Chapter 13 plan. These include student loans, back child support or alimony, and money owed because of a death or personal injury claim.

Voluntary Dismissal of Your Case

Since Chapter 13 Bankruptcy is a voluntary plan, you may ask to have your case dismissed at any time. Your attorney will need to file the proper paperwork with the Court. Please discuss this thoroughly with your attorney.

Filing Chapter 7 Bankruptcy

It sometimes becomes necessary during your bankruptcy to change your case to a "complete bankruptcy". This is called converting your case to Chapter 7 Bankruptcy. You need to discuss this thoroughly with your attorney.

The Chapter 13 Trustee's Office cannot give you any legal advice on filing Chapter 7 Bankruptcy.

We only administer Chapter 13 cases!
Final Report and Audit

The Trustee's office will send a Final Report to Bankruptcy Court once your case is paid in full and all payments made to your creditors have cleared the bank. We do an in-house audit to make sure everything was set up and paid correctly. You will get a successful completion letter at that point from the Trustee's office. It may be a few months before you get the official Order of Discharge from the federal government.

Your Credit Rating

Your bankruptcy is a matter of public record. It will appear in the newspaper and on credit reports. Generally, the Chapter 13 information will stay on your credit report for 10 years. It is up to any potential lending institution to evaluate your credit record for future credit purposes.

You should wait about 3 months after your bankruptcy case has been closed out to request a copy of your credit report. Check to see if there is anything that needs to be corrected or updated.
Three Major Credit Reporting Agencies

<table>
<thead>
<tr>
<th>Agency</th>
<th>Address</th>
<th>Contact Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Experian (formerly TRW)</td>
<td>PO Box 2350, Chatsworth, CA 91313-2350</td>
<td>(800) 682-7654</td>
</tr>
<tr>
<td>Equifax</td>
<td>PO Box 740241, Atlanta, GA 30374</td>
<td>(800) 685-1111</td>
</tr>
<tr>
<td>Trans Union Corporation</td>
<td>PO Box 390, Springfield, PA 19064-0390</td>
<td>(800) 888-4213</td>
</tr>
</tbody>
</table>

Please send a copy of my credit report

Name: ____________________________
Spouse Name: ____________________________
Current Address: ____________________________
Previous Address: ____________________________
Social Security Number: ____________________________
Spouse Social Security Number: ____________________________
Date of Birth: ____________________________
Date of Birth - Spouse: ____________________________

Signature ____________________________ Spouse Signature ____________________________
Important Documents

There are several documents you need to keep when you file Chapter 13 Bankruptcy, as well as those sent to you after you complete your Bankruptcy.

1. Copy of your Petition
2. Plan Amendments or Plan Modifications
3. All Schedules
4. Trustee's Final Report
5. Order of Discharge

Important questions you need to ask yourself:

1. Did all your creditors file timely claims?
   (Remember a creditor can still refuse future credit because your debt is viewed as a loss if it was not paid in full).

2. Were there other debts not paid through the bankruptcy?

3. Were all liens cancelled?

4. Do you have all clear titles due you?

REMEMBER:

You may still need to pay any liens, judgments, tax debts or student loans if they were not paid in full through your plan.
CHAPTER 13 RESPONSIBILITIES

DEBTOR
Files plan with Bankruptcy Court through Attorney
Attends 341 Meeting of Creditors
Attends Confirmation Hearing
Makes timely payments to Trustee's office
Continues regular payments to mortgage company
Calls Attorney with any changes needed to plan
Notifies Trustee of any changes in:
  employer or salary; marital status; address; phone number
Notifies Bankruptcy Court Clerk of change of address

ATTORNEY
Advises Debtor on any legal matters
Files petition and plan with Bankruptcy Court Clerk
Attends 341 Meeting of Creditors with Debtor
Attends Confirmation Hearing with Debtor
Files any changes to the plan with Bankruptcy Court Clerk

TRUSTEE
Recommends approval or confirmation of plan
Sends monthly payments to creditors who file claims
Notifies the Court when Debtors miss payments
Sends quarterly reports to Debtors
Recommends approval of applications to go into debt
Audits case upon completion

CREDITORS
File proofs of claim with Bankruptcy Court Clerk
Unsecured creditors have 90 days from 341 meeting to file a claim
Governmental creditors (IRS) have 180 days from petition date.

BANKRUPTCY COURT
Final authority on any matters of dispute (by court hearing)
Approves bankruptcy plan
Receives all correspondence filed on case (clerk's office)
Dismisses or converts case if terms of plan are not followed
Officially "Discharges" case after successful completion
Arrearage - amount of payments the debtor is behind at time of filing bankruptcy.

Automatic Stay - creditors stop trying to collect payments listed in bankruptcy. Goes into effect when debtor files.

Bar Date - last date for a creditor to timely file a proof of claim.

Chapter 13 - wage earner's plan - allows debtor to pay back debts over a period of 3-5 years.

Chapter 7 - straight bankruptcy - allows certain assets or property to be sold to pay back creditors.

Co-Debtor Stay - automatic stay which protects people who did not file bankruptcy but are listed on same debt as the debtor who filed bankruptcy.

Confirmation - Court approves the debtor's filed plan.

Conversion - changing a bankruptcy case from one chapter to another.

Delinquency - plan payments made to the Trustee are past due, case could get dismissed.

Dismissal - a Court Order ending the bankruptcy case. The debtor is no longer under the protection of the Court. Creditors have the right to begin collecting on debts again. This is not the same as completing, or paying out, a case.
DEFINITIONS - Continued

Meeting of Creditors - also known as 341 Meeting or First Meeting. Trustee and Creditors question the debtors under oath about their plan.

Modification of Plan - changes the plan in some way, has to be approved by the Judge.

Order - a ruling by the Judge that requires some action to be taken in the case.

Post Petition - something that happens after the bankruptcy petition is filed.

Pro Se - a debtor who files bankruptcy without an attorney or legal counsel.

Proof of Claim - a creditor files a form with the Bankruptcy Court Clerk in order to start receiving payments on a case.

Relief from Stay - an Order allowing one particular creditor to start collecting payments again from the debtor.

Secured Creditor - any party holding a lien on property or who has issued a loan with some type of collateral used as security.

Special Class - an unsecured claim, such as a co-signed debt, which is treated differently from other unsecured claims.

Trustee - person appointed to handle bankruptcy cases.

Unsecured Creditor - one whose debt is not secured by any property or collateral, such as credit card debt or a signature loan.
## Where Your Money Goes

Write down an estimate of your expenses in these categories.

<table>
<thead>
<tr>
<th>Spending Category</th>
<th>Monthly Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Savings</td>
<td>$ _____________</td>
</tr>
<tr>
<td>2. Housing</td>
<td>$ _____________</td>
</tr>
<tr>
<td>3. Groceries</td>
<td>$ _____________</td>
</tr>
<tr>
<td>4. Cigarettes</td>
<td>$ _____________</td>
</tr>
<tr>
<td>5. Clothing</td>
<td>$ _____________</td>
</tr>
<tr>
<td>6. Transportation/Parking</td>
<td>$ _____________</td>
</tr>
<tr>
<td>7. Medical/Dental</td>
<td>$ _____________</td>
</tr>
<tr>
<td>8. Car Payment</td>
<td>$ _____________</td>
</tr>
<tr>
<td>9. Car Insurance</td>
<td>$ _____________</td>
</tr>
<tr>
<td>10. Gasoline</td>
<td>$ _____________</td>
</tr>
<tr>
<td>11. Insurance (Life, Car, Other)</td>
<td>$ _____________</td>
</tr>
<tr>
<td>12. Utilities (Heat, Water, Gas)</td>
<td>$ _____________</td>
</tr>
<tr>
<td>13. Telephone</td>
<td>$ _____________</td>
</tr>
<tr>
<td>14. Garbage</td>
<td>$ _____________</td>
</tr>
<tr>
<td>15. Taxes (IRS, Property, etc.)</td>
<td>$ _____________</td>
</tr>
<tr>
<td>16. Support &amp; Child Care</td>
<td>$ _____________</td>
</tr>
<tr>
<td>17. Tuition and Books</td>
<td>$ _____________</td>
</tr>
<tr>
<td>18. School Loans</td>
<td>$ _____________</td>
</tr>
<tr>
<td>19. Haircuts</td>
<td>$ _____________</td>
</tr>
<tr>
<td>20. Recreation &amp; Entertainment</td>
<td>$ _____________</td>
</tr>
<tr>
<td>21. Gifts and Donations</td>
<td>$ _____________</td>
</tr>
<tr>
<td>22. Newspaper</td>
<td>$ _____________</td>
</tr>
<tr>
<td>23. Basic Cable</td>
<td>$ _____________</td>
</tr>
<tr>
<td>24. Eating Out</td>
<td>$ _____________</td>
</tr>
<tr>
<td>25. Lunches/Snacks</td>
<td>$ _____________</td>
</tr>
<tr>
<td>26. Pets</td>
<td>$ _____________</td>
</tr>
<tr>
<td>27. Miscellaneous</td>
<td>$ _____________</td>
</tr>
</tbody>
</table>

**TOTAL:** $ _____________
BANKRUPTCY FRAUD IS A FEDERAL CRIME !!!

It is against the law to:

- Hide your property from creditors or the bankruptcy Trustee.

- Give your property to a family member in order to keep the property away from your creditors or the bankruptcy Trustee.

- Lie about your finances under oath!

- Make false statements in your bankruptcy petition or schedules.

- File a false claim against a person in bankruptcy.
CHAPTER 13 TRUSTEE

WESTERN DISTRICT OF KENTUCKY

H - 103
I. Western District Of Kentucky: Chapter 13 Trustee

A. Generally

Chapter 13 practice under the United States Bankruptcy Code is basically the same all over the United States, but different local rules and practices create differences which are worthy of note.

In the Western District of Kentucky there were approximately 2,400 Chapter 13 filings for the fiscal year ending September 30, 2000. We are averaging about 205 filings per month for the year ending September 30, 2000. Chapter 13 First Meetings of Creditors are held in four (4) locations in the Western District of Kentucky with approximately 85% of the cases being heard in Louisville, 7% in Paducah and the balance almost equally divided between Owensboro and Bowling Green. Chapter 341 Hearings are held 3 full days per month in Louisville and 1 day each in Paducah, Bowling Green and Owensboro.

B. Confirmation Hearings

Of particular interest to Chapter 13 debtor and creditor representatives is the fact that Confirmation Hearings are usually held on the same day as the 341 Hearings. Objections to confirmation must be filed promptly so that the Trustee and counsel for the debtor will be aware of them and they can be presented to the court at the conclusion of the 341 docket. Chapter 13 cases are routinely confirmed by the court upon the recommendation of the Trustee unless there is an objection to confirmation by a creditor or the Trustee or the case proposes to pay less than 70% to unsecured creditors. In the event of a Trustee or creditor objection, or if the case proposes to pay less than 70% to unsecured creditors, a Confirmation Hearing is held before the court the same day as the 341 Hearing. The time and place of that hearing will be noted on the Notice to creditors regarding the meeting of creditors.

C. Filing Of Claims

The Bankruptcy Code provides ninety (90) days to creditors to file claims from the date of the first scheduled Meeting of Creditors. Local rules in the Western District of Kentucky provide that secured and priority claims of creditors should be filed in the Clerk’s office at least three (3) business days preceding the Meeting of Creditors and should contain a statement of the net balance as of the date of the filing of the petition and any appropriate documentation. This is particularly important so that the Trustee, debtors and creditors will have an opportunity to establish the secured value of any such claim and to also establish the interest rate to be applied to that secured value. As the local rules provide, the contract rate of the secured creditor may be modified to the market rate by agreement of the parties or by hearing before the court if no agreement can be reached regarding a modified interest rate.

D. Property Appraisal

In the Louisville Division of the Western District, the court has appointed an appraisal company to appraise personal property of debtors. This personal property typically includes automobiles, furniture, appliances and other property which appears from the petition to serve as collateral for a debt. These appraisals are typically available at the First Meeting of Creditors so that a value for secured claims can be established. With the help of an objective third party appraisal,
it is much easier to reach an agreement as to the value of the automobile or other collateral which secures a debt. In most Chapter 13 cases, valuing collateral is a very important function. As such, it is important for secured creditors to have their claims filed on a timely basis so that the amount of the claim, the secured portion, and the interest rate can be established at the First Meeting of Creditors and then included in the Order of Confirmation.

E. Orders of Confirmation

Orders of Confirmation reflecting the amounts, secured values and interest rates for secured claims, the amounts of priority claims and a percentage proposed to be paid to unsecured creditors are prepared by the office of the Chapter 13 Trustee for submission to the court after the Confirmation Hearing. The Order of Confirmation also provides for the amount of the payment to be paid by the debtor and how it is to be paid (monthly, weekly, bi-weekly, semi-monthly or other). The question of a payroll deduct order is addressed at the Meeting of Creditors, and unless there is a good reason why it should not be done, the court will typically order a payroll deduct to ensure the Plan payment is made. Approximately 75% to 80% or more of the Chapter 13 cases in the Western District of Kentucky have payroll deduction orders, and the Trustee has found that these cases work much more effectively than cases in which payroll deduct orders are not possible. Obviously there are some cases, such as where the debtors are self-employed, on Social Security or otherwise unable to provide a payroll deduction, where such deductions are not possible.

F. Attorney Fees

It has been the custom and practice in Chapter 13 cases in the Western District of Kentucky for the debtor’s counsel attorney fees to be paid through the Chapter 13 Plan rather than being paid directly by the debtors. The Court has set attorney fees in typical Chapter 13 cases and has reviewed those fees on an annual basis such that for the year 2000, attorney fees in a typical Chapter 13 case are $1,140.00 for work done from the beginning of the case through the submission of the Schedule of Allowed Claims. If counsel believes that a particular case has taken more time and merits greater compensation, counsel should advise the Trustee at the Meeting of Creditors that an application for a fee will be filed. The fee application will then be acted upon by the court. Whether the fee is the standard set amount or the amount approved by the court pursuant to a fee application, normally one-half of the fee will be paid with the first distribution to secured creditors with the balance being paid after the Schedule of Allowed Claims has been filed with the court.

G. Section 341 Hearings

In preparing for the Section 341 Hearing, counsel for the debtor must be aware that 11 U.S.C. Sec. 1326 requires debtors to begin making payments within thirty (30) days of the filing of the Plan. Due to the fact that in some cases the Section 341 Hearing is longer than thirty (30) days after the filing of the petition, counsel for the debtor should collect and hold in escrow the amounts of the proposed Plan payments from the debtors so that they will be available at the time of the Section 341 Hearing. This will allow the debtor to be current with the amount of the proposed payment at the time the case is considered for confirmation. If the debtor is not able to make payment at the time of the First Meeting of Creditors, it may be a basis for denying confirmation of the case. If a case is confirmed, but the debtor gets behind in his payments by thirty (30) days or more, the Trustee will file a motion with the court asking the court to require the debtor to show cause why his case should
not be dismissed for failure to make the Plan payments. A hearing will then be scheduled on this request.

As was mentioned earlier, unsecured creditors have ninety (90) days from the date of the first scheduled 341 Hearing to file claims. The Order of Confirmation will provide that the attorney for the debtor will have a period beginning at the end of that ninety (90) day period and extending for thirty (30) days to file a Schedule of Unsecured Claims which have been timely filed which are to be paid in the Plan. After the filing of the schedule, the second installment of the attorney fees is paid.

**H. Less Than 100% Plan**

In any case proposing to pay less than 100% to unsecured creditors, the Order of Confirmation provides that the attorney for the debtor is to compute the amount of unsecured claims which have been filed to see if less than all the claims scheduled were in fact filed on a timely basis. If so, the attorney for the debtor should compute the amount of unsecured debt to be paid in the Plan. In other words, if all the unsecured debt is not paid, the percentage to be paid to the filing claimants should increase.

**I. Tax Returns, Tax Refunds, and Revised Budgets**

An additional requirement imposed by local rule is that any debtor with less than a 100% Plan is to file with the Trustee annually a copy of his federal and state income tax returns and a revised budget. Additionally, so as to be sure that all disposable income is paid into the Plan, the debtor is required to pay to the Trustee any income tax refund which he is to receive from the state or federal government. This refund is to be used to pay the percentage of unsecured debt which is not proposed to be paid in the Plan. In other words, if the Plan is a 70% Plan and an income tax refund is received, that refund is applied toward paying the 30% that was not to be paid under the Plan rather than to satisfying the provisions of the 70% Plan. The court has ruled that earned income credit is not considered to be a refund and is not covered by this rule. As a result, earned income credit is not required to be paid to the Trustee. Tax returns and budgets have to be filed with the Trustee by May 15 of each year and the tax refund paid to the Trustee when received.

**J. Semi-Annual Debtor Report**

The Trustee is required by regulations of the United States Trustee to provide a semi-annual Debtor Report to all debtors in Chapter 13 cases and their attorneys. These reports are typically mailed on or about March 30 and September 30 of each year and show the amounts paid by the debtor, the distribution of the amounts received by the Trustee for the payment of creditors, and the balances due the creditors after their payments. Since there are more than 5000 pending cases in the Western District of Kentucky, debtors are requested to ask any questions concerning these reports in writing so that the Trustee can appropriately respond.

**K. Priority And Mortgage Payments**

Secured claims are paid in a Chapter 13 Plan prior to a payment of priority claims. Unsecured claims are paid last. With respect to claims that are secured only by the principal residence of a debtor, if there is a default in the payments owed to the mortgage lender prior to the
bankruptcy filing, the Bankruptcy Code requires that such a default be cured within a reasonable period of time. The Bankruptcy Court for the Western District of Kentucky has determined that a reasonable time is twenty-four (24) months or less. As a result, the default on any mortgage loan of this type must be cured within twenty-four (24) months while the debtor continues to pay the current payments owed to the lender. Virtually all mortgage payments are made directly to the creditor ("outside the Plan") while all payments to cure a default are made through the Trustee.

L. Trustee Commission And Expenses

The Trustee is entitled by law to charge a commission and expenses which cannot exceed 10%. The current charge for the Trustee of the Western District of Kentucky is 2.75%, an amount set by the United States Trustee based upon the budget of the Chapter 13 Trustee. That fee is subject to change effective October 1 of each year.

M. Plan Period

The Bankruptcy Code requires debtors to pay all of their disposable income into the Plan for only thirty-six (36) months. However, most of the Plans confirmed in the Western District of Kentucky are longer than thirty-six (36) months. The reason for this seems to be that if the debtor is going to make payments for sixty (60) months rather than thirty-six (36) there is not as much scrutiny of the disposable income question. Additionally, in cases in which there is a question of the "liquidation" test, (the Code-imposed requirement that creditors get for their claims as least as much as they would get if non-exempt assets of the debtor were liquidated by a Chapter 7 Trustee) the longer time period increases the ability of the debtor to meet that test in a Chapter 13.

N. General Trustee Office Information

The Office of the Chapter 13 Trustee, Western District of Kentucky, is located at 310 Legal Arts Building, 200 South Seventh Street, Louisville, Kentucky 40202. This building is located at the corner of Seventh and Market Street in downtown Louisville. The telephone numbers for the office are (502) 581-9042 and (502) 581-9087. However, any creditor seeking a report regarding the status of a particular case and when payment will be made should request that report in writing. Alternatively, the Trustee has available in the office a terminal which may be accessed by a creditor representative to obtain information about cases in which they are involved. To make an appointment to use this terminal, the representative should contact the Trustee’s office.

In dealing with the Trustee’s office, the creditor seeking a report and the debtor making a payment should be sure to use the applicable case number. This will ensure that the creditor gets the correct information and that the debtor’s payment is credited to the proper case.

O. Case Closure

Once a case is completed or dismissed for any reason, the Trustee’s office will file a final report with the Bankruptcy Court showing all receipts and disbursements and to whom disbursements were made. This final report cannot be filed with the court until all the checks used to make disbursements in that particular case have cleared the bank and been returned to the Trustee.
Debtor-Creditor Rehabilitation

In conjunction with the International Credit Association of Kentuckiana and ACCEPT, a consumer credit counseling service of the American Red Cross, the Chapter 13 Trustee presents a program by which Chapter 13 debtors completing 100% plans can attend two seminars, each approximately 3 hours long, one at the beginning of the Plan and one at the time that the Plan is completed. The seminars deal with consumer financial matters such as budgeting, credit reports, applying for credit and other similar topics.

The purpose of the seminar is to provide Chapter 13 debtors with information that will be useful to them in avoiding the problems that led to the bankruptcy filing. The benefit of being involved in the program is that a number of potential creditors have agreed that they will look favorably upon credit applications of persons in this program who have both completed their Plans and attended the seminars. The program is coordinated through the office of the Chapter 13 Trustee and is taught by attorneys, credit counselors and a representative from the Chapter 13 Trustee’s office.
STRATEGIES FOR REPRESENTING CREDITORS
IN CHAPTER 13 CASES

Thomas L. Canary, Jr.
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Louisville, Kentucky

and

Lisa Koch Bryant
Foley Bryant & Holloway
Louisville, Kentucky

and

Dean A. Langdon
Mapother & Mapother
Lexington, Kentucky

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SECTION I
STRATEGIES FOR REPRESENTING CREDITORS IN CHAPTER 13 CASES

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SECTION I
I. STAY LITIGATION IN CHAPTER 13 CASES

A. Stay Relief Against Co-Makers

As in all bankruptcy filings, the automatic stay of 11 U.S.C. Section 362 is imposed immediately upon the entry of the Order for relief. In addition, a second stay is imposed in Chapter 13 cases by 11 U.S.C. Section 1301. This stay applies to any action against co-makers on consumer debts. (In other words, business debt would not be subject to the co-maker stay of Section 1301.)

There are three grounds for stay relief against a co-maker under Section 1301. These are as follows:

1. If the co-maker received the benefit of the loan proceeds,
2. If the creditor's interest would be “irreparably harmed”, or
3. If the plan does not propose to pay a particular debt.

The following are examples of how each of these grounds can come into play.

Co-maker received the benefit of the loan proceeds

Son goes into a car dealership to purchase his first car. Since the son has not established a credit history yet, the dealership requires him to get a co-maker. Dear old Dad comes to the rescue once more and co-signs the debt with the son.

Dad is laid off at work and files Chapter 13 bankruptcy proposing to pay 100% to all unsecured creditors. Can you get the co-maker stay terminated? The answer is yes.

The non-bankrupt co-maker (Son) is the party that got the benefit of the loan. He is not the bankrupt, so you have grounds to have the co-maker stay terminated. If this is a 100% plan, why would you want to do that? Remember, the stay under § 1301 is just like the stay under § 362 as to the co-maker. Technically, you should not be contacting the co-maker, sending him notices, sending him monthly statements, etc. This would include the creditor’s ability to repossess the vehicle upon a future default. By getting the co-maker stay terminated, you allow your creditor client to deal with the co-maker directly without fear of violating the § 1301 stay.

Irreparable Harm

This is the same kind of “harm” that you would show in order to get a temporary restraining order. Some examples are the co-maker taking the car out of the jurisdiction while he is stationed in Germany, the vehicle has been abandoned in a repairman’s shop, the
vehicle has been seized by the police for transporting drugs and you need to file a petition for remission or risk forfeiture of the unit, etc. The point is that this cannot be some run of the mill inconvenience. It has to be something severe that endangers the creditor’s interest in the collateral.

The plan does not propose to pay the debt

If a Plan proposes to pay unsecured claims at the rate of 70 percent (with no interest paid thereon), a creditor would be entitled to co-maker stay relief for the 30 percent of its unsecured claim not being paid by the Chapter 13 debtor. The creditor would also be entitled to co-maker stay relief for the interest which is to accrue on the entire loan, plus any attorney fees allowable pursuant to its loan documents. Similarly, if a Plan proposes to pay a secured creditor’s claim as “fully secured” but at a reduced rate of interest, the creditor would be entitled to seek co-maker stay relief in order to collect the difference between its contract rate of interest and the interest rate proposed by the Plan (as well as any attorneys fees recoverable pursuant to the terms of the loan documents).

Once the co-maker stay is terminated you may file suit in state court for the sums that you are not being paid through the bankruptcy. The natural tendency it to file suit only for the amounts that you are not being paid in the Chapter 13 plan (in the example above, the 30 percent, the unpaid interest and attorney fees). This is a mistake. You would sue for your entire debt, including court costs, interest on the entire amount owed and attorney fees.

The trap lies in Kentucky Rule of Civil Procedure 55.03. It states in pertinent part that:

A judgment by default shall not be
different in kind from or exceed in amount
that prayed for in the demand for judgment

Here is what will happen. You will get the co-maker stay terminated, and then you file suit for what you are not being paid in the Chapter 13. You get a judgment by default. Then, the bankrupt either converts his petition to one under Chapter 7, the bankruptcy gets dismissed and the former bankrupt skips or he dies with no assets before completing the plan. By receiving a judgment in the amount of the shortfall from the Chapter 13, only, you have foreclosed yourself from ever collecting all that you were owed on the debt.

The solution is to sue for the entire debt, but be very careful to collect only the amount that you are not being paid through the bankruptcy. Yes, you will have to keep very close tabs on what you are collecting, but you prevent a potential malpractice action by your client for limiting their recovery on the debt.

The customary $75.00 filing fee for stay relief motions is not required to be paid when a motion to terminate the co-maker stay is filed pursuant to 11 U.S.C. Section 1301.

Bankruptcy Rule 9014 states that: “... reasonable notice and opportunity for hearing
shall be afforded the party against whom relief is sought.” Accordingly, a copy of the motion must be sent to the co-maker. Therefore, one must question whether the creditor and debtor can enter into an *Agreed* Order Terminating the Co-maker Stay unless the co-maker signs off on it, or unless a motion is made for approval of the Order pursuant to 4001(d) [which speaks only to the termination of the § 362 stay and does not mention the stay afforded co-makers under § 1301]. This is but another one of those questions that cause the bankruptcy practitioner to wake up screaming in the middle of the night.

B. Termination Of Section 362 Automatic Stay

The automatic stay of 11 U.S.C. Section 362, which is applicable to both the debtor and “property of the estate,” may be terminated for a myriad of reasons, which are less clearly delineated. These reasons include “lack of adequate protection” and “good cause”. While the latter is a rather amorphous standard, the standard of “lack of adequate protection” is more easily defined.

1. Proposed Plan does not Amortize Claim Over Plan Term

“Lack of adequate protection” would include the fact that the Plan as proposed would not amortize a secured creditor’s claim over the three to five-year term of the Plan. The Plan as proposed must provide for payment of the creditor’s allowed secured claim (as that is defined in 11 USC § 506(a)) plus a “market” rate of interest over the term of the Plan since the debtor usually will not be able to pay creditor’s allowed secured claim on the “effective date of the plan,” i.e., upon confirmation. (See, 11 USC § 1325(a)(5)(B)(ii)) If the Plan does not generate sufficient monthly payments to amortize the allowed claim, stay relief would be appropriate.

The amount that the creditor is to receive under the plan must also keep pace with depreciation of creditor’s collateral. For instance, if the creditor’s claim is secured by a vehicle that is depreciating at the rate of $100 per month and the amount that the creditor is receiving under the plan is only $30 per month, then the creditor is not adequately protected. The entire debt may get paid out over the life of the plan, but if the case were to be dismissed or converted to Chapter 7, then creditor would be much worse off than when the bankruptcy commenced.

In order to get a good idea of rate of depreciation on an automobile, you could take several months’ worth of NADA blue books and see how the value of your client’s collateral changes from month to month. If the payments that your client receives from the plan monthly are not equal to or greater than this, your client is not adequately protected.

2. Plan Payments Deferred For Extended Period

Additionally, even if the total payments to a secured creditor over the five-year term of the Plan will amortize its claim, stay relief may still be appropriate if those payments will be deferred for a great length of time. Specifically, the payment of administrative expenses or real estate mortgage arrearages may be paid prior to disbursements to general secured creditors. If it will take an inordinate amount of time to pay administrative expenses (such as attorneys fees, appraiser’s fees, Trustee’s fees, etc.), then a secured creditor may be
entitled to stay relief if many months will elapse before the Trustee disburses to general secured creditors.

For example, a Plan might propose a payment to the Trustee of $200.00 per month. If the debtor's attorney is allowed a fee of $975.00, and the Court-appointed appraiser (particular to the Western District of Kentucky) is allowed a fee of $100.00 then the debtor will have to pay approximately $1,075.00 to the Chapter 13 Trustee before disbursements to secured creditors begin. If the debtor is paying $200.00 per month to the Trustee, it will take approximately eight (8) months before secured creditors ever receive the first disbursement from the Chapter 13 Trustee. In the interim, your client's collateral is presumably depreciating, and thus the secured creditor's interest in its collateral is not being adequately protected during this delay. See In Re: Estes, 185 B.R 745 (Bkrtcy. W.D.Ky. 1995).

One resolution to this dilemma is request that the creditor receive some adequate protection payment during the time that the administrative claims are being paid. Some courts are hesitant to do this, so your only option may be to file your motion.

3. Payments to One Secured Creditor Ahead of Another

Even if administrative expenses are being promptly retired (so that disbursements to secured creditors will begin quickly), sometimes certain secured creditors are paid ahead of other secured creditors, thus resulting in a lack of adequate protection to the secured creditor which is being paid later. Specifically, if the debtor has substantial real estate mortgage arrearages, these must be retired by the Chapter 13 Trustee within 18-24 months (pursuant to local practice). Thus, a situation can arise where the Trustee must pay substantial mortgage arrearages within 24 months, and must devote substantially all of the monthly Plan payments for this period in order to retire these sums. This can result in the Trustee's inability to make any payments to other secured creditors until the third year of the Plan! Obviously, other secured creditors are not being adequately protected in such a situation, and should move for stay relief and/or adequate protection. Note, however, if you have not objected to the plan on these grounds, you may be barred by res judicata from bringing such a motion at a later time.

4. Failure to Maintain Insurance on Collateral

An additional basis for stay relief (lack of adequate protection) would be the debtor’s failure to maintain insurance on a creditor’s collateral. In fact, in the Western District of Kentucky, a debtor’s failure to provide satisfactory proof of full coverage insurance on a motor vehicle at the Section 341 Meeting results in the immediate termination of the automatic stay, without further notice or hearing. See Appendix containing Local Rules. [NOTE: At the writing of this Chapter the Courts for the Eastern and Western Districts of Kentucky are investigating the possibility of having joint local rules. This could affect or modify the relief mentioned in the Western District’s Local Rule]

However, it is important to note that this Local Rule is only in effect in the Western District of Kentucky, and thus a motion to terminate the automatic stay is necessary in the Eastern District of Kentucky when the debtor fails to provide insurance on a motor vehicle.
5. Cancellation of Certificate Insurance and Accident and Health Insurance

The cancellation of credit life insurance and accident and health insurance (which are financed by many creditors) is an additional area which may require stay relief. Many creditors finance credit life insurance and accident and health insurance on behalf of their customers. The substantial premiums for these insurance coverages are then added into the principal amount of the loan and financed over the term of the contract. If the debtor is unwilling to increase the amount of the creditor’s allowed secured claim by the value of these separate contracts, the creditor should move the Court to cancel the credit life insurance and accident and health insurance (if the debtor is unwilling to permit these cancellations voluntarily). The rebated premiums can then be applied to reduce the unsecured portion of the debtor’s loan.

6. Repossession of Collateral

A final area where stay relief is necessary is with respect to collateral which has been lawfully repossessed prior to the filing of the bankruptcy. If it has not yet been sold, a motion for stay relief is necessary to enable the creditor to consummate the sale.

Frequently, though, the pre-petition repossessions spawns the filing of the debtor’s Chapter 13 petition, so that the debtor may seek “turn-over” of the repossessed collateral. Prior to June 4, 1999, there was no obligation on a creditor’s part to return the vehicle if the pre-petition repossession was lawful. If the debtor wanted the vehicle returned, then he had to file an adversary proceeding, rather than by motion. See, BR 7001(1) and In Re Estes, 185 B.R 745 (Bkrtcy. W.D.Ky. 1995). The creditor was under no obligation to return the repossessed collateral simply upon the debtor’s request for same. See In Re Young, 193 B.R. 620 (Bk. D.C., 1996). Rather, the Court must have found that the creditor’s interest in its collateral will be “adequately protected” before the Court orders the return of the collateral.

While the answer probably has not changed in Kentucky, The Bankruptcy Appellate Panel for the Sixth Circuit has held to the contrary. In the case of Transsouth Fin. Corp. v. Sharon (In re Sharon), 234 B.R. 676 (BAP 6th Cir. 1999), the BAP upheld the decision of the lower court mandating that the creditor return the vehicle to the debtor upon the filing of the Chapter 13 petition. There the court found:

Nothing in §§ 362 itself suggests the "adequate protection" exception to the automatic stay argued by TranSouth. As demonstrated above, the presence of "property of the estate" triggers the proscription in §§ 362(a)(3). There is no "exception" to property of the estate for property with respect to which a creditor claims a right of "adequate protection." To the contrary, as recognized by the Supreme Court in Whiting Pools, §§ 541 and 542 of the Code work together to draw back into the estate a right of possession that is claimed by a lien creditor pursuant to a prepetition seizure; the Code then substitutes "adequate protection" for possession as one of the lien creditor's
rights in the bankruptcy case. (Citations Omitted)

Sharon at 683.

Decisions from the 6th Cir. BAP are not binding precedent in Kentucky. In fact, for a succinct summation of the other side of this coin, see the dissenting opinion from Judge Stosberg ("The panel's automatic turnover approach sanctions a procedure used to bludgeon creditors by employing the petition as a device to recover a repossessed vehicle without a hearing."). See also, Barringer v. EAB Leasing (In re Barringer), 244 B.R. 402 (Bkrtcy E.D. Mich., 1999); In re U.S Physicians, Inc., 235 B.R. 367 (Bkrtcy E.D. Pa., 1999); In re Bernstein, 252 B.R. 846 (Bkrtcy D.D.C. 2000). Be that as it may, this is another factor to consider when advising your client on how to handle the situation. It is advisable to immediately make a motion to terminate the stay and ask the court for an expedited hearing if the debtor is clamoring for return of the collateral. That should assuage the debtor and minimize the chance that the court may impose sanctions for a creditor’s inaction.

Caveat: If the collateral is inadvertently repossessed post-petition, however, then it must be returned to the debtor immediately! In the case of a post-petition repossession, the debtor is not required to file a complaint for turn-over, but simply make demand on the creditor. A creditor’s failure to immediately make amends will quickly turn its innocent violation of the automatic stay to a willful one, thus subjecting the creditor to the penalties found under 11 USC § 362(h).

II. OBJECTION TO PLAN CONFIRMATION

A. Filing Of Objections To Confirmation

Objections to confirmation must be filed in writing, and it is imperative that the deadlines for same be observed. The if a creditor fails to object and the plan is confirmed, then the creditor is stuck with the result and will not be able to convince the court to reconsider absent fraud or extraordinary circumstances.

B. Bases For Objections To Confirmation

Typical bases for Objections to Confirmation include the following:

• Valuation of collateral
• Feasibility
• Failure to commit all “disposable income” to the Plan
• Liquidation analysis
• Interest rate
• Lack of good faith
• Debtor’s proposal to surrender collateral “in full satisfaction..."
of debt”

- Attempted “write-down” of home mortgages
- Disparate treatment of classes of unsecured creditors

1. Valuation of Collateral

A creditor is secured, and paid post-petition interest, only to the extent of the value of its collateral. See 11 U.S.C. Section 506(a). Not surprisingly, Chapter 13 debtors and their creditors have very divergent views on the value of particular items of collateral. In the Western District of Kentucky, Louisville Division, the Court sends an appraiser to value the debtor’s personal property. The appraisal is filed prior to the Section 341 Meeting. It is not binding on either party, but is usually followed by the Judge, unless the creditor can show that it was obviously in error. The creditor does have a right to demand a valuation hearing, though, pursuant to Rule 3012.

What measure of value should be used? Retail? Wholesale? Something in between? Everyone thought when the Supreme Court of the United States agreed to hear the case of Associates Commercial Corp. v. Rash, 520 U.S. 953, 117 S. Ct. 1879, 1997 U.S. LEXIS 3688, 138 L. Ed. 2d 148 (1997) that the question had been answered. Specifically, the Court held:

is the value of the collateral to be determined by (1) what the secured creditor could obtain through foreclosure sale of the property (the "foreclosure-value" standard); (2) what the debtor would have to pay for comparable property (the "replacement-value" standard); or (3) the midpoint between these two measurements? We hold that §506(a) directs application of the replacement-value standard.

Rash at 956.

Most people originally reading the opinion thought that this meant that “replacement value” would be equated with retail value. However, what the text of the opinion giveth, the footnotes taketh away. The now infamous footnote 6 reads:

Our recognition that the replacement-value standard, not the foreclosure-value standard, governs in cram down cases leaves to bankruptcy courts, as triers of fact, identification of the best way of ascertaining replacement value on the basis of the evidence presented. Whether replacement value is the equivalent of retail value, wholesale value, or some other value will depend on the type of debtor and the nature of the property. We note, however, that replacement value, in this context, should not include certain items. For example, where the proper measure of the replacement value of a vehicle is its retail value, an adjustment to that value may be necessary: A creditor
should not receive portions of the retail price, if any, that reflect the
value of items the debtor does not receive when he retains his vehicle,
items such as warranties, inventory storage, and reconditioning. Cf.
90 F.3d at 1051-1052. Nor should the creditor gain from
modifications to the property—e.g., the addition of accessories to a
vehicle—to which a creditor's lien would not extend under state law.

Where does all this leave us? Pretty much back to where we were before the Rash
decision. In the Western District of Kentucky, Louisville Division, value is established
by an appraiser that is paid from by the estate as an administrative expense. Those values
come close to retail. While there is no appraiser in the Eastern District of Kentucky, or in
the other Divisions of the Western District, values there generally come close to
approximating retail, "blue book" (NADA) value.

If a secured creditor is being paid directly ("outside the plan") is valuation of the
collateral important? It is, and this is another trap for the unwary.

Many times a debtor will propose to pay a creditor its entire claim directly, that is,
the payments do not go through the Chapter 13 trustee. The creditor, being thrilled with
the prospect that they are not going to incur a loss on the account, will continue to get
their contract payments on time and pay no attention to the value placed on the collateral
by the debtor. They think, "why do I care? I am going to be paid in full? I don't care if
they value my collateral at half the value, it does not matter." It does not matter unless
the debtor converts the Chapter 13 petition to one under Chapter 7.

§ 348(f)(1) states that:

(1) Except as provided in paragraph (2), when a case under chapter 13 of this
title is converted to a case under another chapter under this title -

(A) property of the estate in the converted case shall consist
of property of the estate, as of the date of filing of the
petition, that remains in the possession of or is under the
control of the debtor on the date of conversion; and

(B) valuations of property and of allowed secured claims in the
chapter 13 case shall apply in the converted case, with allowed
secured claims reduced to the extent that they have been paid in
accordance with the chapter 13 plan. (Emphasis added)

Therefore, even if the debtor is paying you directly, they, would be able to redeem
the collateral upon conversion for the remaining balance of the allowed secured claim. See,
11 USC § 722. An example will help explain.
A creditor has a $10,000 loan secured by an automobile worth $7,000. The debtor proposes to pay this debt outside the plan, but Schedules B, C and D show the value of the vehicle at $5,000. Three years into the plan, the debtor loses his job and has to convert to Chapter 7. By that time, the debtor has paid down $4,000 on the principal and all of the interest to that time. Since the value of the collateral as established and unchallenged in the Chapter 13 was $5,000, the debtor could redeem for $1,000. The remaining $2,000 in value and the undersecured portion of the loan would be discharged. Unless the creditor could show that the setting of the value was incident to some sort of fraud, the creditor can do nothing.

Being paid directly can be a wonderful thing, but the creditor must be wary.

2. Feasibility

Creditors' counsel should review the debtor's budget of monthly income and expenses (Schedules I and J) carefully to determine whether the debtor has sufficient income to fund the Plan. At a minimum, the debtor's net income should equal or exceed the monthly living expenses and the proposed Plan payment. Any budget showing a negative cash flow would be subject to a feasibility attack.

However, even if the budget purports to show that the debtor has sufficient income to fund a Plan, the creditor's counsel should look carefully at the individual items in the budget of monthly expenses to determine if they are reasonable. The debtor may have estimated his/her monthly expenses much too low, and an argument can be made that this particular debtor cannot reasonably be expected to live the next five years of his/her life on such a "spartan" budget. For example, the debtors may have budgeted too little for food, or may have nothing in the budget for medical expenses. Additionally, a review of the debtor's automobile insurance policy may indicate that the actual monthly premium is much higher than the monthly expenditure reflected in the budget.

Other places to look to see if the Schedules I & J may need to be amended are

1. How many tax deductions has the debtor taken? Is he trying to inflate his refund?
2. Has the debtor confused a "union due" with a payment to a credit union on an unsecured debt?
3. How regular is overtime?
4. If the debtor is self-employed, is there an allowance for the payment of taxes?
5. Is the debtor sure that his mortgage payment does not include taxes and insurance?
6. If the debtor is paying a creditor directly ("outside the plan") has that expense item been deducted from Schedule J?
7. If only one spouse has filed is the other one working and has that spouse's
income been included in the Schedule I? If not, are the expenses in Schedule J ALL the family expenses, such that it appears that the bankrupt is paying for all the family expenses?

Is there any cushion for emergencies, birthday presents for children? If so, is it reasonable?

3. Failure to Pay all “Disposable Income” to the Plan

If a review of the debtor’s budget of income and expenses shows that the budget appears feasible, the next question which the creditor’s counsel should address is whether the debtor is in fact committing all “disposable income” to the Plan. See Section 1325(b)(1)(B). In other words, if the debtor’s budget shows excess “disposable income” which is left-over after payment of monthly living expenses and the proposed Plan payment, the creditor should object to the fact that the debtor is not paying all disposable income into the Plan. If the debtor pays more into the Plan, the Plan may be able to be shortened from sixty (60) months to thirty-six (36) months, pursuant to 11 U.S.C. Section 1322(d), or the percentage paid to unsecured creditors may be increased.

The creditor’s counsel should also look closely at the withholdings from the debtor’s wages. Frequently, debtors have payroll deductions to repay unsecured loans to their credit unions, or payroll deductions for savings plans, such as 401-K’s. This is additional “disposable income” which can and should be committed to the Plan, thus resulting in a higher monthly Plan payment (which correspondingly results in a faster pay-back to creditors).

4. Liquidation Analysis

Section 1325(a)(4) provides that the debtor’s Plan must propose to pay creditors as much as they would receive in a liquidation of the debtor’s assets under Chapter 7. Thus, the debtor’s Schedules of Real Property and Personal Property should be reviewed, to determine if the debtor has non-exempt equity in either his realty or personal property.

If the debtor’s assets could be liquidated in a Chapter 7, so that all general unsecured creditors would receive more by such a liquidation than they would through the plan, then the court cannot confirm that plan. This could be true even if the debtor proposes a 100% plan.

Is a dollar today worth the same as a dollar 36 or 60 months from now? Of course not. Therefore, if the debtor’s estate could be liquidated today and all creditor paid in full, the debtor has to pay those unsecured creditors the time value of their money. Call it interest, call it a discount factor, call it a net present value, call it whatever you will. The bottom line is that the unsecured creditors must be paid their claim plus interest if the debtor’s estate is solvent. See In Re: Hardy, 755 F.2d. 75 (6th Cir. 1985).

5. Interest Rate

The Plan must pay creditors the value of their claim as of the effective date of the plan, i.e., the confirmation date. See, Section 1325(a)(5)(B)(ii) Since few debtors (at least
none that the authors have ever seen) cannot pay all claims upon confirmation, they must provide a market rate of interest, to compensate for having to wait to be paid (see discussion immediately above). Occasionally, Plans are proposed which provide for no interest whatsoever to secured creditors. This is a clear violation of § Section 1325(a)(5)(B)(ii) and confirmation of those plans should be summarily denied.

Other plans may propose a grossly insufficient rate. Such Plans are obviously objectionable. An appropriate "market" rate of interest has not been conclusively established, but presumably varies on a case-by-case basis. The creditor should stress, though, that it is a market rate for similarly situated borrowers, i.e., borrowers who presumably have no equity in any of their assets, and are obviously financially distressed. In other words, the current "market" rate to a financially distressed borrower, such as a Chapter 13 debtor, will presumably be higher than the "market" rate to an average bank customer. See, Memphis Bank and Trust Company v. Whitman, 692 F.2d 427 (6th Cir. 1982). Moreover, if the creditor's loan was made close to the filing of the bankruptcy, one can probably safely assume that the contract rate is reflective of the "market" for this particular debtor.

6. Lack of Good Faith

Section 1325(a)(3) requires that the Plan be proposed in "good faith". This is an elusive and evolving standard. However, the Sixth Circuit Court of Appeals has set forth twelve factors to be considered in making this determination. See Caldwell v. Hardin, 851 F.2d. 852 (6th Cir. 1988) and 895 F.2d. 1123 (6th Cir. 1990); see also In re Okoreeh-Baah, 836 F.2d 1030 (6th Cir. 1988); In re: Barrett, 964 F.2d. 588 (6th Cir. 1992). The twelve points to be considered as follows:

a. the amount of the proposed payments and the amount of the debtor's surplus;

b. the debtor's employment history, ability to earn and likelihood of future increase in income;

c. the probable or expected duration of the Plan;

d. the accuracy of the Plan's statements of the debts, expenses and percentage repayment of unsecured debt and whether any inaccuracies are an attempt to mislead the court;

e. the extent of preferential treatment between classes of creditors;

f. the extent to which secured claims are modified;

g. the type of debt sought to be discharged and whether any such debt is nondischargeable in Chapter 7 (also, how much of this type debt is the debtor seeking to discharge in his plan);

h. the existence of special circumstances such as inordinate medical expenses;
the frequency with which the debtor has sought relief under the Bankruptcy Reform Act;

j. the motivation and sincerity of the debtor in seeking Chapter 13 relief;

k. the burden which the Plan’s administration would place upon the trustee; and,

l. whether the debtor is attempting to abuse the spirit of the Bankruptcy Code.

Typical “bad faith” objections which can and should be filed include debts which were incurred immediately prior to the bankruptcy filing, debts premised on false financial statements, and debts which would otherwise be nondischargeable in Chapter 7. However, the fact that a debt would be nondischargeable in a Chapter 7 case does not automatically require the Court to deny confirmation of the debtor’s Plan. As noted parenthetically above, if only a small percentage of the debt that is sought to be discharged in the Chapter 13 would not be discharged in a Chapter 7, then that is not enough. Additionally, if the percentage that the debtor is proposing to pay to unsecured creditors is relatively high such that creditors with this type debt are not being significantly harmed, then this element alone will not be sufficient to challenge confirmation. This is simply one of the factors to be considered by the Court in determining whether the Plan has been filed in “bad faith”. The more factors that are present, the stronger the objection to confirmation.

7. Debtor’s Proposal to Surrender Collateral “In Full Satisfaction of Debt”

Debtors frequently propose to surrender collateral in Chapter 13 Plans. However, a creditor is not required to accept its collateral in full satisfaction of its indebtedness. The creditor is entitled to sell the collateral, and have any deficiency balance treated as a general unsecured claim. See In re Claypool, 122 B.R. 371 (Bk. W.D. Mo. 1991).

This may happen even after the plan has been confirmed. Example: the debtor will have been in the Chapter 13 for several years, and will want to return a vehicle. The debtor will want the creditor to sell the vehicle and then reclassify the remaining debt as unsecured, while at the same time moving the court to incur new credit to purchase another vehicle. Another scenario would be where the debtor wrecks the car, but the insurance proceeds are less than the remaining balance on the creditor’s allowed secured claim (as established in the Order of Confirmation). Here the debtor will want the creditor to take the insurance proceeds and reclassify the remaining portion of the debt as unsecured. Can the debtor avail himself to the provisions of 11 USC § 1329(a) and reclassify these debts?

The answer is now a resounding "NO." The Court of Appeals for the Sixth Circuit recently held in the case of In re Nolan, 2000 U.S. App. LEXIS 26642, 2000 FED App. 0376, Bankr. L. Rep (CCH) P78,284 that Congress did not intend for 11 USC § 1329(a) to permit debtors to modify a plan and reap a windfall. Confirmation of a Chapter 13 plan binds ALL parties, including the debtor. See, 11 USC § 1327(a) Upon confirmation, both
parties accept the risk of depreciation and deficiency. In rejecting cases to the contrary, the Sixth Circuit held:

First, section 1329(a) does not expressly allow the debtor to alter, reduce or reclassify a previously allowed secured claim. 11 U.S.C. §§ 1329(a) (1993). Instead, section 1329(a)(1) only affords the debtor a right to request alteration of the amount or timing of specific payments. A debtor cannot use section 1329(b)(1) to enlarge the modifications permitted by section 1329(a), since section 1329(b)(1) does not apply unless the proposed modification first complies with section 1329(a)(1). See, Chrysler Fin. Corp. 234 B.R. at 394 (quoting Taylor, 99 B.R. at 904-05). A modification that reduces the claim of a secured debtor would add a claim to the class of unsecured creditors, a change prohibited by section 1329(a). [footnt omitted] See, 234 B.R. at 394-95 (quoting Taylor, 99 B.R. at 905 n.3). Section 1329(a)(1) should not be read so broadly as to authorize the reclassification of claims. See, Coleman, 231 B.R. at 400.

Just like a creditor, the debtor is bound by the valuations of collateral fixed by the entry of the Order of Confirmation. What is grease for the goose is grease for the gander.

8. “Write-Down” of Home Mortgages

Section 1322(b)(2) provides that loans secured only by mortgages on the debtor’s principal residence cannot be modified by a Chapter 13 plan. However, Section 506(a) provides that a claim is treated as “secured” only to the value of the collateral. If a mortgage loan is “under-secured” (with collateral value being less than the balance owed), can a debtor invoke Section 506(a) and (d) to modify the home mortgage debt?

Fortunately, the answer is generally “no”. Debtors are no longer able to “write-down” home mortgages to the value of the real estate collateral. Despite a majority of lower Court opinions to the contrary, the United States Supreme Court ruled in Nobleman v. American Savings Bank, 113 S.Ct. 2106 (1993), that Chapter 13 debtors cannot modify the rights of home mortgage lenders by “bifurcating” the debt, i.e., by “writing-down” the debt to the value of the collateral, and treating the balance as unsecured. (But see, Judge Lee’s opinion in the In re Hiler case, 94-50299 that can be found on the Eastern District of Kentucky’s website). Prior to the Supreme Court’s decision in Nobleman, debtors’ Plans frequently provided that home mortgages would be treated as secured only to the value of the collateral. However, this is no longer permissible, so long as the creditor’s only collateral is a mortgage on the debtor’s principal place of residence, for which the last payment is due after the Plan is complete. The debtor’s Plan must provide that all post-petition mortgage payments will be paid pursuant to the contract schedule.

The debtor can “cure” pre-petition arrearages, though, pursuant to 11 U.S.C. Section 1322(b)(5). However, this must be done within a “reasonable” time, which is typically
limited to twenty-four (24) months in the Western District of Kentucky.

9. Disparate Treatment of Classes of Unsecured Creditors

A further basis for objection to a Chapter 13 Plan is if the debtor proposes to treat unsecured creditors differently. With the exception of co-signed unsecured or undersecured debts (which can be paid as a separate class, in order to protect the co-signers - See, 11 USC § 1322(b)(1)), all general unsecured debts must receive the same treatment. However, debtors frequently propose to treat student loans as a special class of unsecured debt, and sometimes even seek to have the student loans given a “priority” status. This constitutes a basis for objection, pursuant to an unpublished opinion from the Bankruptcy Court for the Western District of Kentucky, In re Crenshaw, Bankruptcy No. 5-91-0926. Crenshaw held that it is impermissible for debtors to propose to pay student loans as priority debt, or to otherwise provide for student loans to receive “better” treatment than other general unsecured creditors would receive under the Plan.

However, there may be a new ploy in town that is a different slant on this same subject.

Student loans are usually long term in nature. 11 USC § 1322(b)(5) allows the debtor to propose a plan that provides for the "maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due." One interpretation of this section would allow the debtor to propose to maintain contract payments on this long term debt during the term of the Chapter 13 plan. While this is not a classification per se, it is classification in practice. See also, 11 USC § 1322(b)(4).

Similarly, many debtors propose to pay signature loans to their credit unions “outside” of the Plan, by payroll deduction. This is clearly objectionable, because such a proposal allows the credit union to receive its contract payments (including post-petition interest), while other general unsecured creditors receive less than 100 percent of the principal amount of their debt (and receive no post-petition interest whatsoever). See In Re Harshbarger, 66 F.3d 775 (6th Cir. 1995). If you are representing a general unsecured creditor (or even if you are representing a secured creditor, which could benefit from having more money paid into the Plan on a monthly basis), an Objection to Confirmation is appropriate if the debtor is proposing to pay unsecured loans to a credit union, etc., by payroll deduction.

III. CONFIRMATION AND DISMISSAL LITIGATION

A. Confirmation

In addition to the specific bases for Objections to Confirmation set forth above, an additional issue which can be raised at the Confirmation Hearing is whether the debtor is current in his escrowed Plan payments (in the Western District) or in his payments to the trustee (in the Eastern District). Pursuant to 11 U.S.C. Section 1326(a)(1), the debtor is to commence Plan payments within thirty (30) days after the date of filing. Thus, on the date of the Confirmation Hearing, the debtor is required to have made all Plan payments accrued
It is important that the Plan payments be current on the date of confirmation of the Plan, or the Plan will obviously be in default immediately following confirmation. These are the creditor's adequate protection payments. It is much more cost-effective to bring this fact to the Court's attention at the Confirmation Hearing, rather than to wait until after confirmation to file a motion for stay relief or dismissal. Obviously, if a creditor is aware of this prior to the hearing on confirmation the motions to convert to a Chapter 7, to dismiss and a motion to terminate the § 362 and § 1301(if applicable) stay(s) could be filed and noticed for the confirmation hearing.

B. Dismissal

The most obvious basis for a post-confirmation Motion to Dismiss is Plan default in payments. The Trustee's office should monitor the debtor's compliance with the terms of the Plan, and if the debtor is not making the payments as required, the Trustee will frequently file a Motion to Dismiss the case (sometimes known as a "show cause" motion). However, creditors are not required to wait for the Trustee to file a "show cause" motion. Creditors are free to file Motions to Dismiss and/or Motions for Stay Relief at any time (assuming, of course, that good cause exists for the filing of same).

If a creditor's claim is not being paid post-confirmation, it is prudent to order a copy of the Trustee's report, to ascertain why the creditor's claim is not being paid. If the debtor is making all payments to the Trustee as agreed, then a Motion to Dismiss would not be appropriate. Rather, a Motion to Terminate the Automatic Stay due to lack of adequate protection for this particular creditor's interest might be in order. However, as noted above, if the debtor is paying in accordance with the provisions of the plan, a plan to which the creditor did not object, then the creditor may be precluded from seeking stay relief by the doctrine of res judicata. Additionally, it may be prudent to make a courtesy call the trustee in this instance. Your client's not getting paid may be due to situation in the trustee's office that can be remedied by picking up the phone.

However, if the debtor is not making his Plan payments per the terms of the confirmed plan, then a Motion to Dismiss would be appropriate (unless the Court has authorized a payment suspension). If the debtor is in default in the Plan payments without prior Court authorization, then a Motion to Dismiss should be filed pursuant to 11 U.S.C. Section 1307. A sample Motion to Dismiss is attached as Appendix B to this chapter.

At the hearing on the dismissal motion, the debtor's counsel will invariably have a proposal for curing the defaulted Plan payments. Obviously, though, this proposal must be analyzed in terms of feasibility. After all, if the debtor has been unable to make the plan payments, it is highly unlikely that he will be able to make increased Plan payments in order to promptly cure the default. If the court is inclined to grant such a forbearance, then request a provision in the order.

When a post-confirmation default has occurred, the creditor can file either a Motion to Dismiss or a Motion to Terminate the Automatic Stay. One potential benefit to filing a Motion to Dismiss (as opposed to a stay relief motion) is that no $75.00 filing fee is required.
Also, if the debtor’s Plan default is not substantial, a Motion to Dismiss may serve to get the debtor “back on track” with the Plan payments.

However, remember that if the plan is dismissed, then it will be a free-for-all amongst creditors to vie for the debtor’s remaining assets. It may spur the debtor into converting the petition to one under Chapter 7 where any deficiency balance remaining due after liquidating your collateral would be discharged rather than paid as an unsecured claim in the Chapter 13. Also, from a cost standpoint, remember that with a motion to dismiss, ALL creditors have to be noticed.

If the default is substantial, and a voluntary conversion by the debtor is a potential (or has even been mentioned by debtor’s counsel), then it may be wise to file the motion to terminate the stay to take advantage of 11 USC § 109(g). If a debtor requests a voluntary dismissal following the filing of a motion for relief from the automatic stay, then that individual may not qualify as a debtor for 180 days after the dismissal. This is a little known, yet powerful weapon.

Likewise, make sure the individual qualifies for relief under Chapter 13 of the Code. 11 USC § 109(e) sets out the debt limits for an individual in order to qualify to be a debtor under Chapter 13. Currently, the individual must have less than $269,250 in noncontingent, liquidated unsecured debt, and less than $807,750 in noncontingent, secured debt. If the individual is over these limits, then they do not qualify for relief under Chapter 13 and may have to file a Chapter 7 or Chapter 11 petition. This is not uncommon for small, sole proprietorships.

This is not the only tool available to a creditor in order to limit a debtor’s ability to file another bankruptcy petition. Say for instance you represent a client that is secured by real estate. You are at the courthouse steps ready to sell the debtor’s home when you get a notice of a Chapter 13 filing. This, in and of itself is permissible. What if, however, that this is your third trip to the courthouse steps, because each time you get the stay terminated, the debtor dismisses that petition and files another on the eve of the foreclosure sale. You will file an objection to the plan on good faith grounds and a motion to dismiss. You are confident that the judge will grant the motion to dismiss (again), but anticipate the filing of yet another Chapter 13 petition. What can you do?

In your motion, ask the judge to condition the dismissal so the debtor may not file another petition under any chapter for (as an example) 120 days. You set out the history of filings in the case and tell the judge that you think that denying the debtor the ability to file another petition for 120 days will allow you time to get the property sold. You predicate your motion on the language in 11 USC § 349(a) that says: "[u]nless the court, for cause, orders otherwise, the dismissal of a case under this title does not ... prejudice the debtor with regard to the filing of a subsequent petition under this title... ." Such an abuse of the bankruptcy process may be the "cause" the judge needs to afford your client this relief.

IV. PRACTICE ISSUES IN CHAPTER 13 CASES FOR CREDITORS
Unless your creditor client is a large bank, consumer finance company or business which has a significant number of its collection accounts in bankruptcy proceedings, it is unlikely that the creditor has a complete understanding of the differences between a Chapter 7 liquidation and a Chapter 13 consumer reorganization. It is important to give your client a basic understanding of how a Chapter 13 works. One of the leading Treatise's on Chapter 13 Bankruptcy practice, Judge Keith Lundin's Chapter 13 Bankruptcy, Second Edition (John Wiley & Sons, Inc. 1994) [a new edition of this book is being sold at the writing of this article - your writers have ordered it, but it has not yet arrived. The citation above will be dated] recommends that attorneys discuss the following topics with their creditor clients to ensure that they can protect their rights in a Chapter 13 proceeding:

1. Differences between Chapter 13 and Chapter 7
2. Existence and role of the Chapter 13 trustee
3. Handling of the notice of filing of a Chapter 13 case
4. The automatic stay and the codebtor stay
5. When to refer a Chapter 13 case to counsel
6. The meeting of creditors
7. Negotiation of (favorable) treatment in the plan
8. The special rights of secured claim holders; valuation, interest, and periodic payments
9. The (more) special rights of real estate secured claim holders
10. The special rights of landlords and lessors
11. The best-interest-of-creditors test, disposable income test, and other rights of unsecured claim holders
12. Effects of confirmation
13. Importance of filing a proof of claim
14. Dividend checks - when they can be expected and in what amounts
15. Monitoring the debtor's performance after confirmation - how to know when a plan is failing
16. When conversion or dismissal is appropriate
17. How to get reports and information on a pending case.

Lundin, Chapter 13 Bankruptcy at §1.130.

By the same token, there are several important issues which creditors attorneys should consider in approaching a Chapter 13 bankruptcy. While this list is clearly not a
comprehensive guide to Chapter 13 Creditor practice, it does provide an excellent "quick reference" to several important issues.

A. File Your Proof Of Claim Early

Unless a creditor has a litigation based claim against the debtor for which it may be entitled to a trial by jury, Langenkamp v. Culp, 498 U.S. 896 (1990), that creditor should always file a proof of claim. See 11 U.S.C. §§501, 502, 503, 506, 507 and 1305; Bankruptcy Rules of Procedure 3001, 3002, 3004, 3007 and 3012. Under the amendments to section 502 enacted in the Bankruptcy Reform Act of 1994, the failure to file a timely proof of claim can result in the disallowance of that claim. See generally, In re Schaffer, 173 B.R. 393, 395 (Bkrtcy N.D. Ill. 1994); In re Weissman, 126 B.R. 889 (Bkrtcy W.D. Ill. 1991) (failure to file claim for nondischargeable debt prevents Creditor holding the claim from receiving a distribution from Chapter 13 Plan); In re Crooker, 159 B.R. 790 (Bkrtcy E.D.Ky. 1993), (a late filed claim may not be accepted in a Chapter 13 case)

In the event your client does not timely file a proof of claim, check and see if you can claim that an "informal" proof of claim has been filed in the Chapter 13 case. See In re McCoy Management Services, Inc., 44 B.R. 215 (Bkrtcy W.D. Ky. 1984). See also, In re Southwest Equip. Rental, 193 BR 276 (Bkrtcy E.D Tenn., 1996) (five elements necessary for a valid informal proof of claim. One, it must be in writing; two, it must contain a demand by the creditor on the debtor's estate; three, it must express an intent to hold the debtor liable for the debt; four, it must be filed with the Bankruptcy Court; and five, the facts of the case must make allowance equitable); But see, In re M. J. Waterman and Assoc., 227 F.3d 604 (6th Cir., 2000) (Upheld: lower court’s refusal to treat creditor's pre-bar date filings as an informal proof of claim and his objection to debtor's bankruptcy reorganization plan as an informal ballot in a Chapter 11) If any writings filed with the Court and sent to the debtor's counsel contain the claim, then you may be able to have the claim allowed in the Chapter 13.

Finally, even secured claim holders should file timely proof of claim in Chapter 13 cases. While a majority of cases hold that liens and mortgages will survive a bankruptcy discharge even if no proof of claim is filed (See Cen-Pen Corp. v. Hanson, 58 F.3d 89 (4th Cir. 1995)), there is substantial authority to the contrary. In re Penrod, 50 F.3d 459 (7th Cir. 1995). Therefore, care should always be taken when notice of a bankruptcy is received to file your proof of claim.

B. Review The Debtor's Plan: You May Not Like What You See

Under 11 U.S.C. §1327, the provisions of a confirmed Chapter 13 plan are binding on both a debtor and Creditor even if the claim of the creditor is not provided for by the Plan. See generally, In re Ivory, 70 F.3d 73 (9th Cir. 1995); Homebanc v. Chappell, 984 F.2d 775 (7th Cir. 1993); In re Szostek, 886 F.2d 1405 (3d Cir. 1990). But see Cen-Pen Corp. v. Hanson, 58 F.3d 89 (4th Cir. 1995). Therefore, if you represent a creditor and fail to file an objection to a Chapter 13 Plan provision which is unfavorable to your client, that client will be bound to the terms of the Chapter 13 Plan under the doctrine of res judicata. See In re Rodgers, 180 B.R. 504 (Bkrtcy E.D. Tenn. 1995) (Creditor's failure to object to Plan which
proposed to pay the Creditor nothing on its $338,746.20 timely filed proof of claim meant
that the Plan was binding on the Creditor even though it was unconfirmable). While there
is no direct Chapter 13 authority from either the Sixth Circuit or Kentucky Federal Courts
on this issue, the Sixth Circuit decision in Thompson v. Kentucky Lumber, 860 F.2d, 674
(6th Cir. 1984), a Chapter 11 case, clearly supports the line of cases which holds that a
confirmed Plan is binding on a non-objecting Creditor.

It is important to note that where a Creditor does not receive adequate notice of a
Chapter 13 filing or the contents of a Plan, that a confirmation of a Chapter 13 plan will not
be binding on that creditor if to do so would result in a denial of due process. Piedmont
Trust Banks v. Linkous, 990 F.2d 160 (4th Cir. 1993).

Perhaps the most controversial issue in this area concerns whether a lien can be
removed by a confirmed Chapter 13 Plan. The majority position, lead by the cases of
Cen-Pen Corp. v. Hanson, 58 F.3d 89 (4th Cir. 1995); Sun Finance Co. v. Howard, 972 F.2d
639 (5th Cir. 1992); and Southtrust Bank of Alabama v. Thomas, 883 F.2d 991 (11th Cir.
1989) hold that the confirmation of a Chapter 13 Plan cannot, by itself, adversely affect
the lien rights of a secured claim holder. These are in opposition to a growing line of cases
which holds that if a Chapter 13 Plan treats a claim as an unsecured claim, that claim will
lose any lien it had if the Chapter 13 Plan is confirmed without objection. See In re Penrod,
50 F.3d 459 (7th Cir. 1995); In re Chappell, 984 F.2d 775 (7th Cir. 1993); and In re Pence,
905 F.2d 1107 (7th Cir. 1990). These cases interpret the provisions of 11 U.S.C. §1327
literally, and hold that a confirmed Plan is binding on both the debtor and his or her creditors,
even to the extent of releasing an otherwise valid lien. While there is no Sixth Circuit or
Kentucky case on point, the better practice is to avoid this problem by carefully reviewing
Chapter 13 Plans and objecting if your claim is not properly treated.

The cases cited above seem to ignore the clear mandate of Bankruptcy Rule 7001(2)
which states that any proceeding to determine the validity, priority or extent of a lien or
other interest in property (other than the avoidance of a lien pursuant to BR 4003(d)), must
be done by adversary proceeding. Your writers would submit that rule, alone, makes such
provisions in plan void (versus voidable). However, with courts allowing the dischargability
of student loans and the creation of exemption where none previously existed (see discussion
of Taylor case, infra) when a creditor rests on its rights, prudence dictates a close inspection
of the plan and objection where necessary.

Another area where ignoring the provisions of a plan can adversely affect a secured
creditors is in the area of release of a lien upon payment of the creditor’s allowed secured
claim plus interest. 11 USC § 506(d) states that to the extent that a claim is undersecured, the
creditor’s lien is void. Does that mean that upon payment of that allowed secured claim, plus
interest the creditor must release that lien prior to completing the plan? If a creditor does
not object to such a provision in a plan, then the debtor could demand release of the lien. If
the collateral is sold, and the bankruptcy later dismissed prior to completion, then the creditor
could be out in the cold.

However, there is case law that does support an objection to such a plan provision.
Judge Howard held in the case of In re McPherson, 230 B.R. 99 (Bkrtcy E.D. Ky., 1999) that
a creditor may not be required to release its lien until all payments under the plan have been made. Here, a plan was confirmed with a provision stating that "the holder of any allowed secured claim provided for by the plan shall retain a lien securing such claim until the amount for which the claim is allowed as secured is paid in full. 11 U.S.C. §§ 1325(a)(5)(B)(I), 1327(c)." Upon payment in full of the allowed secured claim, the debtor requested the creditor to release its lien, which request was refused. Thereafter, the Chapter 13 trustee filed a motion to require the creditor to release its lien and for penalties against the creditor. In overruling the trustee's motion, the Judge Howard observed at page 101 of his decision that:

This Court believes, however, that in order to protect the creditor from premature lien termination, and insure that the debtor is not held hostage beyond the time he/she has performed according to the confirmed plan, that the better approach is to require that a lien be released upon successful completion of the Chapter 13 plan, but before a discharge is entered.

Your authors suggest the better practice is to object to such provisions at the outset so that you are not playing "catch up" later.

C. The Automatic Stay In Chapter 13 Cases

As discussed elsewhere in this Monograph, 11 U.S.C. §362 applies in Chapter 13 proceedings. That means that upon the filing of a Bankruptcy petition, nearly all collection activities against a debtor or debtor's property, including all lawsuits, all efforts to repossess property and all acts to obtain, perfect or enforce a lien. However, in two important respects, the scope of the automatic stay is far broader in Chapter 13 proceedings than it is in other bankruptcy cases.

1. Post Petition Property

As noted above, the automatic stay protects both the debtor and the debtor's property. Under 11 U.S.C. §1306 property of the estate includes a debtor's post petition earnings and property acquired by the debtor after the filing of the Chapter 13. See generally, In re Scott, 142 B.R. 126 (Bkrtcy. E.D. Va. 1992); In re Euerle, 70 B.R. 72 (Bkrtcy. D.N.H. 1987); In re Koonce, 54 B.R. 643 (Bkrtcy. D.S.C. 1985) ($1.3 million prize won in Lottery by debtors after confirmation of their Chapter 13 Plan was property of the estate). Contra In re Tschiderer, 73 B.R. 133 (Bkrtcy. W.D. N.Y. 1987). This means that even creditors holding post petition debts must take care when attempting to collect so as not to violate the automatic stay. See In re Heflin, 145 B.R. 560 (Bkrtcy. S.D. Ohio 1992).

2. The Codebtor Stay

One of the unique features of a Chapter 13 case is 11 U.S.C. §1301, which protects people who are jointly liable with a debtor or a consumer debt from having the creditors holding such joint debts proceed against them until the conclusion of the Chapter 13 case or until they obtain relief from the Codebtor stay. See 11 U.S.C. §1301. See also In re
Sommersdorf, 139 B.R. 700 (Bkrtcy. S.D. Ohio 1991) (discussing broad scope of Section 1301).


Further, a creditor may obtain relief from the Codebtor stay by showing:

A). the nonbankrupt Codebtor received the consideration for the debt. See generally, In re Motes, 166 B.R. 147 (Bkrtcy. E.D. Mo. 1994); In re Rhodes, 85 B.R. 64 (Bkrtcy. N.D. Ill. 1988);

B). the Debtor's Chapter 13 Plan does not propose to pay the creditor's claim in full. See Friendly Finance Discount Corp. v. Bradley, 705 F.2d 1409 (5th Cir. 1983); In re Fink, 115 B.R. 113 (Bkrtcy. S.D. Ohio 1990); First National Bank v. Garrett, 36 B.R. 432 (Bkrtcy. MD.Tenn. 1984); or

C). that the Creditor's interest would be irreparably harmed by a continuation of the codebtor stay. See Harris v. Ft. Oglethorpe State Bank, 721 F.2d 1052 (6th Cir. 1983).

However, if a Creditor files a Motion for Relief from the Codebtor stay, either the debtor or the nonbankrupt codebtor must object to that motion within 20 days after it is filed or relief from the Codebtor stay will be automatically granted. See 11 U.S.C. §1301.

D. Review A Debtor's Claimed Exemptions

As in other Bankruptcy proceedings, Chapter 13 debtors in Kentucky are entitled to claim their state law exemptions. Property which is exempt is excluded from the liquidation test of 11 U.S.C. §1325(a)(4). See In re Alderman, 150 B.R. 246 (Bkrtcy. D.Mont 1993). See also, In re Soloman, 67 F.3d 1128 (4th Cir. 1995).

In 1992 the Supreme Court in Taylor v. Freeland & Kronz, 507 U.S. 976 (1992) held that unless a timely objection to an exemption is made within thirty (30) days after the meeting of creditors, any exemption will be deemed allowed even if there is no basis for the claimed exemption under applicable law. Therefore, it is extremely important for creditors to review the debtor's claimed exemptions at the beginning of the case or they may forfeit their ability to look to those assets in a Chapter 13 Plan. But see In re Walker, 153 B.R. 565 (Bkrtcy. D. Or. 1993) (Creditor can object to improperly claimed exemption as objection to confirmation of Plan, even if no timely objection to exemption was made).

E. Leases And Other Executory Contracts: A Forgotten Issue

In the current financial climate of car leases, time shares, rent-to-own furniture, leases and executory contracts are an increasingly important aspect of Chapter 13 practice. Under 11 U.S.C. §1322(b)(7), a Chapter 13 debtor may assume or reject an unexpired lease or executory contract in either the Chapter 13 Plan or by separate motion under the provisions
of 11 U.S.C. §365. Creditors need to be aware of the special protections creditors holding executory contracts are entitled to in Bankruptcy proceedings.

The initial issue which a creditor must determine is whether an "executory contract" is actually a contract or a disguised security agreement. See In re Terrell, 892 F.2d 469 (6th Cir. 1989) (Michigan Land Sale contract); In re Yost, 54 B.R. 818 (Bkrtcy W.D. Ky. 1985). If an agreement has been validly terminated before the bankruptcy filing then there could be nothing left to assume. See generally In re Morgan, 181 B.R. 579 (Bkrtcy N.D. Ala. 1994). Further, a Debtor may not be allowed to reject a contract if the rejection is in bad faith. Shell Oil Co. v. Waldron, 785 Ed.2d 936 (11th Cir. 1986). Unless the contract in question is a true lease and not a disguised security agreement, the protections of 11 U.S.C. §365 are not available and a secured debt can be "crammed down" to the value of its collateral under 11 U.S.C. §1325. See Ledford v. NRM, Inc., 94 B.R. 103 (Bkrtcy. S.D. Ohio 1988).

If a contract is found to be executory, then in order to assume the contract if there has been a default in the contract, a debtor must:

1) cure, or provide adequate assurance that the default will be promptly cured;

2) compensate, or provide adequate assurance of prompt compensation to any party other than the debtor, for any actual pecuniary loss resulting from the default; and

3) provide adequate assurance of future performance under such contract.

How prompt is a prompt cure or prompt compensation for purposes of 11 U.S.C. §365 is not exactly known and will have to be determined on a facts and circumstances basis. See In re Yokley, 99 B.R. 394 (Bkrtcy. M.D. Tenn. 1989). However, the rule in the Western District of Kentucky on an automobile lease is six months. See, In re Reed, 226 B.R. 1 (Bkrtcy W.D Ky. 1998).

Further, if the agreement in question is a lease of nonresidential real property, then either the motion to assume the lease or the Plan containing an assumption of the lease must be filed in court no more than sixty (60) days after the bankruptcy petition is filed. If one of these filings is not made, then the lease is deemed rejected by operation of law. In re Anuro, 72 B.R. 424 (Bkrtcy. S.D. Cal. 1987).

Finally it is important to note that the rejection of a lease or executory contract may give rise to an unsecured claim for damages which arise as a result of the breach of the lease. See 11 U.S.C. §502. Subject to certain limitations, the rejection of a lease of a house or apartment can give rise to a claim of damages for up to one (1) year's rent. Also, the resulting deficiency balance may also give rise to an administrative priority expense if the lease is accepted, and there is a post-confirmation default. See, 11 USC § 365(g)(2)(A) and Lundin, Chapter 13 Bankruptcy at §4.89.

F. Homes Are A Lender's Castle: 11 U.S.C. §1322(b)(2)
As a general rule, debtors may "write down" a secured debt to the value of the collateral under 11 U.S.C. §1322(b)(2). However, in light of Nobleman v. American Savings Bank, 506 U.S. 1020 (1993) a debtor may not generally "write down" a claim "secured only by a security interest in real property that is the debtor's principal residence..." This general rule has a narrow exception in the Eastern District of Kentucky for second mortgages which have no equity to which to attach. See In re Williams, 161 B.R. 27 (Bkrtcy E.D. Ky 1993); In re Moncrief, 163 B.R. 492 (Bkrtcy E.D. Ky 1993). The Western District of Kentucky has not yet considered this issue.

However, in order to obtain the protection of Section 1322(b)(2) a lender must have 1) a security interest; 2) secured only; 3) by real property that is 4) the debtor's principal residence. Each of these elements must be met or the secured claim may be modified.

1. A Security Interest

Under 11 U.S. C. § 101(51) a security interest is defined by the Bankruptcy Code as a "lien created by agreement." Therefore any nonresidential liens on a debtor's principal residence will be subject to foreclosure. The only exception to this general rule is when a creditor has a judgement lien against debtors arising from the foreclosure of a mortgage on the debtor's principal residence. See First National Fidelity Corp. v. Perry, 945 F.2d 61 (3d Cir. 1991).

2. Secured Only by Debtor's Principal Residence

In the Sixth Circuit, it is settled law that credit life, credit disability or other similar insurance are not "additional security" for the underlying loan for purposes of 11 U.S.C. §1322(b)(2). In re Davis, 989 F.2d 208 (6th Cir. 1993). Further, other intangible collateral such as "Hereditaments, appurtenances, rents, royalties, profits and fixtures" will generally not be considered as additional security so as to destroy the protections of §1322(b)(2). Id. However, if the collateral is more tangible in nature, then the protections of 11 U.S.C. §1322(b)(2) will be lost. See Wilson v. Commonwealth Mortgage Corp., 895 F.2d 123 (3rd Cir. 1990). Unfortunately, there is no clear guidance on what "boilerplate" mortgage language is acceptable and what is not. See In re Hammond, 27 F.3d 52 (3d Cir. 1994).


3. A Security Interest in Real Property

One of the most unusual issues in Bankruptcy is whether a mobile home is real estate for purposes of 11 U.S.C. §1322(b)(2). This issue turns on whether a mobile home is considered real property or personal property under applicable state law. See In re Weaver, 69 B.R. 554 (Bkrtcy. W.D. Ky. 1987) (discussing Kentucky law on mobile homes); Hiers v.
Hiers, 3 Ky. AR 15 at p.10 (Ky. Ct. App. Oct. 18, 1996). As noted by one authority "this question will be...[determined] on whether the mobile home is really affixed to the ground or... merely stuck in the mud. Debtor's counsel might be tempted to suggest that the debtor put the wheels back on the trailer if modification... is a goal... Creditor's counsel might consider stealing the wheels or at least getting pictures before the home becomes mobile again." Lundlin, 1 Chapter 13 Bankruptcy 4-41 (1994 John Wiley & Sons, Inc.).

4. The Real Estate is Used as the Debtor's Principal Residence

It is clear from the language of the statute that the protections of 11 U.S.C. §1322(b)(2) do not protect claims secured by second or vacation homes. See In re Saglio, 153 B.R. 4 (Bkrtcy. D.R.I. 1993). A difficult question arises, though, when a debtor lives on a tract of property which is used for agricultural or commercial purposes or a business of the debtor is located in the same structure as the debtor's principal residence. Several courts have held that where the debtor's residence contains both substantial income producing property and the principal residence, the obligation will be modifiable. See In re Del Valle, 186 B.R. 347, 349 (Bkrtcy. D. Conn. 1995); In re Dinsmore, 141 B.R. 499 (Bkrtcy W.D. Mich. 1992). See also In re McVay, 150 B.R. 254 (Bkrtcy. D. Or. 1993) (Bed & Breakfast home). However, depending on the facts of a given case, such property may be given 11 U.S.C. §1322(b)(2) protection. See Paulsen v. Fed. Home Loan Mortgage Corp., 179 B.R. 492 (E.D. La. 1995).

G. Dischargeability Of Debts In Chapter 13

Finally, even if you represent an unsecured creditor, your debt may be nondischargeable in a Chapter 13 case. Under 11 U.S.C. §1328, debts which are for restitution or a criminal fine, debts which are provided for under §1322(b)(5) (long term secured debt which will not be relieved until after the termination of a Chapter 13 Plan), certain unauthorized post-petition consumer debts under 11 U.S.C. §1305 and debts which are nondischargeable under 11 U.S.C. §523(a)(5) (alimony and child support), (a)(8) (student loans) or (a)(9) ("drunk driving" debts) are nondischargeable in Chapter 13 proceedings. With respect to these debts, to the extent a Chapter 13 plan does not propose to pay these debts in full, any unpaid balance will survive the Chapter 13 discharge. Further, if the debtors acquire any assets which are not property of the estate, stay relief could be sought so the creditor can attach these assets.

As a general rule, there is little a creditor can do if it holds a nondischargeable Chapter 13 claim during the case given the broad definition of property of the estate, unless you can convince the debtor to separately classify your claim and pay it in full. However, except for nondischargeable debts under 11 U.S.C. §523(a)(5) which have the status as priority claims, a classification which would give a de facto priority position to nondischargeable debts will probably be disallowed if challenged because it would unfairly discriminate between similar classes of creditors under 11 U.S.C. §1322(b)(1). See Groves v. LaBarge, 39 F.3d 212 (8th Cir. 1994); McCullough v. Brown, 162 B.R. 506 (N.D. Ill. 1993); In re Hiner, 161 B.R. 688 (Bkrtcy. D. Idaho 1993). There is some caselaw to the contrary, but it is clearly a minority position. See In re Tucker, 159 B.R. 325 (Bkrtcy. D. Mont. 1993); In re Strictland, 181 B.R. 598 (Bkrtcy. N.D. Ala. 1995).
V. APPENDIX

Note: many of the forms relative to Chapter 13 practice in the Eastern and Western Districts of Kentucky are subject to change upon the adoption of Joint Local Rules for these two Bankruptcy Districts. At the writing of this Chapter, proposed Joint Local Rules have been submitted to the judges for both Divisions, subject to change, amendment and comment by the Bar. Check the websites for the Eastern District at http://www.kyeb.uscourts.gov/ and the Western District at http://www.kewb.uscourts.gov/ for changes in these rules and forms.

A. Notice Of Commencement Of Case Under Chapter 13

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF KENTUCKY

546 U.S. Courthouse
601 W. Broadway
Louisville, KY 40202

NOTICE OF COMMENCEMENT OF CASE UNDER CHAPTER 13
OF THE BANKRUPTCY CODE, ORDER FOR RELIEF
MEETING OF CREDITORS, AND FIXING OF DATES

Case Number: IN RE (Name of Debtor)
Date Filed (or Converted)
ADDRESS OF DEBTOR

NAME/ADDRESS OF ATTORNEY FOR DEBTOR
NAME/ADDRESS OF TRUSTEE

William W. Lawrence
310 Legal Arts Bldg.
200 S. Seventh Street
Louisville, KY 40202
Telephone Number: (502) 581-9042

DATE/TIME/LOCATION OF MEETING OF CREDITORS
September 26, 1996 at 3:00 pm
509 U.S. Courthouse (use 6th Street Elevators)
601 W. Broadway
Louisville, KY 40202

Filing Claims: Deadline to File a Proof of Claim is 12/26/96 - The debtor has filed a plan

AVOIDANCE OF LIEN. All motions to avoid liens shall be filed within 60 days following the first date set for the 341 meeting. Failure to file within said time shall result in denial of such motions.

NOTICE: Confirmation hearings will be held in Courtroom #3 on the same date as the 341 meeting. For cases having 341 meetings in the a.m., confirmation hearings will be held at 11:30 a.m. For cases having afternoon 341 meetings, confirmation hearings will be held at 4:00 p.m.

THIS CASE MAY BE DISMISSED WITHOUT FURTHER NOTICE IF THE SCHEDULES ARE NOT FILED WITHIN 15 DAYS FROM THE DATE THE PETITION WAS FILED.

COMMENCEMENT OF CASE. An individual's debt adjustment case under chapter 13 of the Bankruptcy Code has been filed in this court by the debtor or debtors named above, and an order for relief has been entered.

CREDITORS MAY NOT TAKE CERTAIN ACTIONS. A creditor is anyone to whom the debtor owes money. Under the Bankruptcy Code, the debtor is granted certain protection against creditors. Common examples of prohibited actions by creditors are contacting the debtor to demand repayment, taking action against the debtor to collect money owed to creditors or to take property of the debtor, and starting or continuing foreclosure actions, repossessions, or wage deductions. Some protection is also given to certain codebtors of consumer debts. If unauthorized actions are taken by a creditor against a debtor, or a protected codebtor, the court may punish that creditor. A creditor who is considering taking action against the debtor or the property of the debtor, or any codebtor, should review Sec. 362 and 1301 of the Bankruptcy Code and may wish to seek legal advice. The staff of the clerk of the bankruptcy court is not permitted to give legal advice.

MEETING OF CREDITORS. The debtor (both husband and wife in a joint case) is required to appear at the meeting of creditors on the date and at the place set forth above labeled "Date/Time/Location of Meeting of Creditors" for the purpose of being examined under oath. Attendance by creditors at the meeting is welcomed, but not required. At the meeting, the creditors may examine the debtor and transact such other business as may properly come before the meeting. The meeting may be continued or adjourned from time to time by notice at the meeting, without further written notice to the creditors. Failure to attend the Sec. 341 Meeting shall result in dismissal unless the court orders the meeting continued upon motion of debtor.

PROOF OF CLAIM. Except as otherwise provided by law, in order to share in any payment from the estate, a creditor must file a proof of claim by the date set forth above
labeled "Filing Claims." The place to file the proof of claim, either in person or by mail, is the office of the clerk of the bankruptcy court.

**All creditors filing claims shall serve a copy on the attorney for the debtor.**

**PURPOSE OF A CHAPTER 13 FILING.** Chapter 13 of the Bankruptcy Code is designed to enable a debtor to pay debts in full or in part over a period of time pursuant to a plan. A plan is not effective unless approved by the bankruptcy court at a confirmation hearing. Creditors will be given notice in the event the case is dismissed or converted to another chapter of the Bankruptcy Code.

**ALL SECURED CLAIMS MUST BE FILED IN THIS OFFICE THREE (3) BUSINESS DAYS PRECEDING THE MEETING OF CREDITORS.** ALL SUCH CREDITORS WHO FAIL TO DO SO WILL NOT BE TREATED AS SECURED CREDITORS FOR PURPOSES OF DISTRIBUTION.

**OBJECTION TO THE CONFIRMATION OF A PLAN MUST BE FILED BY THE FIRST DATE SET FOR THE CONFIRMATION HEARING.**

For the Court: Diane S. Rohl 8/23/96
Clerk of the Bankruptcy Court Entered
FORM B 91 0011

US Bankruptcy Court
COURT
200 Merrill Lynch Plaza
Kentucky
100 East Vine Street
Lexington, KY 40507-1406

UNITED STATES BANKRUPTCY
Eastern District of Covington

NOTICE OF COMMENCEMENT OF CASE UNDER CHAPTER 13 OF THE BANKRUPTCY CODE,
MEETING OF CREDITORS, AND FIXING OF DATES

CASE NUMBER: DATE FILED:

NAME OF DEBTOR(S)/aka/dba/SSN/EIN: ATTORNEY FOR DEBTOR(S):

ADDRESS OF DEBTOR(S): TRUSTEE:
Sidney N. White
100 E. Vine St. #500
MEETING OF CREDITORS:  
HEARING  
April 16, 1996 at 10:00 am  
US Bankruptcy Courtroom  
Greenberg Bldg 2nd Fl  
513 Madison Ave  
Covington, KY 41011  

CONFIRMATION  
June 4, 1996 at 10:15 am  
US Bankruptcy Courtroom  
Greenberg Bldg 2nd Fl  
513 Madison Ave  
Covington, KY 41011  

FEE APPLICATIONS BY COUNSEL FOR THE  
PROOF OF CLAIM:  
DEBTOR(S) FOR SERVICES PERFORMED IN  
REPRESENTATION OF THE DEBTOR(S) IN THIS  
CASE FOR AN AMOUNT NOT IN EXCESS OF $500  
90 DAYS AFTER  
THE DATE SET FOR THE  
MEETING OF CREDITORS  
SHOWN ABOVE.  
MAY BE RECEIVED AND ACTED ON BY THE COURT  
AT THE CONFIRMATION HEARING.  
FEE APPLICATIONS IN EXCESS OF SUCH AMOUNT WILL  
BE ACTED ON ONLY AFTER NOTICE TO ALL  
CREDITORS AND PARTIES IN INTEREST  

COMMENCEMENT OF CASE. An individual's debt adjustment case under chapter 13 of the Bankruptcy Code has been filed in this court by the debtor or debtors named above, and an order for relief has been entered. You will not receive notice of all documents filed in this case. All documents filed with this court, including lists of the debtor's property and debts, are available for inspection at the office of the clerk of the bankruptcy court.  

CREDITORS MAY NOT TAKE CERTAIN ACTIONS. A creditor is anyone to whom the debtor owes money or property. Under the Bankruptcy Code, the debtor is granted certain protection against creditors. Common examples of prohibited actions by creditors are contacting the debtor to demand repayment, taking action against the debtor to collect money owed to creditors or to take property of the debtor, and starting or continuing foreclosure actions, repossessions, or wage deductions. Some protection is also given to certain codebtors of consumer debts. If unauthorized actions are taken by a creditor against a debtor or protected codebtor, the court may penalize that creditor. A creditor who is considering taking action against the debtor or the property of the debtor, or any codebtor, should review sections 362 and 1301 of the Bankruptcy Code and may wish to seek legal advice. The staff of the clerk of the bankruptcy court is not permitted to give legal advice.  

MEETING OF CREDITORS. The debtor (both husband and wife in a joint case) is
required to appear at the meeting of creditors on the date and at the place set forth above for the purpose of being examined under oath. Attendance by creditors at the meeting is welcomed, but not required. At the meeting the creditors may examine the debtor and transact such other business as may properly come before the meeting. The meeting may be continued or adjourned from time to time by notice a the meeting, without further written notice to creditors.

PURPOSE OF CHAPTER 13 FILING. Chapter 13 of the Bankruptcy Code is designed to enable a debtor to pay debts in full or in part over a period of time pursuant to a plan. A plan is not effective unless approved by the bankruptcy court at a confirmation hearing. Creditors will be given notice in the event the case is dismissed or converted to another chapter of the Bankruptcy Code.

PROOF OF CLAIM. Except as otherwise provided by law, in order to share in any payment from the estate, a creditor must file a proof of claim by the date set forth above labeled "Deadline to File a Proof of Claim."

The place to file the proof of claim, either in person or by mail, is the office of the clerk of the bankruptcy court. Proof of claim forms are available in the clerk's office of any bankruptcy court.

***FILE CLAIM FORM ON REVERSE SIDE IN DUPLICATE WITH: US BANKRUPTCY COURT, 200 MERRILL LYNCH PLAZA, 100 EAST VINE STREET, LEXINGTON, KY 40507-1406***

DATED: FOR THE COURT

FORM B91

Betty L. Jennette, CLERK

B. Motion To Dismiss

UNITED STATES BANKRUPTCY COURT

_______ DISTRICT OF _______

IN RE: )
) CASE NO.
) )
)
)
)
)
)
)
)
)
)
)
)
)
)
)
)
)

I - 29
MOTION TO DISMISS

Comes ____________________, a creditor, by counsel, and respectfully moves the Court to dismiss the within Chapter ____ proceeding, and as basis therefor states that the debtor is $______________ is arrears on his/her plan payments.

WHEREFORE, ________________ respectfully requests that this case be dismissed.

Respectfully submitted,

__________________________________________

COUNSEL FOR

__________________________________________

CERTIFICATE OF SERVICE

The undersigned certifies that a true and correct copy of the foregoing was this ___ day of ______, 19___, served by mail upon the following.

__________________________________________

UNITED STATES BANKRUPTCY COURT
__________ DISTRICT OF __________

IN RE: __________________________ )
) ) CASE NO.
) ) DEBTOR
) )

__________________________________________  )

I - 30
ORDER

On motion of _____________, and the Court being otherwise sufficiently advised;

IT IS HEREBY ORDERED that the within case be, and it hereby is dismissed with prejudice.

_____________________________
JUDGE, U.S. BANKRUPTCY COURT

_____________________________
DATE
CASE MANAGEMENT/ELECTRONIC CASE FILING SYSTEM
(The Paperless Bankruptcy Court)

Hon. Joan Lloyd Cooper
Judge, United States Bankruptcy Court
Western District of Kentucky
Louisville, Kentucky

Copyright 2000, Hon. Joan Lloyd Cooper

SECTION J
# CASE MANAGEMENT / ELECTRONIC CASE FILING SYSTEM

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Case Management
Case Filing System
Electronic
Overview

- What is CM/ECF?
- When will it be here?
- What will it take to be connected?
- How much will it cost?
- What will it look like?
What is CM/ECF?
When will CM/ECF be available?

- We are estimating 2 to 3 years from now.
- Currently, CM/ECF has not been fully developed.
- Courts may start receiving a finished product in 2001.
- It may take up to 3 years for all Courts to receive the product.
Why discuss CM/ECF now?

Participation in electronic case filing by attorneys is critical to success.

Preparation in the system must work well for the attorneys, public and Clerk's Office.

Preparation is the key to success.

Way business is conducted in the CM/ECF is going to be a big change in the

Why discuss CM/ECF now?
What does it take to get connected?

Internet Access with a Browser

Login and Password

For files, a copy of Adobe Acrobat Writer

and possibly a scanner

can get Internet access

(?)
How much will it cost?

Number of times printed does not affect cost.

Time is irrelevant.

One page is defined as 54 lines of data.

7 cents per page viewed (N/A to filing).

How much will it cost?
What will CM/ECF look like?

The format and placement on our Internet site have not been finalized. The following slides show what it could look like in the future to view and file documents.
This is a Restricted Web Site for Official Court Business only. Unauthorized entry is prohibited.

Subject to prosecution under Title 18 of the U.S. Code. All activities and access attempts are logged.

ECF Login

Notice

Authentication

Password: 
Login: 

Case Number (Example: 99-80013)

Last Name

First Name

SSN

Middle Name

Type

Tax Id

SSN

Middle Name

First Name

Last Name

Case Number

(Example: Desoto, Desoto, Desoto)

(Example: 99-80013)

(Example: 00-0523)

NOTICE: Access to the information in this system is currently available at no charge; however, a user fee, approved by the Judicial Conference of the United States, may be applied in the future.

Search Clues

Query
Query

Notice of Bankruptcy Case Filing
Judge
Docket Report
Creditor
Case Summary
Calendar By Case
Attorney
Associated Cases
 Alias

Case Type: bk Chapter: 13 Asset: Y Vol: 7 Judge: John J. Hargrove
00-05123-JH George Michael Tipps and Cynthia Lynn Tipps
Docket Text

Case Type: BK Chapter: 13 Asset: Y Vol: 1 Judge: John J. Hargrove

00-05123-JH George Michael Tipps and Cynthia Lynn Tipps

05/19/2000 Chapter 13 Plan filed by Ivan Trahan on behalf of Cynthia Lynn Tipps, George Michael Tipps. (M:cFarlane, T.) (Entered: 05/22/2000)

05/27/2000 Application for Confirmation of Plan; Order Confirming Plan and Allowing Attorney Fees.

06/27/2000 Notice of Classification of Claim and Right To Request a Hearing with Certificate of Service with 341(a) Meeting.

06/28/2000 Order Confirming Plan and Allowing Attorney Fees.

09/08/2000 Notice of Classification of Claim and Right To Request a Hearing with Certificate of Service.

Filing Date
00-05123-JH George Michael Tipps and Cynthia Lynn Tipps

Docket Number 136023. Fee Amount 185.00 filed by Ivan Trahan on behalf of Cynthia Lynn Tipps. George Michael Tipps. (M:cFarlane, T.) (Entered: 05/22/2000)

Chapter 13 Plan filed by Ivan Trahan on behalf of Cynthia Lynn Tipps, George Michael Tipps. (M:cFarlane, T.) (Entered: 05/22/2000)

Chapter 13 Plan filed by Ivan Trahan on behalf of Cynthia Lynn Tipps, George Michael Tipps. (M:cFarlane, T.) (Entered: 05/22/2000)

Chapter 13 Plan filed by Ivan Trahan on behalf of Cynthia Lynn Tipps, George Michael Tipps. (M:cFarlane, T.) (Entered: 05/22/2000)

Chapter 13 Plan filed by Ivan Trahan on behalf of Cynthia Lynn Tipps, George Michael Tipps. (M:cFarlane, T.) (Entered: 05/22/2000)

Chapter 13 Plan filed by Ivan Trahan on behalf of Cynthia Lynn Tipps, George Michael Tipps. (M:cFarlane, T.) (Entered: 05/22/2000)

Chapter 13 Plan filed by Ivan Trahan on behalf of Cynthia Lynn Tipps, George Michael Tipps. (M:cFarlane, T.) (Entered: 05/22/2000)
UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF CALIFORNIA

In re: George Michael Tipps and Cynthia Lynn Tipps

Case Number: 00-05123-JH

Chapter 13 (Mandated Form)

Case Type: BK Chapter: 13 Asset: y Vol: 
Judge: John J. Hargrove

Case Summary:

Case Type: BK Chapter: 13 Asset: y Vol: 
Judge: John J. Hargrove

00-05123-JH George Michael Tipps and Cynthia Lynn Tipps

Case Summary:

Case Type: BK Chapter: 13 Asset: y Vol: 
Judge: John J. Hargrove

00-05123-JH George Michael Tipps and Cynthia Lynn Tipps

Case Summary:

Case Type: BK Chapter: 13 Asset: y Vol: 
Judge: John J. Hargrove

00-05123-JH George Michael Tipps and Cynthia Lynn Tipps
If this document was filed by a non-attorney, please select the Party Filer Link.

Address new attorney

Select the attorney on whose behalf you are filing this document.

99-7000 John Humble Binder and Big Bank Lending
Please select the filer:

Select the Party:
Add/Create New Party

File a Motion: 99-70000 John Humble Brubaker and Big Bank Lending
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<td>Motion for Setting Hearing</td>
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File a Motion: 99-70000 John Humble Brubaker and Big Bank Lending
File a Motion: 99-70000 John Humble Brubaker and Big Bank Lending
Motion for Relieve from Stay, to repossess sailJoatfiled by Joe B. Cool on behalf of Big Bank.

Warning! Submitting this screen commits this transaction. You will have no further opportunity to modify this submission if you continue.

Motion for Relief from Stay, to repossess sailJoatfiled by Joe B. Cool on behalf of Big Bank.

File a Motion: 99-70000 John Humble Brubaker and Big Bank Lending
Motion for Relief from Stay, to repossess sailboat filed by Joe B. Cool on behalf of Big Bank Lending.

Pocket Text:
Motion for Relief from Stay, to repossess sailboat filed by Joe B. Cool on behalf of Big Bank Lending.

Documents associated with this transaction:
- Document description: Main Document
- Document path: /temp/motion.pdf
- Document stamp:
  - CASBStamp_ID=875559582
  - FileNumber=16022-0

Notice will be electronically mailed to:
annie_333@yahoo.com

Notice will not be electronically mailed to:

Filing receipt

Docket Text:
Motion for Relief from Stay, to repossess sailboat filed by Joe B. Cool on behalf of Big Bank Lending (Brubaker, John)
Questions

- Albert Einstein

"The important thing is not to stop questioning."
The Case Management/Electronic Case Files (CM/ECF) system uses Internet technology to give the U.S. federal judiciary a new mechanism for information handling. Attorneys can file pleadings from their offices via a Web browser; judges, court staff, and attorneys have immediate access to new and historical documents; and case data and documents are managed effectively.

CM/ECF is currently used in four district and five bankruptcy courts around the country. Since its inception, CM/ECF has handled over 15,000 cases and 175,000 documents and docket entries for a user community of 75 judges, 400 court staff, and 1000 attorneys who use it to file their documents. Because of its initial success, CM/ECF service will be expanded throughout the federal courts over the next few years. Consequently, the federal courts are reexamining traditional policies, practices, and rules that may need to be adjusted for the Internet world.

The prototype for CM/ECF was developed by the Administrative Office (AO) of the U.S. Courts with the participation of nine volunteer courts. The AO’s Technology Enhancement Office (TEO) designed and programmed the software and was assisted by the Applications Management and Development Division (AMDD). This prototype for bankruptcy and civil cases was evaluated against various commercial and court-developed alternatives and was chosen as the basis for a CM/ECF system to serve all appellate, district, and bankruptcy courts. An AO project team under AMDD is managing the ongoing development and implementation of CM/ECF.

Features of CM/ECF

- Next-generation case management, tracking of motions, answers, deadlines, and hearings.
- Up-to-date reports, queries, and docket sheets produced.
- Electronic delivery of documents to, from, and within the courts.
- Electronic retrieval of case documents and dockets by all users.
- Electronic document management, storage, security, and archiving.
- Automatic creation of docket entries from attorney filings.
- Electronic notices of filing to other CM/ECF participants.

What CM/ECF users say they like...

- Capability to view filings after normal court business hours
- Advantage of instant filing any time of the day or night
- You don’t have to leave your office, spend time making extra copies, or use messengers
- Less paper, smaller files, more efficiency
- Ease and speed of running reports
- Availability of documents from the Web
- Immediate notification and access to pleadings
- You don’t have to move the actual paperwork through the court process, mail copies to parties, etc.
- It’s easy to use
The CM/ECF Project

The goal of the CM/ECF project is to create a system that allows nearly all documents associated with a court case to be handled electronically.

CM/ECF supports the unique interests of different communities (the courts, the attorneys, and the public) while providing the same range of document processing capabilities to all.

We expect that many people will file documents electronically over a network by using a standard Web browser, even though CM/ECF does allow people to submit the same documents on a computer disk or even on paper if they prefer. The documents submitted electronically must be in Portable Document Format (PDF).

The network used to access CM/ECF is the DCN (the Judiciary's private network), in the case of the courts, or the Internet, in the case of the attorneys and the public.

Interaction with CM/ECF is via a Web browser, HTML forms that enable document "attachments," and interactive software. The Web server application software collects the forms data, processes it, and forwards data and documents to a private server for storage.

As byproducts of the filing, case management information is created and notices of filing are transmitted to case participants. Immediately upon filing, the case docket sheet and associated documents become available on-line to both the case participants and the public.

For example, an attorney prepares a motion on her PC with her word processor of choice. She saves the document and "prints" it using Adobe's PDFWriter. Using her Web browser, she then connects to the home page of the federal court associated with the filing and "files" the motion. The attached PDF document is automatically forwarded to the court's CM/ECF Web site. Once the data is validated, it is stored in the court's CM/ECF database.

CM/ECF was first introduced as a prototype in the fall of 1996 and has been used by other federal district and bankruptcy courts since late 1997 and early 1998. CM/ECF activity has steadily increased with more than 1,000 new cases and 15,000 additional entries each month.

The nine prototype demonstration courts have helped us prioritize and refine the capabilities of the system. By combining our systems expertise with the courts' business expertise, we have developed a system that exactly matches the needs of the federal courts.
CM/ECF...designed for the federal courts

CM/ECF is being developed by the AO’s TEO and AMDD in cooperation with federal district, bankruptcy, and appellate courts. These organizations have been involved in the development of virtually every national case management system for the federal judiciary since 1976. The six original TEO application developers have, in total, over 120 years of experience with computer systems for the federal judiciary; the full implementation team has more than 250 years of experience.

The designers understand that, while staffing and money is tight in the federal courts, the caseloads continue to increase and the case document management challenges are enormous. They know that any new system cannot add to the workload. For these reasons, they designed the CM/ECF architecture in such a way that it allows for:

- Use of the networks, machines, and word processing facilities in use today by the federal courts and legal community.
- Gradual implementation of electronic filing at each court’s chosen pace.
- Tailoring of the system to local court preferences and practices.

The system design is based on the following key “enablers” — the standards, hardware components, and software components that minimize the cost to create, modify, support, and deploy the CM/ECF system:

- DCN (“inside”) access to enable the courts to use the communications network already in place.
- Internet (“outside”) access to enable easy and inexpensive electronic communication from the attorneys (unlike other case management systems, CM/ECF enables information submission over the Internet).
- Web browser is free and available to everyone, to replace the previous requirement for PC-based software.
- PDFWriter, which enables any word processor on any platform to be used.
- Any existing PC or Macintosh with a network connection; federal courts already have DCN access and most attorneys have Internet access.

The Benefits of CM/ECF

For the courts:

- Immediate docket entries
- Immediate local or remote access from any location
- No waiting for file room retrieval
- No lost folders or documents

For the attorneys:

- No couriers, no post offices
- Immediate Internet access from any location
- Easy notice to other counsel
- Immediate and up-to-the-minute reports and data
- 24-hour/7-day access and filing

What does CM/ECF cost?

For users:

The CM/ECF design provides for low-cost user access to the system. Any modern PC with Internet or DCN access and Web browser software can access CM/ECF. Retrieving electronically filed documents requires the Adobe Acrobat PDF Reader software (or equivalent), which is available at no cost from Adobe over the Internet.

Adobe Acrobat PDFWriter and/or Acrobat Exchange is required for filing. Any attorney with a Bar ID can obtain these for $129 (list price is $295); for federal court employees, the cost is about $50.

For the court:

CM/ECF requires two servers: an Internet-accessible (outside) Web server to handle attorney and public access, and a DCN-accessible (inside) Web server to handle court access.

The outside Web server can be a medium-sized system, e.g., Pentium processor; the inside database server a slightly larger Pentium processor, with some upgrades and much expanded disk space for document storage.
The CM/ECF Technical Solution

The success of CM/ECF is largely due to the chosen technical solution, which is characterized by the following practices.

**Use of commercial products and standard languages**
- Commercially available products (Informix and StrongHold) are used to manage the database and the Web servers, respectively.
- Standard programming languages (Perl, HTML, and JavaScript) are used for the application system.

**Ease of maintenance through high-level tools**

The CM/ECF design team created some programming tools that combine the developers' programs together in such a way that many standard programming tasks are eliminated. These include complicated processes associated with the latest technology, such as maintaining accurate page context information as the Internet user navigates between pages, collecting data from those pages and saving it for special database interface procedures, checking the user's access rights to those pages, and issuing special database commands when appropriate. Because of these support tools, changes can be made faster and a programmer's learning process is simplified.

**The provision for user customization**

Three basic activities occur when a person selects a docket category from a CM/ECF menu:
- User identifies the specific event type to be docketed, such as "answer to cross-claim."
- CM/ECF prompts for preliminary information, such as the case number and parties.
- CM/ECF runs the processes for that event type.

For each event type, the court's CM/ECF administrator can specify (using a simple Excel spreadsheet) which processes to run, the sequence in which to run them, and certain behaviors of the processes, such as how the user will be prompted and what data will be collected. The administrator can also set up overall CM/ECF parameters that are unique to the particular court site, such as court name and date formats.

CM/ECF provides special tables that enable these tailoring activities.
Graphical User Interface

Once a person logs into CM/ECF, he is immediately presented with a series of very simple, interactive pages that provide choices and input fields and that hyperlink to other pages, based on the person's selection.

We learned a very important lesson from prior systems: keep it simple. We are in the process of refining the interface to ensure this is true in every aspect of a person's interaction with the system.

Isolation of the public and private systems

The Outside Environment

CM/ECF is publicly accessible from the Internet. Any authorized user, such as an attorney, can access the system by using a standard Web browser, such as Netscape. His or her CM/ECF requests and data are submitted through the Common Gateway Interface (CGI) recognized by Internet browsers.

An "outside" server, protected by a special "firewall" designed for the Internet, processes all public requests. The firewall software protects against intruders and unauthorized activities.

The Inside Environment

CM/ECF is privately accessible by the federal courts from their Data Communications Network (DCN). They submit simple requests and data over this network.

An "inside" server, protected by special firewall software designed for the inside environment, processes all court user requests.

Both servers have identical software to enable this separation of public and private activity and to handle access to the Internet.

Use of Portable Document Format

All documents uploaded to CM/ECF must be in Portable Document Format (PDF). This format enables regular documents to be viewed electronically and shared with others on the Internet without loss of any document formatting characteristics. PDF is also a secure format that doesn't allow hidden text or links, as do many word processors. Saving a document in PDF requires only a few clicks of your mouse.
Filing with CM/ECF

You can see from the following example that CM/ECF is very easy to use. These windows show the steps you would take to file a motion using CM/ECF. Although each court can tailor specific aspects of docketing processes, such as the selections and text displayed, the basic process is the same for all court types.

1. **Prepare the document**

   You can create the document to be filed by using any word processor. Then select *Aubbat PDFWriter* as the printer to prepare your document for CM/ECF.

   In filing a document, you just show CM/ECF that this is the document you want to file (see Step 8).

2. **Log into ECFp**

3. **Select a function**

4. **Select the document type**

5. **Enter the case number**
6. Select the party

You can select the individual party already associated with the case, or you can use the "group" option.

7. Select the relief(s)

The list items shown for selection are determined by the court.

8. Specify the document

You can browse your file list to select the filing document by using the Browse button.

9. Specify the details

The details provided in this window are determined by the court. In this window, the person has selected a response deadline by using a pop-up calendar.

10. Review the docket text

You can modify the generated docket text or just press the Next button.

11. Done!

CM/ECF gives you a filing receipt to print or store on your computer. A notice of the filing is also sent via e-mail to other participants and interested parties, who can view the document and docket sheet without logging into CM/ECF.
CM/ECF offers a wide variety of reports. You can select one of these, the Docket Sheet, to verify the filing we just completed in this example.

The Docket Sheet shows the filing just completed. You can click on the document number to display the associated PDF document.

The following can be found at the Judiciary's Internet site (www.uscourts.gov):


Inquiries can be directed to:

Electronic Case Files Initiative, Gary Bockweg, Project Manager
(202-273-2736; bockweg@teo.uscourts.gov)

Electronic Case Files Prototype, Michael Greenwood, Project Manager
(202-273-2748; greenwoo@teo.uscourts.gov)

Summer 1999
The Bankruptcy Clerk's Office for the Western District of Kentucky is located at 601 W. Broadway, Suite 546, Louisville, Kentucky 40202 (502-627-5700). There are several different means of obtaining case information from the Bankruptcy Court:

1) **VCIS** The Voice Case Information System (VCIS) allows a caller to access basic case information from any touch-tone telephone at any time by dialing 502-627-5660 or 800-263-9385. There is no fee charged with this service. The information that can be obtained from VCIS includes the debtor's name, case number, date case was filed, type of case, trustee, debtor's attorney, debtor's attorney's phone number, discharge date, closing date, creditors' meeting date and whether assets appear to be available for distribution. [Cases available on VCIS are those that were filed on or after July, 1992.]

2) **WebCIS.** All information available on VCIS may be obtained via the Internet at www.kywb.uscourts.gov by clicking on WebCIS. There is no fee charged for this service.

3) **PACER** The local PACER system allows computer access to not only basic case information but also to recent docketing entries, claims registers, and case reports. This system, like VCIS, is available at any time. PACER subscribers also have access to the National U.S. Party/Case Index, which provides case name, case number, filing date and the court in which the case was filed. Information on registering for these services and the fees charged may be obtained from the PACER Service Center at www.pacer.psc.uscourts.gov or by calling 1-800-676-6856. Registered PACER users can access the local PACER system via the Internet at www.kywb.uscourts.gov or modem at 502-627-5664 or 1-800-263-9385. The National U.S. Party/Case Index can be accessed at www.pacer.uspci.uscourts.gov or by modem at 1-800-974-8899. [Cases available on the local PACER are those that were filed on or after July, 1992*, and cases available on the National Index vary by each court.]

4) **PUBLIC TERMINAL.** A computer terminal for use by the public to obtain case information is available in the Louisville Clerk's Office. This terminal may be used at no cost during normal office operating hours (8:30 a.m. - 4:30 p.m., Monday through Friday).

5) **CLERK'S OFFICE PERSONNEL.**

If you are unable to obtain information from VCIS, PACER, or the public terminals, you may be able to obtain the following information from the Clerk's Office without charge:

a) If the exact name of the debtor or the case number is provided and the information is easily retrievable from the Court's automated database (case filed in this federal judicial district on or after July 1, 1992*), you may obtain the following basic information: debtor's name, case number, whether a debtor has filed for bankruptcy, whether the case is voluntary or involuntary, chapter of case, attorney for debtor, trustee, whether there are assets, date of section 341 meeting, discharge/dismissal date (if entered), debtor's social security number, and a general status of the case. You may contact the Clerk's Office staff with up to two case requests either by telephone or a visit to the Clerk's Office.
b) If the exact name of a party or an adversary proceeding number is provided and
the information is easily retrievable from the Court's automated database
(adversary proceedings filed in this federal judicial district on or after July 1, 1992),
you may obtain the following basic information: adversary name, adversary
number, date the complaint was filed, name of party's attorney of record, the
related case number and a general status of the adversary proceeding. You may
contact the Clerk's Office staff with up to two adversary proceeding requests
either by telephone or a visit to the Clerk's Office. (Limited information is also
available on adversary proceedings filed from 1980 to 1992. Additional information
will require a review of the closed record. See Item 5-e.)

c) Requests for photocopies of case or adversary proceeding documents can be made
in writing, in person or by phone. If the requestor provides a clear document
reference (i.e., document number or date document entered where very few
documents entered on such date) and the document is available within the Court
premises, the Clerk's Office will provide the copies free of any additional search
charge (copywork fee of $.50 per page still applies).

d) All pending cases & adversary proceedings may be reviewed in
person free of charge.

e) Information on reviewing or obtaining copies of documents in closed cases and
adversary proceedings can be obtained from Clerk’s Office personnel or our web
site at www.kywb.uscourts.gov.

A $15 search fee is required in the following requests:

f) Requests for docketing events that are not basic information.

g) Requests for basic information regarding cases filed before 1986; such information
is maintained on microfiche film, and requires a physical search by the Clerk's
Office.

h) Requests to examine or copy a document where the requestor does not provide an
accurate case number and docket number and the deputy must physically search
the Court's record.

i) Written search requests, which require a written response by the Clerk's Office.

PROCEDURAL INFORMATION The Clerk's Office personnel will furnish general procedural
information, but pursuant to 28 U.S.C. Section 955, the Clerk's Office is PROHIBITED FROM
GIVING LEGAL ADVICE.

*Limited information is available on cases filed between 1986 and June 1992. Additional
information on these cases will require a review of the closed case (see Item 5-e). For basic
information on cases filed prior to 1986, see Item 5-g.
JUDGES’ ROUNDTABLE ON FEES, ETHICS AND PROFESSIONALISM

Moderator:

C.R. “Chip” Bowles, Jr.
Greenebaum Doll & McDonald PLLC
Louisville, Kentucky

Panelists:

Hon. Joan Lloyd Cooper
United States Bankruptcy Court
Western District of Kentucky

Hon. Henry H. Dickinson (Retired)
Formerly of the United States Bankruptcy Court
Western District of Kentucky

Hon. William S. Howard, Chief Judge
United States Bankruptcy Court
Eastern District of Kentucky

Hon. Joe Lee (Recalled)
United States Bankruptcy Court
Eastern District of Kentucky

Hon. Joseph M. Scott, Jr.
United States Bankruptcy Court
Eastern District of Kentucky

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SECTION K
JUDGES’ ROUNDTABLE ON FEES, ETHICS AND PROFESSIONALISM

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Caselaw Update on Bankruptcy Ethics

Claude R. Bowles, Jr.

1. In re Downs, 103 F.3d 472 (6th Cir. 1996) The leading case out of the Sixth Circuit on the application of Bankruptcy Rule of Procedure 9011 and section 329 of the Bankruptcy Code. The Sixth Circuit held that if a debtor's attorney violated a fiduciary duty, the attorney's minimum sanction would be total denial of all fees.


3. Kentucky Bar Association v. Devers, 936 S.W. 2d 89 (Ky. 1997) A detailed analysis of how not to represent a debtor at a 341 meeting. A copy of this case is attached to this update.
In attorney discipline proceeding, the Supreme Court held that three-year suspension was warranted for attorney’s failure to appear on behalf of clients, failure to communicate adequately with clients, and closure of attorney’s practice without returning fees paid to attorney.

Suspension ordered.

[1] ATTORNEY AND CLIENT

Attorney violated rule prohibiting lawyer from knowingly making false statement of material fact or law to tribunal, by filing answer on behalf of client which stated that civil proceeding was stayed due to pending bankruptcy action when there was no such bankruptcy action. Sup.Ct.Rules, Rule 3.130, Rules of Prof.Conduct, Rule 3.3(a).

[2] ATTORNEY AND CLIENT

Attorney violated rules requiring lawyer to act with reasonable diligence and promptness in representing client and providing that lawyer having direct supervisory authority over another lawyer shall make reasonable efforts to ensure that other lawyer conforms to rules of professional conduct, by failing to adequately explain to bankruptcy trustee that his clients could not produce title to trailer in which they were living and by sending untrained and uninformed representative from attorney’s office to represent clients in bankruptcy proceeding. Sup.Ct.Rules, Rule 3.130, Rules of Prof.Conduct, Rules 1.3, 5.1(b).

[3] ATTORNEY AND CLIENT

Attorney violated rule providing that lawyer shall be responsible for another lawyer’s violations of rules of professional conduct under certain circumstances, when another attorney in a attorney’s office filed answer to civil action using client’s alias. Sup.Ct.Rules, Rule 3.130, Rules of Prof.Conduct, Rule 5.1(a-c).

[4] ATTORNEY AND CLIENT

Attorney violated rule prohibiting lawyer from knowingly making false statement of material fact or law to tribunal when another attorney in attorney’s office filed answer in civil suit on behalf of client under alias undisclosed to courts. Sup.Ct.Rules, Rule 3.130, Rules of Prof.Conduct, Rule 3.3(a)(1).

[5] ATTORNEY AND CLIENT

Attorney violated rule requiring lawyer to act with reasonable diligence and promptness in representing client when neither attorney nor anyone from attorney’s office appeared in civil suit to defend clients against plaintiff’s motion for judgment on the pleadings. Sup.Ct.Rules, Rule 3.130, Rules of Prof.Conduct, Rule 1.3.

[6] ATTORNEY AND CLIENT

Attorney violated rules requiring lawyer to keep client reasonably informed about status of case, represent client competently, and act with reasonable diligence, when attorney advised client that she should stop making payments to bankruptcy trustee, which resulted in dismissal of client’s bankruptcy case, and when no appearance was made by either attorney or representative from attorney’s office at meeting of creditors after client filed.

[7] ATTORNEY AND CLIENT ☞ 44(1) 45k44(1)
Attorney violated rule stating level of competence required and rule holding that lawyer must adequately communicate with his clients, by failing to inform clients that their motion to amend their bankruptcy plan had been overruled as a result of absence of counsel for clients at hearing on motion. Sup.Ct.Rules, Rule 3.130, Rules of Prof.Conduct, Rules 1.1, 1.4(a).

[8] ATTORNEY AND CLIENT ☞ 37.1 45k37.1
Attorney violated rule prohibiting aiding in unauthorized practice of law by operating office which was staffed by unlicensed employees, persons whose daily activities consisted of activities which constituted practice of law. Sup.Ct.Rules, Rule 3.130, Rules of Prof.Conduct, Rule 5.5(b).

[9] ATTORNEY AND CLIENT ☞ 44(1) 45k44(1)
Attorney violated rules requiring lawyer to communicate adequately with his clients and requiring lawyer to refund unearned fees upon termination of representation, by closing office without informing clients and by failing to refund fees paid to attorney by clients. Sup.Ct.Rules, Rule 3.130, Rules of Prof.Conduct, Rules 1.4(a, b), 1.16(d).

[9] ATTORNEY AND CLIENT ☞ 44(2) 45k44(2)
Attorney violated rules requiring lawyer to communicate adequately with his clients and requiring lawyer to refund unearned fees upon termination of representation, by closing office without informing clients and by failing to refund fees paid to attorney by clients. Sup.Ct.Rules, Rule 3.130, Rules of Prof.Conduct, Rules 1.4(a, b), 1.16(d).

[10] ATTORNEY AND CLIENT ☞ 44(2) 45k44(2)
Attorney violated rules holding that lawyer must be diligent, that lawyer may withdraw from case only if withdrawal will create no prejudice to client, and that lawyer must refund any unearned fee upon termination of representation, by closing his office without any notice to client, without refunding any portion of monies that client had paid and without filing petition for relief on her behalf, and by closing out client's file without notifying her. Sup.Ct.Rules, Rule 3.130, Rules of Prof.Conduct, Rules 1.3, 1.16(b, d).

Three-year suspension was warranted for attorney's actions of, inter alia, failing to appear on behalf of clients, failing to communicate with clients, and closing offices without refunding fees paid to attorney, despite attorney's loss of office managers and staff and inability to find competent replacements.

*91 Barbara S. Rea, Kentucky Bar Association, Frankfort, for Complainant.

Stephen G. Montoya, Robert L. Devers, Phoenix, AZ, for Respondent.

OPINION AND ORDER

The Inquiry Tribunal issued eleven charges, containing a total of twenty-six counts, against respondent, Robert L. Devers. The Board of
Governors of the Kentucky Bar Association found respondent to be guilty on sixteen counts and not guilty on ten counts. The Board recommended a two year suspension accompanied by an order to pay costs. Respondent filed a notice of review with this Court. Due to the voluminous nature of the counts of which respondent was found guilty, each one will be taken in turn.

[1] 1. Respondent was found guilty of violating SCR 3.130-3.3(a) which prohibits a lawyer from knowingly making a false statement of material fact or law to a tribunal.

Respondent filed an answer in Knott District Court, on behalf of his client, Bill Smith, which stated that the civil proceeding was stayed due to a pending bankruptcy action. However, there was no such bankruptcy action. It was not actually filed until two months after the District Court had continued the civil matter.

There was ample evidence to support a finding of guilt on this charge.

[2] 2. Respondent was found guilty of violating SCR 3.130-1.3 which requires a lawyer to act with reasonable diligence and promptness in representing a client. Respondent was also found guilty of violating SCR 3.130-5.1(b) which provides that a lawyer having direct supervisory authority over another lawyer shall make reasonable efforts to ensure that the other lawyer conforms to the rules of professional conduct.

Respondent failed to adequately explain to the Bankruptcy trustee that respondent's clients, Sidney and Violet Johnson, could not produce the title to the trailer in which they were living due to the fact that the Johnson's were purchasing the trailer via a land contract and therefore did not possess title although the residence was listed on the Johnson's bankruptcy schedules as personal property.

Also, at the meetings of the creditors, an untrained and uninformed representative from respondent's office was sent to represent the Johnsons. The bankruptcy petition was ultimately dismissed and the representative from respondents office told the Johnsons that they must wait a period of time prior to refiling when in actuality, the Order dismissing the petition stated that the Johnsons could refile immediately.

There is ample evidence for findings of guilt on these charges.

[3] 3. Respondent was found guilty of a violation of SCR 3.130- 5.1(a), (b) and (c) which provides that a lawyer shall be responsible for another lawyer's violation of the rules of professional conduct only if the lawyer orders or, with knowledge of the specific conduct, ratifies the conduct involved or the lawyer is a partner in a law firm in which the other lawyer practices, or has direct supervisory authority over the other lawyer, and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take adequate remedial action.

Warren Kent Williams and Donna Jo Williams came to respondent's office for the purpose of filing a Chapter 13 bankruptcy action. After the filing, Mr. Williams was sued upon a deficient loan. However, in the civil suit, Mr. Williams was sued under a name that he had previously used, Kent A. Williams. The bankruptcy court was not aware of this additional name. Mr. Williams returned to respondent's office and met with another attorney who filed an answer to the civil action under the name Kent A. Williams, stating that Kent A. Williams did owe the debt but that he (Kent A. Williams) was preparing to file for bankruptcy and therefore the proceedings should be stayed. The attorney also assured Mr. Williams that she would take care of the civil suit.

There is ample evidence to support a finding of guilt on this charge.

[4] 4. Under the above stated facts, respondent was also found guilty of violating *92 SCR 3.130-3.3(a)(l) which prohibits a lawyer from knowingly making a false statement of material fact or law to a tribunal.

The Board looked to the filing of the answer by an attorney in respondent's office under an alias undisclosed to the courts in this instance and determined that it amounted to a false statement of a material fact.

There is ample evidence to support a finding of guilt on this charge.
Respondent was found guilty of violating SCR 3.130-1.3 which requires a lawyer to act with reasonable diligence and promptness in representing a client.

Neither respondent nor anyone from respondent's office appeared in the civil suit to defend against the plaintiff's motion for a judgment on the pleadings. Judgment was entered against the respondent's client, Kent A. Williams, due to the lack of any defense and due also to the fact that the court was never adequately informed of the actual status of the Williams' case in bankruptcy; the only information that the civil court had was a boiler plate statement that Kent A. Williams intended to file bankruptcy.

There is ample evidence to support a finding of guilt on this charge.

Respondent was found guilty of violating SCR 3.130-1.4 and 3.130-1.1 and 1.3 which require a lawyer to keep a client reasonably informed about the status of the case, represent the client competently and to act with reasonable diligence.

Respondent filed a motion in Bankruptcy Court for a hardship discharge of a Barbara Jo Deering's Chapter 13 payment schedule. The motion was overruled but Respondent advised Ms. Deering that she should stop making payments to the Chapter 13 trustee. Ms. Deering followed this advice and, as a result, the trustee moved to dismiss her case, which the court did. Therefore Ms. Deering was left with no bankruptcy protection. Thereafter, Ms. Deering's creditors initiated vigorous efforts toward collection.

Ms. Deering was unable to contact respondent personally, but filed a Chapter 7 petition pursuant to advice she received from an associate in respondent's office. No appearance was made by either respondent or a representative from his office at the first meeting of creditors and Ms. Deering was never informed by respondent or his office that respondent had been banned from further practice in the United States Bankruptcy Court for the Eastern District of Kentucky.

There is ample evidence to support a finding of guilt on this charge.

Respondent was found guilty of violating SCR 3.130-1.1 which states the level of competence required and SCR 3.130-1.4(a) which holds that a lawyer must adequately communicate with his clients.

Respondent failed to inform Jerry Owens and Barbara Owens that their motion to amend their Chapter 13 payment plan had been overruled as a result of the absence of counsel for the Owenses at the hearing on the motion. Due to this failure to inform, the Owenses systematically reduced their payments to the trustee in accordance with the reduced payment plan that their motion had requested. In response to the delinquency in payments, the trustee moved the court to dismiss the case, which was granted at a hearing of which the Owenses had no knowledge. No one from respondent's office appeared on the Owenses behalf.

There is ample evidence to find guilt on this charge.

Respondent operated an office which was staffed by unlicensed employees, persons whose daily activities consisted of activities which constituted the practice of law as defined as, "any service rendered involving legal knowledge or legal advice, whether of representation, counsel or advocacy in or about of court, rendered in respect to the rights, duties, obligations, liabilities, or business relations of one requiring the services." SCR 3.020.

There is ample evidence to support a finding of guilt on this charge.

Respondent was found guilty of violating SCR 3.130-1.4(a) and (b) which requires a lawyer to communicate adequately with his clients and KRPC 1.16(d) which requires a lawyer to refund unearned fees upon the termination of the representation.

Respondent was hired to represent Hughey Rice and Imagene Rice in the filing of a bankruptcy petition. The Rices were informed of the Respondent's fee and accompanying court costs. The Rices began installment payments of the respondent's fee. When
over half of the fee had been paid, Mrs. Rice discovered that the respondent's office had been closed. When she inquired at respondent's office in another town, she was told that the office was unable to help her and therefore she was unable to complete the payments. Respondent never filed a bankruptcy petition for the Rice's and there is no evidence that any legal work was undertaken on their case.

Respondent refunded $300 of the $525 paid by the Rices, but only upon the instigation of these proceedings.

There is ample evidence to find guilt on these charges.

[10] 10. Respondent was found guilty of violations of SCR 3.130-1.3 which holds that a lawyer must be diligent, SCR 3.130-1.16(b) which holds that a lawyer may withdraw from a case only if the withdrawal will create no prejudice to the client and SCR 3.130-1.16(d) which holds that a lawyer must refund any unearned fee upon the termination of the representation.

Respondent was retained by Judith Stanley in a Chapter 7 proceeding. Mrs. Stanley paid respondent $700, via his office employees, at his Pikeville office. Respondent then closed his eastern Kentucky offices, without any notice given to Mrs. Stanley, without refunding any portion of the monies that she had paid and without filing a petition for relief on her behalf. Respondent also closed out or inactivated Mrs. Stanley's file without notifying her; she continued to believe that she was being represented by respondent.

There is ample evidence to support a finding of guilt on these charges.

[11] 11. Respondent was found guilty of violating SCR 3.130-1.16(d) which holds that a lawyer shall refund any unearned fees upon the termination of the representation.

Respondent accepted $700 from David Murphey and Sonda Murphey as a fee for services to be rendered in a bankruptcy proceeding. Respondent closed the Murphey's file as well as respondent's practice, without informing the Murpheys that respondent was no longer allowed to practice in the United States Bankruptcy Court for the Eastern District of Kentucky. Respondent also failed to inform the Murpheys that no petition had been filed for them.

Respondent refunded $700 to the Murpheys, but not until two weeks before the hearing before the Board of Governors was scheduled to take place.

There is ample evidence for a finding of guilt on this charge.

[12] Respondent argues that the recommendation of the Board of Governors is excessive due to a list of circumstances over which respondent had no control. Such circumstances include the loss of office managers and staff in several of respondent's offices and respondent's inability to find competent replacement employees who could effectively manage a practice that was growing rapidly. Respondent also requests that his past practice history and reputation in the legal community be considered.

The Court considered the facts as presented by respondent, but there is no way to overcome the obvious, egregious and serious nature of the charges of which respondent has been found guilty. Due to the nature of these findings and the pattern of ethical misconduct they reflect (KBA v. Frazer, Ky., 883 S.W.2d 878 (1994); KBA v. L.M. Tipton Reed, Ky., 631 S.W.2d 633 (1982)), it is unnecessary to go further with our legal analysis. The evidence overwhelmingly supports the suspension recommended by the Board of Governors of the Kentucky Bar Association.

Pursuant to SCR 3.370(9), this Court adopts the decision and recommendation of the Board of Governors as to all matters *94 pertaining to the respondent, Robert L. Devers.

THEREFORE IT IS HEREBY ORDERED as follows:

1. That the respondent, Robert L. Devers is hereby suspended from the practice of law in Kentucky for a period of three (3) years. The period of suspension shall commence on the date of entry of this Order and continue until such time as he is reinstate to the practice of law by order of this Court pursuant to SCR 3.510.

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2. Respondent is directed to pay the costs of this action in the amount of $7,723.22.

3. Pursuant to SCR 3.390, respondent shall, within ten (10) days from the entry of this Order, notify all clients in writing of his inability to represent them and to furnish copies of said letters of notice to the Director of the Kentucky Bar Association.

STEPHENS, C.J., and COOPER, GRAVES, JOHNSTONE, LAMBERT, STUMBO and WINTERSHEIMER, JJ., concur.

ENTERED: December 19, 1996.

/s/ Robert F. Stephens

Chief Justice

END OF DOCUMENT
A lawyer shall provide competent representation to a client. Competent representation requires the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation.

[Adopted by Order 89-1, eff. 1-1-90]

Commentary

Supreme Court
1989:

Legal Knowledge and Skill

[1] In determining whether a lawyer employs the requisite knowledge and skill in a particular matter, relevant factors include the relative complexity and specialized nature of the matter, the lawyer's general experience, the lawyer's training and experience in the field in question, the preparation and study the lawyer is able to give the matter and whether it is feasible to refer the matter to, or associate or consult with, a lawyer of established competence in the field in question. In many instances, the required proficiency is that of a general practitioner. Expertise in a particular field of law may be required in some circumstances.

[2] A lawyer need not necessarily have special training or prior experience to handle legal problems of a type with which the lawyer is unfamiliar. A newly admitted lawyer can be as competent as a practitioner with long experience. Some important legal skills, such as the analysis of precedent, the evaluation of evidence and legal drafting, are required in all legal problems. Perhaps the most fundamental legal skill consists of determining what kind of legal problems a situation may involve, a skill that necessarily transcends any particular specialized knowledge. A lawyer can provide adequate representation in a wholly novel field through necessary study. Competent representation can also be provided through the association of a lawyer of established competence in the field in question.

[3] In an emergency a lawyer may give advice or assistance in a matter in which the lawyer does not have the skill ordinarily required where referral to or consultation or association with another lawyer would be impractical. Even in an emergency, however, assistance should be limited to that reasonably necessary in the circumstances, for ill considered action under emergency conditions can jeopardize the client's interest.

[4] A lawyer may accept representation where the requisite level of competence can be achieved by reasonable preparation. This applies as well to a lawyer who is appointed as counsel for an unrepresented person. See also Rule 6.2.

Thoroughness and Preparation

[5] Competent handling of a particular matter includes inquiry into and analysis of the factual and legal elements of the problem, and use of methods and procedures meeting the standards of competent practitioners. It also includes adequate preparation. The required attention and preparation are determined in part by what is at stake: major litigation and complex transactions ordinarily require more elaborate treatment than matters of lesser consequence.

Maintaining Competence

[6] To maintain the requisite knowledge and skill, a lawyer should engage in continuing study and education. If a system of peer review has been established, the lawyer should consider making use of it in appropriate circumstances.
(a) A lawyer's fee shall be reasonable. Some factors to be considered in determining the reasonableness of a fee include the following:

1. The time and labor required, the novelty and difficulty of the questions involved, and the skill requisite to perform the legal service properly;
2. The likelihood that the acceptance of the particular employment will preclude other employment by the lawyer;
3. The fee customarily charged in the locality for similar legal services;
4. The amount involved and the results obtained;
5. The time limitations imposed by the client or by the circumstances;
6. The nature and length of the professional relationship with the client;
7. The experience, reputation, and ability of the lawyer or lawyers performing the services; and
8. Whether the fee is fixed or contingent.

(b) When the lawyer has not regularly represented the client, the basis or rate of the fee should be communicated to the client, preferably in writing, before or within a reasonable time after commencing the representation.

(c) A fee may be contingent on the outcome of the matter for which the service is rendered, except in a matter in which a contingent fee is prohibited by paragraph (d) or other law. Such a fee must meet the requirements of Rule 1.15(a). A contingent fee agreement shall be in writing and should state the method by which the fee is to be determined, including the percentage or percentages that shall accrue to the lawyer in the event of settlement, trial or appeal, litigation and other expenses to be deducted from the recovery, and whether such expenses are to be deducted before or after the contingent fee is calculated. Upon recovery of any amount in a contingent fee matter, the lawyer shall provide the client with a written statement stating the outcome of the matter and showing the remittance to the client and the method of its determination.

(d) A lawyer shall not enter into an arrangement for, charge, or collect:

1. Any fee in a domestic relations matter, the payment or amount of which is contingent upon the securing of a divorce or upon the amount of alimony, maintenance, support, or property settlement, provided this does not apply to liquidated sums in arrears; or
2. A contingent fee for representing a defendant in a criminal case.

(e) A division of a fee between lawyers who are not in the same firm may be made only if:

1. (a) The division is in proportion to the services performed by each lawyer or,
   (b) By written agreement with the client, each lawyer assumes joint responsibility for the representation;
   and
2. The client is advised of and does not object to the participation of all the lawyers involved; and
3. The total fee is reasonable.

[Adopted by Order 89-1, eff. 1-1-90]

COMMENTARY

Supreme Court

1989:

Basis or Rate of Fee

[1] When the lawyer has regularly represented a client, they ordinarily will have evolved an understanding concerning the basis or rate of the fee. In a new client-lawyer relationship, however, an understanding as to the fee should be promptly
established. It is not necessary to recite all the factors that underlie the basis of the fee, but only those that are directly involved in its computation. It is sufficient, for example, to state that the basic rate is an hourly charge or a fixed amount or an estimated amount, or to identify the factors that may be taken into account in finally fixing the fee. When developments occur during the representation that render an earlier estimate substantially inaccurate, a revised estimate should be provided to the client. A written statement concerning the fee reduces the possibility of misunderstanding. Furnishing the client with a simple memorandum or a copy of the lawyer's customary fee schedule is sufficient if the basis or rate of the fee is set forth.

Terms of Payment

[2] A lawyer may require advance payment of a fee, but is obliged to return any unearned portion. See Rule 1.16(d). A lawyer may accept property in payment for services, such as an ownership interest in an enterprise, providing this does not involve acquisition of a proprietary interest in the cause of action or subject matter of the litigation contrary to Rule 1.8(j). However, a fee paid in property instead of money may be subject to special scrutiny because it involves questions concerning both the value of the services and the lawyer's special knowledge of the value of the property.

[3] An agreement may not be made whose terms might induce the lawyer improperly to curtail services for the client or perform them in a way contrary to the client's interest. For example, a lawyer should not enter into an agreement whereby services are to be provided only up to a stated amount when it is foreseeable that more extensive services probably will be required, unless the situation is adequately explained to the client. Otherwise, the client might have to bargain for further assistance in the midst of a proceeding or transaction. However, it is proper to define the extent of services in light of the client's ability to pay. A lawyer should not exploit a fee arrangement based primarily on hourly charges by using wasteful procedures. When there is doubt whether a contingent fee is consistent with the client's best interest, the lawyer should offer the client alternative bases for the fee and explain their implications. Applicable law may impose limitations on contingent fees, such as a ceiling on the percentage.

Division of Fee

[4] A division of fee is a single billing to a client covering the fee of two or more lawyers who are not in the same firm. A division of fee facilitates association of more than one lawyer in a matter in which neither alone could serve the client as and most often is used when the fee is contingent and the division is between a referring lawyer and a trial specialist. Paragraph (e) permits the lawyers to divide a fee on either the basis of the proportion of services they render or by agreement between the participating lawyers if all assume responsibility for the representation as a whole and the client is advised and does not object. It does not require disclosure to the client of the share that each lawyer is to receive. Joint responsibility for the representation entails the obligations stated in Rule 5.1 for purposes of the matter involved.

Disputes over Fees

[5] If a procedure has been established for resolution of fee disputes, such as an arbitration or mediation procedure established by the bar, the lawyer should conscientiously consider submitting to it. Law may prescribe a procedure for determining a lawyer's fee, for example, in representation of an executor or administrator, a class or a person entitled to a reasonable fee as part of the measure of damages. The lawyer entitled to such a fee and a lawyer representing another party concerned with the fee should comply with the prescribed procedure.

[6] Factor (3) is intended to prohibit unreasonably high fees and does not prevent a lawyer from sharing fees that are less than "customary."
SCR 3.130(1.6) CONFIDENTIALITY OF INFORMATION

(a) A lawyer shall not reveal information relating to representation of a client unless the client consents after consultation, except for disclosures that are impliedly authorized in order to carry out the representation, and except as stated in paragraph (b).

(b) A lawyer may reveal such information to the extent the lawyer reasonably believes necessary:

1. To prevent the client from committing a criminal act that the lawyer believes is likely to result in imminent death or substantial bodily harm; or
2. To establish a claim or defense on behalf of the lawyer in a controversy between the lawyer and the client, to establish a defense to a criminal charge or civil claim against the lawyer based upon conduct in which the client was involved, or to respond to allegations in any proceeding concerning the lawyer's representation of the client; or
3. To comply with other law or a court order.

[Adopted by Order 89-1, eff. 1-1-90]

COMMENTARY

Supreme Court

1989: [1] The lawyer is part of a judicial system charged with upholding the law. One of the lawyer's functions is to advise clients so that they avoid any violation of the law in the proper exercise of their rights.

[2] The observance of the ethical obligation of a lawyer to hold inviolate confidential information of the client not only facilitates the full development of facts essential to proper representation of the client but also encourages people to seek early legal assistance.

[3] Almost without exception, clients come to lawyers in order to determine what their rights are and what is, in the maze of laws and regulations, deemed to be legal and correct. The common law recognizes that the client's confidences must be protected from disclosure. Based upon experience, lawyers know that almost all clients follow the advice given, and the law is upheld.

[4] A fundamental principle in the client-lawyer relationship is that the lawyer maintain confidentiality of information relating to the representation. The client is thereby encouraged to communicate fully and frankly with the lawyer even as to embarrassing or legally damaging subject matter.

[5] The principle of confidentiality is given effect in two related bodies of law, the attorney-client privilege (which includes the work product doctrine) in the law of evidence and the rule of confidentiality established in professional ethics. The attorney-client privilege applies in judicial and other proceedings in which a lawyer may be called as a witness or otherwise required to produce evidence concerning a client. The rule of client-lawyer confidentiality applies in situations other than those where evidence is sought from the lawyer through compulsion of law. The confidentiality rule applies not merely to matters communicated in confidence by the client but also to all information relating to the representation, whatever its source. A lawyer may not disclose such information except as authorized or required by the Rules of Professional Conduct or other law. See also Scope.

[6] The requirement of maintaining confidentiality of information relating to representation applies to government lawyers who may disagree with the policy goals that their representation is designed to advance.

Authorized Disclosure

[7] A lawyer is impliedly authorized to make disclosures about a client when appropriate in carrying out the representation, except to the extent that the client's instructions or special circumstances limit that authority. In litigation, for example, a lawyer may disclose information by admitting a fact that cannot properly be disputed, or in negotiation by making a
disclosure that facilitates a satisfactory conclusion.

[8] Lawyers in a firm may, in the course of the firm’s practice, disclose to each other information relating to a client of the firm, unless the client has instructed that particular information be confined to specified lawyers.

Disclosure Adverse to Client

[9] The confidentiality rule is subject to limited exceptions. In becoming privy to information about a client, a lawyer may foresee that the client intends serious harm to another person. However, to the extent a lawyer is required or permitted to disclose a client’s purposes, the client will be inhibited from revealing facts which would enable the lawyer to counsel against a wrongful course of action. The public is better protected if full and open communication by the client is encouraged than if it is inhibited.

[10] Several situations must be distinguished.

[11] First, the lawyer may not counsel or assist a client in conduct that is criminal or fraudulent. See Rule 1.2(d). Similarly, a lawyer has a duty under Rule 3.3(a)(4) not to use false evidence. This duty is essentially a special instance of the duty prescribed in Rule 1.2(d) to avoid assisting a client in criminal or fraudulent conduct.

[12] Second, the lawyer may have been innocently involved in past conduct by the client that was criminal or fraudulent. In such a situation the lawyer has not violated Rule 1.2(d), because to “counsel or assist” criminal or fraudulent conduct requires knowing that the conduct is of that character.

[13] Third, the lawyer may learn that a client intends prospective conduct that is criminal and likely to result in imminent death or substantial bodily harm. As stated in paragraph (b)(1), the lawyer has professional discretion to reveal information in order to prevent such consequences. The lawyer may make a disclosure in order to prevent homicide or serious bodily injury which the lawyer reasonably believes is intended by a client. It is very difficult for a lawyer to “know” when such a heinous purpose will actually be carried out, for the client may have a change of mind.

[14] The lawyer’s exercise of discretion requires consideration of such factors as the nature of the lawyer’s relationship with the client and with those who might be injured by the client, the lawyer’s own involvement in the transaction and factors that may extenuate the conduct in question. Where practical, the lawyer should seek to persuade the client to take suitable action. In any case, a disclosure adverse to the client’s interest should be no greater than the lawyer reasonably believes is necessary to the purpose. A lawyer’s decision not to take preventive action permitted by paragraph (b)(1) does not violate this Rule.

Withdrawal

[15] If the lawyer’s services will be used by the client in materially furthering a course of criminal or fraudulent conduct, the lawyer must withdraw, as stated in Rule 1.16(a)(1).

[16] After withdrawal the lawyer is required to refrain from making disclosure of the clients’ confidences, except as otherwise provided in Rule 1.6. Neither this rule nor Rule 1.8(b) nor Rule 1.16(d) prevents the lawyer from giving notice of the fact of withdrawal, and upon withdrawal the lawyer may also withdraw or disaffirm any opinion, document, affirmation, or the like.

[17] Where the client is an organization, the lawyer may be in doubt whether contemplated conduct will actually be carried out by the organization. Where necessary to guide conduct in connection with this Rule, the lawyer may make inquiry within the organization as indicated in Rule 1.13(b).

Dispute Concerning Lawyer’s Conduct

[18] Where a legal claim or disciplinary charge alleges complicity of the lawyer in a client’s conduct or other misconduct of the lawyer involving representation of the client, the lawyer may respond to the extent the lawyer reasonably believes necessary to establish a defense. The same is true with respect to a claim involving the conduct or representation of a former client. The lawyer’s right to respond arises when an assertion of such complicity has been made. Paragraph (b)(2) does not require the lawyer to await the commencement of an action or proceeding that charges such complicity, so that the defense may be established by responding directly to a third party who has made such an assertion. The right to defend, of course, applies where a proceeding has been commenced. Where practicable and not prejudicial to the lawyer’s ability to establish the
defense, the lawyer should advise the client of the third party’s assertion and request that the client respond appropriately. In any event, disclosure should be no greater than the lawyer reasonably believes is necessary to vindicate innocence, the disclosure should be made in a manner which limits access to the information to the tribunal or other persons having a need to know it, and appropriate protective orders or other arrangements should be sought by the lawyer to the fullest extent practicable.

[19] If the lawyer is charged with wrongdoing in which the client’s conduct is implicated, the rule of confidentiality should not prevent the lawyer from defending against the charge. Such a charge can arise in a civil, criminal or professional disciplinary proceeding, and can be based on a wrong allegedly committed by the lawyer against the client, or on a wrong alleged by a third person; for example, a person claiming to have been defrauded by the lawyer and client acting together. A lawyer entitled to a fee is permitted by paragraph (b)(2) to prove the services rendered in an action to collect it. This aspect of the rule expresses the principle that the beneficiary of a fiduciary relationship may not exploit it to the detriment of the fiduciary. As stated above, the lawyer must make every effort practicable to avoid unnecessary disclosure of information relating to a representation, to limit disclosure to those having the need to know it, and to obtain protective orders or make other arrangements minimizing the risk of disclosure.

Disclosures Otherwise Required or Authorized

[20] The attorney-client privilege is differently defined in various jurisdictions. If a lawyer is called as a witness to give testimony concerning a client, absent waiver by the client, paragraph (a) requires the lawyer to invoke the privilege when it is applicable. The lawyer must comply with the final orders of a court or other tribunal of competent jurisdiction requiring the lawyer to give information about the client.

[21] The Rules of Professional Conduct in various circumstances permit or require a lawyer to disclose information relating to the representation. See Rules 2.2, 2.3, 3.3 and 4.1. In addition to these provisions, a lawyer may be obligated or permitted by other provisions of law to give information about a client. Whether another provision of law supersedes Rule 1.6 is a matter of interpretation beyond the scope of these Rules, but a presumption should exist against such a supersession.

[22] Paragraph (b)(4) gives the lawyer professional discretion to reveal such information as the lawyer reasonably believes is necessary to comply with a court order.

Former Client

[23] The duty of confidentiality continues after the client-lawyer relationship has terminated.
(a) A lawyer shall not represent a client if the representation of that client will be directly adverse to another client, unless:

(1) The lawyer reasonably believes the representation will not adversely affect the relationship with the other client; and
(2) Each client consents after consultation.

(b) A lawyer shall not represent a client if the representation of that client may be materially limited by the lawyer's responsibilities to another client or to a third person, or by the lawyer's own interests, unless:

(1) The lawyer reasonably believes the representation will not be adversely affected; and
(2) The client consents after consultation. When representation of multiple clients in a single matter is undertaken, the consultation shall include explanation of the implications of the common representation and the advantages and risks involved.

[Adopted by Order 89-1, eff. 1-1-90]

COMMENTARY

Supreme Court

1989:

Loyalty to a Client

[1] Loyalty is an essential element in the lawyer's relationship to a client. An impermissible conflict of interest may exist before representation is undertaken, in which event the representation should be declined. If such a conflict arises after representation has been undertaken, the lawyer should withdraw from the representation. See Rule 1.16. Where more than one client is involved and the lawyer withdraws because a conflict arises after representation, whether the lawyer may continue to represent any of the clients is determined by Rule 1.9. See also Rule 2.2(c). As to whether a client-lawyer relationship exists or, having once been established, is continuing, see Comment to Rule 1.3 and Scope.

[2] As a general proposition, loyalty to a client prohibits undertaking representation directly adverse to that client without that client's consent. Paragraph (a) expresses that general rule. Thus, a lawyer ordinarily may not act as advocate against a person the lawyer represents in some other matter, even if it is wholly unrelated. On the other hand, simultaneous representation in unrelated matters of clients whose interests are only generally adverse, such as competing economic enterprises, does not require consent of the respective clients. Paragraph (a) applies only when the representation of one client would be directly adverse to the other.

[3] Loyalty to a client is also impaired when a lawyer cannot consider, recommend or carry out an appropriate course of action for the client because of the lawyer's other responsibilities or interests. The conflict in effect forecloses alternatives that would otherwise be available to the client. Paragraph (b) addresses such situations. A possible conflict does not itself preclude the representation. The critical questions are the likelihood that a conflict will eventuate and, if it does, whether it will materially interfere with the lawyer's independent professional judgment in considering alternatives or foreclose courses of action that reasonably should be pursued on behalf of the client. Consideration should be given to whether the client wishes to accommodate the other interest involved.

Consultation and Consent

[4] A client may consent to representation notwithstanding a conflict. However, as indicated in paragraph (a)(1) with respect to representation directly adverse to a client, and paragraph (b)(1) with respect to material limitations on representation of a client, when a disinterested lawyer would conclude that the client should not agree to the representation under the circumstances, the lawyer involved cannot properly ask for such agreement or provide representation on the basis of the client's consent. When more than one client is involved, the question of conflict must be resolved as to each client. Moreover,
there may be circumstances where it is impossible to make the disclosure necessary to obtain consent. For example, when the lawyer represents different clients in related matters and one of the clients refuses to consent to the disclosure necessary to permit the other client to make an informed decision, the lawyer cannot properly ask the latter to consent.

**Lawyer's Interests**

[5] The lawyer's own interests should not be permitted to have adverse effect on representation of a client. For example, a lawyer's need for income should not lead the lawyer to undertake matters that cannot be handled competently and at a reasonable fee. See Rules 1.1 and 1.5. If the probity of a lawyer's own conduct in a transaction is in serious question, it may be difficult or impossible for the lawyer to give a client detached advice. A lawyer may not allow related business interests to affect representation, for example, by referring clients to an enterprise in which the lawyer has an undisclosed interest.

**Conflicts in Litigation**

[6] Paragraph (a) prohibits representation of opposing partisan litigation. Simultaneous representation of parties whose interests in litigation may conflict, such as coplaintiffs or codefendants, is governed by paragraph (b). An impermissible conflict may exist by reason of substantial discrepancy in the parties' testimony, incompatibility in positions in relation to an opposing party or the fact that there are substantially different possibilities of settlement of the claims or liabilities in question. Such conflicts can arise in criminal cases as well as civil. The potential for conflict of interest in representing multiple defendants in a criminal case is so grave that ordinarily a lawyer should decline to represent more than one codefendant. On the other hand, common representation of persons having similar interests is proper if the risk of adverse effect is minimal and the requirements of paragraph (b) are met. Compare Rule 2.2 involving intermediation between clients.

[7] Ordinarily, a lawyer may not act as advocate against a client the lawyer represents in some other matter, even if the other matter is wholly unrelated. However, there are circumstances in which a lawyer may act as advocate against a client. For example, a lawyer representing an enterprise with diverse operations may accept employment as an advocate against the enterprise in an unrelated matter if doing so will not adversely affect the lawyer's relationship with the enterprise or conduct of the suit and if both clients consent upon consultation. By the same token, government lawyers in some circumstances may represent government employees in proceedings in which a government agency is the opposing party. The propriety of concurrent representation can depend on the nature of the litigation. For example, a suit charging fraud entails conflict to a degree not involved in a suit for a declaratory judgment concerning statutory interpretation.

[8] A lawyer may represent parties having antagonistic positions on a legal question that has arisen in different cases, unless representation of either client would be adversely affected. Thus, it is ordinarily not improper to assert such positions in cases pending in different trial courts, but it may be improper to do so in cases pending at the same time in an appellate court.

**Interest of Person Paying for a Lawyer's Service**

[9] A lawyer may be paid from a source other than the client, if the client is informed of that fact and consents and the arrangement does not compromise the lawyer's duty of loyalty to the client. See Rule 1.8(f). For example, when an insurer and its insured have conflicting interests in a matter arising from a liability insurance agreement, and the insurer is required to provide special counsel for the insured, the arrangement should assure the special counsel's professional independence. So also, when a corporation and its directors or employees are involved in a controversy in which they have conflicting interests, the corporation may provide funds for separate legal representation of the directors or employees, if the clients consent after consultation and the arrangement ensures the lawyer's professional independence.

**Other Conflict Situations**

[10] Conflicts of interest in contexts other than litigation sometimes may be difficult to assess. Relevant factors in determining whether there is potential for adverse effect include the duration and intimacy of the lawyer's relationship with the client or clients involved, the functions being performed by the lawyer, the likelihood that actual conflict will arise and the likely prejudice to the client from the conflict if it does arise. The question is often one of proximity and degree.

[11] For example, a lawyer may not represent multiple parties to a negotiation whose interests are fundamentally antagonistic to each other, but common representation is permissible where the clients are generally aligned in interest even though there is some difference of interest among them.

[12] Conflict questions may also arise in estate planning and estate administration. A lawyer may be called upon to prepare
wills for several family members, such as husband and wife, and, depending upon the circumstances, a conflict of interest may arise. In estate administration the identity of the client may be unclear under the law of a particular jurisdiction. Under one view, the client is the fiduciary; under another view the client is the estate or trust, including its beneficiaries. The lawyer should make clear the relationship to the parties involved.

[13] A lawyer for a corporation or other organization who is also a member of its board of directors should determine whether the responsibilities of the two roles may conflict. The lawyer may be called on to advise the corporation in matters involving actions of the directors. Consideration should be given to the frequency with which such situations may arise, the potential intensity of the conflict, the effect of the lawyer's resignation from the board and the possibility of the corporation's obtaining legal advice from another lawyer in such situations. If there is material risk that the dual role will compromise the lawyer's independence of professional judgment, the lawyer should not serve as a director.

Conflict Charged by an Opposing Party

[14] Resolving questions of conflict of interest is primarily the responsibility of the lawyer undertaking the representation. In litigation, a court may raise the question when there is reason to infer that the lawyer has neglected the responsibility. In a criminal case, inquiry by the court is generally required when a lawyer represents multiple defendants. Where the conflict is such as clearly to call in question the fair or efficient administration of justice, opposing counsel may properly raise the question. Such an objection should be viewed with caution, however, for it can be misused as a technique of harassment. See Scope.
(a) A lawyer shall not enter into a business transaction with a client or knowingly acquire an ownership, possessory, security or other pecuniary interest adverse to a client unless:

   (1) The transaction and terms on which the lawyer acquires the interest are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which can be reasonably understood by the client;
   (2) The client is given a reasonable opportunity to seek the advice of independent counsel in the transaction; and
   (3) The client consents in writing thereto.

(b) A lawyer shall not use information relating to representation of a client to the disadvantage of the client unless the client consents after consultation.

(c) A lawyer shall not prepare an instrument giving the lawyer or a person related to the lawyer as parent, child, sibling, or spouse any substantial gift from a client, including a testamentary gift, except where the client is related to the donee.

(d) Prior to the conclusion of representation of a client, a lawyer shall not make or negotiate an agreement giving the lawyer literary or media rights to a portrayal or account based in substantial part on information relating to the representation.

(e) A lawyer shall not provide financial assistance to a client in connection with pending or contemplated litigation, except that:

   (1) A lawyer may advance court costs and expenses of litigation, the repayment of which may be contingent on the outcome of the matter; and
   (2) A lawyer representing an indigent client may pay court costs and expenses of litigation on behalf of the client.

(f) A lawyer shall not accept compensation for representing a client from one other than the client unless:

   (1) Such compensation is in accordance with an agreement between the client and the third party or the client consents after consultation;
   (2) There is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and
   (3) Information relating to representation of a client is protected as required by Rule 1.6.

(g) A lawyer who represents two or more clients shall not participate in making an aggregate settlement of the claims of or against the clients, or in a criminal case an aggregated agreement as to guilty or nolo contendere pleas, unless each client consents after consultation, including disclosure of the existence and nature of all the claims or pleas involved and of the participation of each person in the settlement.

(h) A lawyer shall not make an agreement prospectively limiting the lawyer's liability to a client for malpractice unless permitted by law and the client is independently represented in making the agreement, or settle a claim for such liability with an unrepresented client or former client without first advising that person in writing that independent representation is appropriate in connection therewith.

(i) A lawyer related to another lawyer as parent, child, sibling or spouse shall not represent a client in a representation adverse to a person who the lawyer knows is represented by the other lawyer except upon consent by the client after consultation regarding the relationship.

(j) A lawyer shall not acquire a proprietary interest in the cause of action or subject matter of litigation the lawyer is conducting for a client, except that the lawyer may:

   (1) Acquire a lien granted by law to secure the lawyer's fee or expenses; and
SCR 3.130(1.8) CONFLICT OF INTEREST: PROHIBITED TRANSACTIONS

(2) Contract with a client for a reasonable contingent fee in a civil case.

[Adopted by Order 89-1, eff. 1-1-90]

COMMENTARY

Supreme Court

1989:

Transactions Between Client and Lawyer

[1] As a general principle, all transactions between client and lawyer should be fair and reasonable to the client. In such transactions a review by independent counsel on behalf of the client is often advisable. Furthermore, a lawyer may not exploit information relating to the representation to the client's disadvantage. For example, a lawyer who has learned that the client is investing in specific real estate may not, without the client's consent, seek to acquire nearby property where doing so would adversely affect the client's plan for investment. Paragraph (a) does not, however, apply to standard commercial transactions between the lawyer and the client for products or services that the client generally markets to others, for example, banking or brokerage services, medical services, products manufactured or distributed by the client, and utilities' services. In such transactions, the lawyer has no advantage in dealing with the client, and the restrictions in paragraph (a) are unnecessary and impracticable.

[2] A lawyer may accept a gift from a client, if the transaction meets general standards of fairness. For example, a simple gift such as a present given at a holiday or as a token of appreciation is permitted. If effectuation of a substantial gift requires preparing a legal instrument such as a will or conveyance, however, the client should have the detached advice that another lawyer can provide. Paragraph (c) recognizes an exception where the client is a relative of the donee or the gift is not substantial.

Literary Rights

[3] An agreement by which a lawyer acquires literary or media rights concerning the conduct of the representation creates a conflict between the interests of the client and the personal interests of the lawyer. Measures suitable in the representation of the client may detract from the publication value of an account of the representation. Paragraph (d) does not prohibit a lawyer representing a client in a transaction concerning literary property from agreeing that the lawyer's fee shall consist of a share in ownership in the property, if the arrangement conforms to Rule 1.5 and paragraph (j).

Person Paying for Lawyer's Services

[4] Paragraph (f) requires disclosure of the fact that the lawyer's services are being paid for by a third party unless such payment is provided for in an agreement between the client and the third party. Such an arrangement must also conform to the requirements of Rule 1.6 concerning confidentiality and Rule 1.7 concerning conflict of interest. Where the client is a class, consent may be obtained on behalf of the class by court-supervised procedure.

Limiting Liability

[5] Paragraph (h) is not intended to apply to customary qualifications and limitations in legal opinions and memoranda.

Family Relationships Between Lawyers

[6] Paragraph (i) applies to related lawyers who are in different firms. Related lawyers in the same firm are governed by Rules 1.7, 1.9, and 1.10. The disqualification stated in paragraph (i) is personal and is not imputed to members of firms with whom the lawyers are associated.

Acquisition of Interest in Litigation

[7] Paragraph (j) states the traditional general rule that lawyers are prohibited from acquiring a proprietary interest in
litigation. This general rule, which has its basis in common-law champerty and maintenance, is subject to specific exceptions developed in decisional law and continued in these Rules, such as the exception for reasonable contingent fees set forth in Rule 1.5 and the exception for certain advances of the costs of litigation set forth in paragraph (e).
A lawyer who has formerly represented a client in a matter shall not thereafter:

(a) Represent another person in the same or a substantially related matter in which that person's interests are materially adverse to the interests of the former client unless the former client consents after consultation;

(b) Represent a person in the same or a substantially related matter in which a firm with which the lawyer formerly was associated had previously represented a client whose interests are materially adverse to that person: and

(1) about whom the lawyer had acquired information protected by Rules 1.6 and 1.9(c) that is material to the matter; unless the former client consents after consultation.

(c) A lawyer who has formerly represented a client in a matter of whose present or former firm has formerly represented a client in a matter shall not thereafter:

(1) use information relating to the representation to the disadvantage of the former client except as Rule 1.6 or Rule 3.3 would permit or require with respect to a client or when the information has become generally known; or processed by the Clerk. excepting. however, any communication between the parties concerning negotiations for an agreed sanction which shall not be transmitted to the Disciplinary Clerk or Trial Commissioner nor filed of record unless the sanction proposal is approved by the Court. No such paper or copy thereof shall be sent by. or on behalf of. any party to the Court. the Board. the Trial Commissioner. Inquiry Commission. or any member thereof.

(2) reveal information relating to the representation except as Rule 1.6 or Rule 3.3 would permit or require with respect to a client.

[Amended by order 99-1, eff. 2-1-00; adopted by Order 89-1, eff. 1-1-90]
SCR 3.130(1.10) IMPUTED DISQUALIFICATION: GENERAL RULE

(a) While lawyers are associated in a firm, none of them shall knowingly represent a client when any one of them practicing alone would be prohibited from doing so by Rules 1.7, 1.8(c), 1.9 or 2.2.

(b) When a lawyer has terminated an association with a firm, the firm is not prohibited from thereafter representing a person with interests materially adverse to those of a client represented by the formerly associated lawyer and not currently represented by the firm, unless:

(1) The matter is the same or substantially related to that in which the formerly associated lawyer represented the client; and
(2) Any lawyer remaining in the firm has information protected by Rules 1.6 and 1.9(b) that is material to the matter.

(c) A disqualification prescribed by this rule may be waived by the affected client under the conditions stated in Rule 1.7.

(d) A firm is not disqualified from representation of a client if the only basis for disqualification is representation of a former client by a lawyer presently associated with the firm, sufficient to cause that lawyer to be disqualified pursuant to Rule 1.9 and:

(1) the disqualified lawyer is screened from any participation in the matter and is apportioned no specific part of the fee therefrom; and
(2) written notice is given to the former client.

[Amended by Order 99-1 eff. 2-1-2000; prior amendment eff.1-1-90]

COMMENTARY

Supreme Court

1989:

Definition of "Firm"

[1] For purposes of the Rules of Professional Conduct, the term "firm" includes lawyers in a private firm, and lawyers employed in the legal department of a corporation or other organization, or in a legal services organization. Whether two or more lawyers constitute a firm within this definition can depend on the specific facts. For example, two practitioners who share office space and occasionally consult or assist each other ordinarily would not be regarded as constituting a firm. However, if they present themselves to the public in a way suggesting that they are a firm or conduct themselves as a firm, they should be regarded as a firm for purposes of the Rules. The terms of any formal agreement between associated lawyers are relevant in determining whether they are a firm, as is the fact that they have mutual access to confidential information concerning the clients they serve. Furthermore, it is relevant in doubtful cases to consider the underlying purpose of the rule that is involved. A group of lawyers could be regarded as a firm for purposes of the rule that the same lawyer should not represent opposing parties in litigation, while it might not be so regarded for purposes of the rule that information acquired by one lawyer is attributed to another.

[2] With respect to the law department of an organization, there is ordinarily no question that the members of the department constitute a firm within the meaning of the Rules of Professional Conduct. However, there can be uncertainty as to the identity of the client. For example, it may not be clear whether the law department of a corporation represents a subsidiary or an affiliated corporation, as well as the corporation by which the members of the department are directly employed. A similar question can arise concerning an unincorporated association and its local affiliates.

[3] Similar questions can also arise with respect to lawyers in legal aid. Lawyers employed in the same unit of a legal service organization constitute a firm, but not necessarily those employed in separate units. As in the case of independent practitioners, whether the lawyers should be treated as associated with each other can depend on the particular rule that is involved, and on the specific facts of the situation.
Where a lawyer has joined a private firm after having represented the government, the situation is governed by Rule 1.11 (a) and (b); where a lawyer represents the government after having served private clients, the situation is governed by Rule 1.11(c)(1). The individual lawyer involved is bound by the Rules generally, including Rules 1.6, 1.7, and 1.9.

Different provisions are thus made for movement of a lawyer from one private firm to another and for movement of a lawyer between a private firm and the government. The government is entitled to protection of its client confidences, and therefore to the protections provided in Rules 1.6, 1.9, and 1.11. However, if the more extensive disqualification in Rule 1.10 were applied to former government lawyers, the potential effect on the government would be unduly burdensome. The government deals with all private citizens and organizations, and thus has a much wider circle of adverse legal interests than does any private law firm. In these circumstances, the government's recruitment of lawyers would be seriously impaired if Rule 1.10 were applied to the government. On balance, therefore, the government is better served in the long run by the protections stated in Rule 1.11.

Principles of Imputed Disqualification

The rule of imputed disqualification stated in paragraph (a) gives effect to the principle of loyalty to the client as it applies to lawyers who practice in a law firm. Such situations can be considered from the premise that a firm of lawyers is essentially one lawyer for purposes of the rules governing loyalty to the client, or from the premise that each lawyer is vicariously bound by the obligation of loyalty owed by each lawyer with whom the lawyer is associated. Paragraph (a) operates only among the lawyers currently associated in a firm. When a lawyer moves from one firm to another, the situation is governed by paragraphs (b) and (c).

Lawyers Moving Between Firms

When lawyers have been associated in a firm but then end their association, however, the problem is more complicated. The fiction that the law firm is the same as a single lawyer is no longer wholly realistic. There are several competing considerations. First, the client previously represented must be reasonably assured that the principle of loyalty to the client is not compromised. Second, the rule of disqualification should not be so broadly cast as to preclude other persons from having reasonable choice of legal counsel. Third, the rule of disqualification should not unreasonably hamper lawyers from forming new associations and taking on new clients after having left a previous association. In this connection, it should be recognized that today many lawyers practice in firms, that many to some degree limit their practice to one field or another, and that many move from one association to another several times in their careers. If the concept of imputed disqualification were defined with unqualified rigor, the result would be radical curtailment of the opportunity of lawyers to move from one practice setting to another and of the opportunity of clients to change counsel.

Reconciliation of these competing principles in the past has been attempted under two rubrics. One approach has been to seek per se rules of disqualification. For example, it has been held that a partner in a law firm is conclusively presumed to have access to all confidences concerning all clients of the firm. Under this analysis, if a lawyer has been a partner in one law firm and then becomes a partner in another law firm, there is a presumption that all confidences known by a partner in the first firm are known to all partners in the second firm. This presumption might properly be applied in some circumstances, especially where the client has been extensively represented, but may be unrealistic where the client was represented only for limited purposes. Furthermore, such a rigid rule exaggerates the difference between a partner and an associate in modern law firms.

The other rubric formerly used for dealing with vicarious disqualification is the appearance of impropriety proscribed in Canon 9 of the ABA Model Code of Professional Responsibility. This rubric has a twofold problem. First, the appearance of impropriety can be taken to include any new client-lawyer relationship that might make a former client feel anxious. If that meaning were adopted, disqualification would become little more than a question of subjective judgment by the former client. Second, since "impropriety" is undefined, the term "appearance of impropriety" is question-begging. It therefore has to be recognized that the problem of imputed disqualification cannot be properly resolved either by simple analogy to a lawyer practicing alone or by the very general concept of appearance of impropriety.

A rule based on a functional analysis is more appropriate for determining the question of vicarious disqualification. Two functions are involved: preserving confidentiality and avoiding positions adverse to a client.

Confidentiality

Preserving confidentiality is a question of access to information. Access to information, in turn, is essentially a question
of fact in particular circumstances, aided by inferences, deductions or working presumptions that reasonably may be made about the way in which lawyers work together. A lawyer may have general access to files of all clients of a law firm and may regularly participate in discussions of their affairs; it should be inferred that such a lawyer in fact is privy to all information about all the firm's clients. In contrast, another lawyer may have access to the files of only a limited number of clients and participate in discussion of the affairs of no other clients; in the absence of information to the contrary, it should be inferred that such a lawyer in fact is privy to information about the clients actually served but not those of other clients.

[12] Application of paragraphs (b) and (c) depends on a situation's particular facts. In any such inquiry, the burden of proof should rest upon the firm whose disqualification is sought.

[13] Paragraphs (b) and (c) operate to disqualify the firm only when the lawyer involved has actual knowledge of information protected by Rules 1.6 and 1.9(b). Thus, if a lawyer while with one firm acquired no knowledge of information relating to a particular client of the firm, and that lawyer later joined another firm, neither the lawyer individually nor the second firm is disqualified from representing another client in the same or a related matter even though the interests of the two clients conflict.

[14] Independent of the question of disqualification of a firm, a lawyer changing professional association has a continuing duty to preserve confidentiality of information about a client formerly represented. See Rules 1.6 and 1.9.

Adverse Positions

[15] The second aspect of loyalty to client is the lawyer's obligation to decline subsequent representations involving positions adverse to a former client arising in substantially related matters. This obligation requires abstention from adverse representation by the individual lawyer involved, but does not properly entail abstention of other lawyers through imputed disqualification. Hence, this aspect of the problem is governed by Rule 1.9(a). Thus, if a lawyer left one firm for another, the new affiliation would not preclude the firms involved from continuing to represent clients with adverse interests in the same or related matters, so long as the conditions of paragraphs (b) and (c) concerning confidentiality have been met.
(a) A lawyer employed or retained by an organization represents the organization acting through its duly authorized constituents.

(b) If a lawyer for an organization knows that an officer, employee or other person associated with the organization is engaged in action, intends to act or refuses to act in a matter related to the representation that is a violation of a legal obligation to the organization, or a violation of law which reasonably might be imputed to the organization, and is likely to result in substantial injury to the organization, the lawyer shall proceed as is reasonably necessary in the best interest of the organization. In determining how to proceed, the lawyer shall give due consideration to the seriousness of the violation and its consequences, the scope and nature of the lawyer's representation, the responsibility in the organization and the apparent motivation of the person involved, the policies of the organization concerning such matters and any other relevant considerations. Any measures taken shall be designed to minimize disruption of the organization and the risk of revealing information relating to the representation to persons outside the organization. Such measures may include among others:

(1) Asking reconsideration of the matter;
(2) Advising that a separate legal opinion on the matter be sought for presentation to appropriate authority in the organization; and
(3) Referring the matter to higher authority in the organization, including, if warranted by the seriousness of the matter, referral to the highest authority that can act in behalf of the organization as determined by applicable law.

(c) If, despite the lawyer's efforts in accordance with paragraph (b), the highest authority that can act on behalf of the organization insists upon action, or a refusal to act, that is clearly a violation of law and is likely to result in substantial injury to the organization, the lawyer may resign in accordance with Rule 1.16.

(d) In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a lawyer shall explain the identity of the client when it is apparent that the organization's interests are adverse to those of the constituents with whom the lawyer is dealing.

(e) A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the organization's consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.

[Adopted by Order 89-1, eff. 1-1-90]

COMMENTARY

Supreme Court

1989:

The Entity as the Client
[1] An organizational client is a legal entity, but it cannot act except through its officers, directors, employees, shareholders and other constituents.

[2] Officers, directors, employees and shareholders are the constituents of the corporate organizational client. The duties defined in this Comment apply equally to unincorporated associations. "Other constituents" as used in this Comment means the positions equivalent to officers, directors, employees and shareholders held by persons acting for organizational clients that are not corporations.

[3] When one of the constituents of an organizational client communicates with the organization's lawyer in that person's organizational capacity, the communication is protected by Rule 1.6. Thus, by way of example, if an organizational client requests its lawyer to investigate allegations of wrongdoing, interviews made in the course of that investigation between the lawyer and the client's employees or other constituents are covered by Rule 1.6. This does not mean, however, that constituents of an organizational client are the clients of the lawyer. The lawyer may not disclose to such constituents information relating to the representation except for disclosures explicitly or impliedly authorized by the organizational client in order to carry out the representation or as otherwise permitted by Rule 1.6.

[4] When constituents of the organization make decisions for it, the decisions ordinarily must be accepted by the lawyer even if their utility or prudence is doubtful. Decisions concerning policy and operations, including ones entailing serious risk, are not as such in the lawyer's province. However, different considerations arise when the lawyer knows that the organization may be substantially injured by action of a constituent that is in violation of law. In such a circumstance, it may be reasonably necessary for the lawyer to ask the constituent to reconsider the matter. If that fails, or if the matter is of sufficient seriousness and importance to the organization, it may be reasonably necessary for the lawyer to take steps to have the matter reviewed by a higher authority in the organization. Clear justification should exist for seeking review over the head of the constituent normally responsible for it. The stated policy of the organization may define circumstances and prescribe channels for such review, and a lawyer should encourage the formulation of such a policy. Even in the absence of organization policy, however, the lawyer may have an obligation to refer a matter to higher authority, depending on the seriousness of the matter and whether the constituent in question has apparent motives to act at variance with the organization's interest. Review by the chief executive officer or by the board of directors may be required when the matter is of importance commensurate with their authority. At some point it may be useful or essential to obtain an independent legal opinion.

[5] In an extreme case, it may be reasonably necessary for the lawyer to refer the matter to the organization's highest authority. Ordinarily, that is the board of directors or similar governing body. However, applicable law may prescribe that under certain conditions highest authority reposes elsewhere; for example, in the independent directors of a corporation.

Relation to Other Rules

[6] The authority and responsibility provided in paragraph (b) are concurrent with the authority and responsibility provided in other Rules. In particular, this Rule does not limit or expand the lawyer's responsibility under Rule 1.6, 1.8, 1.16, 3.3 and 4.1. If the lawyer's services are being used by an organization to further a crime or fraud by the organization, Rule 1.2(d) can be applicable.

Government Agency

[7] The duty defined in this Rule applies to governmental organizations. However, when the client is a governmental organization, a different balance may be appropriate between maintaining confidentiality
and assuring that the wrongful official act is prevented or rectified, for public business is involved. In addition, duties of lawyers employed by the government or lawyers in military service may be defined by statutes and regulation. Therefore, defining precisely the identity of the client and prescribing the resulting obligations of such lawyers may be more difficult in the government context. Although in some circumstances the client may be a specific agency, it is generally the government as a whole. For example, if the action or failure to act involves the head of a bureau, either the department of which the bureau is a part or the government as a whole may be the client for purpose of this Rule. Moreover, in a matter involving the conduct of government officials, a government lawyer may have authority to question such conduct more extensively than that of a lawyer for a private organization in similar circumstances. This Rule does not limit that authority. See note on Scope.

Clarifying the Lawyer’s Role

[8] There are times when the organization’s interest may be or become adverse to those of one or more of its constituents. In such circumstances the lawyer should advise any constituent, whose interest the lawyer finds adverse to that of the organization of the conflict or potential conflict of interest, that the lawyer cannot represent such constituent, and that such person may wish to obtain independent representation. Care must be taken to assure that the individual understands that, when there is such adversity of interest, the lawyer for the organization cannot provide legal representation for that constituent individual, and that discussions between the lawyer for the organization and the individual may not be privileged.

[9] Whether such a warning should be given by the lawyer for the organization to any constituent individual may turn on the facts of each case.

Dual Representation

[10] Paragraph (e) recognizes that a lawyer for an organization may also represent a principal officer or major shareholder.

Derivative Actions

[11] Under generally prevailing law, the shareholders or members of a corporation may bring suit to compel the directors to perform their legal obligations in the supervision of the organization. Members of unincorporated associations have essentially the same right. Such an action may be brought nominally by the organization, but usually is, in fact, a legal controversy over management of the organization.

[12] The question can arise whether counsel for the organization may defend such an action. The proposition that the organization is the lawyer’s client does not alone resolve the issue. Most derivative actions are a normal incident of an organization’s affairs, to be defended by the organization’s lawyer like any other suit. However, if the claim involves serious charges of wrongdoing by those in control of the organization, a conflict may arise between the lawyer’s duty to the organization and the lawyer’s relationship with the board. In those circumstances, Rule 1.7 governs who should represent the directors and the organization.
(a) A lawyer may only act as intermediary between clients if:

(1) The lawyer consults with each client concerning the implications of the common representation, including the advantages and risks involved, and the effect on the attorney-client privileges, and obtains each client's consent to the common representation;
(2) The lawyer reasonably believes that the matter can be resolved on terms compatible with the clients' best interests, that each client will be able to make adequately informed decisions in the matter and that there is little risk of material prejudice to the interests of any of the clients if the contemplated resolution is unsuccessful; and
(3) The lawyer reasonably believes that the common representation can be undertaken impartially and without improper effect on other responsibilities the lawyer has to any of the clients.

(b) While acting as intermediary, the lawyer shall consult with each client concerning the decisions to be made and the considerations relevant in making them, so that each client can make adequately informed decisions.

(c) A lawyer shall withdraw as intermediary if any of the clients so requests, or if any of the conditions stated in paragraph (a) is no longer satisfied. Upon withdrawal, the lawyer shall not continue to represent any of the clients in the matter that was the subject of the intermediation.

[Adopted by Order 89-1, eff. 1-1-90]

COMMENTARY

Supreme Court

1989: This Rule explicitly recognizes the special role of the lawyer acting as an intermediary, to be distinguished from joint representation as an advocate.

[1] A lawyer acts as intermediary under this Rule when the lawyer represents two or more parties with potentially conflicting interests. A key factor in defining the relationship is whether the parties share responsibility for the lawyer's fee, but the common representation may be inferred from other circumstances. Because confusion can arise as to the lawyer's role where each party is not separately represented, it is important that the lawyer make clear the relationship, and obtain the client's consent, preferably in writing.

[2] The Rule does not apply to a lawyer acting as arbitrator or mediator between or among parties who are not clients of the lawyer, even where the lawyer has been appointed with the concurrence of the parties. In performing such a role the lawyer may be subject to applicable codes of ethics, such as the Code of Ethics for Arbitration in Commercial Disputes prepared by a joint Committee of the American Bar Association and the American Arbitration Association.

[3] A lawyer acts as intermediary in seeking to establish or adjust a relationship between clients on an amicable and mutually advantageous basis; for example, in helping to organize a business in which two or more clients are entrepreneurs, working out the financial reorganization of an enterprise in which two or more clients have an interest, arranging a property distribution in settlement of an estate or a marital
division or mediating a dispute between clients. The lawyer seeks to resolve potentially conflicting interests by developing the parties' mutual interests. The alternative can be that each party may have to obtain separate representation, with the possibility in some situations of incurring additional cost, complication or even litigation. Given these and other relevant factors, all the clients may prefer that the lawyer act as intermediary.

[4] In considering whether to act as intermediary between clients, a lawyer should be mindful that if the intermediation fails the result can be additional cost, embarrassment and recrimination. In some situations the risk of failure is so great that intermediation is plainly impossible. For example, a lawyer cannot undertake common representation of clients between whom contentious litigation is imminent or who contemplate contentious negotiations. More generally, if the relationship between the parties has already assumed definite antagonism, the possibility that the clients' interests can be adjusted by intermediation ordinarily is not very good.

[5] The appropriateness of intermediation can depend on its form. Forms of intermediation range from informal arbitration, where each client's case is presented by the respective client and the lawyer decides the outcome, to mediation, to common representation where the clients' interests are substantially though not entirely compatible. One form may be appropriate in circumstances where another would not. Other relevant factors are whether the lawyer subsequently will represent both parties on a continuing basis and whether the situation involves creating a relationship between the parties or terminating one.

[6] In some circumstances a lawyer will undertake representation of a party in litigation or negotiation, and be forced to deal with an unrepresented party. For example, the lawyer representing a spouse in a divorce case may deal with the unrepresented spouse within the limits of Rule 4.3. The fact that that lawyer negotiates with the unrepresented spouse does not make the lawyer an intermediary, or subject the lawyer to the special rule of disqualification contained in Rule 2.2(c).

Confidentiality and Privilege

[7] A particularly important factor in determining the appropriateness of intermediation is the effect on client-lawyer confidentiality and the attorney-client privilege. In a common representation, the lawyer is still required both to keep each client adequately informed and to maintain confidentiality of information relating to the representation. See Rules 1.4 and 1.6. Complying with both requirements while acting as intermediary requires a delicate balance. If the balance cannot be maintained, the common representation is improper. With regard to the attorney-client privilege, the prevailing rule is that as between commonly represented clients the privilege does not attach. Hence, it must be assumed that if litigation eventuates between the clients, the privilege will not protect any such communications, and the clients should be so advised.

[8] Since the lawyer is required to be impartial between commonly represented clients, intermediation is improper when that impartiality cannot be maintained. For example, a lawyer who has represented one of the clients for a long period and in a variety of matters might have difficulty being impartial between that client and one to whom the lawyer has only recently been introduced.

Consultation

[9] In acting as intermediary between clients, the lawyer is required to consult with the clients on the implications of doing so, and proceed only upon consent based on such a consultation. The consultation should make clear that the lawyer's role is not that of partisanship normally expected in other circumstances.
Paragraph (b) is an application of the principle expressed in Rule 1.4. Where the lawyer is intermediary, the clients ordinarily must assume greater responsibility for decisions than when each client is independently represented.

Withdrawal

Common representation does not diminish the rights of each client in the client-lawyer relationship. Each has the right to loyal and diligent representation, the right to discharge the lawyer as stated in Rule 1.16, and the protection of Rule 1.9 concerning obligations to a former client.
SCR 3.130(5.1) RESPONSIBILITIES OF A PARTNER OR SUPERVISORY LAWYER

(a) A partner in a law firm shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that all lawyers in the firm conform to the Rules of Professional Conduct.

(b) A lawyer having direct supervisory authority over another lawyer shall make reasonable efforts to ensure that the other lawyer conforms to the Rules of Professional Conduct.

(c) A lawyer shall be responsible for another lawyer's violation of the Rules of Professional Conduct only if:

(1) The lawyer orders or, with knowledge of the specific conduct, ratifies the conduct involved; or

(2) The lawyer is a partner in the law firm in which the other lawyer practices, or has direct supervisory authority over the other lawyer, and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action.

[Adopted by Order 89-1, eff. 1-1-90]

COMMENTARY

Supreme Court

1989: [1] Paragraphs (a) and (b) refer to lawyers who have supervisory authority over the professional work of a firm or legal department of a government agency. This includes members of a partnership and the shareholders in a law firm organized as a professional corporation; lawyers having supervisory authority in the legal department of an enterprise or government agency; and lawyers who have intermediate managerial responsibilities in a firm.

[2] The measures required to fulfill the responsibility prescribed in paragraphs (a) and (b) can depend on the firm's structure and the nature of its practice. In a small firm, informal supervision and occasional admonition ordinarily might be sufficient. In a large firm, or in practice situations in which intensely difficult ethical problems frequently arise, more elaborate procedures may be necessary. Some firms, for example, have a procedure whereby junior lawyers can make confidential referral of ethical problems directly to a designated senior partner or special committee. See Rule 5.2. Firms, whether large or small, may also rely on continuing legal education in professional ethics. In any event, the ethical atmosphere of a firm can influence the conduct of all its members and a lawyer having authority over the work of another may not assume that the subordinate lawyer will inevitably conform to the Rules.

[3] Paragraph (c)(1) expresses a general principle of responsibility for acts of another. See also Rule 8.4(a).

[4] Paragraph (c)(2) defines the duty of a lawyer having direct supervisory authority over performance of specific legal work by another lawyer. Whether a lawyer has such supervisory authority in particular circumstances is a question of fact. Partners of a private firm have at least indirect responsibility for all work being done by the firm. While a partner in charge of a particular matter ordinarily has direct authority over other firm lawyers engaged in the matter. Appropriate remedial action by a partner would depend on the immediacy of the partner's involvement and the seriousness of the misconduct. The supervisor is required to intervene to prevent avoidable consequences of misconduct if the supervisor knows that the misconduct occurred. Thus, if a supervising lawyer knows that a subordinate misrepresented a matter to an opposing party in negotiation, the supervisor as well as the subordinate has a duty to correct the resulting misapprehension.

[5] Professional misconduct by a lawyer under supervision could reveal a violation of paragraph (b) on the part of the supervisory lawyer even though it does not entail a violation of paragraph (c) because there was no direction, ratification or knowledge of the violation.

[6] Apart from this Rule and Rule 8.4(a), a lawyer does not have disciplinary liability for the conduct of a partner, associate or subordinate. Whether a lawyer may be liable civilly or criminally for another lawyer's conduct is a question of law beyond the scope of these Rules.
SCR 3.130(5.2) RESPONSIBILITIES OF A SUBORDINATE LAWYER

(a) A lawyer is bound by the Rules of Professional Conduct notwithstanding that the lawyer acted at the direction of another person.

(b) A subordinate lawyer does not violate the Rules of Professional Conduct if that lawyer acts in accordance with a supervisory lawyer's reasonable resolution of an arguable question of professional duty.

[Adopted by Order 89-1, eff. 1-1-90]

COMMENTARY

Supreme Court

1989: [1] Although a lawyer is not relieved of responsibility for a violation by the fact that the lawyer acted at the direction of a supervisor, that fact may be relevant in determining whether a lawyer had the knowledge required to render conduct a violation of the Rules. For example, if a subordinate filed a frivolous pleading at the direction of a supervisor, the subordinate would not be guilty of a professional violation unless the subordinate knew of the document's frivolous character.

[2] When lawyers in a supervisor-subordinate relationship encounter a matter involving professional judgment as to ethical duty, the supervisor may assume responsibility for making the judgment. Otherwise a consistent course of action or position could not be taken. If the question can reasonably be answered only one way, the duty of both lawyers is clear and they are equally responsible for fulfilling it. However, if the question is reasonably arguable, someone has to decide upon the course of action. That authority ordinarily reposes in the supervisor, and a subordinate may be guided accordingly. For example, if a question arises whether the interests of two clients conflict under Rule 1.7, the supervisor's reasonable resolution of the question should protect the subordinate professionally if the resolution is subsequently challenged.
SCR 3.130(5.5) UNAUTHORIZED PRACTICE OF LAW

A lawyer shall not:

(a) Practice law in a jurisdiction where doing so violates the regulation of the legal profession in that jurisdiction; or

(b) Assist a person who is not a member of the bar in the performance of activity that constitutes the unauthorized practice of law.

[Adopted by Order 89-1, eff. 1-1-90]

COMMENTARY

Supreme Court

1989: The definition of the practice of law is established by law and varies from one jurisdiction to another. Whatever the definition, limiting the practice of law to members of the bar protects the public against rendition of legal services by unqualified persons. Paragraph (b) does not prohibit a lawyer from employing the services of paraprofessionals and delegating functions to them, so long as the lawyer supervises the delegated work and retains responsibility for their work. See Rule 5.3. Likewise, it does not prohibit lawyers from providing professional advice and instruction to nonlawyers whose employment requires knowledge of law: for example, claims adjusters, employees of financial or commercial institutions, social workers, accountants and persons employed in government agencies. In addition, a lawyer may counsel nonlawyers who wish to proceed pro se.
PROBLEM #1

"And you can pay our fees with Chickens"

You have a client who operates a small gift shop. He and his wife clearly qualify for a Chapter 13 and could propose a 100% 60-month plan. Unfortunately, they need about $3,000 in tax and other nonbankruptcy legal work pre-petition before their Chapter 13 would be a success and they have no extra funds and no way to borrow the money to pay the needed pre-petition fees. They propose to pay you by giving you $3,000 in country hams, Kentucky Crafts, and a $1,000.00 watch. The bank, which has a mortgage on the inventory of the Gift shop, has no problem with this payment and you can use the items.

ISSUE A. Can you accept this type of payment for doing the pre-petition work and still represent the debtors in their Chapter 13? If so, what disclosures should you make to the Bankruptcy Court?

ISSUE B. Your Spouse likes the Gift Shop’s merchandise and as the debtors are short of funds they would like to reduce their monthly payments under the plan and pay your fees through gift certificates. Can you do this?

ISSUE C. Shortly before you file the Chapter 13 you determine that it would be better for the wife to file a Chapter 7. Unfortunately, the debtors have no extra funds and need the Gift Shop’s entire inventory for the Christmas Holidays. The debtors’ offer to pay your normal fees from the wife’s salary from the gift shop within the next six months after you file her Chapter 7. Can you agree to the debtor paying your fees after you file the Bankruptcy? Can you attempt to collect your Chapter 7 legal fees after the Bankruptcy is filed and the wife’s debts are discharged?
PROBLEM # 2

“You own a What!”

You have a client who needs to file a Chapter 7 Bankruptcy. He went through a divorce 8 months ago and has closed his small motorcycle repair shop. The Bank repossessed all the equipment in full satisfaction of its secured debt and has no claim on the remaining inventory which your client values at approximately $600.00. The only other property the debtor tells you he owns is a car worth $1,000.00, $700.00 in clothing, and $500.00 in tools. The Debtor owes about $35,000.00 in credit card debt, $20,000.00 in bad business debts, and $4,000.00 in back Federal taxes. The agreed divorce decree has as part of the property settlement section an agreement by the debtor that he will hold his former spouse harmless for all of the above debts. You review the schedules with the debtor, fully disclose his duties under the Bankruptcy Court and file them on December 1, 2000. On December 3, 2000 the Debtor’s former spouse calls you and says she knows they Debtors schedules are false and wants to meet with you to tell you about the problems. You call your client who tells you the divorce was bitter and his former spouse will do anything to “get him” and that you should not waste your time talking to her.

ISSUE A. Do you have to meet with the Debtors former spouse? Even if you are not required to meet with the former spouse should you meet with her?

ISSUE B. Assume you meet with the Debtor’s former spouse and she tells you that he has a 1967 Corvette, in perfect condition, which he keeps at his fathers farm. When you discuss this matter with the debtor, he tells you that the car was purchased by his brother 4 years ago just before his brother got a divorce and is held in the name of his old motorcycle repair shop. The car was titled in the shop’s name so his brother’s former spouse would not find out about the car. He presents you with proof that his brother purchased the car with his own funds as well as a copy of his will (which was prepared 4 years ago) which states that the car is the property of his brother. The debtor says he did not disclose the car because he did not want to get his brother in trouble. What should you advise the debtor to do? Should you disclose this information to anyone? Assuming your client refuses to amend his schedules, what should you do?

ISSUE C. Assume the former does not disclose any new information to you. However, 2 months after the case is closed a motorcycle collector visits the debtor and discovers that the room full of outdated spare parts contains several hundred rare Indian and HD motorcycle parts which have never been removed from their original cases. Your client calls and asks you to draw up a sale agreement to sell the parts for $100,000.00. You know that the trustee did not have the parts appraised because both you and your client assured the trustee that the old parts were outdated and of little value. What do you do? Assuming your client did not know these used parts were in the back of his old shop.
and did not intend to deceive the trustee when he filled out his schedules, what should you do if the debtor now refuses to reveal these facts to the trustee?

**ISSUE D.** Nine months after the case is closed, you are at state court motion hour and see the Debtor settle a car accident case for $40,000.00 with the Witless Insurance Co. The Debtor PI attorney states in open Court that the accident occurred 4 weeks before the Debtor filed his chapter 7 case. You review the debtor’s schedules and find no mention of the accident claim. You review your notes and find that the debtor expressly told you that he had no outstanding claims, including claims from accidents. The debtor refuses to take your phone calls or respond to your letters. What should you do? What should you do if you see the Debtor’s PI attorney and he tells you he is glad the accident occurred after the bankruptcy was file or the Debtor “would not have gotten the money”.

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I. INTRODUCTION

As a general rule, Bankruptcy law is truly a different world from the rest of "normal legal practice". The Bankruptcy Code's detailed and complex provisions, the mass of technical opinions from the specialized Bankruptcy courts and the broad equity powers of courts under the Bankruptcy Code make bankruptcy an extremely difficult area of the law in which to practice. However, as noted by a leading commentator in the field of bankruptcy ethics, there is some good news because: "if you know anything about the rules governing lawyer professional responsibility (aka 'legal ethics'), then you know most of what you need to know about bankruptcy ethics".1

This general observation, while correct, does not mean that there are only a few "special" Bankruptcy ethics issues. Indeed, legal ethics may play a greater role in bankruptcy proceedings than any other area of the law due to four general factors which arise from the unique nature of practice under the Bankruptcy Code.

First, it is important to note that unlike most tribunals, courts overseeing Bankruptcy proceedings have to approve the retention of counsel for bankruptcy estates under Chapter 11 and Chapter 123, creditors committees in Chapter 11 cases2 and Bankruptcy trustees4. Therefore, there is an open judicial review of an attorney's decision to take a client in the majority of bankruptcy cases, which is normally a private matter in most other litigation settings.

Second, there is extensive judicial review of legal fees in Bankruptcy cases. While most cases involve fee requests of counsel for debtors-in-possession, unsecured creditors committees, and trustees, a Bankruptcy Court will review any legal fees for which a party is seeking reimbursement from the Bankruptcy estate5. This judicial review and the fact that payment of bankruptcy professionals reduces the "pot of money" available for distribution to a debtor's creditors means that any fee application in a bankruptcy proceeding must be prepared with care, and in general accordance with certain guidelines set forth by the Office of The United States Trustee under the provisions of 28 U.S.C.§ 5864.

A third reason why legal ethics are more complex in a bankruptcy setting is the unusual nature of the parties to a bankruptcy case. In a law suit or the purchase or sale of a business, there are generally a small number of legal interests which must be considered by an attorney in the representation of a particular client. However, in a Bankruptcy case you have a debtor, upwards of thousands of creditors as well as other interested parties, each of whom have wildly differing interests vis-a-vis the debtor, and most, if not all, other interested parties. Indeed even doing a simple conflict check can be a nightmare in a large case where an attorney would have to cross check thousands of creditors and other interest holders to see if he or she can accept the representation of any party in a bankruptcy case6.

A final factor which also complicates bankruptcy ethical considerations is the seemingly simple issue of "who is your client"? As noted throughout this Chapter, situations involving closely held busi-
nesses where attorneys outside of bankruptcy may have no problem in representing both the business, the primary shareholders and/or the corporate officers, become conflict ridden dilemmas, due to the “differing” interests of the bankruptcy estate (i.e. collecting the most money for creditors) and the individuals who have the fiduciary duty to operate the business of the estate.

It is the purpose of this Chapter to review in detail some of the most important ethical considerations which an attorney must deal with when representing a debtor, bankruptcy estate, or creditor’s committee. While attorneys who are representing creditors in bankruptcy also have ethical issues arise, these issues are almost always issues which would also arise in a non-bankruptcy context and are therefore beyond the scope of this chapter. Therefore, in the alleged words of the great Yogi Berra, “Let’s begin at the beginning!”


11 U.S.C. §327(a) governs the employment of all professionals, including attorneys, who are to be hired by trustees or debtors-in-possession. Under this provision, an attorney can be employed as the “general counsel” for a bankruptcy estate only if: 1) the attorney is “disinterested” and 2) the attorney neither represents nor holds an interest which is adverse to the bankruptcy estate. While these tests are somewhat similar in nature, they are independent tests, each of which must be met by prospective attorneys, if they wish to be employed as counsel for a Bankruptcy estate. For an excellent discussion of these two requirements, see In re Omegas Group, Inc., 195 B.R. 875 (Bkrtcy W.D. Ky. 1996).

In the Sixth Circuit, the two-part test of 11 U.S.C. § 327(a) is applied both literally and strictly by courts in reviewing whether a professional can be employed by a bankruptcy estate. The Sixth Circuit has refused to allow either a broad reading of 11 U.S.C. §1107(b), which provides that an attorney will not be disqualified from representing a debtor solely because of the attorney’s pre-petition representation of the debtor, or the general powers of 11 U.S.C. § 105 to override the plain language of section 327. Therefore, if an attorney does not fall within the literal definition of a disinterested person then there is no chance that his or her employment will be approved.

Other than failing to meet the statutory definition of disinterestedness, there are two broad classes of “situations” which could prevent a law firm from being able to represent a bankruptcy estate under 11 U.S.C. § 327(a): (1) multiple representation of related entities by the proposed attorney, and (2) conflicts between the debtor and the attorney due to interests, unrelated to the debtor, which the attorney either holds or represents.

1. Multiple Representation of Related Parties

The problems related to a law firm’s representation of related parties probably causes more disqualifications or rejections of proposed counsel under 11 U.S.C. § 327(a) than any other ethical problem. While, representation of multiple related entities does not require a per se disqualification of a law firm seeking to represent a bankruptcy estate under 11 U.S.C. § 327(a), a law firm’s employment should not be approved under section 327(a) if there is even “the appearance of conflict irrespective of the integrity of the firm or person under consideration.” Among the situations which can give rise to either the appearance of impropriety or an actual conflict warranting a rejection of a law firm’s employment application are:

a. Representation of a partnership and its partners

b. Representation of a corporation and related corporations
c. Representation of a corporation and its owners

d. Representation of a corporation and its officers or directors

e. Representation of an individual’s bankruptcy estate and the individual

f. Representation of related bankruptcy estates for the same bankruptcy trustee.

The leading test on whether a law firm should either be refused employment or removed as counsel for a bankruptcy estate can be found in the Third Circuit’s decision in In re BH & P, Inc. In that case the court was faced with the question of whether a bankruptcy trustee and his attorneys, who served as a Chapter 7 trustee in the Chapter 7 cases of a corporation and each of its two principals had to be disqualified due to the fact that the three Chapter 7 bankruptcy estates held claims against each other. The Third Circuit noted that there were two separate situations under section 327(a) where counsel for a bankruptcy estate could be disqualified: 1) where the professional had an actual conflict of interest; and 2) where there is only a “potential” conflict of interest. In the former case court’s have no discretion and must refuse to approve a professional’s employment under section 327(a). However, in the latter case a court could approve the retention of the professional, even in light of the potential conflict, if such an appointment would be appropriate under the facts and circumstances of the case.

2. Conflicts Between the Debtor and its Attorney

There are a number of situations which prevent an attorney from representing a debtor under the provisions of 11 U.S.C. § 327(a) that do not involve the representation of entities related to the debtor. While such conflicts are rather uncommon, they can be broadly grouped into 4 categories.

a. Representation of Third Parties

As noted by the Bankruptcy court in Matter of Allied Artists Pictures Corp.: [The ABA’s] Code of Professional Responsibility provide[s] that the professional judgment of a lawyer must be exercised solely for the benefit of this client, free of compromising influences and loyalties, and precludes [his or her] acceptance of employment that will adversely affect his judgment or dilute his loyalty. In bankruptcy cases, this means that the debtor’s or the trustee’s counsel can generally not represent creditors of the debtor’s estate, although some exceptions have been made in large Chapter 11 cases where law firms represent creditors in “small” matters not related to the bankruptcy case. Further, counsel cannot also represent noncreditor parties who may be targets of a lawsuit by a bankruptcy estate.

b. Business and Financial Ties Between the Debtor and the Proposed Attorneys

As a general rule, Bankruptcy Courts have refused to allow the employment of attorneys to represent the estate where the attorneys, their law firms or some member of their law firms have a direct financial or business tie to the debtor or the debtor’s principals. While this obviously includes attorneys who are disqualified because they are not disinterested under the express terms of 11 U.S.C. § 101(14) as they had an ownership interest in the debtor, it also includes cases where members of an attorney’s law firm have served as officers or directors of a debtor corporation, co-owned property with the debtor, possibly owed money to the debtor or has some other connection to the debtor. Therefore, a law firm should carefully examine all of its ties and its attorneys’ ties to a debtor before applying to be counsel for a Bankruptcy estate.

c. Retainer and Pre-Petition Payment Problems

One of the oldest and most critical problems facing attorneys in representing a bankruptcy estate is “How do you get paid”? The problem of getting paid for representing the debtor in a bank-
Bankruptcy proceeding is often complicated by the real and practical need to get your own pre-petition bills paid before the bankruptcy is filed. The primary problems are: 1) do pre-petition payments of outstanding bills by a debtor render an attorney ineligible to be approved as counsel for the estate under section 327(a) because the payments may have been a preference; and 2) do certain types of retainers (i.e. retainers in the form of liens or mortgages on the debtor's property) disqualify a law firm from seeking employment as a bankruptcy estate’s general counsel.

The initial problem, of pre-petition payments to law firms, is bankruptcy's version of the famous "catch 22". As noted by the Bankruptcy court in the case of In re Decor Corporation:

Regarding the issue of the pre-petition payments, but for [the debtor paying its attorney's pre-petition legal bills, the debtor's attorney] would have been a creditor of the estate and subject to the statutory disqualification mandated by section 101(14)(A). In absence of a waiver of its unsecured claim- the ultimate "curative" measure- [the debtor's attorneys] would have been non-disinterested. Here, creditor status has been avoided by receiving payment within ninety(90) days prior to the filing, and such transfers may well constitute preferential payments. This role as a prospective defendant may constitute a disqualifying adverse interest and render the [debtor's attorneys] ineligible to claim the designation of a "disinterested" professional.

The best advice which can be given in this situation is to review the case law in this area and make a careful judgment as to whether it would be practical to perform the ultimate curative measure and waive any pre-petition claim which the law firm may have against the debtor.

The second major problem facing law firms is whether a law firm can take a retainer in the form of a lien against the debtor's property? In the Sixth Circuit, such retainers do not automatically disqualify an attorney from being employed under section 327(a). In the Ohio case of In re Watson, the court adopted a ten(10) element test to determine whether under the facts of a particular case such a retainer would cause the disqualification of an attorney from employment as counsel for a bankruptcy estate under section 327. Therefore, while it is risky to take a lien as a retainer, it is not per se improper and could be approved by a court under appropriate circumstances.

d. Other Problems

Finally, there are some situations, which are beyond characterization, that prevent an attorney from being employed as Counsel for the estate. These situations generally involve ethical considerations which will not be discussed in detail here. Perhaps, the most famous of these cases is In re Philadelphia Athletic Club, Inc. where the court refused to appoint a law firm to represent a Chapter 11 trustee where the law firm represented two of the debtor's three partners against the third partner in bitter litigation.

B. 11 U.S.C. §327(e): Employment As Special Counsel

Under 11 U.S.C. §327(e) an attorney can be hired for a "specified special purpose", if the attorney does not represent or hold any interest adverse to the estate. This provision cannot be used to "end run" section 327(a)'s requirements by appointing a de facto general counsel in the guise of a "special counsel". The leading case from courts in the Sixth Circuit discussing this issue is Matter of F & C Intern., Inc. from the Southern District of Ohio. In a well reasoned opinion, the court held that counsel who had been jointly representing the debtor and several of the debtor's directors in securities litigation had an actual conflict of interest, as opposed to merely being disinterested, and refused to expand the special counsel's role in the bankruptcy proceedings. The court also held, on it's own motion, that in order for the law firm to continue as special counsel for the bankruptcy estate, it would have to withdraw as counsel for the directors.
C. 11 U.S.C. §1103(b): Employment As Counsel For A Committee Of Creditors

Under section 1103(b), a committee of creditors may retain attorneys and have them compensated by the debtor's bankruptcy estate, if the attorneys do not hold or represent having an adverse interest to the interests represented by the committee. Merely representing individual creditors of the same class as the creditors represented by the committee does not, per se constitute representation on an adverse interest.

In the Sixth Circuit, there are two recent appellate decisions, National Liquidators and Daido Steel which recently addressed what constituted an adverse interest under section 1103(b). In National Liquidators the U.S. District Court for the Southern District of Ohio reversed and remanded a decision of the Bankruptcy Court where the Bankruptcy court had denied all fees to counsel for the unsecured creditor's committee due to an undisclosed representation of certain committee members in a related SEC investigation of the debtor which the Bankruptcy court held was the representation of an adverse interest due to the committee members' possible exposure to preference and or fraudulent conveyance actions by the debtor.

The District Court carefully reviewed the requirements of Section 1103(b) and found that the adverse interest rule was clearly designed to prevent "attorney conflicts of interest". It found that while there was a slight potential for a conflict of interest in the case, there was no actual conflict of interest and that disallowance of the entire fee was unwarranted. It remanded the case to the bankruptcy court for a reduction in fees due to the lack of appropriate disclosure concerning the related representation.

In Daido Steel, the District Court affirmed the Bankruptcy Court's order allowing the committee's counsel to remain employed under Section 1103(b) even though one of the law firm's clients became interested in purchasing the debtor's assets. One of the key elements to this decision was the fact that the committee's attorneys promptly notified the Bankruptcy Court of their intention of the prospective purchaser in other matters unrelated to the bankruptcy. The District Court specifically found that this representation did not constitute an "adverse interest" for purposes of Section 1103(b) and that disqualification was not warranted.

D. Full Disclosure, The Key Issue?

An issue which is often overlooked in the discussion of conflicts of interest is whether the attorney made a full disclosure of any potential conflict at the beginning of the case? There seems to be an erroneous view in some quarters that ignoring "minor" potential conflict matters in the disclosure is appropriate as it may avoid "needless litigation". Such a view not only conflicts with the requirements of the Bankruptcy Code concerning the employment of counsel but it also is a very dangerous tactic as courts are almost universally more offended by the nondisclosure than they are with the underlying conflict.

Perhaps the leading case concerning the problem with failing to make full disclosure is In re National Liquidators, Inc. In that case, the District Court reviewed a Bankruptcy court decision which had denied all fees to counsel for the unsecured creditors committee due to the committee's undisclosed representation of one of the members of the committee in SEC investigations related to the debtor's business. The Bankruptcy Court found this representation to be an actual conflict of interest.

The District Court, after a detailed review of the facts surrounding the representation, found that there was no conflict of interest in the law firm's representation of the committee and one of its members under these circumstances and held that denial of all fees was inappropriate. However, the District Court did find that the law firm did fail to make an appropriate disclosure and that a reduced amount of sanctions was appropriate and remanded the case to the bankruptcy court for further proceedings.
It is therefore clear that any representation or connection which a law firm has which might possibly be a problem in being approved as counsel for a bankruptcy estate or creditor’s committee must be disclosed in the initial employment application. The worst that can happen is that the application may not be approved and you will not work “for free” during the bankruptcy. When in doubt, disclose.

E. Nunc Pro Tunc Employment: Better Late Than Never?

As discussed in detail above, an attorney’s employment must be approved prior to being eligible to have fees awarded in a bankruptcy proceeding. However, in far too many cases, attorneys fail to make timely applications for employment and must request retroactive, or “nunc pro tunc” approval of their employment by the court. In 1984, the Sixth Circuit seemingly approved the practice of retroactive employment in the Georgetown of Kettering decision where the court noted that such employment could be approved in appropriate circumstances, but overruled the lower court’s decisions to approve employment in this case due to a massive conflict of interest on the part of debtor’s counsel.

Courts in the Sixth Circuit have generally used two tests to determine whether retroactive employment should be approved. The court in In re Vlahos employed a four part test, centering on parties’ knowledge of the services being provided and the lack of an otherwise valid objection to the employment, to determine whether an attorney should be employed as a professional under section 327(a). Other courts have used the nine part facts and circumstances test of In re Twinton Properties when considering this issue.

It is important to note that the general “rule” of Georgetown of Kettering is now in some doubt in light of the Sixth Circuit’s recent Federated decision. In Federated, the Sixth Circuit stated: “Accordingly, we hold that a valid appointment under §327(a) is a condition precedent to the decision to grant or deny compensation under §330(a) or §328(c).” While this language does not expressly overrule the dicta of Georgetown of Kettering, it does cast some doubt on the strength of that decision as to the issue of nunc pro tunc employment of professionals.


While only attorneys who seek to be employed by a bankruptcy estate or creditors committee need to formally apply to the court to have their employment approved, all attorneys including attorneys for Chapter 7 and Chapter 13 debtors must make the disclosures required by Section 329(a) of the Bankruptcy Code. Under Section 329(a), all attorneys who represent debtors must file a statement of all compensation paid or agreed to by the debtors for services in connection with the bankruptcy case. This statement must also disclose the source of these payments. One Sixth Circuit and several Bankruptcy Court decisions discuss the ease of compliance with this provision and the many problems which can arise if it is ignored.


While the collection of legal fees is not directly an ethical issue, the relationship of fee awards to an attorney’s “employability” and the court’s control over fees, makes section 330 an important ethical section under the Bankruptcy Code. Section 330 is often involved in key ethical decisions due to the fact that many objections to fee awards involve requests for an attorney disqualification as counsel for a bankruptcy estate under the provisions discussed above. These issues have been reviewed above and will not be addressed in this section.
As a general rule, an attorney’s fees and expenses are governed by the “Lodestar” standard of compensation which states that a reasonable attorney fee in a given matter is determined by multiplying a reasonable hourly rate by the reasonable number of hours expended on the matter. While a detailed discussion of this standard is beyond the scope of this chapter below is a listing of cases which in general discuss lodestar and fee application requirements in Kentucky:

1. **In re Boddy**, 950 F.2d 334 (6th Cir. 1991)
2. **In re A & A Energy Properties, Ltd.**, 865 F.2d 256 (6th Cir. 1988)

Recently, the Office of the United States Trustee announced new technical requirements for fee applications under 11 U.S.C. §330. These guidelines have not yet be adopted by Kentucky courts in bankruptcy cases, but should be followed, if nothing else, to prevent an objection to your fee application by the U.S. Trustee’s Office. The U.S. Trustee guidelines are in line with the requirements of **In re J.F. Wagner’s Sons Co.**, the leading Kentucky case on what information a fee application should contain.

### V. BANKRUPTCY RULE OF PROCEDURE 9011

While an attorney is under an ethical obligation to “zealously” represent his or her client, Bankruptcy Rule of Procedure (“BRP”) 9011 places limitations on how far those actions may go. As explained by the Honorable Guy Cole in **In re R. and D. Group, Inc.** “Rule 9011 delineates two types of sanctionable conduct: "One, where the papers are frivolous, legally unreasonable, or without factual foundation", and two, "where the pleading is filed for an improper purpose". The first type of prescribed conduct under Rule 9011 addresses whether a party and/or its attorney’s conduct were objectively reasonable, while the second form of improper conduct goes to issues primarily related to subjective “good faith”. In Kentucky, the standard for imposing Rule 11 sanctions is whether “the individual’s conduct was reasonable under the circumstances”.

In determining whether an attorney’s conduct is objectively reasonable, the Sixth Circuit has indicated that factors such as: 1) the time available to the attorney for investigation of the claims; 2) whether the attorney had to rely on a client for information as to the facts underlying the pleading in question; 3) whether the pleading was based on a plausible view of the law; and 4) whether the attorney relied upon another attorney’s investigation in filing the pleading, must be considered. In determining whether the pleading was filed for an improper purpose, the court must examine the facts and circumstances surrounding the case.

Two unpublished decisions, **In re Dixon** and **In re Braun** address the method of determining damages under Rule 9011 and the procedural requirements for putting a party on notice of a request for such damages. These opinions, along with **R. and D. Group** are required reading for any party which is serious about pursuing a Rule 9011 motion in a bankruptcy matter.
VI. 28 U.S.C. § 1927

28 U.S.C. § 1927\(^{28}\) is a provision which predates both Federal Rule of Procedure 11 and BRP 9011 and permits a court to impose costs, attorney fees and expenses on any attorney who "so multiplies the proceedings in any case unreasonably and vexatiously..."\(^{29}\). As 28 U.S.C. § 1927 is much more limited in scope that Rule 9011, it is no longer used frequently in bankruptcy proceedings. Its main use is for those few situations where an attorney pursues a non-frivolous claim through the use of "multiplicative litigation tactics that are harassing...[or] dilatory"\(^{39}\) which are not covered by Rule 9011. For a discussion of the relationship between Rule 9011 and 28 U.S.C. § 1927 the Tennessee case of In re Southern Industrial Banking Corp., 91 B.R. 463 (Bkrtcy. E.D. Tenn. 1988) provides the best treatment of the topic of any published decision from the Sixth Circuit.

VII. DUTY TO THE BANKRUPTCY ESTATE: WHO IS YOUR CLIENT?

In the typical nonbankruptcy case, it is fairly easy to identify your client. As more than one legal sage has expressed it, "your client is the guy [or gal] who pays you!". However, when representing a debtor in a reorganization proceeding under Chapter 11 or Chapter 12\(^{35}\) such a generalization just does not work. To understand this problem we must first discuss the difference between a bankruptcy estate\(^{34}\) (i.e. the actual entity undergoing bankruptcy reorganization and which is paying your bills) and the individuals who are managing the estate (and are signing the checks).

In simple, non-technical terms the bankruptcy estate is an entity which arises upon the filing of a bankruptcy and consists of the non-exempt assets which were owned by the debtor prior to the filing of a bankruptcy reorganization. It is the "purpose" of the bankruptcy estate to obtain the highest possible return for the estate's creditors and, in certain limited circumstances, other interest holders\(^{37}\). The individuals who manage the bankruptcy estate's affairs in a reorganization proceeding are usually either the debtor-in-possession ("DIP") or a Chapter 11 trustee. DIPs are generally either the management of a business entity debtor or an individual or couple in a so-called "individual" Chapter 11. Problems in identifying your client arise in reorganization cases when the interests of the DIP conflicts with the interests of the bankruptcy estate. Several cases serve to illustrate this point.

One of the leading cases in this emerging area of bankruptcy legal ethics is In re United Utensils Corp.\(^{38}\). In this case the court was confronted with the question of whether a law firm which represented a bankruptcy estate in a Chapter 11 proceeding could represent a subsequently appointed bankruptcy trustee, in actions against the debtor's former officers and shareholders. The court in considering the objection of a former officer to the employment on the grounds that it violated his individual attorney client privilege with the proposed counsel held that the law firm did not individually represent the individual officer and sole shareholder through its representation of the debtor corporation during the Chapter 11. The court held that the firm could be employed as special counsel to the trustee under Section 327(e) unless the officer/shareholder could produce specific evidence of an attorney client relationship independent of the attorney client relationship between the debtor and the law firm\(^{37}\).

The case of In re Love\(^{38}\) shows the special problems an attorney for a bankruptcy estate faces in an individual Chapter 11 case. In Love the court was reviewing the attorney's fee application in a complex Chapter 11 proceeding. In the Chapter 11 proceeding the attorneys for the estate, at the direction of the individual DIP, resisted efforts of a major creditor to force the DIP to repay unauthorized draws from various businesses owned by the bankruptcy estate, and opposed the unsecured creditor's committee's efforts to prevent the debtor from settling estate claims against the debtor's children and wife. The court found that the attorneys breached their duty to the Chapter 11 estate by assisting the DIP in his efforts to protect his family and ultimately denied their fee application in full\(^{39}\).
The full extent of this problem can best be seen, however, in the case of In re DeVlieg Inc. Here, counsel for a Chapter 11 bankruptcy estate were fired by the DIP, after the debtor’s counsel filed suit against several insiders of the debtor, including the debtor’s sole officer. However this firing did not go unnoticed and the DIP was quickly replaced by a Chapter 11 trustee who sought to hire the Chapter 11 estate’s former attorneys as the trustee’s special counsel to pursue the law suit which got them fired. Not surprisingly some of the insiders who fired the attorneys in the first place objected to this employment. The Bankruptcy Court approved the employment and the insider appealed. After reviewing 11 U.S.C.§ 327(e) the District Court ruled that the attorneys neither held or presented an adverse interest to the estate and that their employment should be authorized. However in a footnote to the opinion the court noted:

This footnote shows the confusion this situation can generate for even federal courts in this area. To the extent that DeVlieg suggests that counsel for Chapter 11 bankruptcy estates have an ethical duty other than to the bankruptcy estate as their client, such a ruling is clearly wrong and against the weight of authority.

VIII. DUTY TO THE COURT

One of the most unusual and least explored aspects of legal ethics in the bankruptcy context concerns the duty of attorneys, to the court, to disclose information about the misconduct of the individuals who control the bankruptcy estate. Due to the expansive nature of the financial disclosures required in a bankruptcy proceeding this duty of disclosure must be balanced against an attorney’s duty of loyalty to his client. In this respect, state ethical duties can come into some conflict with a bankruptcy attorney’s duty to the Bankruptcy Court as an officer of the Court and a Court appointed Counsel for a bankruptcy estate.

In Chapter 7 cases, it is clear that an attorney cannot counsel or assist his or her client in filing false bankruptcy schedules or concealing estate assets for the same reasons an attorney cannot allow his client to commit perjury in a criminal case without protest. These ethical issues are beyond the scope of this Chapter and will not be reviewed in detail.

However, attorneys in a reorganization proceeding, have a far higher burden. In reorganization cases, attorneys are representing clients in a continuing judicial proceeding, not merely counseling clients about past misconduct or legal problems. In such proceedings, attorneys for the estate are considered officers of the court, and are fiduciaries to the Bankruptcy Estate. As noted by the Bankruptcy Court in In re Sky Valley, Inc.

The unique circumstances which surround insolvency and the filing of a Chapter 11 case place the attorney for the debtor-in-possession in the unusual position of sometimes owing a higher duty to the estate and the bankruptcy court than
to his client. In fact, the status of the client and the attorney often overlap in a Chapter 11 case, as the debtor’s attorney must take conceptual control of the case and provide guidance for management of the debtor, not only to discern what measures are necessary to achieve a successful reorganization, but to assure that, in doing so, compliance with the Bankruptcy Code and Rules is sought rather than avoided. Debtor’s attorney duty as fiduciary of the estate requires an active concern for the interests of the estate and its beneficiaries.

Recently, several Bankruptcy Courts have held that counsel for bankruptcy estates have a duty to the courts to inform them if the individuals operating a bankruptcy estate’s affairs are acting against the best interests of the estate. The Bankruptcy Court in In re United Utensils Corp., clearly articulated this duty by holding: “If the debtor is not fulfilling its obligation to the estate, it is the responsibility and duty of Debtor’s counsel to bring such matters to the attention of the court.”

This developing duty was discussed in detail by the U.S. Bankruptcy Court for Utah in In re Bonneville Pacific Corp., 196 B.R. 868 (Bkrtcy. D. Utah 1996). This opinion is, without a doubt, the strongest statement of a court appointed counsel’s duty to the bankruptcy estate and Bankruptcy Court in a Chapter 11 proceeding. Bonneville was a complexChapter 11 case, involving numerous related business entities, which was heavily involved in a series of classic “land flips” (i.e. insider sales of property designed to artificially inflate the value of the property in order to defraud third party investors and lenders). After a stormy reorganization attempt, a Chapter 11 trustee was appointed, and evidence of serious fraud was uncovered by the trustee. This Bonneville opinion arose in the context of a motion to reconsider the Bankruptcy Court’s earlier denial of the entire fee application of the debtor’s Chapter 11 counsel.

In this long and harshly worded opinion, the Utah Bankruptcy Court made it clear that all counsel who are retained with court approval in a bankruptcy proceeding have a fiduciary duty to the bankruptcy estate and the Bankruptcy Court to disclose suspected wrong doing by the insiders of a corporate debtor. 196 B.R. at 885. While this opinion arose in a large Chapter 11 proceeding, it is still advised reading for any attorney who may find him or herself representing a “less-than-honest” debtor in a Bankruptcy case.

This trend toward imposing a fiduciary duty on debtor’s counsel and counsel for the various committees will require all counsel retained with court approval to carefully monitor the activities of the person or persons running the debtor’s affairs or run the risk of being disqualified or having the Bankruptcy Court deny their fee applications, due to their failure to fulfill their fiduciary obligations.

IX. CRIMINAL BANKRUPTCY ATTORNEYS

This case sadly illustrates the peril of practicing law in an unfamiliar subject area, for, as one attorney has learned, ignorance of the law does not excuse an offense. U.S. v. Parkhill

The ultimate “rules” of bankruptcy ethics can be found at 18 U.S.C. §§ 152–157 which are the federal statutes directly relating to bankruptcy crimes. 18 U.S.C.§ 157 relating to “Bankruptcy Fraud” is a recent addition to the federal criminal statutes and is especially broad and should be read by any attorney who plans to represent a debtor in bankruptcy.

The problem of “criminal” bankruptcy attorneys in not a new issue. See U.S. v. Switzer, 252 F. 2d 139 (2d Cir. 1958); Coghlan v. U.S., 147 F.2d 235 (8th Cir. 1945). Nor is it confined to inexperienced or “poor” practitioners. See U.S. v. Goodstein, 883 F. 2d 1326 (7th Cir. 1989)(Attorney with 40 years of bankruptcy experience). While there is not a large number of reported cases involving attorneys who have
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been convicted of “bankruptcy crimes” there are several instructive Court of Appeal cases which address the troubling aspect of this topic.

By far the largest class of “bankruptcy crimes” for which attorneys have been convicted, involve the concealment of assets of the bankruptcy estate. In the cases of U.S. v. Smithson, U.S. v. Center and U.S. v. Parkhill attorneys were convicted of assisting their clients in concealing assets from the bankruptcy estate through a variety of means. A brief review of these cases shows that the attorneys in question were actively involved in the fraud and their convictions were not unexpected.

Far more troubling is the case of U.S. v. Zimmerman. There an attorney was charged, along with clients of his law firm, his law partner and one of his associate attorneys, with conspiracy to commit criminal fraud in connection with the hiding of a client’s assets from its creditors through the use of the law firm’s trust account. The attorney in this case had only minimal connections with the debtor or the debtor’s representation in the bankruptcy case, but was nevertheless indicted and ultimately convicted on the strength of two Bankruptcy Court opinions which found the attorney’s law firm probably was conspiring with the debtor to hide assets. The attorney’s conviction was overturned and the case remanded for a new trial due to the improper use of the Bankruptcy Court opinions, but the case still emphasizes the danger in this area even when you are not directly overseeing a bankruptcy case for your firm.

Perhaps the most blatant case of defrauding a bankruptcy estate of its assets is U.S. v. Edgar. In that case the attorney for the owner of a corporation in a Chapter 11 proceeding negotiated the sale of the debtor’s business, drew up the paper work concerning the transfer of the business, and structured the sale so the assets of the debtor and the proceeds of the sale paid to the debtor’s owner would be difficult to trace. Needless to say the bankruptcy court was not informed of the debtor’s president’s excellent salesmanship until seven months after the completion of the sale. The Court of Appeals upheld the conviction but remanded this case for resentencing.

The strangest bankruptcy related crime an attorney has been convicted of is undoubtedly the crime of circumventing the blind case draw system of assigning judges to bankruptcy cases found in the case of U.S. v. August. In August, the attorney was having an affair with a Bankruptcy Court “intake” clerk. The attorney conspired with the intake clerk to ensure that his cases were not assigned to a bankruptcy judge who was conservative in awarding attorney fees. While the crime in August is unlikely to be repeated, it does illustrate that any attempt to manipulate the bankruptcy system in a questionable manner could lead to federal criminal charges.

X.

KENTUCKY CASES ON BANKRUPTCY ETHICS

As discussed at the beginning of this article, the basic concepts of state ethics law form the core of Bankruptcy ethics law. Therefore, it is not surprising that Kentucky’s state bar association and the Kentucky Supreme Court have a great interest in enforcing their ethical standards against attorneys who engage in unethical conduct in bankruptcy proceedings. While a detailed discussion of Kentucky’s ethical rules and enforcement procedures is beyond the scope of this Chapter, below is a brief list of cases dealing with various types of ethical problems.

1). Failure to Timely Perform Duties: KBA v. Reeves, 851 S.W. 2d 478 (Ky. 1993); KBA v. Goodrich, 851 S.W. 2d 479 (Ky. 1993).

2). Bankruptcy of an attorney is not, in and of itself, grounds for disbarment: See Greene v. KBA, 904 S.W. 2d 233 (Ky. 1995). However, repayment of discharged debts could be a condition of reinstatement: Barrett v. KBA, 819 S.W.2d 316 (Ky. 1991).
3. Attorneys may not prosecute individuals who they represented in bankruptcy proceedings: Nunn v. Commonwealth, 896 S.W.2d 911 (Ky. 1995).

4. Giving the Bankruptcy Court a NSF check for bankruptcy filing fee, which the client has prepaid, is an ethical violation: KBA v. Watson, 867 S.W. 2d 191 (Ky. 1993).

5. Taking payment of attorney fees, prior to paying the bankruptcy filing fee, in violation of Bankruptcy Rule 1006, is an ethical violation: KBA v. Wharton, 810 S.W.2d 832 (Ky. 1991).

6. Aiding in a fraudulent conveyance is an ethical violation: Roberts v. KBA, 771 S.W. 2d 46 (Ky. 1989).

7. Making false financial statements to lenders is an ethical violation: Evans v. KBA, 764 S.W.2d 61 (Ky. 1989).

8. Bankruptcy Trustee stealing money from a Bankruptcy estate is an ethical violation: In re Shumate, 382 S.W. 2d 405 (Ky. 1964).

XI. CONCLUSION

Understanding the principals of ethics in the practice of bankruptcy law is, in many ways, a far simpler task than understanding the intricacies of the Bankruptcy Code. What makes bankruptcy ethics somewhat different from the traditional rule of ethics, is not a different set of rules regulating professional conduct, but the unusual nature of the underlying bankruptcy proceedings themselves. It is the hope of this author that the preceding Chapter provides a useful guide to all attorneys who wish to practice bankruptcy law and prevents them from falling prey to some of the unusual ethical considerations which must be addressed in this field.
1 Ayer, PROFESSIONAL RESPONSIBILITY IN BANKRUPTCY CASES, (January 1993).

2 See 11 U.S.C. § 327, a copy of which is included in the statutory appendix and notes 11-51, infra and accompanying text.

3 See 11 U.S.C. § 1103(b), a copy of which is included in the statutory appendix, and notes 52-56, infra and accompanying text.

4 See 11 U.S.C. § 327(a) and notes 11-48, infra, and accompanying text.

5 See generally 11 U.S.C. § 506(4) which allows creditor's attorneys to have their fees paid from the bankruptcy estate in certain circumstances.

6 A copy of the official U.S. Trustee guidelines for reviewing Bankruptcy fee applications is located as an attachment to Chapter 5 of Consumer Bankruptcy in Kentucky, Chapter 13 Practice (UK/CLE).

7 See Ayer, BANKRUPTCY ETHICS, at p.2.


9 This chapter will not address certain important bankruptcy issues, such as pre-bankruptcy exemption planning, which only have indirect ethical overtones as such subjects, are in the opinion of the author beyond the scope of this Chapter. See generally, Wolfe, Prefiling Engineering and Denial of Discharge: Who should Slaughter the Hog?, 96 COM. L.J. 189 (1991).

10 See SLC LTD. v. Bradford Group West, Inc., 147 B.R. 596 (D. Utah 1992) (Law firm representing large secured creditor disqualifled from representing said creditor in bankruptcy proceeding due to the prior representation of the debtor's general partner and principals by a member of the law firm prior to the time he joined the firm). See also In re Highway Drivers and Helpers Local No. 107, 17 BCD 803 (Bkrtcy. E.D. Pa. 1992) (Law firm disqualified from representing a major creditor in a bankruptcy proceeding where law firm had a prebankruptcy consultation with the debtor concerning the possibility of the debtor filing bankruptcy).


13 11 U.S.C. § 267(a). The term "adverse interest" has been defined as "any economic interest that would tend to lessen the value of the bankruptcy estate or that would create an actual or potential dispute" In re American Printers & Lithographers, Inc., 28 CBC 2d 242,245 (Bkrtcy. N.D. Ill. 1992).

14 See In re Eagle-Picher Industries, Inc., 999 F.2d 969,972 (6th Cir. 1993).
See In re Federated Department Stores, 44 F.3d 1310 (6th Cir. 1995); In re Eagle-Picher Industries, Inc., 999 F.2d 969 (6th Cir. 1993); In re Middleton Arms, L.P., 934 F.2d 723 (6th Cir. 1991); In re Georgetown of Kettering, Ltd., 750 F.2d 536 (6th Cir. 1984).

See In re Federated Department Stores, 44 F.3d at 1318. A copy of 11 U.S.C. § 1107 is included in the statutory appendix.

In re Middleton Arms, L.P., 750 F.2d at 536.

See generally In re Eagle-Picher Industries, Inc., 999 F.2d at 972 (“Although it may make little sense to the bankruptcy court and the debtors-or, for that matter, to this court-that Goldman Sachs is not permitted to serve as financial adviser, the statute requires that result. This court is bound to apply the plain meaning of the statute even when the application apparently results in an apparent anomaly”).


In re Codesco, 18 B.R. 997,999 (Bkrtcy. S.D.N.Y. 1982).


See In re Alcala, 918 F. 2d 99 (9th Cir. 1990).


949 F.2d at 1300.

Id. at 1317.

Id. See also In re Hurst Lincoln Mercury, Inc., 80 B.R. 894 (Bkrtcy. S.D. Ohio 1989).


See In re Decor Corp., 171 B.R. 277 (Bkrtcy. S.D. Ohio 1994) for a detailed discussion of this issue and other issues related to possible problems under 327(a) a firm may face in filing a large Chapter 11 case. See also In re Lee Way Holding, Co., 102 B.R. 616 (S.D. Ohio 1989).

See Matter of Perry, Adams & Lewis Securities, 5 B.R. at 63. See also In re Asher, 168 B.R. 614 (Bkrtcy. N.D. Ohio 1994).


See In re Thompson, 116 B.R. 679 (Bkrtcy. W.D. Ark. 1990) (The enterprising counsel for the debtor in this case was the subject of a potential pre-petition legal malpractice action by the debtor and compromised the “claim” during his client's bankruptcy. When the Bankruptcy court discovered this clever piece of lawyering, it denied the debtor’s counsel all requested fees and referred the case to the state Supreme Court for further disciplinary action.). See also In re 419 Company, 133 B.R. 867 (Bkrtcy. N.D. Ohio 1991) (Debtor’s prepetition counsel received prepetition payments which could be preferences: Held, employment application had to be denied.).

In re McGinty, 119 B.R. 289 (Bkrtcy. M.D. Fla. 1990) (Debtor tried to hire the law firm of which he was a member as his bankruptcy counsel. Court refused to approve the employment.).

See Matter of Arlan’s Department Stores, Inc., 615 F. 2d 925 (2d Cir. 1979) (For an interesting discussion of the problems relating to the payment of a retainer.).


171 B.R. at 283 (citations omitted).

See also In re American Thrift & Loan Ass’n, 137 B.R. 381 (Bkrtcy. S.D. Cal. 1992); In re 419 Co., 133 B.R. 867 (Bkrtcy. N.D. Ohio 1991).


20 B.R. 328 (Bkrtcy E.D. Pa. 1982).

In re Servico, Inc., 149 B.R. 1009 (Bkrtcy S.D. Fla. 1993) (Holding a potential preference does not prevent law firm from being approved for employment under section 327(e).)


Id. at 196. This opinion is worth noting for its discussion of what constituted notice at the committee's law firm of the conflict.

See In re The Leslie Fay Companies, 175 B.R. 525 (Bkrtcy. S.D.N.Y. 1994) (One of the leading bankruptcy law firms in the country ordered to disgorge over $800,000 in fees due primarily to nondisclosure of what it though were minor issue related to potential conflicts)

In re Federated Dept. Stores, Inc., 44 F.3d at 1320.

See 11 U.S.C. § 329, a copy of which is included in the statutory appendix.

See generally In re Boddie, 950 F.2d 334 (6th Cir. 1991); In re A & A Energy Properties, Ltd., 865 F.2d 256 (6th Cir. 1988).

See Chapter 5 of Consumer Bankruptcy in Kentucky, Chapter 13 Practice (UK/CLE) for the full text of the U.S. Trustee's Fee guidelines.

See BRP 9011. See also In re Cascade Energy & Metals Corp., __ F.3d __, 1996 WL 354680 (10th Cir. 1996) for a general discussion of Rule 11 in a Bankruptcy context.
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Id. at 165.
See 28 U.S.C § 1927, a copy of which is included in the statutory appendix.
See Jones v. Continental Corp., 789 F.2d 1225 (6th Cir. 1986).
In Chapter 7 proceedings there is little problem in this area as the attorney who filed the Chapter 7 petition on behalf of the debtor, clearly represents the debtor’s interests throughout the bankruptcy, while the Chapter 7 trustee’s counsel represents the bankruptcy estate’s interests.
For a brief discussion of the problems related to what interests a bankruptcy estate represents, See Ayer, BANKRUPTCY ETHICS, at pp 7-10.
See generally In re Central Ice Cream, 836 F.2d 1068 (7th Cir. 1987).
See also In re Central Ice Cream Co., 114 B.R. 956 (N.D. Ill. 1989) (Contains a detailed discussion of possible conflicts which can arise in attempting global settlements of claims involving both debtors and nondebtors).
See also In re Alcala, 518 F.2d 99 (9th Cir. 1990); In re Granite Sheet Metal Works, Inc., 159 B.R. 840 (Bkrtcy. S. D. Ill. 1993) (Similar situation in a corporate bankruptcy).
Id. at 502 n.7.
See notes 93-99, infra, and accompanying text.
Ayer, BANKRUPTCY ETHICS at p.17. See also notes 100-108, infra, and accompanying text concerning an attorney's criminal liability.
However, see In re Ward, 894 F.2d 771 (5th Cir. 1990) for a discussion of the duties of a debtor's attorneys in a Chapter 7 proceeding. See also FDIC v. O'Melveny & Meyers, 1995 U.S. App. LEXIS 19609 (9th Cir. July 26, 1995) (Discussing the responsibility of attorneys for their client's conduct in nonbankruptcy cases).

Ayer, BANKRUPTCY ETHICS at p.17.


Id. at 939 (citations omitted).


775 F. 2d 612 (5th Cir. 1985).

See 18 U.S.C. §§ 152, 153, 154, 155, 156, and 157, which are set forth in the statutory appendix.

49 F. 3d 138 (5th Cir. 1995).

853 F.2d 568 (7th Cir. 1988).

775 F. 2d at 612.

943 F. 2d 1204 (10th Cir. 1991).

971 F. 2d 89 (8th Cir. 1992).

Id. at 91.

745 F. 2d 400 (6th Cir. 1984).