

Newsletter

Volume XXII, Number 2 Debtor-Creditor Section, Oregon State Bar Summer 2003

COMMENTS FROM THE CHAIR

By **Gary Scharff**



Gary Scharff

The Oregon economy continues to languish under a burden of high unemployment and weak business growth. As a result, bankruptcy numbers, and case-

loads for creditor- and debtor-side attorneys, continue to grow. The people we serve continue to be especially harshly affected by the economic downturn. For debtors, the harsh effects go beyond simply losing a job or being unable to find one after months of unemployment. Because Oregon is so dependent upon the income tax to fund schools and other services, the ripple effects of lost state revenues exacerbate the damage to people who need state help during periods of collapsed financial resources.

In the last issue I invited Section members to consider how our experience as debtor-creditor practitioners, as well as our training and skills as attorneys generally, equip us to take on the extra role of informed and analytical citizen and neighbor. In the face of ideological polarization and often emotional rhetoric grounded in inaccuracies and presumptions, I suggested becoming active in respectful and responsible policy discussions. We have an

opportunity to help our community develop practical, collective responses to the real experiences of suffering and loss resulting from the economic difficulties of Oregonians.

One area deserving policy attention is the tax structure of our state and local governments. That discussion has already begun in various areas, from initiatives of legislators and the governor, to invitations to participate in a dialogue on the pages of *The Oregonian*. I urge you to weigh in as various proposals are developed and evaluated at what may be an historic policy moment for our state.

Underlying whatever restructuring suggestions may evolve from these discussions, I believe a dialogue is needed now about the role of taxation in a democratic society. It is a given that no one but the soft of head "likes" taxes. There are always some items that substantial tax dollars are spent on that we view as mistaken priorities. Those of us who work hard for our income are frustrated to see our toil translated into forced tax payments that fund bad choices. For those fortunate enough to inherit wealth or whose wealth comes from investments rather than work, there is a similar frustration: ownership of one's gold implies an entitlement to control the disposition of it, and forced tax payments that fund bad choices compromise that entitlement.

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In a larger sense, however, “taxes” is a word for the collective choices we make as a democratic people. We choose to fund public schools; we choose to train and arm police and corrections officers; we choose to pay for medication, care and support for people – children, the ill and mentally impaired, the disabled, the elderly – who are unable to generate the money required to support themselves; we choose to fund implementation of our federal and state constitutions and statutes through court systems that adjudicate disputes over the rights created by these constitutional, statutory and common law choices.

Since the Reagan years some citizens have developed an especially strong antipathy toward taxes in general. Libertarians, as well as President Bush and others who share his radically conservative ideology, suggest by their rhetoric that taxes are an illegitimate process of taking “your money” as a citizen. How we spend our tax dollars is always a fair and necessary policy issue. However, in my view this rhetoric is dangerous to our life as a people. It denies our common commitment, established in the Declaration of Independence and the Constitution, to make collective policy choices which, to have practical effect, must be funded. Taxes are high because of the choices we have made; if taxes are too high we need to review our choices and make better ones. But choosing against taxes in principle, with the sometimes open and sometimes hidden objective of “starving” government, is not simply choosing against particular undesirable choices. It is choosing to disable the very process of choosing, thereby undermining our ability to act responsibly as a democratic people.

Not only is anti-tax rhetoric dangerous to democracy, it is also inaccurate in its implication that wealth is a result of individual choices and effort alone. This focus ignores the collective source of any particular individual’s development of wealth. The billionaire Warren Buffett recently wrote in the *New York Times* in opposition to President Bush’s recent tax proposal (since enacted in part). He noted that he and his hardworking receptionist paid roughly the same proportion of their incomes in taxes – about 33%, when sales, payroll and other taxes were included. With the president’s tax break for dividends, his proportion drops to 3%, while hers is unchanged. He found that outrageous. He noted that if he and she had been both born in Bangladesh, the value assigned by the market there to his skill-set – capital allocation savvy – would not have differed significantly from the value assigned to hers. Luck, along with a pre-existing American investment market, was the primary source of his wealth.

Oregon debtors and creditors continue to move through our offices and courts, and we continue to make our livings by providing services to them. As we do, it may help us better appreciate their circumstances, and our responsibilities as American citizen-lawyers, to consider that the services we provide have value only because of the debtor-creditor laws which are among the collective choices we and our forbears have made as a democratic people. We would do well to work to preserve the democratic value that affirms the importance of making responsible, collective choices, including tax choices.

Please mark your calendars for Friday, November 7, 2003, as the date of our 2003 Annual Meeting. We have scheduled our business meeting to occur over the lunch hour of the all-day Judge Perris-David Epstein bankruptcy CLE program occurring in Portland on that date. Budget permitting, we hope to provide the lunch free of charge to Section members. Our custom in the past has been to link the annual meeting with a CLE that begins at 1:00 on a Friday and concludes on Saturday at noon; this year we will add a Saturday morning program to the Perris-Epstein event to include a state-law case update, an ethics presentation, and one or two shorter topics including a report on the progress of the bankruptcy court’s rollout, beginning in late 2003, of its electronic case management (ECM) plan.

A word of caution to those members of the Section who have discovered the value of our email Listserv for communicating questions and comments on various topics of law and practice. What is posted to the Listserv reaches most of the 670 members of our section, including the bankruptcy judges and section members who are or may become opposing counsel on a matter for which advice is asked or offered, lawyer to lawyer. Although the Listserv does not function in “real time,” it has come to resemble a chatroom as messages often fly fast and furious on a daily basis. One bankruptcy judge has expressed concern to the section’s Executive Committee that specific scenarios that might eventually become matters of adjudication come to this judge unsolicited and ex parte. Other section members simply prefer not to have their emailboxes fill with messages unrelated to official Section business.

So email junkies: stay tuned. The Executive Committee is working with the Bar to develop a second, “opt-in” listserv as a “law and practice” alternative to the official section listserv. In the next issue of the

Newsletter we will focus on ethical and malpractice issues relating to the dissemination of too much detail on specific matters to too broad a class of recipients. In the meantime it may be useful to some Section members to reconsider the full significance of your use of the Listserve for law and practice matters, and to check the Listserv invitation email you received initially to understand the protocols of use of this very handy communication device.

If you have suggestions or comments concerning areas where the Section may better serve you as Section member or the public, please feel free to contact me (telephone 503-493-4353; email gs@scharfflaw.com) or any of the chairs of our various Section committees noted below.

SECTION COMMITTEES AND CHAIRS:

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Susan Ford - 503-227-1111

Consumer Bankruptcy

Mike Scott - 503-236-0209

Continuing Legal Education

Miles Monson - 503-646-9230

Legislative Action

Gary Blacklidge - 503-295-2668

Moot Court Competition

Judge Randall Dunn - 503-326-4175

Newsletter

Deborah Guyol - 503-281-2446

Pro Bono Activities

Valerie Auerbach - 503-228-6044

Saturday Session

Doug Schultz - 541-686-8833

Many thanks to the committee chairs, and to you all, Section members, for your contributions as professionals to our legal system and to the public.

NOMINATIONS FOR 2004

The annual meeting will be held on November 7, 2003 at 12:45 pm during the Perris-Epstein Bankruptcy Updates seminar at the Oregon Convention Center in Portland.

Following are executive committee nominations:

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Debtor-Creditor Newsletter

The Debtor-Creditor Newsletter is published three times a year by the Debtor-Creditor Section, Oregon State Bar, P.O. Box 1689, Lake Oswego, OR 97035.

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The purpose of this publication is to provide information on current developments in the law. Attorneys using information in this publication for dealing with legal matters should also research original sources and other authorities.

AVOIDING TAX ERRORS WITH COD

By Jeff Wong

Greene & Markley PC

Discharges and other cancellations of indebtedness (known as COD) are common in debtor-creditor practice. The Internal Revenue Code makes some COD transactions taxable. The tax laws deem relief from the obligation to repay a loan or pay the full price for goods or services to be a form of income.

The notion that the settlement or discharge of a debt can give rise to an income tax is odd and easy to overlook. Many COD transactions are not reported on returns, and the IRS is not particularly vigilant with COD. COD income does, however, become an audit item a few times each year, and a COD adjustment can be catastrophic. COD, like capital gain, is a form of income that can be realized without receiving any money. When the debt discharged is large, the tax due can be large, and the debtor might not have money to pay the tax.

Fortunately, discharge of debt is the *raison d'être* of bankruptcy. Internal Revenue Code (IRC) §108 protects a fresh start by relieving debtors from paying tax on debts discharged in bankruptcy. Outside bankruptcy, the "insolvency exception" of §108 relieves debtors from tax on canceled debts to the extent they are insolvent when the debts are canceled. That is, the debtor who is \$40,000 insolvent (*e.g.*, who has assets of \$60,000 and debts of \$100,000) at the time he realizes \$50,000 in COD income (*e.g.*, by settling a \$70,000 debt for \$20,000) reports only \$10,000 as income.

Section 108 provides three other kinds of COD on which no tax is due: (1) the excess of secured debt over the market value of and debt remaining due on real property used in a taxpayer's trade or business; (2) certain types of farm debts; and (3) student loans forgiven under the terms of the loan agreement upon the borrower's performance of services.

ATTRIBUTE REDUCTION AFTER RELIEF FROM COD

The tax analysis, however, does not stop with the conclusion that the debtor need not pay tax on COD. Although §108 relieves a debtor from paying tax, it sometimes extracts a price. When §108 allows a debtor to exclude COD from taxable income, it also requires him to reduce beneficial tax attributes that would otherwise reduce tax in future years (*e.g.*, net operating loss-

es, capital losses, and basis in property) to the extent of the excluded COD. Assume a bankruptcy debtor got \$20,000 of debts discharged on December 15, 2002. At that time, he has a \$50,000 net operating loss. Assume that the bankruptcy exception of §108 relieves the debtor of paying tax on the discharged debts. The debtor may use the loss to offset income earned during 2002. On the first day of 2003, the debtor must reduce any remaining losses by \$20,000.

If the debtor does not have operating losses, but has a \$30,000 capital loss, must he reduce his capital loss by \$20,000. If the debtor had no losses, but has a parcel of real property with a \$100,000 basis, he must reduce his basis by \$20,000. Section 108 protects the debtor's fresh start by not burdening him with a new tax. It also, however, precludes him from using old losses to reduce tax on income earned in his new financial life.

The obligation to reduce tax attributes cannot safely be ignored. Several timing issues should be considered, because filing a bankruptcy case or disposing of property at the wrong time can dramatically increase the tax a debtor incurs. The time to consider the effect of attribute reduction is before the bankruptcy or other event causing cancellation of the debt. Once the COD occurs, it will usually be too late to avoid adverse tax consequences.

AUDITS FOR FAILING TO REDUCE TAX ATTRIBUTES

Failing to reduce tax attributes as required by the IRC is a common mistake. Many lawyers and some accountants are not aware of the attribute reduction requirement. The IRS occasionally ferrets out taxpayers who didn't reduce attributes after receiving a bankruptcy discharge.

This can be disastrous. If the taxpayer, for example, should have eliminated a \$150,000 operating loss, but instead incorrectly claimed the losses as deductions against two or three years of post-discharge income, the IRS can disallow the loss deductions and assess the tax that should have been paid. State and federal rates could produce a tax of \$50,000 or more with \$150,000 of income, plus interest. The bankruptcy schedules are a convenient road map to debts and the required reduction.

If the debtor had no losses or basis in property, no attribute reduction in the discharge or later years is required. Reducing the basis of a personal residence typically has no adverse tax effect, since individuals generally pay no tax on the first \$250,000 of gain from residence sales.

MAXIMIZING THE USE OF AVAILABLE LOSSES AND BASIS

Losses are valuable assets. The debtor with significant losses or basis in property should consider how to make the best use out of these attributes before they are eliminated. Together, federal and Oregon tax rates make every dollar of net operating loss worth up to fifty cents on each dollar of earned income (federal maximum income tax rate is 38.6%; state tax rate is 9%). Maximizing the use of losses and basis before they are reduced can yield significant tax savings.

Attribute reduction occurs on the first day of the tax year following the year in which the COD occurs. Thus, the debtor described above who got his bankruptcy discharge on December 15, 2002 can offset income earned during 2002, and may lose the balance of his losses on January 1, 2003. If, however, that debtor had delayed the filing of his case or confirmation of his plan for three weeks, so his discharge came on January 5, 2003, he would not have to eliminate losses until January 1, 2004. A three-week delay could allow the debtor to avoid paying tax on another full year of income. We all know that the discharge in a chapter 7 case is usually granted about four months after filing. This knowledge is valuable if the debtor has losses.

If the debtor owns properties which will be sold or lost to creditors and the properties produce gain upon sale or foreclosure, the debtor should try to dispose of the properties before his losses and basis are eliminated. Individual debtors disposing of gain-rich property should also insure that the properties are transferred while the debtor still has the right to use his own losses. When individuals file chapter 7 or 11, IRC §1398 passes the debtor's operating and capital losses to the estate. The estate can use them against its income, and the debtor has no losses during the case. The laws provide for the return of unused losses to the debtor after the case is closed, but estate income and attribute reduction often eliminate the losses before closure.

Failing to consider the transfer of losses to the bankruptcy estate can be costly. Assume a debtor holding gain-rich property files chapter 7 just before foreclosure. Assume the debtor has significant capital or ordinary losses. Commencement of the case slows foreclosure momentarily, but the creditor gets relief from stay and the Trustee abandons the property. Abandonment shifts the tax consequences of foreclosure back to the debtor, and the property is foreclosed while the estate holds all the debtor's losses. Result? The debtor pays taxes on gains he could have offset with losses if he had simply let the property go before filing bankruptcy.

IS COD ALWAYS TAXABLE?

The tax laws deem discharge of certain types of debts **not** to be taxable. Section 108 exempts COD from taxation and attribute reduction when payment of the debt would have been deductible. A debtor's discharge of \$20,000 of business vendor debt, for example, has no tax effect since payment of the vendors would have been deductible (unless the debtor was an accrual basis taxpayer who had deducted the debts when they became due). The discharge of home mortgage interest or business loan interest also is usually not taxable.

The US Tax Court's decision in *Whitmer v. Comm'r*, Tax Court Memo 1996-83, holds that the discharge of personal guaranty debts generally produces no tax. The theory making COD taxable is that receiving money, goods, and services without having to pay for them is a form of enrichment. If a guarantor did not receive personal benefit from the money, goods, or services, but rather agreed to potential liability for the benefit of another, the guarantor is not enriched by the discharge and no tax should result.

There is no tax due when a debtor is relieved of payments on a non-recourse debt. Assume the debtor owns real property subject to a \$100,000 mortgage obligation. The property is worth \$80,000, and the debtor is not personally liable on the debt. If the property is forfeited to the secured creditor, the debtor can walk away from the remaining \$20,000 due. Quite logically, the tax laws say the debtor has no COD income, since there was no personal indebtedness. They also say, however, the debtor realizes a full \$100,000 of value from the surrender of the property when computing gain. The debtor escapes COD income, but gets stuck with a larger gain tax.

These principles warrant careful scrutiny of the debtor's schedules after receipt of a discharge. The debt schedules of a crashed business owner typically contain numerous deductible debts and personal guaranties. The taxable COD or attribute reduction required by the discharge might not be as bad as it first appeared.

BEWARE OF COD WITH PASS-THROUGH ENTITIES

Liquidating pass-through entities (S corporations, partnerships, and partnership LLCs) poses special COD issues. When COD is realized by a pass-through entity, it is passed to the entity's owners.

Liquidating entities do not get a discharge in bankruptcy, and thus the discharge exception to COD does not

apply. If the entity is insolvent, the date of final distribution is often the date that unpaid debts are deemed canceled for tax purposes. The insolvency exception is typically the only exception that protects owners from flow-through COD.

Attribute reduction with an S corporation, if it must occur, occurs at the corporate level under special rules. Fortunately, liquidating S corporations typically do not pass taxable COD to shareholders. Section 108 states that for purposes of the insolvency exception, insolvency of an S corporation is tested at the corporate level. The corporation being liquidated in bankruptcy is usually insolvent enough to produce no taxable COD.

Partnerships and LLCs that have chosen partnership accounting are a different story. Attribute reduction, if it must occur, occurs at the partner level. Insolvency, for purposes of the insolvency exception, is tested at the partner level. This allows a hopelessly insolvent partnership to produce taxable COD tax for partners, since solvent partners cannot use the insolvency exception despite the partnership's insolvency. The joint liability general partners share with their partnerships (and similarly, personal guaranties of LLC members) creates difficult questions about the timing of cancellation of partnership and LLC debt. Since the tax laws do not deem a debt to be canceled until all reasonable collection efforts have been exhausted, joint liability can protract realization of COD for years. Placing a partnership with debts greatly exceeding its assets into liquidating bankruptcy can be the beginning of a long and treacherous tax odyssey.

CONCLUSION

COD should be a significant consideration in many debtor cases. If the debtor has large losses or secured debts exceeding asset value, tax analysis is a key part of pre-bankruptcy or workout planning.

SATURDAY SESSION

The Saturday Session this year will be held on September 6 at the Sweetbrier Inn, 7125 SW Nyberg Road, Tualatin, right off I-5. It runs from 8:30 am to 1:00 pm and includes continental breakfast and box lunch. Please mark your calendar and watch your mailbox for your invitation. Contact Doug Schultz for more information.

A TRAP DOOR IN LANDLORD STATUTES

By Casey Mills

Miller Nash, LLP

Imagine you are a lender secured by an interest in debtor's equipment used at a plant that debtor rents from landlord. Debtor is in financial distress, but you feel pretty good because this is one of those rare cases where the collateral is worth much more, even at liquidation value, than debtor's combined obligation to you and the landlord. The landlord brings a foreclosure action and provides you with notice. You send a letter to the landlord setting forth your interest and asking that proceeds in excess of the claim secured by the landlord's lien be provided to you. You sit back and let the landlord liquidate the collateral, expecting the excess proceeds to be delivered to you. But the proceeds never come, and you have lost your lien.

Can't happen? It appears that under the Oregon landlord lien statute, it will happen.

In Oregon a landlord has a lien against all chattels, except wearing apparel, brought by a tenant onto the leased premises to secure the payment of rent and certain additional advances. ORS 87.162. Under ORS 87.146(1)(a), a landlord's lien has

priority over all other liens, security interests and encumbrances on the chattel subject to the lien, except that taxes and duly perfected security interests existing before chattels sought to be subjected to a lien created by ORS 87.162 are brought upon the leased premises have priority over that lien.

There is little case law (and very little legislative history) interpreting ORS 87.146(1)(a). It appears safe to say that when the tenant enters into the lease of the property, brings onto the property expensive equipment, and then grants a security interest in the equipment to the lender, the landlord's lien would have priority over the perfected security interest of the lender. In any event, we assume here that the landlord's lien does have priority over the lender's perfected security interest.

The Oregon statutory scheme provides the landlord with the option of foreclosing its lien by suit or at a public auction to the highest bidder. ORS 87.182(2). The landlord is required to provide notice of the foreclosure sale to all persons with a security interest in the property to be sold who filed financing statements perfecting that security interest in the office of the Secretary of State or in the office of the appropriate county officer of

the county where the sale is to be held. ORS 87.196. Notice also must be provided to the tenant, posted, and, if the fair market value of the property to be sold is more than \$1,000, published once a week for two successive weeks in a daily or weekly newspaper. ORS 87.192. So, as noted in the hypothetical above, the lender will receive notice.

The landlord must sell all the tenant's property; there is no provision for repeat partial sales to satisfy recurring rent. ORS 87.206 determines the disposition of the proceeds after the foreclosure sale. The proceeds of the sale are applied first to pay the expenses associated with the sale and then to discharge of the landlord's lien. Any excess funds are distributed as follows:

After the payment of expenses and the discharge of the lien, any amount remaining shall be paid by the lien claimant to the treasurer of the county in which the foreclosure sale is made. The remainder shall be accompanied by a statement of the lien claim and the cost of foreclosing the lien, a copy of the published or posted notice and a statement of the amount received for the chattel sold at the sale. The county treasurer shall credit the remainder to the general revenue fund of the county, subject to the right of the lien debtor or the representative of the lien debtor to reclaim the remainder at any time within three years of the date of deposit with the treasurer. If the remainder is not demanded and claimed within such period, it shall become the property of the county.

ORS 87.206(2).

According to this section, excess funds go to the county to be provided to the debtor tenant. The lender with a junior security position is out of luck. The only remedy the statutory scheme provides to the junior lienholder is noted in ORS 87.196(2), under which the lender with a junior security interest is afforded the privilege of paying the landlord the amount of the landlord's claim secured by the lien and the reasonable expenses actually incurred in the foreclosure. The statute goes on to state that "[i]f the person does not so discharge the lien before the day of the foreclosure sale, the person's security interest is extinguished." These two statutes, ORS 87.196(2) and ORS 87.206, were enacted in 1975 and have not been materially changed since that date.

This scheme, of course, runs contrary to the general scheme provided under the Uniform Commercial Code. Pursuant to ORS 79.0615(1), after satisfaction of the claims secured by the lien that has been foreclosed, the remaining proceeds are distributed to subordinate liens. The Oregon landlord's-lien statute also runs afoul of the UCC provision that the secured creditor has an interest in the proceeds of its collateral. *See, eg,* ORS 79.0315.

Accordingly, Oregon's statutory scheme provides the tenant-debtor with a windfall – the proceeds of the lender's collateral, free of the lender's security interest, even though the lender's claim has not been satisfied. The only way the lender can preserve its lien is to make an advance to satisfy the landlord's claim.

The legislative history does not explain why the statute was structured this way. There does not appear to be any legitimate purpose for freezing out the secured lender in this manner. If the landlord's-lien statute provided for distribution of proceeds to the junior secured creditor after satisfaction of the claim secured by the landlord's lien and all costs of sale, the landlord would be protected and paid. This change would not require any additional effort on the part of the landlord, which already must provide notice to the secured creditor. Indeed, the Washington landlord's lien statute provides for surplus proceeds to be paid to the junior secured lender. *See* RCW 60.10.030.

It appears that this trap for lenders was caused by an oversight of the legislature. Until the trap is sealed, the secured lender can protect itself either by obtaining a landlord's lien waiver (or subordination agreement) from the landlord or by making sure that its loan documents allow advances to pay claims secured by senior interests, which advances would be added to the secured claim of the lender.

YOUNG LAWYERS' COMMITTEE OF DEBTOR-CREDITOR SECTION IS BEING FORMED

An organizational meeting and elections for the young lawyers group will be held on Thursday, September 18 from noon to 1 p.m. at the Bankruptcy Courthouse, 8th floor meeting room. A Bankruptcy Clerk's Office tour of the Portland Bankruptcy Court will held from noon to 1 p.m. on Wednesday, October 8, starting in the 8th floor meeting room. A Bankruptcy Clerk's Office tour will held at the Eugene Bankruptcy court in November, date and time to be announced.

Please contact Scott Hutchinson (503-231-9333, scott@hutchinson-law.com) or Charlie Harrell (503-241-4869, charrell@vandenbos-chapman.com) if you have questions or would like to be added to the email list and receive notice of upcoming events and meetings.

SUPREME COURT CASE NOTE

By Matthew Arbaugh
Farleigh, Wada & Witt, PC

**DEBT FROM SETTLEMENT AGREEMENT CAN
STILL BE DEBT FOR FRAUD**

Archer v. Warner, 123 SCt 1462 (2003)

Before filing bankruptcy, the debtors settled a state court suit alleging fraud by the debtors. The debtors agreed to pay a promissory note in return for a full release of claims against them. The debtors never made a payment and the creditors sued to enforce the settlement agreement. In response, the debtors filed a chapter 7 petition and sought to discharge the debt. The bankruptcy court granted the discharge and the district court and court of appeals affirmed, holding the settlement agreement and release effected a novation, substituting the new settlement debt for the old fraudulent debt.

The Supreme Court took this appeal because the circuits disagreed over the proper treatment of the debt. The Court reversed. It ruled that despite the release of the underlying tort claims, the debt could still be treated as one for money obtained by fraud and nondischargeable pursuant to §523(a)(2). The Court relied on its ruling in *Brown v. Felsen*, 442 US 127 (1979), holding that reducing a debt to judgment does not “bar inquiry into the true nature of the debt.” The Court remanded to the bankruptcy court for further hearings on the true nature of the debt.

NINTH CIRCUIT CASE NOTES

By Karl E. Hausafus
Preston Gates & Ellis, LLP

SWINGIN’ SWAP AGREEMENTS

Thrifty Oil Co v Bank of America,
310 F3d 1188 (9th Cir 2002)

The Ninth Circuit has held that termination damages under an interest rate swap agreement are allowable and do not constitute unmatured interest under §502(b)(2).

APPELLATE PRACTICE FOR DUMMIES

In re O’Brien, 312 F3d 1135 (9th Cir 2002)

The Ninth Circuit dismissed a creditor’s appeal that ignored the Federal Rules of Appellate Procedure. The appellant’s brief did not contain the required corporate disclosure statement, jurisdictional statement, appropriate references to the record, appropriate summary of argument, and statement of standard of review; the appellate record was missing the notice of appeal, a complete docket from the lower courts, and relevant excerpts of trial transcript; and many documents that were provided were so poorly copied as to be incomplete and unintelligible.

**WHOLLY UNSECURED TRUST
DEED NOT ENTITLED TO
ANTIMODIFICATION PROTECTION**

In re Zimmer, 313 F3d 1220 (9th Cir 2002)

Chapter 13 debtor filed suit to avoid lien of second position trust deed. Bankruptcy court held that creditor’s lien was protected from modification under 1322(b)(2) and the district court affirmed. The Ninth Circuit reversed.

The Supreme Court in *Nobelman v Am Sav Bank*, 508 US 324, 113 SCt 2106 (1993), held that a creditor whose claim is at least *partially* secured by value in the debtor’s residence is entitled to protection from modification under §1322(b)(2). Here, in a case of first impression, the Ninth Circuit held that where amounts secured by a prior deed of trust exceed the *entire* value of the debtor’s principal residence, a creditor in second position holds a wholly unsecured claim under § 506(a). Such a claim is not entitled to § 1322(b)(2)’s antimodification protection and may therefore be stripped in its entirety. This decision places the Ninth Circuit in line with the majority of other circuits to consider this question.

FILING TO ALTER CREDITOR'S RIGHTS IS NOT BAD FAITH PER SE

In re Sylmar Plaza, LP, 314 F3d 1070 (9th Cir 2002)

Solvent debtor filed chapter 11 solely for purpose of securing its prepetition default and avoiding contractual default interest rate. At confirmation, the bankruptcy court overruled creditor's objection that the plan had not been proposed in good faith and the BAP affirmed. The Ninth Circuit rejected the creditor's proposed *per se* bad faith rule and upheld the BAP.

While confirmation of a plan under §1129(a)(3) requires that the plan be proposed in "good faith," that term is not defined within the Code. The creditor argued that a proposed plan that leaves the debtor solvent while permitting it to avoid paying post-petition interest at the default rate lacks good faith *per se*. The Ninth Circuit held that the power to cure under §1123(a)(5)(G) authorizes a plan to nullify all consequences of default, including default interest penalties. Given the specific power to cure a default, "it makes no sense to treat a plan invoking that power as lacking good faith." The court therefore upheld the BAP's decision and the bankruptcy court's finding of good faith.

COURT EXPANDS ORDINARY COURSE DEFENSE

In re Jan Weilert RV, Inc, 315 F3d 1192 (9th Cir 2003)

Debtor RV dealer took two vehicles as trade-ins and paid the lienholders within 21 and 41 days after each vehicle's resale. Debtor filed bankruptcy within 90 days of the first payment and the trustee filed suit to recover each payment under § 547(b). Each lienholder asserted a § 547(c)(2) ordinary course defense (among other things), but the bankruptcy court held that the payments did not satisfy § 547(c)(2)(C)'s requirement that each payment be made according to ordinary business terms. The court therefore ordered the payments set aside, and the BAP affirmed.

The Ninth Circuit reversed, holding that the lower courts erroneously limited their analysis to the average transaction in the industry rather than examining the broad range of practices between similar debtors and creditors in financial straits. Based on trial testimony, the bankruptcy court found that payoffs in the RV business would meet the §547(c)(2)(C) ordinary course standard if made within 20 days of receipt of funds from a third-party purchaser. Consistent with its previous decisions, the Ninth Circuit held that "ordinary business terms" means a payment must be "ordinary in relation to prevailing business standards." A court must therefore look to "those terms employed by similarly situated debtors and creditors facing the same or similar problems. If the terms in question are ordinary for industry participants

under financial distress, then that is ordinary for the industry." Here, the court held that "ordinary business terms" refers to the *broad range* of terms encompassing the practices employed by debtors and creditors, including terms that are ordinary for those in financial distress. Under this "broad range" analysis, only a transaction that is so unusual or uncommon "as to render it an aberration in the relevant industry" will fall outside the ordinary course. In this case, the evidence established that the average time for payoff of a trade-in was 20 days from receipt of funds from a third-party purchaser. However, the testimony also established that the overall range was from one to 45 days of receipt of such funds. Therefore, the court held that the lower courts' limitation to a 20-day average was a mistake and that both payments fell within the "broad range" of terms that encompasses the practices employed by similarly situated debtors and creditors facing the same or similar financial problems.

DEBTOR'S ATTORNEYS AWARDED COSTS OF PREPARING AND DEFENDING FEE PETITIONS

In re Smith, 317 F3d 918 (9th Cir 2002)

Chapter 11 debtor's case was converted to chapter 7 after he defaulted under the terms of his plan. After conversion, special counsel employed by debtor to handle state-court community property litigation sought to recover its fees and costs as administrative expenses, including fees incurred in defending its fee petitions against the debtor's challenges. In addition, debtor's bankruptcy counsel sought compensation for fees it incurred after it withdrew as debtor's counsel, including fees for preparing its fee petitions and defending them against the debtor's challenges. The bankruptcy court awarded both attorneys most of their fees, the district court affirmed and the debtor appealed. The debtor argued that §330(a) does not permit the award of fees to chapter 7 or 11 debtors' attorneys, and that even if it did, the fees awarded to both attorneys failed to satisfy the benefit analysis employed in *In re Xebec*, 147 BR 518 (9th Cir BAP 1992).

In a lengthy opinion, the Ninth Circuit upheld the fee awards. The Court noted that in 1994, Congress amended 330(a) of the Code to codify much of *Xebec* in §330(a)(4)(A) and that the statutory framework now controlled any fee analysis. In accordance with its previous decisions, the court held that §330(a)(4)(B)'s express authorization of fee awards to debtors' attorneys in chapter 12 and 13 cases does not exclude such an award in chapter 7 or 11 cases. The court held that §330(a)(4)(A) no longer distinguishes between compensation for services rendered before or after a trustee has

been appointed. Fees may be awarded to attorneys under §330(a)(4)(A) so long as they do not include an unnecessary duplication of services or include services that were not reasonably likely to benefit the estate or that were necessary to the administration of the case.

The debtor argued that preparation of a fee petition benefits only the law firm and not the estate; §330(a)(6), however, expressly provides for compensation of such services. Furthermore, while §330(a) does not mention compensation for other services associated with the preparation of fee applications, such as litigation in defense, it does not prohibit such compensation so long as it meets the above requirements (actual and necessary, not unnecessarily duplicative, and reasonably likely to benefit the estate or necessary to its administration). In this case the fees awarded to both firms were meritorious, the fee applications were not filed merely to get litigation fees and the fees satisfied the §330(a)(4)(A) analysis.

**DEBTOR'S MAGIC – NOW YOU SEE IT,
NOW ITS EXEMPT!**

In re Stern, 317 F3d 1111 (9th Cir 2003)

After arbitration resulted in a \$4.5 million award against debtor, and after the state court issued a writ of attachment, the debtor transferred funds from his IRA into a pension plan and filed for chapter 7. The trustee sought avoidance of the transaction as a fraudulent transfer. The bankruptcy court held that the pension funds were excluded from the estate as an ERISA-qualified plan and that the transfer was not fraudulent. On appeal, the district court held that although the pension plan was not ERISA-qualified (its only beneficiaries were the debtor and his wife – neither of whom qualified as an “employee”), it remained exempt under California law, and affirmed the decision that the transfer was not fraudulent.

The Ninth Circuit affirmed. The purposeful conversion of nonexempt assets to exempt assets on the eve of bankruptcy is not fraudulent per se. A finding of fraud based upon the mere inference of such a transfer immediately prior to bankruptcy is insufficient as a matter of law to establish a fraudulent conveyance. The court found that the “badges of fraud” relied upon by the trustee were not supported by clear and convincing evidence.

**INTEREST ON NONDISCHARGEABLE DEBT
IS NONDISCHARGEABLE**

In re Foster, 319 F3d 495 (9th Cir 2003)

County filed priority claim in chapter 13 case for delinquent child support payments. After completion of plan and discharge, the county garnished debtor's wages for postpetition interest on its claim and debtor sued to enforce the discharge injunction. The bankruptcy court granted summary judgment for the County and the district court affirmed.

The Ninth Circuit affirmed. Postpetition interest on nondischargeable child support obligations, like interest on nondischargeable tax debt, continues to accrue after a petition is filed and is itself not dischargeable. Further, postpetition interest was not part of the debt as of the date of the petition. Therefore, a creditor cannot insist that such interest be provided for in the debtor's plan, and the interest is collectable postpetition. The county was thus entitled to collect its additional interest, even though it did not request post-petition interest in its proof of claim and even though it did not object to the debtor's plan.

**SECTION 365(D)(3) DOES NOT APPLY TO
DEBTOR LESSORS**

In re BCE West, LP, 319 F3d 1166 (9th Cir 2003)

Sublease required the chapter 11 debtor to use its best efforts to obtain a non-disturbance agreement from the lessor for the sublessee. Prior to filing bankruptcy, debtor defaulted on its lease payments and failed to obtain a non-disturbance agreement benefiting sublessee. Debtor failed to cure its default or obtain the non-disturbance agreement postpetition, and sublessee relocated its business and filed an administrative claim for its relocation costs. Sublessee sought administrative treatment under §365(d)(3) on the basis that debtor's breach of the lease and its failure to obtain the non-disturbance agreement caused uncertainty regarding sublessee's continued occupation of its offices, thereby forcing sublessee to incur the relocation costs. The bankruptcy court granted summary judgment on the trustee's objection to the claim because the language of §365(d)(3) was ambiguous and the legislative history supported limiting its application to debtor lessees only. The BAP agreed.

The Ninth Circuit affirmed, holding that the last sentence of §365(d)(3) limits its application to situations where the debtor is the lessee. The court also held that the sublessee was not entitled to an administrative claim under §503(b)(1)(A), because the source of the sublessee's claim arose prepetition, and its actions did not directly and substantially benefit the estate.

BAP CASE NOTES

By Matthew Arbaugh
Farleigh, Wada & Witt, PC

LIEN RELEASES AS NEW VALUE UNDER 11 USC 547(C)(1)

In re JWJ Contracting Co., Inc.,
287 BR 501 (9th Cir BAP 2002)

The debtor negotiated a payment arrangement with two creditors, whereby the creditors granted unconditional lien releases in exchange for payments from the debtor. The debtor's payments were made less than ninety days before the petition date and were therefore preferential transfers. The debtor's check to the second creditor bounced and was later replaced by a cashier's check. The trustee attempted to avoid the transfers. The creditors both claimed the lien releases constituted a contemporaneous exchange for new value under §547(c)(1).

The bankruptcy court agreed, and held that the transfers were not avoidable. The BAP reversed. With respect to one transfer, which released claims against a surety bond, the court held that the lien release could constitute new value only to the extent the underlying contingent claim of the surety was secured. The court could not discern the status of the surety's claim, and so remanded for determination of the proper amount of new value in the transaction. The BAP held the other transfer was not a contemporaneous exchange for new value. The replacement of the NSF check with a cashier's check was not contemporaneous because the cashier's check was issued in response to a demand letter from the creditor and not in exchange for the previously completed lien release.

WHEN SPOUSES ARE ALSO BUSINESS PARTNERS, FRAUDULENT INTENT CAN BE IMPUTED FROM ONE TO THE OTHER

In re Tsurukawa, 287 BR 515 (9th Cir BAP 2002)

The chapter 7 debtor's husband, who was employed by Nikon, sent repair work for Nikon's equipment to the business owned by his wife. This work was being done not by the debtor's business but by third parties, and the debtor's business overcharged Nikon for the work. Nikon sued and received a stipulated judgment. The debtor was not aware of the fraudulent actions. In a dischargeability proceeding, the BAP held the marital union alone did not justify imputing the business's fraud to the wife and excepting the judgment debt from discharge, and remanded for determination of whether there was a partnership or principal-agent relationship between the spouses. The bankruptcy court ruled that there was.

On the record and under relevant California law, the BAP affirmed the finding of a business partnership between the debtor and her non-debtor spouse. The BAP decided that under §523(a)(2), innocent partners can be liable for the fraud of their partners and the resulting debts will be nondischargeable due to the fraudulent activity. The husband's fraud could be imputed to his debtor wife, not because of the spousal relationship, but because of their status as business partners.

SECURED CREDITORS CAN REQUEST PAYMENTS POST-DISCHARGE WHEN DEBTOR RETAINS COLLATERAL

In re Garske, 287 BR 537 (9th Cir BAP 2002)

The chapter 7 debtor retained possession of her vehicle post-discharge without either reaffirming the secured debt or redeeming the vehicle. After discharge, the debtor did not make timely payments and the secured creditor contacted the debtor (in writing and by telephone) to determine whether she intended to retain the vehicle and make payments. The debtor initiated a class action suit against the creditor for violations of the discharge injunction. The trial court granted the creditor's cross-motion for summary judgment, finding the creditor was not attempting to collect the debt as a personal liability, but rather to repossess the vehicle if payments were not made. The court also ruled that telephone contacts were not improper.

In affirming, the BAP held that because the creditor was secured and the debtor retained the collateral, requests for payment were not prohibited by §524(a)(2). Contacts between debtor and creditor were inevitable because the debtor had to make payments to retain the vehicle. The creditor did not threaten the debtor. The court found the telephone contact was not a *per se* violation of §524(a)(2). The BAP also affirmed the ruling that the debt was not being collected as a personal liability but only as a condition to continued possession of the vehicle.

DISCHARGE INJUNCTION CANNOT BE MODIFIED AND OFFERS NO PROTECTION REGARDING NONDISCHARGEABLE DEBTS

In re Munoz, 287 BR 546 (9th Cir BAP 2002)

The debtor, an illegally uninsured employer, owed a substantial amount of worker's compensation to an employee's dependants. After the debtor received his discharge in bankruptcy, the Worker's Compensation Appeals Board sought to modify the discharge injunction to pursue an award against the debtor, a procedural precursor to receiving payment from the Uninsured Employer's Fund. The bankruptcy court denied the

WCAB's motion in order to "protect the debtor's discharge."

The BAP reversed for several reasons. The BAP first held that the bankruptcy court should not have treated the creditor's request as relief from stay because the stay terminates on the granting of the discharge. The BAP next held that discharge injunctions cannot be modified. Finally, the court held the WCAB's motion should have been granted nevertheless because the discharge injunction does not protect the debtor from an action to determine the debtor's liability on a nondischargeable debt. If the WCAB's award led to a claim against the debtor for reimbursement, the claim would be nondischargeable. Therefore, the WCAB should have been allowed to proceed in obtaining an award against the debtor.

"GOOD FAITH" SHOULD FIRST BE RULED ON BY THE LOWER COURT

In re Thomas, 287 BR 782 (9th Cir BAP 2002)

The bankruptcy court authorized the sale of real property under 11 USC § 363(b) but did not address the issue of the purchaser's good faith. The debtor appealed. The trustee contended that pursuant to §363(m) the property was sold to a "good faith purchaser" and the sale could not be overturned.

The BAP ruled that the existence of good faith under the Bankruptcy Code is a fact-intensive determination. The BAP stated that trial courts possessing sufficient evidence on good faith can make the determination as part of the sale approval process. Determination of good faith is not always a necessary part of approving a sale under §363, however, because "the really interesting facts" may not have emerged yet. Because the issue of good faith is too fact-intensive to be dealt with for the first time on appeal, the BAP remanded for the limited purpose of ruling on the good faith of the purchaser.

CREDITOR'S MOTION TO SET ASIDE JUDGMENT MUST BE TIMELY FILED

In re Williams, 287 BR 787 (9th Cir BAP 2002)

The debtor sought a default judgment against Sallie Mae Servicing, LP, after the creditor failed to respond to the debtor's motion to discharge the debt. Judge Brown granted the default judgment. The creditor moved to set aside the judgment, but that motion was denied because the creditor had received adequate notice of the complaint and waited too long after learning of the default before seeking to set aside the judgment.

The BAP affirmed. It was the creditor's burden to establish an adequate record for review and this creditor failed to meet the burden. Nonetheless, the BAP examined the

available record for "any plausible basis" to support the bankruptcy court's ruling, and found the motion to set aside the judgment was not filed within a reasonable time. The BAP held that the interest in the finality of judgments, coupled with the creditor's lack of justification for the delay in filing the motion dictated a finding that the motion to set aside the default judgment was not timely. The debt was discharged.

OREGON HOMESTEAD EXEMPTION APPLIES TO LEASEHOLD INTERESTS

In re Casserino, 290 BR 735 (9th Cir BAP 2003)

The debtor claimed a homestead exemption in the prepaid rent and security deposit held by his landlord. The Trustee objected and Judge Radcliffe held that the homestead exemption in ORS 23.240 applied to the debtor's leasehold interest.

The BAP affirmed. It observed the policy in Oregon is to interpret exemption statutes liberally. Further, the BAP observed that the statute references only the "abode of the owner of the exemption" and does not limit the property interests qualifying for the homestead exemption. The deposit and prepaid rent were subject to the exemption because payment of those amounts was necessary for the creation of the debtor's possessory interest. The BAP noted that Oregon case law interpreting the statute also supported the bankruptcy court's conclusion, and found support in case law interpreting similar statutes in other jurisdictions.

NEVER UNDERESTIMATE THE IMPORTANCE OF ESTABLISHING GOOD FAITH IN A SALE UNDER 11 USC § 363

In re M Capital Corp., 290 BR 743 (9th Cir BAP 2003)

The chapter 11 debtor was granted approval to sell its assets pursuant to 11 USC §363 and the approval was challenged by entities holding liens on the assets to be sold. The creditors argued they should have been allowed to credit-bid at the sale and the sale should not have been free and clear of their liens.

The BAP issued this opinion to further develop the principles for determination of good faith set forth in *In re Thomas*, summarized above. The BAP reiterated that the trial court is the proper place to decide good faith, and refused to presume good faith from the lack of evidence of bad faith. It reasoned that to presume good faith from a poor record would be equivalent to reversing the burden of proof. The BAP reaffirmed its holding in *Thomas* that the lower court does not have to find good faith, recognizing that the evidence is not always readily available at the time of the sale hearing. It did not remand this case, however, because the appellants had

waived their right to a determination of good faith when they chose to rely on the existing record and proceed with the appeal although the bankruptcy court had scheduled a hearing on good faith. Creating a detailed trial record on the issue of good faith is central to protecting subsequent purchasers of the debtor's assets.

**AVOIDABLE TRANSFERS MUST BE REPAYED
BEFORE CREDITOR CAN RECEIVE
ADMINISTRATIVE CLAIM**

In re Microage Inc., 291 BR 503 (9th Cir BAP 2002)

A stipulated settlement between the debtor and a creditor provided the creditor would receive an allowed administrative claim in a set amount. After confirmation of the chapter 11 plan, the debtor failed to pay the administrative claim. The creditor moved to compel; the debtor argued the creditor could not recover the claim until it repaid its avoidable transfer. The trial court ruled that §502(d) did not apply to administrative claims and ordered payment of the administrative claim.

The BAP affirmed the result on different grounds. After examining the statutory construction and legislative history behind §502(d) the BAP held that it applies to administrative claims as well as unsecured claims. The BAP also held, however, that this creditor's administrative claim should be paid. Because these arguments were not raised when the administrative claim was agreed to, and the claim had already been allowed by the court, the debtor could not raise new arguments at this stage of the bankruptcy in an attempt to avoid paying the agreed amount.

**EQUITABLE POWERS OF COURT DO NOT
SUPERSEDE BRUNNER TEST**

In re Blair, 291 BR 514 (9th Cir BAP 2003)

The debtor sought a discharge of student loan debt for undue hardship. The bankruptcy court applied the *Brunner* test and found none of the elements were satisfied. The debtor could maintain a minimal standard of living, was not unable to pay, and had not made a good faith effort to repay the loans. Nonetheless, the court used its equitable powers under 11 USC § 105 to grant a partial discharge of the debt. The BAP held that partial discharges can be granted under the *Brunner* test, but reversed the lower court's ruling. The BAP ruled that the bankruptcy court cannot grant a discharge of student loans under §105 without finding the debtor was experiencing "undue hardship" pursuant to the *Brunner* test.

**LOCAL BANKRUPTCY COURT
CASE NOTE**

By Karl E. Hausafus

Preston Gates & Ellis, LLP

**NON-DEBTOR SPOUSE CAN'T FORCE CREDITOR
TO SUPPORT HER LIFESTYLE**

In re Falke, 284 BR 133 (Bankr D Or 2002)

Debtor filed chapter 7 and US Trustee (UST) moved to dismiss for substantial abuse of the bankruptcy system. The UST alleged that the debtor had the ability to repay a substantial portion of his debt in a chapter 13 case if his non-debtor spouse paid her proportionate share of the joint household expenses.

Judge Brown granted the UST's motion and held that the filing was a substantial abuse of the bankruptcy system. In the Ninth Circuit, a substantial abuse may be found if the debtor has the ability to pay a significant portion of debt through a chapter 13 without undue hardship. A debtor's ability to repay is determined using the same test to see whether a debtor is contributing all of his or her income to a proposed plan. While the Ninth Circuit has not addressed whether the income of a non-debtor spouse should be considered when determining whether the debtor is committing all disposable income to the plan, Judge Brown followed the reasoning of the majority of courts that have ruled on the issue and held that a court should attribute at least one-half of the family living expenses to the debtor and the other half to the nondebtor spouse. The appropriate measure of the debtor's ability to pay for purposes of §707(b) is the debtor's sole income minus his or her one-half share of the family living expenses. Although the debtor's net monthly income was substantially the same as that of his nondebtor spouse, the spouse's *individual* expenses exceeded her net income thereby burdening the debtor with all joint expenses. After reallocating the joint expenses, Judge Brown determined that the debtor could repay 58% of the unsecured claims over a three-year plan. Judge Brown therefore held that the debtor could fund a chapter 13 plan and granted the UST's motion.

STATE COURT CASE NOTES

By Heather Harriman
Greene & Markley PC

**ATTORNEY'S LIEN ENFORCEABLE AGAINST
EITHER PARTY TO LITIGATION**

Potter v. Schlessor Co., Inc.,
335 Or 209, 63 P3d 1172 (2003)

ORS 87.474 and ORS 87.445, taken together, establish that an attorney's lien upon an action remains even after the parties have settled the legal dispute. Here, Hunt had sued Schlessor for racial discrimination. Hunt and Schlessor settled their lawsuit, Schlessor paid Hunt, and neither party informed Hunt's counsel. Potter (plaintiff in this action and Hunt's former attorney) filed his notice of attorney's lien and then instituted proceedings against Schlessor to collect his attorney fees. Schlessor argued that Potter could not enforce his attorney's lien against Schlessor because the lien attached to the proceeds of the settlement and Schlessor, having paid the settlement funds to Hunt, no longer had possession of the proceeds of the settlement.

The court held that the parties to an action cannot extinguish or affect the attorney's lien by any means (*i.e.*, settlement) other than by satisfying the underlying claim for attorney fees. Thus, both Hunt and Schlessor are obligated to satisfy Potter's attorney's lien. Although there is no statutory mechanism for enforcing the lien against Schlessor, the court held that Potter's suit against Schlessor was an acceptable method for enforcing Potter's lien.

**ETHICAL CONSIDERATIONS: IF YOU BELIEVE
THERE IS A SOUND BASIS FOR IT, ARGUE IT**

In re Magar, 335 Or 306, 66 P3d 1014 (2003)

In this disciplinary proceeding, the court considered whether the accused attorney violated DR-7-102(A)(1) and (A)(2) (pleadings and/or arguments not filed/made within the bounds of law) by filing various pleadings, motions and appeals.

In 1985, the accused represented the Korgans in a chapter 13 bankruptcy proceeding. The chapter 13 plan was confirmed. The Korgans then purchased real property from another couple, the Walslebens, and the sale contract required the Korgans to pay the property taxes. The Korgans failed to pay the taxes. In 1990, in response to a letter demanding payment of the taxes, the accused wrote a letter to the Walslebens' counsel asserting that

any foreclosure action was barred by the automatic stay in the chapter 13 bankruptcy. The opposing counsel concluded that the stay did not apply to the property in question since it was post-confirmation, and filed a state court action for strict foreclosure. The Korgans filed another chapter 13 petition and the Walslebens moved for relief from the stay, which the court granted. The accused appealed that decision. The appeal was dismissed as moot after the Walslebens sold the property. The accused appealed to the Ninth Circuit. The accused then filed an adversary proceeding against the Walslebens, seeking injunctive and declaratory relief. The Walslebens successfully moved to dismiss the adversary proceeding.

In the disciplinary proceeding, the Oregon State Bar argued that the assertions in the accused's 1990 letter were unwarranted by existing law in light of *In re Mason*, 51 BR 548 (Bankr D Or 1985), which held that the bankruptcy estate ceases to exist after confirmation. The accused countered that several other courts (namely, the Southern District of California, the District of Colorado and the Western District of Michigan) had rejected *Mason* before the accused wrote the letter. In fact, the Michigan case held that the automatic stay should remain in place post-confirmation as it applies to residential real property.

The Oregon Supreme Court ruled that the accused had not violated DR 7-102(A)(2) because he did not advance a claim or defense that was unwarranted by existing law. The Court noted in a footnote that the *Mason* decision, although from the Oregon Bankruptcy Court, is not necessarily binding, because some courts, *see, e.g., In re Bakarat*, 173 BR 672 (Bankr CD Cal 1994), have held that unless an entire federal district court binds itself to a decision by issuing that decision *en banc*, that decision is merely law of the case. Thus, the accused did not violate disciplinary rules because his 1990 letter was warranted by the confusion in the case law.

The Oregon Supreme Court also briefly considered the second Chapter 13 filing, the appeals and the adversary proceeding. The Court held that the Bar had not met its burden of proving that the accused had advanced unwarranted positions in those matters. The remainder of the opinion is devoted to another (nonbankruptcy) disciplinary matter involving a different client and relating to competent representation and neglect.

WHAT CONSTITUTES TENDER UNDER ORS 20.080?

Fresk v. Kraemer, 185 Or App 582, 60 P3d 1147 (2003)

Plaintiff sought attorney fees under ORS 20.080, which allows for recovery of attorney fees to the plaintiff in an action for less than \$5,500 where plaintiff prevailed and made a written demand for payment at least 10 days before filing the action. The statute also provides that if the defendant “tendered” an amount not less than the damages awarded to plaintiff before the plaintiff filed the action, the plaintiff may not recover attorney fees. Here, the defendant sent plaintiff a letter offering to pay the plaintiff \$3,806 upon the condition that the plaintiff’s claim would be dismissed. Plaintiff recovered less than that amount at both arbitration and on appeal de novo, but argued she was still entitled to attorney fees because the defendant’s offer was not a “tender” since it was conditional. The court held that because the defendant was legally entitled to have the plaintiff’s claim dismissed after payment (otherwise, it would not be a settlement of claims at all), it was a legally sufficient tender. Plaintiff’s attorney fees were denied.

EMPLOYMENT ISSUES: DON'T WANT TO SUE ON CONTRACT? SUE ON COMMON LAW THEORY.

Dunwoody v. Handskill Corp., 185 Or App 605, 60 P3d 1135 (2003)

The Court of Appeals recently held that a plaintiff may sue on the common law employment claim of wrongful discharge in certain circumstances even if the plaintiff has a contract with the employer providing that the plaintiff could only be terminated for just cause. The court stated existence of a contractual employment relationship does not, by itself, preclude a plaintiff from bringing a claim for common law wrongful discharge. The issue is whether a claim on the employment contract can adequately redress the injury. In this case, the court ruled that the contract did not adequately address the wrong because it only provided for recovery of accrued wages and lost wages, whereas the wrongful discharge claim is in tort and allows recovery of emotional and other damages.

PLEADINGS ALONE CANNOT DETERMINE WHETHER, AS A MATTER OF LAW, CONTRACTORS WERE ENTITLED TO RELIEF

L.H. Morris Electric, Inc. v. Hyundai Semiconductor America 187 Or App 32, 66 P3d 509 (2003)

Samwoo Naewoe (“SN”) and Samwoo America (“SA”) brought cross-claims for breach of contracts to supply labor and materials, specifically the installation of “clean room” walls. SN and SA admitted they were not licensed contractors. The trial court dismissed for failure to state a claim under ORCP 21 based upon the court’s conclusion that the matter related to a construction contract, that SN and SA were not licensed contractors, and that therefore SN and SA were barred from recovery pursuant to ORS ch 701.

The Court of Appeals reversed and remanded, holding that nothing in the pleadings or the definitions of the types of walls at issue precludes a finding that SN and SA performed under the contract. If SN and SA can prove that they performed, they would be entitled to the relief they seek. The pleadings speak for themselves and SN and SA’s claims should not have been dismissed.

EXCUSABLE NEGLIGENCE: YOU BETTER BE ABLE TO SAY WHAT HAPPENED, WITH SOME CERTAINTY

Stull v. Ash Creek Estates, LLC, 187 Or App 63, 66 P3d 515 (2003)

ORCP 71B provides that a court may set aside a judgment based upon excusable neglect. The court discussed a line of cases finding excusable neglect where the person responsible for responding to a complaint or motion “can say with some certainty that he or she took action either to file a document with the court or to have someone else file it,” but failed to ensure that the document was actually filed. The court then distinguished this case from that line of cases, holding that it is insufficient for the responsible person to state that he or she *believed* that someone else had taken care of the matter or that it was his or her usual practice to drop finished pleadings in the mail, or some other routine practice. Held: no excusable neglect.

**DON'T LET A LAWSUIT IN ANOTHER STATE
RESULT IN DEFAULT JUDGMENT WHERE
PERSONAL JURISDICTION IS VALID DEFENSE**

D.K. Realtec, Inc. v. Warren,
187 Or App 254, 66 P3d 552 (2003)

Plaintiffs obtained a default judgment against defendants (Oregon residents) in Arizona and registered the judgment in Oregon. Defendants received notice of the registered judgment, but did nothing. Defendants received notice of a sheriff's sale of their real property and then, finally, moved to stay the sale and have the judgment set aside. Defendants argued that the Arizona courts lacked personal jurisdiction over them and that they could move to set aside a judgment for lack of personal jurisdiction at any time. At approximately the same time, defendants moved to set aside the Arizona judgment for lack of personal jurisdiction. While the Oregon case was pending, the Arizona trial court held that it had personal jurisdiction over defendants.

The issue before the Oregon Court of Appeals was whether to take judicial notice of the Arizona decision and, if so, whether the Full Faith and Credit Clause precludes relitigation of the personal jurisdiction issue in Oregon. The Oregon court held that it could take judicial notice of the Arizona decision and exercised its discretion to do so. The court then held that the Full Faith and Credit Clause precluded any further litigation of the personal jurisdiction issue.

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CONSUMER BANKRUPTCY COMMITTEE

By Michelle Bertolino
Farleigh, Wada & Witt, P.C.

The Consumer Bankruptcy Committee of the Debtor-Creditor Section met on March 20, 2003 and May 22, 2003 and discussed the following matters:

1) Supplemental Attorney Fee Application.

The Portland judges believe the Supplemental Attorney Fee Application procedure may need to be changed. The judges are specifically concerned that creditors are not being adequately advised of the effect a Supplemental Fee Application has on payments to creditors.

The chapter 13 plan in paragraph 2(b)(2) gives creditors notice of the amount of attorney fees to be paid through the plan and whether those fees will be paid before or after payment of 2(b)(1) creditors. In most cases, attorney fees will be paid before secured creditors in paragraph 2(b)(1). Although 2(b)(1) creditors may be aware under the current plan language that they will not receive payments until attorney fees are paid in full, creditors are not given notice that if a supplemental fee application is filed, it could delay payments to them until the additional attorney fees are paid.

Historically, when a Supplemental Fee Application is submitted and the confirmed plan provides for payment of attorney fees prior to 2(b)(1) creditors, the supplemental fees are paid ahead of 2(b)(1) creditors.

The judges believe that the wording of the current chapter 13 Plan does not put creditors on notice that any additional fees incurred from the date the confirmation order is entered and could potentially interrupt payments to them. The Judges' position is that the wording of the current chapter 13 plan allows payment of only the original fees stated in the Chapter 13 Plan and Order Confirming Plan before payment to 2(b)(1) creditors; supplemental fees submitted by the debtor's attorneys should be paid after payment to 2(b)(1) creditors, unless proper notice is given to all creditors.

Several attorneys volunteered to provide the judges with proposals for changes to the supplemental fee application process. The attorneys who volunteered to provide the Judges with a proposal are: Ann Chapman, Todd Trierweiler, Mike Caro, Rick Yarnall and Russ Garrett.

2) Accounting Practices of Mortgage Companies.

Judge Dunn and Judge Perris attended a Judges' Education Seminar in San Francisco, at which a topic of discussion was the accounting practices of mortgage companies – both when accounts are in chapter 13 and post-discharge. There is a growing problem across the country with mortgage companies ineffectively or incompetently tracking a chapter 13 debtor's account through bankruptcy. Often mortgage companies fail to apply arrearage payments correctly or fail to bring an account current after a debtor has successfully completed the chapter 13 plan and obtained a discharge. Thus many successful chapter 13 debtors find themselves back in default and foreclosure within months of discharge.

Judge Perris noted that jurisdictions across the country are trying to address the problem. The Bankruptcy Court for the District of Ohio uses what it calls a "scream or die" letter, in which debtor's counsel provides the mortgage company with an accounting of all payments received during the life of the chapter 13 plan both pre- and post-petition. If the mortgage company has any problem with the debtor's accounting, it must file something with the court to resolve the issues prior to discharge. Such documents require the mortgage company to get its books in order before discharge rather than after. The creditor's failure to respond to such an official notice letter has been used in Ohio State Courts as a defense to post-discharge foreclosures. Judge Perris suggested appointing a committee in this District to address this issue. Todd Trierweiler and Rich Parker volunteered to report back to the group with any suggestions after they attend the NACDA Conference.

3.) General Announcements.

a. Dennis Totten with Courtesy Ford announced the Loan RE-A-Rangers Program which provides low interest, low payments and reliable transportation to individuals currently in a chapter 13 or chapter 7 case or who have recently received a chapter 7 discharge.

b. Tom Renn announced a "Young Lawyers" group. The group will promote networking and education among debtor-creditor attorneys. An organizational meeting was held on June 2, 2003.

c. Judge Brown announced that in anticipation of CM/ECF (electronic filing system) in October of 2003, the "dates unavailable" form currently used in this district will no longer be accepted.

d. Rick Yarnall, the Chapter 13 Trustee, announced that he is adding new standard language regarding proposed car purchases within Chapter 13 Plans. This updated language can be found on Mr. Yarnall's website. Jack Fisher of Rick Yarnall's office indicated the need for debtor's counsel to watch the language used in paragraph 1(e) of the current Chapter 13 Plan. Paragraph 1(e) describes any additional amounts the debtor will pay into the Chapter 13 Plan from potential claims. The language in paragraph 1(e) should describe enough to allow creditors to know what the debtor's potential claim is and analyze whether the claim will affect their treatment under the Plan. Simply referring to a potential claim listed in one of the debtor's schedules is insufficient to put a creditor on notice, given that creditors do not generally receive copies of the schedules.

The Consumer Bankruptcy Subcommittee usually meets every other month on the third Thursday of the month at 4:30 p.m. in the 8th floor conference room at the United States Bankruptcy Court in Portland. The next meeting will be September 18, 2003. All bankruptcy practitioners are encouraged to attend. Please contact Mike Scott at 503-236-0209 to add topics to the agenda or for further information.

The Debtor-Creditor Newsletter will accept camera-ready display ads

Advertising will be limited to those entities which provide goods and services to section members. Cost and ad sizes are:

Quarter page	\$150
Half page	\$250
Full page	\$450

For information, write: **Deborah S. Guyol**
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WOMBATS REPORT

By Laura J. Walker

Cable, Huston Benedict Haagensen & Lloyd, LLP

WOMBATS is a group of Women Bankruptcy Attorneys, which was formed to provide opportunities to interact with other professionals in an informal setting and to facilitate mentoring of women who are new to bankruptcy practice. A similar group in Washington graciously allowed Oregon lawyers to use the name. WOMBATS meets for brown bag lunches four or five times per year in the 8th floor conference room of the US Bankruptcy Court in Portland. The meetings include time for informal networking as well as discussions or speakers on topics of interest. No dues or paperwork are required, and anyone is welcome to attend.

The first two meetings this year were held on January 30, 2003 and March 20, 2003. The January program featured a presentation by Pamela Griffith, Vivienne Popperl and Gail Geiger of the U.S. Trustee's office for the District of Oregon. They explained recent initiatives undertaken to combat bankruptcy fraud and bankruptcy crimes, such as the requirement to present photo identification at creditor's meeting, as well as an increased focus on cases that constitute "abuse" of the bankruptcy system. They also offered interesting statistics on the number of cases dismissed for failure to provide identification and the number of challenges to chapter 7 cases under the substantial abuse standard, as well as the outcomes of the challenges..

Sylvia Stevens of the Oregon State Bar led a discussion of ethics in bankruptcy practice on March 20, 2003. Sylvia emphasized the importance of screening clients and discussed limitations on a lawyer's ability to withdraw from a case after it has been filed. There was also a lively discussion regarding how to deal with difficult clients.

Both programs were accredited by the Oregon State Bar for one hour of CLE credit. The March program is eligible for ethics credit.

WOMBATS will hold two additional meetings this year: on September 25, 2003, from 11:45 am to 1:15 pm, and on December 4, 2003 from 11:45 am to 1:15 pm. The bankruptcy court's plans to implement electronic filing will be discussed at either the September or the December meeting.

If you have ideas for topics or speakers for the WOMBATS meeting, please email me at lwalker@chbh.com. We announce upcoming WOMBATS meetings via email and you can sign up for these notices by contacting the list server at Oregon State Bar. Please call or email me and I can provide the instructions.

SEMINAR CALENDARS AND REGISTRATION INFORMATION

SEPTEMBER

12

Bankruptcy 2003: Views from the Bench; Washington, D.C.; ABI and Georgetown University Law Center

24-25

Dealing with Secured Claims & Structured Financial Products in Bankruptcy Cases 2003; New York, NY; PLI

29-30

The Legal and Business Guide to Airline Restructuring; New York, NY; ACI

OCTOBER

20

How to Incorporate UCC Article 9 Changes in Oregon Secured Transactions; Portland, OR; NBI

22-24

The 59th Annual Convention Asset-Based Financial Services Industry; Chicago, IL; CFA

27-28

The 2nd Annual Distressed Debt Summit; New York, NY; FRA

NOVEMBER

7-8

Annual Meeting
Debtor-Creditor Section
Portland, OR; OSB

DECEMBER

1-2

Distressed Investing 2003; New York, NY; RAM

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