

A LOOK AT THE 2005 BANKRUPTCY LAW
OR
WHAT YOU DON'T KNOW REALLY CAN HURT YOU

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If you are a lawyer who doesn't take bankruptcy cases and hopes to never see a bankruptcy client, what do you care about the major revisions to the Bankruptcy Code which were enacted in 2005? Unfortunately, you need to, because even if you have never filed a bankruptcy case or hope to never file one in the future, the new law still affects you in one way or another. The purpose of this paper is to acquaint you with some of the basics of this new law, and to demonstrate how some of the work which you may be doing in your current non-bankruptcy practice can still be affected by the legislation.

I. Overview of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)

BAPCPA, Public Law 109-8, 119 Stat. 23 was passed by the Congress in early 2005, and signed by the President on April 20, 2005. This law makes the most substantial changes in the Bankruptcy Code since its enactment in 1978.

This law was under consideration by Congress for over eight years. It was actually passed, essentially in its current form, during the Clinton administration, but was vetoed by President Clinton. The credit card industry and creditor trade associations reportedly paid over \$60,000,000.00 to lobby for passage of this bill during the eight years that it was under consideration by the Congress. The credit card industry started the process in the mid-90s, when credit card issuers began to notice an uptick in bad debt writeoffs, which had historically hovered in the area of 2 per cent of outstanding credit card

portfolios, and gradually increased to approximately 4 per cent. Despite all this, credit card issuers continued to earn substantial profit through ever increasing interest rates and the discovery of new charges which could be assessed against customers, including “over-limit fees,” late fees, and other similar devices.

Eventually and ironically, secured lenders got on board the band wagon. Loan companies such as GMAC, Wells Fargo, and American General convinced Congress to include language in BAPCPA which tilted the proposed law in their favor at the expense of unsecured creditors, including credit card companies.

BAPCPA went into effect on October 17, 2005. However, it is important to remember that BAPCPA was grafted onto the existing Bankruptcy Code, which was first enacted in 1978. As a result, the vast majority of the concepts created when the Bankruptcy Code was adopted in 1978 continue on in BAPCPA. The purposes of this paper are to outline those many changes which BAPCPA forced upon the existing code, particularly focusing on the effect which this new law will have on the practicing attorney. It is not an understatement to say that BAPCPA views the legal profession with a jaundiced eye. The same thinking that went into BAPCPA is not particularly friendly to bankruptcy judges either. As will be seen later, much judicial discretion has been removed by BAPCPA, while new obligations and assignments have been given to attorneys. Failure of the lawyer to comply with some of the new BAPCPA requirements can have serious consequences, and unfortunately, less latitude is given to the bankruptcy judge to let the lawyer off the hook.

As we will see below, even those attorneys who shun bankruptcy practice are still governed by the law, and need to have at least a rudimentary understanding of those portions of the law which may apply to the non-bankruptcy practitioner.

II. Highlights of Important Changes Wrought by BAPCPA

The following is a list and discussion of the significant changes to bankruptcy practice brought about by BAPCPA:

A. The Means Test.

The means test is one of the most significant changes to the Bankruptcy Code brought about by BAPCPA. The basic concept of the means test makes some sense: those who have above-average income should be required to pay back their debts. While this is a laudable goal, as will be seen later, the actual effect is that a high income person with substantial secured debt may still be able to eliminate unsecured debt under the auspices of a Chapter 7 filing.

The theory behind the means test is to create a hypothetical Chapter 13 budget to see whether there is any money left over to pay unsecured creditors, and if so, how much. The test first requires a determination of what is known as “current monthly income (“CMI”).” See 11 U.S.C. § 101(10A). However, “current monthly income” is neither current, nor monthly, nor income. The reason why it is not current is that the look-back period is six months prior to the date of filing, but not including the month during which the case is filed. In other words, if a case is filed in June, 2007, then the look-back period begins with December, 2006 and ends with May, 2007. If, for example, the debtor was laid off on May 31 and is now drawing unemployment, it won’t matter in the CMI calculation. The average income the debtor was earning for the six months prior to May 31 will be the “current” income.

It is not monthly, because it is actually an average of six months’ worth of income. The result can be skewed in a number of ways. For example, as already mentioned, a person earning a high-income, who is suddenly laid off and forced to draw unemployment, will still have to include any of that income earned during the six months prior to bankruptcy filing. Likewise, a pensioner who receives an additional, unscheduled pension check, would be required to include that amount in the averaging

process, even though such a payment is not expected in the future. A factory worker earning overtime, who is cut back to a 40 hour week, would still need to include overtime earned during the relevant six month period. A one-time bonus, which may or may not be received in the future, would be included if received during the relevant period.

Finally, it is not income because the determination of CMI includes items which are not ordinarily considered to be income, such as child support payments, or even monies paid by other persons living in the debtors' household as part of an expense sharing arrangement. For example, if a person contemplating bankruptcy has an adult child living in her residence, with the child chipping in \$300.00 or \$400.00 per month to cover that adult child's living expenses, then such contributions will need to be included in the parent's CMI calculation as income. Fortunately, some items are excluded, such as benefits received under the Social Security Act (which could include Social Security payments, SSDI payments, and unemployment insurance benefits).

Once CMI is calculated, then that number is annualized and compared to the median income of the state where the bankruptcy will be filed, which numbers are taken from the U.S. Census Bureau tables for each state, based upon the number of persons in the household. The previous year's numbers are used, and change in October of each year. If the person desiring bankruptcy relief has current monthly income less than the median income for the number of persons in the household, that is the end of the inquiry. There is no "presumption of abuse" as the term is known under Chapter 7 practice, nor is there a requirement for a five year "applicable commitment period" in a Chapter 13 case. However, if the debtor's CMI is above the median income, then CMI is reduced by a list of expenses which are prescribed by BAPCPA, most of which rely upon national and local living expense standards established by the Internal Revenue Service, rather than a debtor's actual monthly expenses.

Once all allowable deductions have been subtracted from CMI, one can determine whether the

presumption of abuse will arise, or in Chapter 13, whether a 5 year plan needs to be proposed. Here is how that is done:

1. Multiply net CMI by 60 to get X, the amount the debtor is deemed able to pay to non-priority unsecured creditors in a hypothetical five year Chapter 13 Plan.
2. If X equals or exceeds \$10,000.00, the presumption of abuse arises.
3. If X is less than \$6,000.00, the presumption of abuse does not arise.
4. If X is at least \$6,000.00, but less than \$10,000.00, the presumption of abuse arises only if X equals or exceeds 25% of the debtor's total non-priority unsecured debt.

What is the purposes of this lengthy exercise? In a Chapter 7 case, if there is no presumption of abuse, then there is no problem. If the presumption of abuse arises, then the U.S. Trustee will likely file a motion requesting that the case be dismissed or converted to Chapter 13, unless the debtor successfully rebuts the presumption of abuse as permitted by Section 707(b)(2)(B). That section states that the presumption of abuse may be rebutted only by demonstrating special circumstances, such as a serious medical condition or a call or order to active duty in the armed forces, to the extent such special circumstances justify additional expenses or adjustments in current monthly income for which there is no reasonable alternative. A recent case from the U.S. Bankruptcy Court for the Western District of Oklahoma, *In re Templeton*, case number 06-11567BH, filed on March 8, 2007, held that a large student loan, which was nondischargeable, qualified as a "special circumstance" which could be included in the means test calculations. The court held that:

The examples listed in § 707 (b) (2) (B) --a medical condition and military service--are not exhaustive, but are merely examples where Congress found there to be special circumstance "for which there is no reasonable alternative." See *In re Thompson*, 350 B.R. at 777. Moreover, the language of the statute makes clear that the Debtors must present documentation for each additional expense; must present a detailed explanation for the additional expenses;

and must attest under oath to the accuracy of those records. See § 707 (b) (2) (B) .

In this regard, the holding in *Templeton* was similar to *In re Thompson* and *In re Lenton*. In both cases, the presumption of abuse arose, but the debtors successfully proved “special circumstances” where they were required to make payments on a loan secured by their 401(k) account at work. In both instances, the loan payments were automatically deducted from the debtors' pay. That deduction was mandatory and would continue as long as the debtors continued their employment. The only way to stop making the payments was to quit their jobs. See *In re Thompson*, 350 B.R. at 777-78; *In re Lenton*, 2006 WL 385001.

What about that high income debtor who owes a lot of money to credit cards but owns an expensive home or drives a high priced car? No problem – that person may well “pass” the means test even if his or her income is above the median. How can that be? The answer lies in the fact that even though the means test form uses IRS “standards” as deductions for living expenses and the like, real numbers can be used in certain circumstances. Thus, if the person contemplating filing has a \$4,000.00 house payment, then that actual amount may be included in the formula even though it would far exceed the IRS “standards.” If the person has a payment of \$1,000.00 on a 2005 Cadillac Escalade, that will help to pass the means test. Adding in the “real” number will override the much smaller IRS “standard” for vehicle ownership in completing the means test form.

Let's see how this works. Assume that David Bigwig is the CEO of a local utility company, but is laid off due to alleged irregularities during his tenure as the chief. Prior to being fired, he made \$1,000,000.00 per year. He has a family of four. His family's life style, of course, required an expensive home for which he paid \$31,000.00 per month. They own two cars, a Ferrari and a Rolls Royce, with payments of \$10,000.00 per month. Mrs. Bigwig is not employed. The Bigwigs file Chapter 7 the month

after David loses his CEO job.

Assume also that, Reddy Kilowatt, a meter reader at the utility company, also with a family of four, makes \$50,000.00 a year. His wife is employed as well as a school teacher making \$40,000.00 a year. The Kilowatts rent their home.

The median income for a family of four is \$59,484.00.¹ Both Bigwig and Kilowatt flunk the “short version” of means test in that their family income exceeds the median income for Kansas. The question remains as to whether they pass the “long version” after allowed expenses are deducted.

Here is the hypothetical:

| | <u>BIGWIG FAMILY</u> | <u>KILOWATT FAMILY</u> |
|------------------------------|-----------------------------|-------------------------------|
| CMI: | \$83,000.00 | \$7,500.00 |
| Living expenses ² | - 1,564.00 | -1,564.00 |
| Housing/utility expenses | - 0.00 ³ | - 1,194.00 ⁴ |
| Vehicle operation expenses | - 345.00 | - 345.00 |

Vehicle ownership

¹ BAPCPA provides that the median income will change each year, and the once the U.S. Census Bureau publishes the information for the previous year, that information will be used. Prior to such publication, the next previous years’ information will be used. Census Bureau information is at www.census.gov. See 11 U.S.C. Section 101(39A).

² National Standards for allowable living expenses. www.irs.gov.

³ Bigwig’s deduction is \$0.00 because later they will be allowed to use their mortgage payments in lieu of this entry.

⁴ Kilowatts are stuck with the IRS “regional standard for their rental house, even if their rent is actually higher than the “standard” of \$1,194.00.

| | | |
|---------------------------|---------------------|-----------------------|
| expenses | - 0.00 ⁵ | - 475.00 ⁶ |
| Other allowable expenses: | | |
| Taxes: | -29,160.00 | - 1,200.00 |
| Term life premiums | - 3,000.00 | - 0.00 |
| Charitable donations | - 8,333.00 | - 0.00 |
| House payment | -31,000.00 | - 0.00 |
| Car payment | <u>- 10,000.00</u> | <u>- 0.00</u> |
| NET: | (\$ 402.00) | \$2,722.00 |

Thus, middle income earner Reddy Kilowatt “flunks” the long form means test and must pay his unsecured creditors under a Chapter 13 plan for five years, while millionaire David Bigwig “passes” the test and can file Chapter 7.

B. Domestic support obligations (DSO’s).

1. What is a DSO?

BAPCPA contains extensive revisions pertaining to obligations relative to spousal and child support. These types of debts are now defined as “domestic support obligations.” The meaning of that phrase is found in the definitions section, Section 101(14A):

The term “domestic support obligation” means a debt that accrues before, on or after the date of the order for relief in a case under this title, including interest that accrues on that debt as provided

⁵ Again, Bigwig’s can deduct their actual car payment later, so gets \$0.00 here.

⁶ The Kilowatts’ lease one car with a payment of \$600.00 per month, but they are again stuck with the IRS allowance. They get no ownership allowance for the second car because it is paid for.

under applicable nonbankruptcy law notwithstanding any provisions of this title, that is —

(A) owed to or recoverable by —

- (I) a spouse, former spouse, or child of the debtor or such child's parent, legal guardian, or responsible relative; or
- (ii) a governmental unit;

(B) in the nature of alimony, maintenance, or support (including assistance provided by a governmental unit) of such spouse, former spouse, or child of the debtor or such child's parent, without regard to whether such debt is expressly so designated;

© established or subject to establishment before, on, or after the date of the order for relief in a case under this title, by reason of applicable provisions of —

- (I) a separation agreement, divorce decree, or property settlement agreement;
- (ii) an order of a court of record; or
- (iii) a determination made in accordance with applicable nonbankruptcy law by a governmental unit; and

(D) not assigned to a nongovernmental entity, unless that obligation is assigned voluntarily by the spouse, former spouse, or child of the debtor, or such child's parent, legal guardian, or responsible relative for the purpose of collecting the debt.

This is an entirely new definition, not found in the former law. Former Section 523(a)(5) contains its own definition of a nondischargeable support obligation, but that section's definition has been removed by the new law. 523(a)(5) now simply exempts from discharge “a domestic support obligation.”

The following discussion of this definition is found in House Report 109-031, although this may not shed much more light on the meaning of domestic support obligations:

Sec. 211. Definition of Domestic Support Obligation. Section 211 of the Act amends section 101 of the Bankruptcy Code to define a domestic support obligation as a debt that accrues before, on, or after the date of the order for relief and that it includes interest that accrues pursuant to applicable nonbankruptcy law. As defined in the Act, the term includes a debt owed to or recoverable by: (1) a spouse, former spouse, or child of the debtor, or such child's parent, legal guardian, or responsible relative; or (2) a governmental unit. To qualify as a domestic support obligation, the debt must be in the nature of alimony, maintenance, or support (including assistance provided by

a governmental unit), without regard to whether such debt is expressly so designated. It must be established or subject to establishment before, on, or after the date of the order of relief pursuant to: (1) a separation agreement, divorce decree, or property settlement agreement; (2) an order of a court of record; or (3) a determination made in accordance with applicable nonbankruptcy law by a governmental unit. It does not apply to a debt assigned to a nongovernmental entity, unless it was assigned voluntarily by the spouse, former spouse, child, or parent solely for the purpose of collecting the debt.

Former Section 523(a)(5) was directed to support obligations owed to a “spouse, former spouse, or child of the debtor.” The new “domestic support obligation” definition is broader. It now also includes “such child’s parent, legal guardian, or responsible relative.” The debt must be “owed to or recoverable by” one of the mentioned persons. This would seem to cover those situations (which are becoming more common) where a grandparent has legal or *de facto* custody of a minor child, or where a court-appointed guardian other than a parent has custody.

The definition also appears to cover the situation where a governmental unit, such as the Kansas Department of Social and Rehabilitation Services, provides medical support to an infant, and then seeks to make one or both of the parents liable for such support, on top of any child support order. Under former law, those medical reimbursement obligations were dischargeable. Under the new law, this has changed. The revisions to the automatic stay provisions, discussed in greater detail below, also support this contention. See new Section 362(b)(2)(G).

2. DSO Exceptions to discharge.

Congress over the years has tinkered with support obligations and their dischargeability. The original 1978 revisions included the 523(a)(5) exception to discharge for spousal maintenance and child support. Any assignment of such debt was dischargeable. A subsequent change ruled that debts assigned to governmental child support enforcement agencies were not dischargeable. Later,

(a)(15) was added, which was designed to except from discharge those spousal obligations “not of a kind described in paragraph (5) . . .” The exception was designed to cover “hold harmless” clauses and other debt assignment provisions of a divorce decree or property settlement agreement, but were not automatically excepted from discharge, as debts under (a)(5) were. Rather, a dischargeability complaint had to be filed, and then the court had to determine whether the debtor had the ability to pay the assigned debt or whether discharging the assigned debt would result in a benefit to the debtor that outweighed any detriment to the non-filing spouse.

Even though Congress may have intended by the (a)(15) exception to get the bankruptcy courts out of the divorce business, this did not occur. If a dischargeability complaint was filed under 523(a)(15), the bankruptcy court then had to decide whether the benefit of discharging the obligation outweighed the detriment which was caused the non-filing ex-spouse. Under the new “domestic support obligations” definition and the revisions of 523(a)(15), that task is now history. Under revised (a)(15), the court is no longer required to balance the plight of the debtor against that of the non-filing former spouse or minor child of the debtor. The debt or obligation is simply nondischargeable in a Chapter 7. Curiously, a 523(a)(15) debt is dischargeable in Chapter 13, unless a hardship discharge is requested under 1328(b).

Section 523(c) also changes the time-limits for filing of a dischargeability complaint under (a)(5) and (a)(15). Under the former law, an (a)(5) complaint could be filed “at any time” while those under (a)(15) had to be filed within 60 days of the date set for the first meeting of creditors. In other words, under the former practice, if an (a)(15) complaint was not filed by the spouse, former spouse, or child of the debtor, then the debt was discharged. Under the new law, the debt is not discharged unless an adversary complaint is filed by the debtor, although this complaint can be filed

at any time. However, practitioners may well wonder when such an adversary complaint could ever be filed under the new law. It would seem that the only possible arguments which could now be made by a debtor would be (1) that the domestic support obligation has been assigned to a nongovernmental entity, such as a collection agency, or (2) that a debt which was the subject of a divorce, separate maintenance, or child support proceeding was never the obligation of the debtor and was never assigned to the debtor by the divorce court, or (3) that the debt is not a domestic support obligation.

House Report 109-031 included the following commentary on these changes:

Sec. 215. Nondischargeability of Certain Debts for Alimony, Maintenance, and Support. Section 215 of the Act amends Bankruptcy Code section 523(a)(5) to provide that a `domestic support obligation' (as defined in section 211 of the Act) is nondischargeable and eliminates Bankruptcy Code section 523(a)(18). Section 215(2) amends Bankruptcy Code section 523© to delete the reference to section 523(a)(15) in that provision. Section 215(3) amends section 523(a)(15) to provide that obligations to a spouse, former spouse, or a child of the debtor (not otherwise described in section 523(a)(5)) incurred in connection with a divorce or separation or related action are nondischargeable irrespective of the debtor's inability to pay such debts.

Also note that 523(c)(1) would allow a state court to have concurrent jurisdiction to determine whether a 523(a)(15) is dischargeable.

Filing for bankruptcy before the domestic proceeding is finalized will probably have no benefit to the debtor, since the new automatic stay provisions found in Section 362 except from the stay proceedings “for the establishment or modification of an order for domestic support obligations.” More on stay relief changes later.

In summary, the following obligations are not dischargeable: child support, maintenance or alimony unless these have been assigned to a nongovernmental agency, debt assignment ordered by

a divorce court or agreed to as part of a property settlement agreement regardless of whether the debtor was originally obligated on the debt, hold harmless provisions pertaining to debt arising out of a marriage or owed on account of a minor child, and property division. Although division of property probably does not fall into the definition of a “domestic support obligation” and specifically subparagraph (B) of the definition, it would be included with the 523(a)(15) definition of “not of a kind described in 523(a)(5), but again, not in a Chapter 13 case unless the plan is concluded with a 1328(b) “hardship” discharge. This same rule applies in Chapter 12 farm bankruptcy cases.

3. Lien avoidance and DSO’s.

Over the years, a number of cases have addressed the issue of whether a judicial lien arising out of a divorce proceeding can be avoided. The Supreme Court finally addressed the issue in *Farrey v. Sanderfoot*, 500 U.S. 291, 111 S.Ct. 1825, 114 L.Ed.2d 337 (1991). In that case, the Supreme Court stated that “to be avoidable under the statute, a judicial lien must ‘fix’ to an interest of the debtor in property at some point in time after the debtor obtains the interest.” Stated conversely, “unless the debtor had the property interest to which the lien attached at some point before the lien attached to that interest, he or she cannot avoid the fixing of the lien under the terms of § 522(f)(1).” *Id.* at 296, 111 S.Ct. at 1829. If the lien fixes before the debtor holds the interest in property, or at the same time the debtor receives the interest, the lien is not avoidable.

The parties in *Sanderfoot* stipulated that prior to the divorce judgment they had held the property in joint tenancy, each possessing an undivided one-half interest. They further stipulated that the divorce decree dissolved any preexisting interest the nondebtor spouse had in the homestead. Because of this stipulation, the Supreme Court concluded that the lien could not have fixed on an interest of the debtor in property because the decree gave Sanderfoot his wholly new fee simple

interest with Ms. Farrey's lien already attached.

In 1978, the Kansas Supreme Court decided *Cady v. Cady*, 224 Kan. 339, 581 P.2d 358. In that case, the court stated that “the filing of a petition for divorce or separate maintenance creates a species of common or co-ownership in one spouse in the jointly acquired property held by the other, the extent of which is determined by the trial court pursuant to K.S.A. 1972 Supp. 60-1610(b).” Kansas bankruptcy decisions, applying *Cady*, have held that the filing of a petition for divorce extinguishes each spouse’s existing rights of ownership to property and creates a new form of property ownership, namely, a vested but undetermined interest in all property jointly or individually held. *Cady, supra.*, at 944. *In re Schmidt* recognizes that state law determines the fixing issue described by Section 522 of the Bankruptcy Code, and construes Kansas law to create an “extinguishment by filing” rule, “and replaces them with a pool of property known as marital property, which is co-owned by the parties. The trial court then divides the marital property in the divorce decree, thus determining the extent of each spouse's interest in that property. All the interests defined by the decree are new ones, received with any liens in favor of the other spouse already attached.” *Schmidt v. Schmidt (In re Schmidt)*, Case No. 90-42457-7, Adv. No. 90-8195 (Bankr.D.Kan. August 17, 1992) (Pusateri, J.).

The former code provisions under Section 522(f) allowed a judicial lien to be avoided except for a judicial lien arising for child support or maintenance which has not been assigned to another entity. The new code language refers back to section 523(a)(5) for definition, presumably to bring into play the definition of a “domestic support obligation.” However, 523(a)(15) is not referenced – in other words the “not of a kind described in [523(a)] 15 language is left out. Thus, it would appear that even though the language of 522 has been changed, the effect would be the same, and

that *Farrey v. Sanderfoot* and its progeny are still applicable.

4. Automatic stay and DSO's.

Under Section 362, a new section (b)(2) replaces the current subsection (2). The automatic stay does not operate as a stay –

(A) of the commencement or continuation of a civil action or proceeding –

(I) for the establishment of paternity;

(ii) for the establishment or modification of an order for domestic support obligations;

(iii) concerning child custody or visitation;

(iv) for the dissolution of a marriage, except to the extent that such proceeding seeks to determine the division of property that is property of the estate;

(v) regarding domestic violence;

(B) of the collection of a domestic support obligation from property that is not property of the estate;

(C) with respect to the withholding of income that is property of the estate or property of the debtor for payment of a domestic support obligation under a judicial or administrative order or a statute;

(D) of the withholding, suspension, or restriction of a driver's license, a professional or occupational license, or a recreational license, under State law, as specified in section 466(a)(16) of the Social Security Act;

(E) of the reporting of overdue support obligations owed by a parent to any consumer reporting agency or specified in sections 464 and 466(a)(3) of the Social Security Act;

(F) of the interception of a tax refund, as specified in Sections 464 and 466(a)(3) of the Social Security Act or under an analogous State law; or

(G) of the enforcement of a medical obligation, as specified under title IV of the Social Security Act;

Even prior to the new law changes, the establishment or collection of a child support or maintenance obligation was not stayed under 362. Our local bankruptcy rules concerning income withholding orders for support obligations also required that a Chapter 12 or 13 debtor file, along with the petition, a motion pursuant to LBR 4001(a).2 © requesting termination of an income withholding order to seek a stay as to current child support orders. Subsection (b) of that rule brings past due support under the ambit of the automatic stay, provided that the Chapter 12 or 13 plan addresses and treats the obligation to pay past due support. This local rule now applies only to old law cases, and is inapplicable to cases filed on or after October 17, 2005.

The former law did not allow for collection of maintenance or support from property which is property of the estate. This is changed under the new law at least insofar as income withholding orders are concerned. Does this mean that the Trustee must be joined as a party in a domestic relations or paternity action if an income withholding order is in place at the time that the bankruptcy is filed, or a domestic relations or paternity case seeking an income withholding order if filed while the bankruptcy is pending? As to property which is not income, the new law excludes property of the estate from this exception to the automatic stay.

House Report 109-031 contains the following commentary on domestic support obligations in connection with stay relief issues:

Sec. 214. Exceptions To Automatic Stay in Domestic Support Proceedings. Under current law, section 362(b)(2) of the Bankruptcy Code excepts from the automatic stay the commencement or continuation of an action or proceeding: (1) for the establishment of paternity; or (2) the establishment or modification of an order for alimony, maintenance or support. It also permits the collection of

such obligations from property that is not property of the estate. Section 214 makes several revisions to Bankruptcy Code section 362(b)(2). First, it replaces the reference to 'alimony, maintenance or support' with 'domestic support obligations.' Second, it adds to section 362(b)(2) actions or proceedings concerning: (1) child custody or visitation; (2) the dissolution of a marriage (except to the extent such proceeding seeks division of property that is property of the estate); and (3) domestic violence. Third, it permits the withholding of income that is property of the estate or property of the debtor for payment of a domestic support obligation under a judicial or administrative order as well as the withholding, suspension, or restriction of a driver's license, or a professional, occupational or recreational license under state law, pursuant to section 466(a)(16) of the Social Security Act. Fourth, it authorizes the reporting of overdue support owed by a parent to any consumer reporting agency pursuant to section 466(a)(7) of the Social Security Act. Fifth, it permits the interception of tax refunds as authorized by sections 464 and 466(a)(3) of the Social Security Act or analogous state law. Sixth, it allows medical obligations, as specified under title IV of the Social Security Act, to be enforced notwithstanding the automatic stay.

Under the old law, noneconomic aspects of divorce such as dissolution of the marriage and child custody were not subject to the automatic stay. See 11 U.S.C. § 362(b)(2)(A)(ii); *In re Taylor*, 233 B.R. 639 (SDNY, 1998); see also *In re Nelson*, (Bankr.Kan. 2004). The new law adopts this rule, but adds to it the proviso that the withholding of *income* that is property of the estate is not a stay violation. In *Nelson*, a 2004 case by Judge Nugent, Victor and Kimberly Nelson were in the process of divorcing. The case was set for trial on both the divorce petition and a protection from abuse (PFA) petition, as well as a pending foreclosure petition concerning the marital residence, which had been consolidated with the divorce and PFA cases. All matters were set for trial on August 23, 2004, commencing at 9:00 a.m. Victor Nelson advised the divorce judge by email on the morning of the trial that he would be filing a Chapter 13 that day. He also told Kimberly of his intent to do so. However, he did not appear for the divorce/PFA/foreclosure trial. The state court

judge and counsel for Kimberly verified that no bankruptcy petition had been filed when the trial commenced at 9:30 a.m. As it was proceeding, Victor filed his *pro se* Chapter 13 petition at 9:54 a.m., but did not bother to walk across the street from the Federal court house to the Sedgwick County court house to advise the parties that the bankruptcy had been filed. Accordingly, the state judge proceeded to grant the divorce, award custody of the children to Kimberly, enter an order for child support, and divide the marital property.

Victor thereafter filed contempt proceedings against Kimberly and her counsel for alleged stay relief violations. Judge Nugent refused to find a willful violation of the automatic stay, but held that

some of the actions taken and relief obtained against Victor by default are excepted from the automatic stay. With respect to the divorce case, the termination of the marital relationship, the child custody and parenting plan determinations, and the child support obligations are excepted from the automatic stay. Except to the extent Kimberly seeks the recovery of child support from property of Victor's estate, these determinations cannot be construed as efforts having an affect upon property of the estate and were not stayed.

The new 362 exceptions from the automatic stay pertaining to domestic relations and paternity cases are consistent with old law pronouncements found in cases such as *Nelson*, but the law adds several new automatic stay exceptions, including withholding of income that is estate property, reporting overdue support to consumer credit reporting entities, interception of tax refunds, and the enforcement of medical obligations.

5. Priority of domestic support obligations.

Domestic support obligations are now the first priority under Section 507. Support obligations were formerly the seventh priority. Now, these claims are ahead of administrative

claims under 503(b), which were formerly the first priority. This first priority is divided into three categories: (1) those claims for domestic support obligations owed to the “spouse, former spouse, or child of the debtor, or such child’s parent, legal guardian, or responsible relative; (2) domestic relations obligations which have been assigned to a governmental unit; and (3) administrative expenses of the trustee under Chapters 7, 11, 12 or 13 (but then only certain limited administrative expenses allowed the trustee under 503).

The first two subsections of this priority also require that this priority is allowed “on condition that funds received under this paragraph by a governmental unit under this title after the date of filing of the petition shall be applied and distributed in accordance with applicable nonbankruptcy law.” Does this mean that if, after a claim is allowed and money paid to a governmental unit, a trustee (or a debtor in Chapters 11, 12, or 13) can show that the money was not applied in accordance with applicable nonbankruptcy law, the money can be recovered from the governmental unit? Additional language is found 507(a)(1)(B), which states that domestic support obligations “voluntarily assigned . . . for the purpose of collecting the debt” are not included within this priority.

6. Impact of domestic support obligations on confirmation of a plan/discharge.

The requirements for confirmation of a Chapter 11 (for individuals), 12, or 13 plan, found in Sections 1129, 1225, and 1325 respectively, each provide that the debtor must have paid all domestic support obligations which have become due since the filing of the of the petition. If a debtor owing a domestic support obligation has failed to stay current after the petition is filed, confirmation is denied. Likewise, if after plan confirmation under Chapters 12 or 13, a debtor fails to stay current on a domestic support obligation, that debtor is not entitled to a discharge. In fact,

to obtain a discharge, under Chapters 12 or 13, the debtor must affirmatively certify that all domestic relations obligations which have accrued since the petition was filed and accruing before the date of the certification have been paid. See Sections 1228 and 1328.

Questions which have yet to be resolved, but which may answered by rule changes, include who, if anyone, is entitled to receive notice of the debtor's certification that domestic support obligations have been paid, and who, if anyone, may object to that certification. It would seem that if a debtor certifies that he or she has remained current on domestic support obligations during the duration of the Chapter 12 or 13 plan, but that if such certification is false, then the trustee or one of the interested parties included within the definition of what constitutes a domestic support obligation would have standing to contest the certification and show that the payments are not current.

C. Debt Relief Agencies.

This is a completely new twist for federal law in general, and the Bankruptcy Code in particular. Historically, the licensing, discipline, and rule-making for the legal profession has been vested at the state level. However, under BAPCPA, Congress has mandated that any attorney involved in a bankruptcy proceeding who provides "bankruptcy assistance" to "an assisted person" in return for the payment of money or other valuable consideration is a "debt relief agency." See 11 U.S.C. § 101(12A). "Involved" is the operative word here since an attorney can be a debt relief agency even if the lawyer does not practice before the bankruptcy court and has never filed a bankruptcy case. The key here is the definition "an assisted person" which is defined at 11 U.S.C. § 101(3). An assisted person means any person whose debts consist primarily of consumer debts and the value of the non-exempt property is less than \$150,000.00. Note here that the definition of "assisted person" does not mention at all whether that person is contemplating a bankruptcy filing. In this connection, 11 U.S.C. § 101(4A) provides additional

information concerning “bankruptcy assistance” as follows:

(4A) The term “bankruptcy assistance” means any goods or services sold or otherwise provided to an assisted person with the express or implied purpose of providing information, advice, counsel, document preparation, or filing, or attendance at a creditors meeting or appearing in a case or proceeding on behalf of another or providing legal representation with respect to a case or proceeding under this title.

Here are some examples of how a lawyer who does not practice bankruptcy can be drawn into the ambit of BAPCPA and become a “debt relief agency.” Assume that a lawyer handles automobile injury cases only. As sometimes happens, a negligent driver will seek bankruptcy relief, perhaps on account of no liability insurance or inadequate liability insurance, or perhaps for other reasons not related to the accident. Even though the lawyer is representing the person injured by that negligent driver, and not the driver, once that negligent driver files bankruptcy, if the personal injury client or “assisted person” has primarily consumer debts and non-exempt property of less than \$150,000.00, the personal injury attorney becomes a “debt relief agency” simply by advising his or her client concerning the negligent driver’s bankruptcy filing, or attending the creditors meeting, or filing a claim in the case. Never mind that the “assisted person” is not seeking discharge of his or her debts!

The family law practitioner may find himself or herself in a similar situation. Oftentimes as people are divorcing, one of the spouses will seek bankruptcy relief while the divorce case is pending. Even if the lawyer is representing the non-filing spouse, that attorney may still be a “debt relief agency” as long as the non-filing spouse has debts consisting primarily of consumer debts and non-exempt personal property of less than \$150,000.00, and the attorney advises the non-filing spouse concerning the bankruptcy filing or attends the meeting of creditors, or files a claim in the bankruptcy case.

These are two scenarios, and undoubtedly, there can be others. What, however, is the effect of becoming a debt relief agency? BAPCPA assigns new duties to anyone who is determined to be a debt relief agency, which duties are spelled out in 11 U.S.C. § 526, 527, and 528. Here is the summary of

requirements under those sections for debt relief agencies:

1. Section 526 Requirements.

- a. Provide a written contract to the client.
- b. Be liable to the client in the amount of any fees or charges in connection with providing bankruptcy assistance to such person, as well as for actual damages and reasonable attorney fees and costs if the attorney is found to have intentionally or negligently failed to comply with any provision of Section 526, Section 527 or Section 528.
- c. Make any statement or provide advice to a client (“assisted person” or “prospective assisted person”) that is untrue or misleading, or if that upon the exercise of reasonable care, should have been known by such attorney to be untrue or misleading.
- d. Allows an injured person to bring an independent cause of action against the attorney for damages sustained in connection with the violation of this section.

2. Section 527 Requirements.

This is the “disclosures” section which requires an attorney who is determined to be a debt relief agency to make certain written disclosures to any client who is determined to be “an assisted person.” Although these disclosures are primarily directed to a person contemplating bankruptcy filing, since the definition of an “assisted person” is so broad, it could cover people who are not contemplating bankruptcy filing, but somehow are connected, as per the examples above or otherwise to a bankruptcy case in some form. In connection with these disclosures, the attorney must advise the client (“assisted person”) of the various bankruptcy relief chapters available. Sample disclosures which

might be used and which may be in compliance with this section are attached as appendices to this paper.

3. Section 528 Requirements.

This specifies certain additional requirements for debt relief agencies, including disclosures required in advertisement made in any form. In this regard, if an attorney is found to be a debt relief agency, that attorney must have “clearly and conspicuously” use the following statement in any such advertisement: “We are a debt relief agency. We help people file for bankruptcy relief under the bankruptcy code,” or substantially similar statement. This section also provides that in any advertisement directed to the general public, any attorney acting as a debt relief agency providing assistance with respect to credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt is included under the requirements of Section 528, even if that attorney never files bankruptcy cases.

D. Exemptions.

New homestead rules are found at Section 522(p), known as the “1,215 day rule.” Historically, Kansas has been known as one of the few unlimited homestead states. A residence and one acre within a city limits and 160 acres outside of city limits is exempt, regardless of value. In an apparent attempt to curb what was perceived as the overutilization of homestead as a protection from creditors, BAPCPA places limitations on a debtor’s ability to claim a state’s exemption as homestead. The homestead exemption is limited to \$125,000.00 if the interest was acquired within 1,215 days of the filing of the bankruptcy. That time period is 3.42 years. This section does not apply to a family farmer as that term is defined by the Code. It also excludes any amount transferred from the sale or disposition of a prior principal residence if the prior residence was acquired prior

to the 1,215 day period, and the two residences are located in the same state. A yet to be answered question is whether in a joint case each spouse would be entitled to claim the \$125,000.00 exemption.

BAPCPA provides a limitation on homestead for certain felonies. 11 U.S.C. § 522(q) provides:

(q)(1) As a result of electing under subsection (b)(3)(A) to exempt property under State or local law, a debtor may not exempt any amount of an interest in property described in subparagraphs (A),(B), (C), and (D) of subsection (p)(1) which exceeds in the aggregate \$125,000 if—

(A) the court determines, after notice and a hearing, that the debtor has been convicted of a felony (as defined in section 3156 of title 18), which under the circumstances, demonstrates that the filing of the case was an abuse of the provisions of this title; or

(B) the debtor owes a debt arising from--

(I) any violation of the Federal securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934), any State securities laws, or any regulation or order issued under Federal securities laws or State securities laws;

(ii) fraud, deceit, or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security registered under section 12 or 15(d) of the Securities Exchange Act of 1934 or under section 6 of the Securities Act of 1933;

(iii) any civil remedy under section 1964 of title 18; or

(iv) any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death to another individual in the preceding 5 years.

(2) Paragraph (1) shall not apply to the extent the amount of an interest in property described in subparagraphs (A), (B), ©, and (D) of subsection (p)(1) is reasonably necessary for the support of the debtor and any dependent of the debtor.

Note that this does not relate to discharge, but only a homestead claim. This provision is designed to limit corporate executives who are convicted of securities fraud from being able to feather their nests in a homestead friendly state and then file bankruptcy. Call it the “Enron” homestead exception.

E. Other Significant Changes.

1. Debtor Education Requirements.

BAPCPA requires that persons filing bankruptcy take two separate debtor educational courses: one to get in to bankruptcy, and the second to get “out” or obtain the hoped-for discharge. The first is a pre-bankruptcy “briefing” which must be taken prior to the filing of the bankruptcy, and through a not-for-profit credit counseling organization approved by the United States Trustee. The US Trustee maintains a list of approved not-for-profit organizations which have sought and obtained compliance from the US Trustee. If the briefing is not obtained prior to the filing of the bankruptcy, the bankruptcy is subject to dismissal, unless the debtor can show that there were exigent circumstances that merit a waiver of the briefing requirements, that the debtor requested the credit counseling services but was unable to obtain the services during the five-day period beginning on the date on which the request was made, and that the explanation is satisfactory to the Court. Even if exigent circumstances are found, the Court can only grant a 30-day extension to comply with the credit counseling requirement. One Court has defined “exigent circumstances” as “including a requirement that the debtor faced an urgent situation that rendered him or her unable to comply with the budget and credit counseling requirements before commencing the bankruptcy case.” *In Re Henderson*, 339 B.R. 34(USBC, EDNY, 2006). Another Court determined that “exigent circumstances” does not appear to refer to a prospective debtor’s problems or situation which gave

rise to the bankruptcy, but rather, to refer to circumstances preventing the person from obtaining the required budget and credit counseling. *In Re Valdez*, 335 B.R. 801 (USBC, SDFI, 2005). Part of the purpose of the pre-filing “counseling” is to allow the credit counseling agency to attempt to assist the would-be bankruptcy debtor to attempt to create a plan of repayment to creditors outside of bankruptcy. As a practical matter, such a plan is rarely, if ever, developed. Even if one is, the debtor may still file bankruptcy.

The second educational requirement is a post-filing, pre-discharge educational course, which is ostensibly more in-depth than the initial pre-bankruptcy briefing. It is designed to help persons in bankruptcy avoid the pitfalls that got them into debt trouble in the first place. Again, it must be taken through a not-for-profit credit counseling organization approved by the US Trustee’s office. In Chapter 7 cases, the instructional course must be taken within 45 days of the 341 Meeting of Creditors. In Chapter 13 cases, it must be completed before the final payment due under the plan. See Interim Bankruptcy Rule 1007(c). Failure to complete the post-filing instructional course can result in the closing of the case without entry of a Discharge Order. The time for completion of this course can be extended on a motion filed prior to the required completion period if good cause is shown. If the motion is filed after the required completion period, then excusable neglect is the required showing.

2. Repeat Filers.

One of the abuses which BAPCPA attempted to squelch is the situation involving so-called “repeat filers.” Under prior law, if a Chapter 7 or Chapter 13 was dismissed without prejudice under 11 U.S.C. § 109(g) then a debtor could immediately file a new case. This situation usually occurred in the context of a Chapter 13, when a debtor would request voluntary dismissal of a case due to a

variety of circumstances, such as job loss or job downsizing, which resulted in a reduction or loss of income. Once the debtor returned to gainful employment, a new case would be filed.

BAPCPA attempts to limit this type of refiling by restricting the scope of the automatic stay. If a second filing occurs within one year of dismissal of the first case, then 11 U.S.C. § 362(c)(3)(A) provides that the stay will terminate 30 days after the filing of the second case. However, the debtor or other party in interest may file a motion for continuation of the automatic stay with the further requirement that the hearing on the motion must be held prior to the expiration of the 30-day period on a showing of good faith in the filing of the new case. The Code presumes that the case was not filed in good faith, and this presumption can be rebutted only by clear and convincing evidence. 362(c)(3)(A) states that the stay is terminated “with respect to any action taken with respect to a debt or property securing any such debt,” so the question remains as to whether the section is even applicable and whether the stay automatically expires if the creditor has taken no action with respect to the debt or property securing the debt between the dismissal of the first case and the filing of the second case.

As to the third filing, the code provides that there is no stay at all, although again, the debtor or other party in interest may, within 30 days after the filing of the third case, request that the Court enter a Stay Order. The presumption of lack of good faith and the clear and convincing burden of proof remains the same. See 11 U.S.C. § 362(c)(4)(A).

3. Time Between Discharges.

Prior to BAPCPA, there was a bar to discharge in a Chapter 7 case if there had been a previous discharge under Chapter 7, 11, 12 or 13. In Chapter 13 there was no bar to discharge despite a previous discharge under Chapter 7, 11, 12 or 13. This has changed under BAPCPA,

which now provides that in Chapter 7, there cannot be a discharge until eight years have elapsed since the last Chapter 7 discharge or six years from a prior Chapter 13 discharge unless the Chapter 13 paid 100 per cent to allowed unsecured claims or at least 70 per cent to such claims with the further finding that the plan was proposed by the debtor in good faith and was the debtor's best effort. See 11 U.S.C. § 727(a)(8) and (9). In the Chapter 13 setting, a discharge may not be granted if there was a previous discharge under Chapters 7, 11 or 12 during the four year period proceeding the filing of the second case or a period of two years with regard to a previous Chapter 13 filing.

4. Chapter 12 Made Permanent.

Chapter 12, which was first enacted in 1986 and was intended for family farmers, contained "sunset" provisions prior to BAPCPA. This resulted in Chapter 12 occasionally expiring as a viable chapter under the Bankruptcy Code, with periodic renewals of the chapter by Congress. Chapter 12 has now been made a permanent chapter of the Bankruptcy Code. It has also been expanded to include fishermen as a class of debtors eligible for relief under Chapter 12.

5. Anti-cram down provisions.

Under Chapter 13, a debtor is allowed to "cram down" a secured creditor's claim, secured by personal property, to the extent of the value of the property. Therefore, a creditor with a debt of \$10,000.00 secured by a car worth only \$8,000.00, only had to be paid \$8,000.00 prior to BAPCPA. The new law changes this with the so-called "hanging" paragraph found in Section 1325 (the paragraph is "hanging" because it is jammed in after 1325(a)(9) with no separate number of its own and with no intent to modify subsection (a)(9) – it simply a product of poor legislative drafting). Under this paragraph, if a motor vehicle was acquired by the debtor for his or her personal use and financed with 910 days (roughly 2.5 years) before bankruptcy filing, then the secured claim must

be paid in full regardless of the value of the vehicle. The same rule applies to personal property other than a motor vehicle acquired by virtue of a purchase money loan with one year of filing.

The “hanging” paragraph says the Section 506 of the Code does not apply. 506(a) is the section that defines how a secured claim is determined. If 506 does not apply, then the question remains as to whether claims brought under the “hanging” paragraph are secured claims at all. One Kansas bankruptcy judge has ruled that they are not, but rather, that they are a special class of unsecured claim, to be paid in full but without interest. *In re Wampler*, case number 05-27659, U.S. Bankruptcy Court, District of Kansas (Judge Berger). That case is on appeal to the Bankruptcy Appellate Panel. Judge Karlin, in the Topeka Division, held just the opposite of *Wampler* in a case decided in 2006: *In re Lowder*, 2006 Bankr. LEXIS 1769 (August 14, 2006). The court held that, pursuant to the hanging paragraph at the end of 11 U.S.C.S. § 1325(a)(9), if debtor acquired the car for other than business use, then creditor was entitled to be paid the full amount of its claim and the court would have to determine what interest, if any, should be paid. Debtor's merely acquiring a vehicle for her own use, with one of the uses contemplated being to drive to and from work, was not for business purposes. The court also held that debtor's plan had to provide for creditor's claim to be paid with interest at the Till rate because the hanging paragraph did not erase a creditor's secured status merely because the valuation mechanism in 11 U.S.C.S. § 506 was not applicable to that particular claim.

III. CONCLUSION.

As noted earlier, these are only some of the highlights of BAPCPA. There are many more “nuggets” buried in this legislation. Hank Hildebrand, a Chapter 13 trustee in Tennessee and one of the more knowledgeable authorities on BAPCPA, has referred to the hidden traps and treasures

in the new law as “Easter eggs” – you continue to find them long after the original hunt is over. And of course, what is found isn’t always that appetizing.

Good hunting!

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