CURRENT DEVELOPMENTS IN BANKRUPTCY LAW - 2009
SUFFOLK COUNTY BAR ASSOCIATIONS SEMINAR DECEMBER 8, 2009 [1]

I. COMPUTATION OF DEBT FOR CHAPTER 13 ELIGIBILITY

A. In re Groh, 405 B.R. 674 (Bankr. S.D.Cal. 2009).

1. Facts: Joint debtors filed a Chapter 13 petition listing a first mortgage of $520,000.00, a second mortgage of $130,000.00, and general unsecured claims of $177,173.00. The Schedules set forth a valuation of the debtor's homestead at $459,500.00.

2. Chapter 13 Trustee's Position. The Chapter 13 Trustee moved to dismiss the case on the grounds that based upon the Schedules, the debtors' first mortgage was undersecured and therefore a bifurcation of the secured claim gave rise to a $61,000.00 unsecured claim, the second mortgage was fully unsecured giving rise to an additional $130,000.00 unsecured claim, and that when these unsecured claims were aggregated with the debtors' scheduled unsecured claims of $177,173.00, the debtors exceeded the eligibility limits set forth in Bankruptcy Code § 109(e), limiting unsecured debt to $336,900.00.

3. Court's Analysis. The court relied upon the Ninth Circuit decision in, In re Scovis, 249 F.3d 975 (9th Cir. 2001), which held that Chapter 13 eligibility "should normally be determined by the debtor's original schedules, checking only to see if the schedules were made in good faith." Scovis further held that the unsecured portion of a judgment creditors judgment lien on the

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debtor's residence should be counted as an unsecured debt under § 109(e). The Ninth Circuit stated:

> The vast majority of courts, and all circuit courts[2] that have considered the issue, have held that the unsecured portion of undersecured debt is counted as unsecured for Section 109(e) (eligibility purposes).

Further, the court interpreted its statement that eligibility should be determined by the debtor's original schedules to mean that while the values of the liabilities and the assets should be taken from the schedules, if filed in good faith, nevertheless, the court had the ability to recharacterize debt based upon inter alia, the fact that Section 522(f) would enable the debtors to avoid liens that impaired their homestead exemption.

Thus, the court granted the Chapter 13 Trustee's motion to dismiss, recharacterizing the debtor's undersecured debt as unsecured.

4. Query: While Scovis dealt with a judgment lien, avoidable under § 522(f), Groh, dealt with mortgage debt. Certainly, with respect to the first mortgage there could be no 522(f) proceeding because such section is inapplicable. Moreover, § 1322 expressly prohibits a Chapter 13 debtor from modifying

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[2] In re Ficken, 2 F.3d 299 (8th Cir. 1993); Brown & Co. Sec. Corp. v. Balbis (In re Balbis) 933 F.2d 246 (4th Cir. 1991); In re Day, 747 F.2d 405 (7th Cir. 1984). Compare In re Gorman, 58 B.R. 372 (Bankr. E.D.N.Y. 1986) (considered secured), with In re Tomlinson, 116 B.R. 80 (Bankr. E.D.Mich. 1990) (considered unsecured). See also, Branch Banking & Trust Co. v. Russell, 188 BR. 542 (E.D.N.C. 1995) (finding debt secured by assets of corporation which was wholly owned by debtors to be secured).

the rights of a secured claimant, secured only by a security interest in the debtor's principal residence.

5. Query: If the undersecured mortgage was non-recourse, would this affect the analysis? See Johnson v. Home State Bank, 111 S.Ct. 2150 (1991) (holding that notwithstanding the fact that a personal liability on mortgage obligation had been discharged in a prior Chapter 7, the secured creditors surviving right against the mortgaged property nevertheless constituted a claim under the bankruptcy code.

6. Query: In light of the foregoing, and in light of the fact that appraisal is an inexact science, does a Chapter 13 debtor's counsel err on the side of a generous valuation of real estate so as to avoid the inclusion of mortgage debt as an unsecured claim.

II. DOES A JOINT CHAPTER 13 FILING INCREASE ELIGIBILITY LIMITS

A. Section 109(e) provides in pertinent part:

> Only an individual with regular income that owes, on the date of the filing of the petition, non-contingent, liquidated, unsecured debts of less than $336,900.00 and non-contingent liquidated secured debts of less than $1,010,650.00 or an individual with regular income and such individual spouse . . . that owe, on the date of the filing of the petition, non-contingent, liquidated, unsecured debts that aggregate less than $336,900.00 and non-contingent liquidated, secured debts of less than $1,010,650.00 may be a debtor under Chapter 13 of this title. (emphasis added)

1. Query: Is a proper construction of this statute that joint debtors are penalized when they file a joint Chapter 13 petition because in such event they are together limited to the debt ceilings which would be available to each of them individually in separate filings.

B. In re Werts, 410 B.R. 677 (Bankr. D.Kan. 2009).

1. Facts: Joint Chapter 7 debtors moved to convert their Chapter 7 case to one under Chapter 13. The United States Trustee objected on the grounds that the debtors' unsecured debt, when coupled with their undersecured second mortgage debt, exceeded the $336,900.00 unsecured debt eligibility limit available under Chapter 13. The husband had accrued general unsecured debt totaling $161,977.71, the wife had accumulated unsecured debt totaling $100,913.37 and the unsecured portion of the second mortgage for which they were jointly liable exceeded the equity in their home by the amount of $134,760.00. The total of the foregoing exceeded the eligibility ceiling.

2. Arguments of the Parties. The debtors took the position that if each filed a Chapter 13 case individually, they would each have the benefit of the $336,900.00 jurisdictional ceiling. Thus, the court should not exalt form over substance, and what they could do individually, they should be allowed to do together. Thus, the debtors argued the jurisdictional ceiling should be doubled.

3. Trustee's Argument. The Trustee pointed to the language of 109(e), which expressly covers both "an individual", setting the eligibility limit at $336,900.00 with respect thereto, and "an individual with regular income and such individual's spouse" setting the same jurisdictional limit of $336,900.00.

4. Court's Analysis. Judge Karlin concluded that the disjunctive contained in 109(e) did not necessarily limit the individual rights of each of the joint debtors. Instead, the court reasoned the purpose of the disjunctive was to deal with the situation where the debtor spouse did not have regular income

otherwise making her eligible for Chapter 13 relief. The court stated

> The provision dealing with an individual with regular income and such individual spouse is intended to apply to those cases where the spouse could not otherwise be a Chapter 13 debtor, because he or she is not an individual with regular income.

Judge Karlin cited the case of In re Crego, 387 B.R. 225, 229 (Bankr. E.D.Wis.2008) to illustrate the facial illogic of an alternative construction:

> of course, in any of these cases, a trustee's objection could be overcome by having the spouses file separate petitions. However, "machinations" such as forcing the debtors to pay a second filing fee, file another set of schedules and plan, and arrange a new set of hearing, "elevates form of a substance. In this case, the court does not find that the circumstances necessitate forcing either of the debtors to file separate petitions, as separation of the cases would not make more money available to the unsecured creditors then there is in this joint case. In fact, there may well be less money available due to the expenses incurred in filing a second petition.

Accordingly, the court granted the debtor's motion to convert to Chapter 13.

5. Query. Would the court's analysis in Werts have saved the Groh's Chapter 13 case?

III. FAILURE OF LAW SCHOOL TO ISSUE DEGREE OR TRANSCRIPT VIOLATES 11 U.S.C. § 524(a) IS A CONTEMPT OF COURT

A. In re Moore, 407 B.R. 855 (Bankr. E.D.Va. 2009).

1. Facts: Prior to the debtor's Chapter 7 filing, he completed a two year juris doctorate program. The course and examinations were conducted entirely on the internet. The total cost of this legal education was $10,000.00. The debtor paid his fee in installments of about $150.00 per month. At the time of the filing, there was a balance of $5,819.10, still remaining to the school.

a. Upon receiving notice of the debtor's Chapter 7 filing, the school responded by e-mail stating "If the debt owed to it is 'liquidated through bankruptcy', . . . [the debtor] 'will not be eligible to receive [his] degree." Nor would Novis "validate, certify and/or verify [his] graduate status to employers."

b. Upon receiving his discharge, the debtor moved to hold the law school in contempt based upon its failure to provide a transcript or to deliver a law degree.

2. Section 523(a)(8) provides the following debt to be non-dischargeable:

> (A)(i) An educational benefit overpayment or loan made, insured, or guaranteed by governmental unit, or made under any program funded in whole or in part by a governmental unit or non-profit institution; or
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> (ii) An obligation to repay funds received as an education benefit, scholarship, or stipend.

3. Existing Case Law: The court noted that it was able to identify only two prior cases directly on point. However, it began its reasoning by identifying the three lines of cases addressing whether the withholding of a transcript or degree violated the automatic stay.

a. The majority view is that the withholding of a transcript or the refusal to issue a diploma violates the automatic stay as they are acts motivated by an attempt to collect a pre-petition debt. See In re Mu'min, 374 B.R. 149, 155 (Bankr. E.D.Pa. 2007) (footnote 15 provides an extensive list of cases finding a violation of the automatic stay).

b. The second line of cases, emanating from the Third Circuit have found that universities do not violate the automatic stay when they withhold a debtor's transcript where the underlying debt is a student loan which is nondischargeable. See eg. Johnson v. Edinborough State College, 728 F.2d 163 (3d. Cir. 1984).

c. The third line of cases reasoned that the withholding of a transcript would constitute a violation of the automatic stay "unless the debt has been declared nondischargeable." See In re Billingsley, 276 B.R. 48 (Bankr. D.N.J. 2002) (debtor conceded at oral argument that debt was nondischargeable).

d. The court identified only two published cases addressing the issue of whether the withholding of a transcript (or refusal to allow the debtor to register for classes) after the discharge of the debt constituted a contempt of the Section 524(a)(2) discharge injunction.

4. Court's Analysis: The court determined that the tuition obligation was not "an educational benefit overpayment", nor was it received as a "education benefit, scholarship, or stipend". Thus, to render the debt non-dischargeable it must be viewed as a "loan". The Moore court, relying upon a decision of the Second Circuit, In re Renshaw, 222 F.3d 82, 90-91 (2d Cir. 2000), found that the non-payment of tuition does not constitute a loan as the school never agreed to extend credit and the student never agreed to pay on account of said credit at a later point in time. On this basis the court viewed the debt as a dischargeable debt and thus not subject to the lines of cases authorizing universities to withhold degrees and transcripts to enforce a non-dischargeable obligation. The Second Circuit reasoned:

> The unilateral [decision] not to pay tuition when it came due did not constitute a loan and that the unpaid tuition debt was therefore not excepted from discharge under 523(a)(8).

Insofar as the debtor was discharged the refusal to deliver the transcript and confer a degree, was deemed to violate the 524 injunction and constituted a contempt.

5. The effect of the court's determination that the debt to Novis was dischargeable distinguished Moore from the more difficult fact pattern where the tuition obligation was determined to be a loan and therefore non-dischargeable.

6. That body of case law holding that there is no violation of the discharge injunction to withhold a transcript, etc. to collect a non-dischargeable debt, have to overcome certain analytical hurdles that may case some doubt upon their result.

a. Does the same course of conduct during the pendency of the automatic say (before the discharge is granted) constitute a violation of the automatic stay? It would appear that it does, as there is no statutory exception to the automatic stay for acts to collect a nondischargeable debt.

(1) If the withholding violates the automatic stay, should the timing of the debtor's demand for a transcript be determinative upon the school's obligation to deliver it.

b. Does a debtor have property rights in his degree and transcript? See In re Kuehn, 563 F.3d 289 (7th Cir. 2009) (Easterbrook, J.) (rights are determined under state law and property rights may be determined by long standing custom and practice.) Court concluded debtor has property rights in transcript and degree.

c. What is impact of § 525 anti discrimination statute?