

Chap 7..13

Bankruptcy Blotter

Bankruptcy Court

Winter 2010

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THE PRUDENT PRACTITIONER SCOTUS Shoots Holes in Rule 4003!

By Rosemary E. Williams*

The consumer debtor’s retention of prepetition interests in property is one of two primary purposes for seeking bankruptcy relief, the other being, of course, receipt of the broadest possible discharge of debt. For such a debtor, the property which is exempt is the springboard for a fresh economic start; for the case trustee and creditors, the debtor’s exemption claim defines the limits of property which can be liquidated to pay the trustee, and to distribute to creditors. For these determinations to be made, there

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From the Editor

We hope this latest Bankruptcy Blotter finds you, and your office, thriving.

Versions 10 and 10.1 have been released recently, and, at the time of publication, version 10.2 is well on its way to being released. Version 10.2 will continue our progress in improving how exemptions are handled in Chap 7..13 as well as containing many other improvements to how you generate documents for your clients.

Also, if you haven’t already heard, the Supreme Court recently issued its decision in *Ransom* (*Ransom v. FIA Card Services, N.A.*, 2011 WL 66438 (U.S. 2011)) that a car-ownership deduction can no longer be taken in calculating projected disposable income where the debtor is not making loan or lease payments.

Please keep the feedback coming and look for more updates throughout the year.

Your Chap 7..13 Project Team

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must be a certainty about when a claim of exemption is final. Those important functions are addressed in Fed R Bankr Pro 4003(b)(1).

Fed R Bankr Pro 4003(b)(1) says that, with two small exceptions, a “party in interest [including the case trustee] may file an objection to the list of property claimed as exempt within 30 days after the meeting of creditors held under § 341(a) is concluded or within 30 days after any amendment to the list or supplemental schedules is filed, whichever is later.” This Rule does not describe any sub-categories of objections to which it does or does not apply.

Rule 4003(b)(1)’s bar date was examined in 1992 by Justice Thomas, writing for SCOTUS.¹ A Chapter 7 debtor claimed an exemption in potential proceeds from an employment discrimination suit pending in a non-bankruptcy court. No written objection was filed within the 30-day period described by the Rule, and thereafter the debtor and non-bankruptcy counsel settled the suit. The case trustee then demanded that the debtor and counsel turn over all the money from the settlement. Upon review, Justice Thomas wrote that a Chapter 7 trustee could not contest the validity of a claimed exemption after 30-day period for objecting had expired without any extension having been granted:

[The trustee’s] failure to promptly object precludes him from challenging the validity of the exemption at this time, regardless of whether or not [the debtor] had a colorable statutory basis for claiming it. By negative implication, Rule 4003(b) indicates that a trustee may not object after 30 days unless a further extension of time is granted. Because no such extension was allowed by the Bankruptcy Court in this case, § 522(1) has made the settlement proceeds exempt.

Thus, no interested party could contest a claim of exemption after the 30-day period described by Rule 4003(b) whether or not the debtor had a colorable statutory basis for claiming it.²

Taylor brought finality to the allowance or objection to the debtor’s claim of exemptions after the 30-day period allowed by Rule, permitting the case trustee, creditors and the debtor to move on.³ Notwithstanding this, in a

2010 ruling in *Schwab v. Reilly*,⁴ Justice Thomas re-defined the 30-day period of Rule 4003(b)(1) as barring only *some* objections to an exemption. Justice Thomas and four other justices modified Taylor so that Rule 4003’s thirty-day time limit applies to objections based on “three, and only three” elements of a claimed Schedule C exemption:

- (1) the description of the property in which a debtor claims an exempted interest;
- (2) the Code provisions governing the claimed exemption; and
- (3) the amount listed in the column in the Schedules titled “value of claimed exemption.”⁵

When an objection is based on other elements, such as the debtor’s market value estimation and “the estate’s right to retain any value in the [property] beyond the value of the exempted interest,” the thirty-day time limit does not apply.⁶ This holding gives interested parties free rein to object once an exempted asset appreciates in value, and denies the debtor finality and access to what could be a major source of funds to support a fresh state – appreciation in real estate value.

In the Schwab line of decision, the Bankruptcy Court, District Court, and Third Circuit Court of Appeals had ruled for the debtor based on Rule 4003(b)’s bar date, as articulated in Taylor. Justice Thomas could not, and did not, ignore Rule 4003 and the earlier ruling in Taylor. He noted that both Taylor and Schwab dealt with the consequences of a trustee’s failure to object to a claimed exemption within Rule 4003(b)(1)’s time period. However, Judge Thomas described Taylor as establishing only the proposition that an interested party must object to a claimed exemption within the 30-day period “*if the amount the debtor lists as the “value claimed exempt” is not within statutory limits.*”⁷ In Taylor, the value of the litigation listed by the debtor in Schedule C was “\$ unknown.” In Justice Thomas view, that plainly was not within those limits, but in Schwab, the debtor’s values for the cooking equipment of \$10,225 were within the allowable exemption amounts in the Code limits. It was on this basis that the Schwab Court distinguished its ruling from Taylor.

After Schwab, there is no rule-based limit to how long a creditor or case trustee can dally before finally filing an

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objection so long as one of the bases for the objection is outside of Rule 4003(b)(1). Thus, if a debtor is the plaintiff in pending litigation to recover money, values the potential recovery at an unknown amount, and the debtor and an attorney do all the work necessary to realize the value of the suit on the assumption that the bar date for objections to exemption have passed, the case trustee, for a presently unknown period of time, can then decide to gobble up all of the proceeds.

One might think that, if Rule 4003 does not place a limit on these belated challenges, equitable estoppel might bar the trustee or a creditor. Soon after the Schwab decision, the Court of Appeals for the Ninth Circuit⁸ took up exactly that question. A trustee of a Chapter 7 case brought a motion to sell the debtors' home more than two years after the petition date based on alleged appreciation in the home's value. The debtor raised inter alia equitable estoppel based on the passage of years. The Court of Appeals held that the trustee was not equitably stopped from proceeding with the sale of the debtor's homestead because the trustee's failure to object to the debtor's homestead exemption "did not result in the entire homestead property being withdrawn from the bankruptcy estate." Since Rule 4003(b)(1) does not bar a challenge to the debtor's exempted property brought at least two years after the petition, one can almost imagine that a bankruptcy case would just be kept open, with the trustee tracking the market value of a claimed exemption, until that value increases, either through changes in the market, or because any debt against the property was paid down by the debtor sufficiently to create equity.

The Schwab decision also places greater emphasis on the concept of "property of the estate" since, if an interest of the debtor in property is excluded from becoming property of the bankruptcy estate, the question of whether the interest would qualify as exempt does not arise.⁹

Faced with all of these hazards which might not appear for years, what does a Prudent Practitioner do?

For the debtor:

1. Clearly state that an exemption is intended by the debtor to include the maximum value allowed by statute.
2. If the debtor has an interest in property which has a value in excess of a certain amount, such as \$5,000, the debtor should consider obtaining an independent appraisal to support a claim of exemption.
3. If the trustee shows signs of wanting to "hide behind the log" in the hope that the value of the asset will appreciate beyond an amount which can be exempted, the debtor could bring a motion seeking an order abandoning the trustee's interest in the property,

or reaching a judicial determination of present and future value which will then become the law of the case.

4. When property is described on the Schedules, the debtor can include language to the effect that the debtor intends to claim all of the property's value as exempt. The debtor can then bring a motion after the 30-day period has expired seeking an order finding that the entire property is exempt.
5. If the property is difficult to value, such as a matter in litigation, the debtor can bring a motion seeking to lift the stay on the debtor's and the estate's interest, showing that the litigation cannot sit in limbo while the trustee waits to see if the debtor will do the work necessary to translate the litigation into money. Further, the debtor can demand that the trustee substitute into the suit as the plaintiff and either undertake the cost of prosecuting the suit, or abandon any interest in it.
6. The one thing the trustee will want to do, and which the debtor must prevent, is delay. The debtor may have to remind the trustee of the fiduciary duty to obtain a return for creditors rather than absorb any value by litigation and appeals which leave nothing for either the debtor or the creditors.¹⁰

For a creditor:

1. The debtor may refuse to make payments on a loan if the trustee appears to be waiting to see if the property increases in value. From a creditor's viewpoint, it is better to have *some* money today rather than pie-in-the-sky money at some indefinite point in the future after all administrative claims are paid. The creditor may wish to urge the trustee to get on with the case administration, or to avoid running up fees and costs so that what might go to creditors instead goes to administrative expenses.
2. If litigation begins with a debtor over a present valuation that shows some excess above the exempt amount, the creditor should carefully monitor the case to see that the trustee is making a comparison of the litigation's probable costs with the probable benefit of a sale. Again, the issue to beware of is trustee litigation which absorbs the value of property otherwise distributable to creditors.

For the trustee:

1. The essence of good administration is economy. Trustees must accept many cases where there are no funds to pay the trustee sufficiently even for the time it takes to review a case. The trustee must therefore avoid the temptation of keeping cases open in the hope that value will appear in the indefinite future.

2. If there is a present or future question of value, promptly contact the attorney for the debtor to see if there are any independent sources already used to determine present and future value.
3. Keep in mind that the purpose of the Bankruptcy Code is not to punish the debtors for seeking relief, or the creditors for making loans, or to pay a trustee for administration, but instead the purpose is an equitable adjustment of financial relationships where costs are contained, the debtor is returned to financial productivity, and creditors are paid promptly whatever funds are available.

For everyone: Urge Congress to either amend Code § 522 to follow SCOTUS' distinctions of the types of objections to exemptions, and the Rules Committee to re-draft Rule 4003 in light of the Schwab ruling.

1. Taylor v. Freeland & Kronz, 503 U.S. 638, 112 S. Ct. 1644, 118 L. Ed. 2d 280 (1992).
2. Taylor v. Freeland & Kronz, 503 U.S. 638, 112 S. Ct. 1644, 118 L. Ed. 2d 280 (1992). Even before Schwab, courts had found holes in Rule 4003(b)(1). See, for example, In re Moe, 179 B.R. 654 (Bankr. D. Mont. 1995) for a decision holding that "exemption by default" was inapplicable to a lien avoidance.
3. Finality is an often-mentioned judicial doctrine that brings in its train such bars to further litigation as res judicata, comity and collateral estoppel. Abreu v. Holder, 378 Fed. Appx. 59 (2d Cir. 2010); Losh v. Fabian, 592 F.3d 820 (8th Cir. 2010); Elliott v. White Mountain Apache Tribal Court, 566 F.3d 842 (9th Cir. 2009). In 2009, SCOTUS applied finality to an appeal from a criminal conviction, noting that the word "has been 'variously defined; like many legal terms, its precise meaning depends on context'. Jimenez v. Quarterman, 555 U.S. 113, 129 S. Ct. 681, 172 L. Ed. 2d 475 (2009) See Lincoln v. Palakovich, 384 Fed. Appx. 193 (3d Cir. 2010) associating finality and comity, and in Greene v. Palakovich, 606 F.3d 85 (3d Cir. 2010), finality and collateral review.
4. Schwab v. Reilly, 130 S. Ct. 2652, 177 L. Ed. 2d 234 (2010). This decision reversed each lower court that had looked at the case.
5. Schwab v. Reilly, 130 S.Ct. at 2663.
6. Schwab v. Reilly, 130 S.Ct. at 2669.
7. Schwab v. Reilly, 130 S.Ct. at 2655.
8. In re Gebhart, 621 F.3d 1206 (9th Cir. 2010). And see In re Messina, 386 Fed. Appx. 152 (3d Cir. 2010), where the Court of Appeals vacated and remanded an appeal by a trustee from the district court's reversal of an order in which the bankruptcy court had granted the trustee's motion to value the debtors' homestead exemption at zero based on the trustee's claim that the debtors had no equity in the home to which an exemption could attach.
9. In re Spector, 2010 WL 4258260 (Bankr. E.D. Mo. 2010) (debtor's interest in non-assignable spendthrift trust).
10. See In re Seven Fields Development Corp., 505 F.3d 237 (3d Cir. 2007) ("A sine qua non in restructuring the debtor-creditor relationship is the court's ability to police the fiduciaries, whether trustees or debtors-in-possession and other court-appointed professionals, who are responsible for managing the debtor's estate in the best interest of creditors. The bankruptcy court must be able to assure itself and the creditors who rely on the process that court-approved managers of the debtor's estate are performing their work, conscientiously and cost-effectively.")

Online Pre-Filing Credit Counseling

Previously, we reported the availability of free credit counseling services at ConsumerBankruptcyCounseling.info. The online pre-filing credit counseling service provided by ConsumerBankruptcyCounseling.info is still free, but there is now a \$5.00 charge to obtain a Certificate of Completion at the conclusion of the free counseling, to cover their costs. More information can be found at <http://www.consumerbankruptcycounseling.info/>.

Our Most Recent Releases

Our latest CD, Version 10.0 was released at the end of November, 2010. It includes several official forms effective 12/1/2010, updated Chapter 13 plans for Kansas, Maryland, the Western District of Missouri and the Middle District of Tennessee, new exemptions tools including auto-calculate features and calculation of spillover exemptions, compatibility with CMECF 4.1, updated desktop and internal icons, updated and new local forms and an updated Help file.

Version 10.1 was released via our software download page on December 23, 2010. It includes the addition of the latest chapter 13 plans for Colorado and Idaho, resolution of some CMECF issues with specific districts, a new local form for the Central District of California and resolution of some issues regarding exemptions.

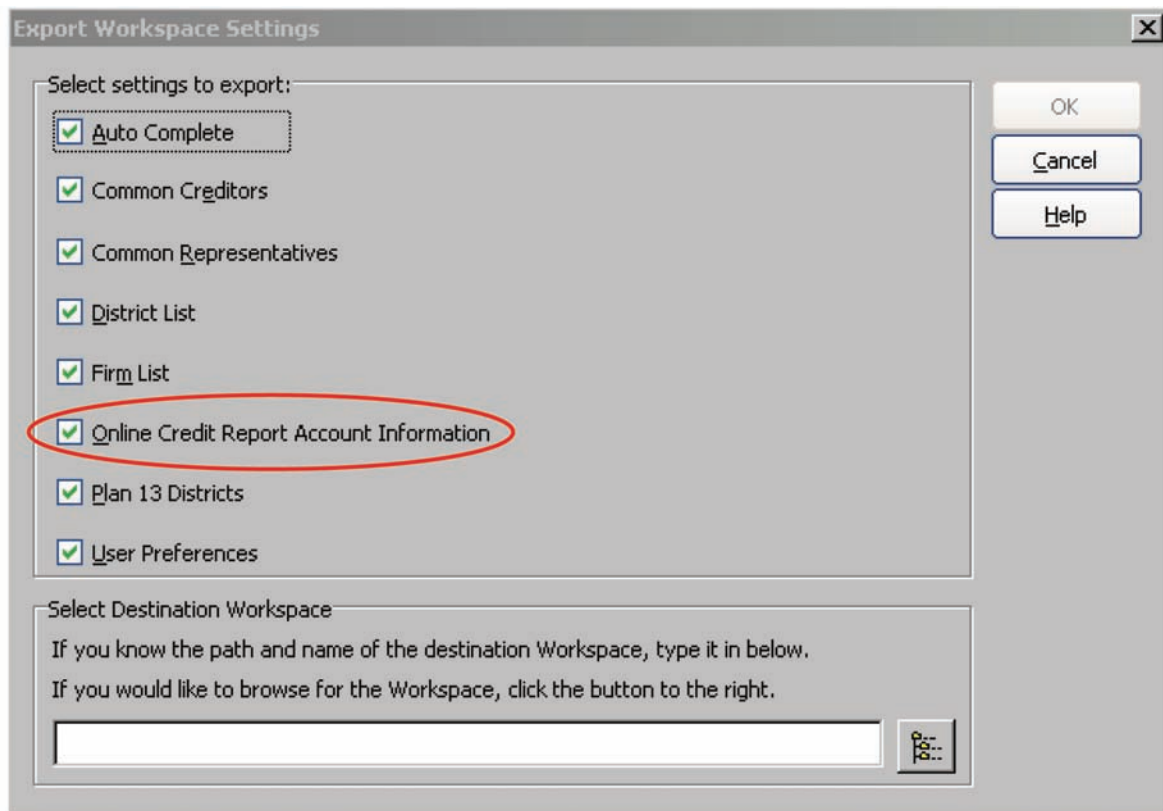
Chap 7..13 Tips

No More Having to Adjust the Zoom Level in the Preview Mode

The Preview window (aka PDF XChange viewer/editor) now lets you save a particular zoom factor (e.g., 100%) as the default. Otherwise, the default zoom is Fit Page. Just preview a document, set the zoom level to whatever you prefer and then check the box in the lower right hand corner of the Preview Window next to “Save as Default Zoom.”

Exporting Suite Solutions Account Information

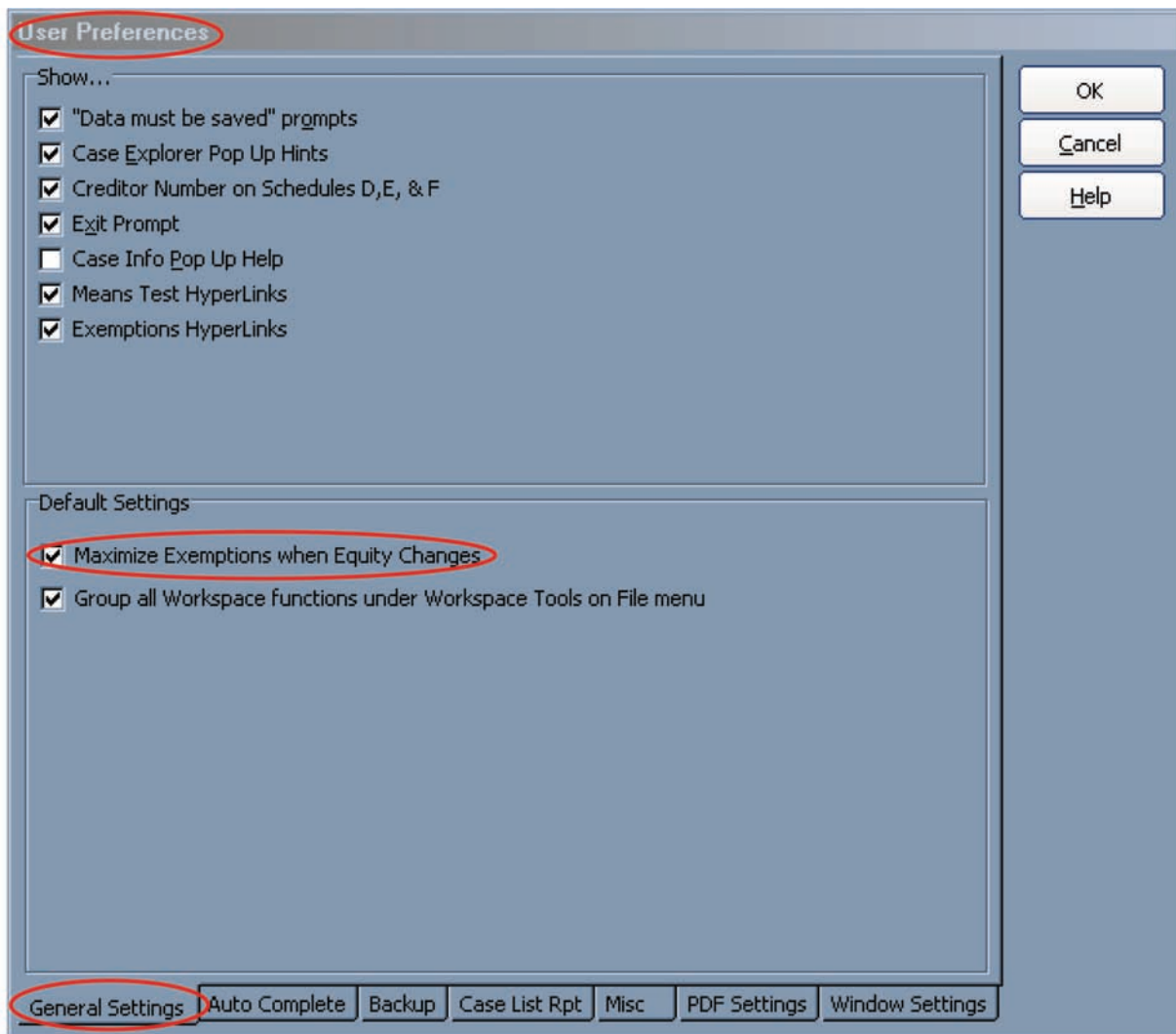
You can now export your Suite Solutions account information to any new workspace. Just click on the File drop down menu, then on Workspace Tools, then on Export Workspace Settings. On the Export Workspace Settings Window, click on Online Credit Report Account Information.



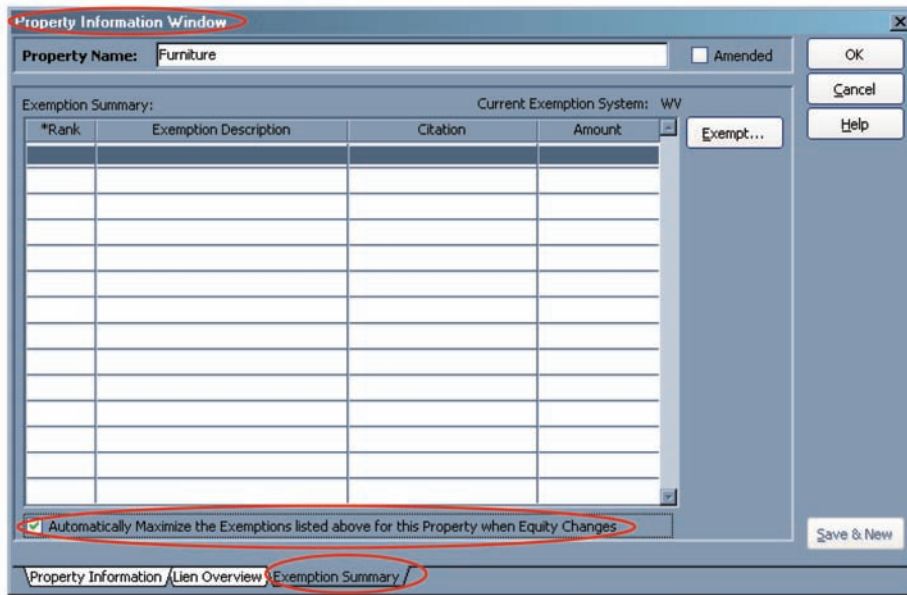
Exemptions News

We've made some enhancements to the way in which Chap 7..13 tracks property exemptions.

The program can now "maximize exemptions" by automatically adjusting the exemptions applied to a property if you change the property's equity. We've added a new user preference to have the program always maximize exemptions.



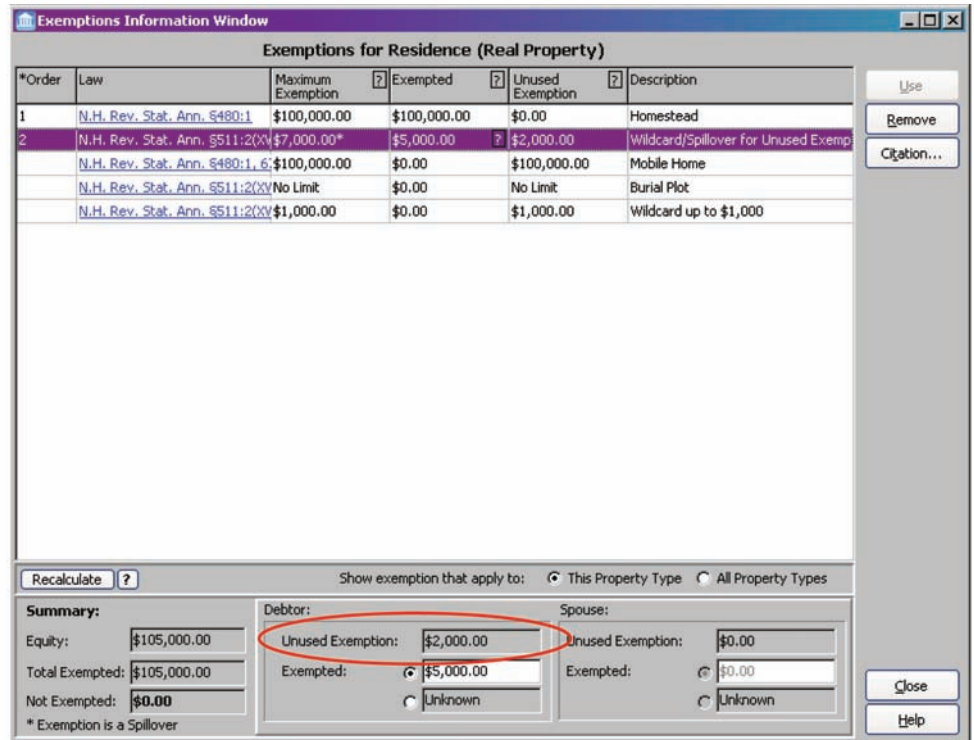
If you prefer not to set this default at the program level, you can maximize exemptions for a specific property on the Property Information window's Exemption Summary tab.



Also, If applicable in your jurisdiction, Chap 7..13 will track spillover exemption amounts automatically. For example, a debtor in New Hampshire files for bankruptcy with a \$105,000 home that he owns outright. He wants to exempt this property entirely. He takes the \$100,000 New Hampshire homestead exemption and he has \$5,000 left to be covered by the spillover exemption. New Hampshire has a spillover/wildcard exemption of \$7,000. Here's how the Exemptions Information Window for this property would look.

The calculation at the bottom of the screen tells the customer that after the deduction of \$5,000 for this particular property, the debtor has an unused wildcard/spillover exemption of \$2,000.

Finally, here's an important exemption tip to remember. By default, the exemption system from which you will select exemptions is the default system set up for the district. If needed, you can change the district's default exemption system or you can select a different exemption system for the open case. Be sure to change the exemption system before applying exemptions to properties in the open case. Otherwise, all exemptions will be lost and you will need to re-apply them.



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