O R E G O N   D E B T O R - C R E D I T O R

# Newsletter

Volume XXV, Number 1 Debtor-Creditor Section, Oregon State Bar Winter 2006

## HIGHLIGHTS

1 **Comments From the Chair**
*By Thomas W. Stilley*

3 **Tax Changes to the Bankruptcy Code**
*By Jeff Wong*

4 **Attorneys Just Say No to New Regulations on Debt Relief Agencies**
*By James T. Yand*

6 **Some Thoughts About Debt Relief Agencies**
*By James Ray Streinz*

8 **The New Bankruptcy Means Test**
*By Chris Fowler*

10 **WOMBATS Group**
*By Laura J. Walker*

11 **Supreme Court Case Note**
*By Douglas Pahl*

12 **Ninth Circuit Case Notes**
*By Matthew A. Goldberg*

13 **BAP Case Note**
*By Doug Pahl*

14 **Local Bankruptcy Court Case Note**
*By Matthew A. Goldberg*

14 **State Court Case Notes**
*By Heather E. Harriman*

16 **Consumer Committee**
*By Michelle Freed*

18 **Legislative Committee**

18 **New Lawyers Committee**

## COMMENTS FROM THE CHAIR

**By Thomas W. Stilley**
Sussman Shank LLP

As I begin my tenure as Chair of the Section, I look back on what the Section has meant to me, both professionally and personally, from the time I became a member of the Oregon State Bar in 1988. As a young lawyer just beginning practice in Portland, I remember wondering what kind of law I would end up practicing. Although I had developed an interest in bankruptcy law while attending law school in Texas during the oil industry collapse of the mid-1980s, I wasn't certain that bankruptcy law would be the root of my future legal career. Nevertheless, it was bankruptcy law that drew me to apply for a position with Sussman Shank and the opportunity to practice with some of the more experienced bankruptcy lawyers in the Pacific Northwest - such as Norm Wapnick and Jerry Shank, both of whom have retired.

I knew very few people in Portland, having lived in Texas all my life. I wanted to get involved in the Portland community, meet other lawyers, and actually learn to practice law. As we all know, law school doesn't prepare you for that. Getting to know the other lawyers by working with them on client matters is a slow process; thus involvement in bar activities is almost a necessity for young lawyers to expand their contacts with other members of the bar. Fortunately, I was asked by one of the lawyers in my firm to get involved with the Section's Legislative Committee. This had two immediate benefits. It helped me become more familiar with Oregon state law and it helped me meet other lawyers. Joining that committee was one of the best moves I ever made from a professional standpoint. I have made many friends throughout the years from my contacts on that committee, I have served on broader legislative work groups involving lawyers in other sections of the bar and state agencies, and I have testified before the Oregon legislature on numerous bills of interest to debtor-creditor practitioners. This has been a rewarding experience and I continue to serve on the Legislative Committee today.

The Section's work is truly done at the committee level. My plea to you is to get involved. If you are not now serving on a committee, please join one. For new Section members, a great place to start is the New Lawyers Committee. For older members, committee membership is a way to stay involved and support the work of the Section. Included in this Newsletter is a list of the Section committees and their chairs.

*Continued on page 2*

Pick a committee, call the chair, and attend the next meeting. If that committee does not suit your interest, try another one. I think you will be glad you did.

I look forward to the coming year with renewed energy. We each have to learn how to deal with the revisions to the Bankruptcy Code brought about by passage of the BAPCPA. We also have to commit ourselves to continue our pro bono activities despite the increased burden and potential risks placed on debtors' attorneys by the BAPCPA. Even if you are primarily a creditors' attorney and have no intention of ever representing a debtor, you can do your part by providing case intake and counseling at the bankruptcy clinic. Please consider attending the training session in February and sign up for a clinic slot later in the year.

Finally, I want to thank the outgoing members of the Section's Executive Committee, Ron Becker, Susan Egnor, David Foraker, Chris Hatfield, and Carolyn Wade, and the Section's Immediate Past-Chair, Peter McKittrick, for all their hard work during the last year. Kudos also go to Susan Ford, Miles Monson, and Judge Elizabeth Perris for putting on one of the best Annual Meeting and CLE events ever.

I am excited about the next year as your Section Chair and hope to provide the leadership and commitment to service that you as the members of the Section deserve. Please feel free to call me if there is something you believe the Section should be doing but is not. Suggestions from the general membership are always welcome.

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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.

# TAX CHANGES TO THE BANKRUPTCY CODE

**By Jeff Wong**
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The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 made more than twenty changes to the treatment of taxes in bankruptcy cases. One change works in favor of debtors - §1222(a)(2)(A) relieves chapter 12 debtors from priority status for capital gain tax liabilities arising from the sale of farm assets. Most of the changes, however, favor taxing authorities – by restricting a debtor's discharge rights, compelling compliance with return filing and tax payment requirements, and increasing the amounts taxing authorities can recover in bankruptcy.

The principal changes to tax treatment are as follows:

**1. Tolling Rule for Priority Status.** New language at the end of Bankruptcy Code §507(a)(8) tolls the three-year and 240-day periods for determining priority of a tax liability when collection of the liability was stayed by the debtor's involvement in a prior bankruptcy case, or a collection due process appeal under Internal Revenue Code §6320 or §6330. The three-year and 240-day periods do not run during the duration of the stay, and the pertinent priority period is extended by 90 days. The filing of an offer in compromise during the 240-day period continues to cause tolling of that period under §507(a)(8)(A)(ii)(I), and extends the 240 day period by an additional 30 days.

**2. Tax Exceptions to the Superdischarge in Chapter 13 and Corporate Chapter 11 Cases.** An amendment to §1141(d)(6) exempts tax liabilities associated with fraud or willful attempts to evade or defeat the tax. These liabilities are no longer subject to the superdischarge granted to corporations in chapter 11. No similar language compels exemption from discharge for a partnership or limited liability company. The superdischarge granted to debtors in chapter 13 under §1328(a) no longer eliminates: (a) liabilities associated with fraud or a willful attempt to evade or defeat the tax, (b) the trust fund portion of employment tax liabilities or other tax liabilities which have a withholding requirement, or (c) taxes associated with a period for which the debtor failed to file a return or filed the return late on a date less than two years prior to the petition date.

**3. Mandatory Compliance with Postpetition Return Filing and Tax Payment Requirements.** Small business chapter 11 debtors-in-possession (or trustees) are required to remain current on postpetition tax obligations and timely file all postpetition returns. §1116. If a small business debtor defaults on a postpetition tax obligation and fails to cure the default within the time prescribed by statute, the court must dismiss the case or convert it to one under chapter 7, unless it is established that conversion or dismissal is not in the best interests of the estate. §1112. Throughout all bankruptcy chapters, §521(j) allows taxing authorities to obtain dismissal or conversion of a debtor's case if the debtor defaults on a postpetition return filing and does not cure it within 90 days after the taxing authority moves for conversion or dismissal.

**4. Mandatory Filing of Prior Four Years of Tax Returns in Chapter 13 Cases.** Under new §1308(a), chapter 13 debtors who failed to file any prepetition tax returns that became due within four years prior to the petition date, must file all such returns before the §341 meeting. The debtor can obtain a maximum of 150 additional days to file the returns. If he or she fails to file the required returns, the court must dismiss the case or convert it a case under chapter 7, whichever is in the best interests of the estate.

**5. Capital Gain Tax Relief for Sales of Farm Assets in Chapter 12.** Section 1222(a)(2) eliminates priority status for income tax liabilities arising from the disposition of farm assets, thereby allowing farmers who must dispose of capital-gain-rich property to confirm and complete liquidating plans without full payment of gains taxes arising from the sales. Gains taxes not paid under the plan may be discharged.

**6. Statutory Interest Rate Required with Tax Claims.** New §511 requires use of the interest rate dictated by the pertinent tax laws whenever interest must be paid on a tax claim. In reorganization cases, the debtor must provide in the plan for payment of the interest rate in effect on the date of confirmation.

**7. Income Tax Accounting in Individual Chapter 7 and 11 Cases.** Section 346, which dictates the accounting rules for state and local income taxes for individuals in chapters 7 and 11, has been revised to eliminate differences between those rules and the accounting rules provided for federal tax purposes under Internal Revenue Code §1398. New §1115 of the Bankruptcy Code, however, makes postpetition earnings of an individual debtor in chapter 11 property of the estate, thereby shifting the income tax consequences of any such postpetition earnings from the debtor to the estate.

**8. Mandatory Disclosure of Return Filed for Most Recent Year Prior to Bankruptcy at §341 Meeting.** Section 521(e)(2)(A) requires all debtors in bankruptcy to provide the trustee, not less than seven days prior to the §341 meeting, with a copy of the income tax return

(or a transcript reflecting that return) for the most recent tax year for which the debtor filed. The debtor's case must be dismissed if the debtor fails to timely produce the return, unless the debtor establishes that the failure was due to circumstances beyond the debtor's control.

**9. The Definition of "Return."** Language added at the end of §523(a) defines "returns" as documents that qualify as returns under applicable non-bankruptcy law, or final orders of courts of competent jurisdiction on the amount of tax due. Within the Ninth Circuit and most other Circuits, to constitute a return a document must (1) be executed under penalties of perjury, and (2) contain sufficient financial information for a tax to be computed. *See, e.g., In re Hatton*, 220 F3d 1057 (9th Cir 2000). "Substitutes for returns" and assessments that occur in the absence of the debtor's filing of an actual return accordingly do not qualify as returns for purposes of the nondischargeability provisions of §523(a)(1)(B)).

**10. Minimum Payment Requirements for Tax Claims in Chapter 11.** Under amendments to §1129(a)(9), chapter 11 priority tax liabilities must receive treatment at least as favorable as the most favored class of unsecured claims, with the exception administrative convenience claims. Secured tax claims that would be entitled to priority if they were unsecured must also be paid within five years of the petition date and receive treatment at least as favorable as all general unsecured claims.

**11. Mandatory Discussion of Tax Consequences in Chapter 11 Disclosure Statements.** Disclosure statements in chapter 11 cases must contain a sufficient discussion of the tax consequences of the plan for a hypothetical investor to make informed decisions about acceptance or rejection. §1125(a)(1).

**12. Stay Relief for Refund Offsets.** New §362(b)(26) allows taxing authorities to offset prepetition refunds against prepetition tax liabilities, unless there is a dispute over the amount of tax due or the Trustee wishes to use the refund and establishes that it can be adequately protected.

**13. Restrictions to Subordination of Tax Liens in Chapter 7 Cases.** Ad valorem taxes are no longer subject to subordination in chapter 7 cases under §724(e). Secured claims for other forms of tax cannot be subordinated unless the trustee marshals proceeds from unsecured assets of the estate and collects fees and expenses incurred in liquidation from the proceeds of the pertinent assets. §724(f). In cases converted to chapter 7 from chapter 11, secured tax claims are not subordinated to administrative expenses incurred during the reorganization proceeding unless they are claims for wages, salaries, commissions, or contributions to an employee benefit plan. §724(b)(2), (f).

**14. Restricted Jurisdiction For Redermination of Property Tax Assessments.** An amendment to §505(a) provides the bankruptcy court may not redetermine the amount of an ad valorem tax after expiration of the period designated by the pertinent tax laws for contesting the assessment.

**15. Addresses for Prompt Determination Requests.** Section 505(b)(1)(A) allows taxing authorities to designate an address with the clerk of the court for the filing of prompt determination requests for postpetition tax liabilities under §505(b)(2). Debtors or trustees who fail to send a prompt determination request to the designated address will not obtain the safe harbor benefits provided by that section.

**16. No Stay of Tax Litigation for Postpetition Tax Periods.** Section 362(a)(8) has been amended to exempt US Tax Court proceedings from the automatic stay where the litigation involves a postpetition tax liability.

## CONCLUSION

The language of many of the tax amendments is less than precise, and Congress's intent is not always completely clear. Bankruptcy practitioners should review the language of the tax amendments carefully, with the understanding that the meaning of these amendments will be developed in the courts over the next few years.

# ATTORNEYS JUST SAY NO TO NEW REGULATIONS ON DEBT RELIEF AGENCIES

**By James T. Yand**
Stafford Frey Cooper

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) established new and significant restrictions on the activities of debt relief agencies in §§526, 527 and 528. Section 528 requires "debt relief agencies" who render "bankruptcy assistance" to enter into written contracts with "assisted persons," disclose the extent of services provided and fees charged, and disclose clearly and conspicuously in all advertising that their services contemplate bankruptcy. Additional requirements are included in §§527 and 526. Section 526(c) creates civil liability for violation of the duties enumerated.

Although attorneys are not expressly included in the definition, academic and legal commentators on the BAPCPA agree that the language defining debt relief agencies is broad enough on its face to include attorneys, and the reference to "providing legal representation" in §101(4A) suggests that attorneys are covered. *See www.abiworld.net/bankbill/changes.html. See also* article by James Ray Streinz at page 6 of this Newsletter.

Nevertheless, one court (so far) does not read the law so broadly. Utilizing the grant of authority of 11 USC §§526(c) and 105 and the inherent power of the court, Chief Bankruptcy Judge Lamar W. Davis, Jr., of the Southern District of Georgia concluded that attorneys are not "debt relief agencies." *In re Attorneys at Law and Debt Relief Agencies*, 332 BR 66 (Bankr SD Ga 2005). In the first reported decision on the issue, entered the day the BAPCPA became effective, Judge Davis noted that the definition of "debt relief agency" in §101(12A), while extremely broad, does not include the word "attorney" or "lawyer." "Attorney" is separately defined in §101(4), which makes no reference to debt relief agencies or to §101(12A). The court concluded that as a matter of plain language, the terms "attorney" and "debt relief agency" are not synonymous nor do they in common understanding include each other.

Further, §527(b) requires debt relief agencies to inform assisted persons that they have the right to hire **an attorney** or to represent themselves, that only **an attorney** can render legal advice, and how to perform services *pro se* that would be universally provided if the person hired **an attorney**. The court reasoned that the language of §101(12A), which conspicuously omits the word "attorney," would not require an attorney to tell an assisted person (1) that he or she has the right to hire an attorney or (2) how to prepare the documents *pro se* that the attorney is poised to prepare on that person's behalf. Applying a logical interpretation of the statute, the court held that Congress intended to regulate entities that interface with debtors in gray areas not already covered by bankruptcy-petition-preparer regulations and to bolster the existing regulation of bankruptcy-petition preparers, but it did not intend to regulate attorneys.

Finally, the court found that it would be a breathtakingly expansive interpretation of federal law to usurp state regulation of the practice of law via the ambiguous provisions of the BAPCPA. Such an act could violate the Tenth Amendment. Judge Davis could not conceive that as long as this bill had been pending such an intent could have gone unnoticed and undebated by the states. Nor could he conceive that Congress would take such an astounding step toward the federal regulation of professionals without forthrightly and expressly stating its intent.

In summary, the court stated its belief that if Congress meant to ensnare attorneys in the thicket of §§526, 527 and 528, it would have used the term "attorney" and not "debt relief agency." Thus attorneys regularly admitted to the Bar of Southern District of Georgia or those admitted pro hac vice are

> not covered by the provisions of the Code regulating debt relief agencies, including without limitation §§101(12A), (4A), 526, 527 and 528, and are excused from compliance with any of those requirements or provisions, so long as their activities fall within the scope of the practice of law and do not constitute a separate commercial enterprise.

322 BR at 71.

The Office of the US Trustee has appealed Judge Davis's order.

Other litigation on the issue is underway. On December 1, 2005, Keith Karnes and Douglas Ricks on behalf of attorneys in their law firm filed a complaint for declaratory and injunctive relief in United States District Court for Oregon, *Olsen v. Gonzales*, Case No. 05-6365-HO. As soon as the government appears, plaintiffs report they intend to move for a preliminary injunction to stop enforcement of §§526-528 and to declare these sections unconstitutional as applied to plaintiffs. Plaintiffs allege that the prohibition on advising their clients to incur debt if the client is an "assisted person," and the requirement that plaintiff perform certain services and make untrue and misleading statements to clients violate the First Amendment. The complaint does not appear to challenge the notion that attorneys are included in the definition of debt relief agencies.

There is also a case before Chief Bankruptcy Judge Karen Overstreet of the Western District of Washington that challenges the constitutionality of including lawyers in the definition of debt relief agency. In a chapter 13 case, *In re Moore*, Case No. 04-24651, debtor's attorney Jay Jump has filed a motion seeking such a ruling. Although the motion was filed October 20, 2005, Judge Overstreet filed a certification in November to Attorney General Alberto Gonzales, informing him of the constitutional challenge. The OUST (part of the Department of Justice) filed an appearance, and requested a continuance. The matter has been set for hearing in February 2006. Stay tuned. It appears we have seen only the tip of the iceberg on this issue.

# SOME THOUGHTS ABOUT DEBT RELIEF AGENCIES

**By James Ray Streinz**
McEwen Gisvold LLP

One of the big issues raised by the Bankruptcy Code as amended by BAPCPA is whether attorneys can be debt relief agencies and thus subject to a number of disclosure and solicitation requirements. Several cases have been filed challenging the application of the requirements governing debt relief agencies to attorneys. *See* article by James Yand, page 4. While one court has already ruled that attorneys are not debt relief agencies in that district, this article takes the position that the statutory language and legislative history support including attorneys. The language of the Code can even be read to include in the definition of "debt relief agency" attorneys who do not represent consumer debtors. This article also examines some questions raised by the conclusion that attorneys are indeed debt relief agencies under the Code.

## STATUTORY LANGUAGE INCLUDES ATTORNEYS

There are three relevant definitions to look at in determining who or what is a debt relief agency. The first is "assisted person," a person whose debts are primarily consumer debts and who owns nonexempt assets worth less than $150,000. §101(3). Next is "bankruptcy assistance," which is defined as services sold or provided to an assisted person with the purpose of providing information, advice, counsel or legal representation with respect to a bankruptcy case or adversary proceeding. §101(4A). Note that the definition of "bankruptcy assistance" specifically includes "legal representation," as well as services attorneys typically provide - such as filing documents, attending creditors' meetings and appearing in a case. *Id.* Finally, a "debt relief agency" is a person providing "**any** bankruptcy assistance" to an assisted person in return for payment or other valuable consideration. §101(12A) (emphasis added). Although some "persons" are excluded from the definition of debt relief agency, none of these exclusions apply to attorneys. These three definitions, all added by BAPCPA, lead to the inescapable conclusion that an attorney representing debtors in bankruptcy cases is a debt relief agency.

## LEGISLATIVE HISTORY SUPPORTS INCLUSION OF ATTORNEYS

Little in BAPCPA's legislative history explains why the provisions governing debt relief agencies were added. Although there have been abuses in the past by organizations calling themselves debt relief agencies, those abuses are not addressed in the legislative history. Rather, the legislative history suggests that the debt relief provisions were intended to apply to attorneys. The House Report on the final bill (S 256), dated April 8, 2005, notes:

> The Bill's consumer protections include provisions strengthening professionalism standards for attorneys and others who assist consumer debtors with their bankruptcy cases. S 256 mandates that certain services and specified notices be given to consumers by professionals and others who provide bankruptcy assistance. To insure compliance with these provisions, the Bill institutes various enforcement mechanisms. H. Rep. 109-31 at 17.

Since BAPCPA requires no other notices to be given only by attorneys to debtors, it seems that Congress intended attorneys to be swept into the provisions governing debt relief agencies.

## THE PAYMENT PROBLEM

One concern among debtors' attorneys is a provision that suggests the attorney may not advise a client to pay an attorney for services performed in a bankruptcy case. The troublesome provision is in §526(a), which includes among actions a debt relief agency shall **not** do:

> (4) advise an assisted person or prospective assisted person to incur more debt in contemplation of such person filing a case under this title or to pay an attorney or bankruptcy petition preparer fee or charge for services performed as part of preparing for or representing a debtor in a case under this title.

Section 526(a)(4) can be read two ways. One means that the attorney may not "advise an assisted person . . . to pay an attorney . . . for services performed as part of preparing for or representing a debtor in a [bankruptcy] case . . . ." The other is that the attorney may not "advise an assisted person . . . **to incur more debt** . . . to pay an attorney . . . for services performed . . . ." (Emphasis added.)

The second reading of the statute, that an attorney is only barred from advising the debtor to **borrow** money to pay the attorney's fee, makes more sense when read with the remainder of §526 and §528. Section 526(c)(2) provides that a debt relief agency may be liable to return any fees or charges in connection with its services if the debt relief agency fails to comply with §§526, 527, or 528 of the Code. Section 528 requires the debt relief agency to execute a written contract with the assisted person that clearly explains the fees or charges for the

services to be provided by the debt relief agency. These provisions clearly contemplate that the attorney providing services to the debtor will charge for those services, and, since the attorney is required to explain those charges and services clearly, the attorney could not logically be barred from advising the debtor to pay for the services provided in filing the bankruptcy.

## THE CREDITORS' COUNSEL PROBLEM

Another concern is precisely which attorneys come within the "debt relief agency" definition. "Bankruptcy assistance" includes not only representing consumer debtors in a bankruptcy case, but also giving "information [and] advice . . . with respect to a [bankruptcy] case . . . ." Is telling a consumer-debtor client with less than $150,000 in nonexempt assets that bankruptcy is an alternative "advice" that would constitute bankruptcy assistance? Does referring a consumer debtor to a bankruptcy attorney constitute "information" with respect to bankruptcy? Does a creditor's attorney provide "bankruptcy assistance" when he or she gives the debtor payoff information that will go into the consumer debtor's bankruptcy schedules? A literal reading of the statute is that all of these attorneys are providing bankruptcy assistance and, if the debtor qualifies as an "assisted person," the attorneys are debt relief agencies.

Even more troubling is the result of interpreting the Code to apply the debt relief agency title to creditors' counsel in a bankruptcy case. The definition of bankruptcy assistance does not require that the services provided to the assisted person be related to the **assisted person's** bankruptcy case. If the creditor is a person with primarily consumer debts (like a home loan) and less than $150,000 in nonexempt assets, the creditor is an assisted person, and any legal representation of that creditor makes the attorney a debt relief agency. If the attorney's practice is limited to representation of creditors, an advertisement that "we help people file for bankruptcy relief under the Bankruptcy Code," as required by §528(a)(4), would be a lie.

We have to hope that common sense will prevail and that neither the state attorney general, the bankruptcy trustee, nor the bankruptcy court will pursue an attorney who technically becomes a debt relief agency by virtue of providing very limited advice or information.

## ENFORCEMENT AND TECHNICAL "DEBT RELIEF AGENCIES"

Even if common sense is abandoned, however, the enforcement mechanisms set forth in §526 of the Code will not be a major problem for creditors' attorneys and should not apply at all to other attorneys who technically become debt relief agencies. In what is probably another example of bad drafting, only two of the enforcement provisions apply to violations of the disclosure and solicitation requirements in §§527 and 528. The first remedy is that a contract for bankruptcy assistance between the debt relief agency and the assisted person cannot be enforced if the contract does not comply with §§526, 527 and 528. §526(c)(1). The second remedy is that a debt relief agency that fails to comply with §§526, 527 and 528 can be liable to refund the fees or charges in connection with providing bankruptcy assistance to the assisted person, and for "actual damages." §526(c)(2).

The more serious remedies, which allow the state attorney general, the court, the bankruptcy trustee, or the debtor to bring suit to enjoin the debt relief agency or impose "an appropriate civil penalty," apply only to violation of "this section." §526(c)(3) and (5). "This section" is §526, which does not contain any disclosure or solicitation requirements. Section 526 only restricts debt relief agencies from certain practices in subsection (a), most of which practices are also barred by either ethical rules (false statements or misrepresentations) or malpractice concerns (failing to perform promised services).

Although an attorney who is a debt relief agency can face a whole set of remedies if the attorney violates §526(a), that may be the least of that attorney's worries. Attorneys who are technically debt relief agencies and creditors' attorneys should only have to worry about the remedies that void the contract and require the refund of fees. (This assumes that there are no actual damages for failing to provide the disclosures or give the right language in the advertisements.) Since attorneys who technically become debt relief agencies would not have a contract for bankruptcy assistance, they have no concerns. The creditor's attorney has a little more concern if the attorney is representing an assisted person. In that case the attorney's contract with his client could be voided and the attorney could have to refund fees. However, this would happen only if the client took the initiative to apply the remedies. That is unlikely, and would probably only occur when the client is unhappy with the attorney's representation.

## CONCLUSION

The provisions of the Code governing debt relief agencies are probably here to stay, and consumer debtor attorneys should learn to live with them - or ignore them at their peril. Most attorneys representing consumer debtors have chosen to include in their advertisements the required language: "We are a debt relief agency. We

help people file for bankruptcy relief under the Bankruptcy Code." In fact, some debtor firms have embraced the phrase debt relief agency and use it in marketing. For example, the Feinberg, Isaak & Smith firm, based in Tampa, Florida, which describes itself as "Florida's largest filer of bankruptcy cases," now advertises as "Debt Relief Legal Centers." An attorney in Burbank, California, appears to suggest that the "debt relief agency" title gives her a special qualification. In her advertisement she states:

> The law office of Lauren Ross is a **federally designated** debt relief agency pursuant to Title 11 of the U.S. Code and provides legal assistance to consumers seeking relief under the Bankruptcy Code. (Emphasis added.)

Other attorneys can ignore the provisions governing debt relief agencies, although creditors' attorneys should make sure that they do a very good job for their clients – or that all their clients are either businesses or wealthy individuals.

# THE NEW BANKRUPTCY MEANS TEST

**By Chris Fowler**

## INTRODUCTION

On December 7, 2005, the Young Lawyers' Division hosted a training session presented by Bankruptcy Judge Elizabeth Perris (Portland) and Assistant U.S. Trustee Gail Geiger (Eugene) on the means test required for chapter 7 cases under BAPCPA. This article summarizes the basics of the new means testing requirement and that presentation. Under §707(b)(2) of the Code, abuse is presumed — and therefore a case may be dismissed or converted to chapter 11 or 13 - if the amount of the debtor's current monthly income, minus allowable expenses, multiplied by 60, equals or exceeds the lesser of: (1) 25% of nonpriority unsecured claims or $6,000, whichever is greater, or (2) $10,000. (Allowable living expenses are governed by IRS standards and are available at www.usdoj.gov/ust/ or from the clerk of the bankruptcy court.)

"Current monthly income," defined in §101(10A), includes the average income received by the debtor (and spouse if it is a joint filing) from all sources, whether or not taxable, during the six months prior to filing, starting on the last day of the month prior to the month in which filing takes place. Monthly income does not include social security benefits received, or certain payments received by victims of terrorism and war crimes.

Under §704(b)(1), the U.S. Trustee must review all materials submitted by the debtor and, no later than 10 days after the §341 meeting, submit a report on whether abuse should be presumed, according to the §707 formula. No later than 30 days thereafter, the U.S. Trustee must file either (1) a motion to dismiss or convert the case, including a statement that the debtor's monthly income multiplied by 12 equals or exceeds the median family income in the debtor's state for a family of comparable size, or (2) a statement why a motion to dismiss or convert is not appropriate.

Form B22A (Chapter 7), STATEMENT OF CURRENT MONTHLY INCOME AND MEANS TEST CALCULATION ("the Form"), is used to determine whether the presumption of abuse arises under the means test.

Monthly income is calculated in Part II of the Form. If the amount calculated in Part II, annualized, is greater than the median income for a family of comparable size in the debtor's state, the debtor must complete the remainder of the form. If, however, the debtor's annualized average monthly income is less than the median income for the state in which the debtor lives, the debtor need proceed no further, and no presumption of abuse arises. In such a case, the debtor will be eligible for chapter 7.

At the December 7th presentation two hypothetical scenarios were distributed based on materials provided at a seminar, "FIGHTING BACK: Helping Debtors Survive the New Bankruptcy Law," by the National Association of Consumer Bankruptcy Attorneys in Orlando, Florida, in September 2005. The presentation focused on completing the means test calculation, and some of the issues that the process raises.

## PART II OF FORM B22A: CALCULATION OF MONTHLY INCOME FOR §707(B)(7) EXCLUSION

The first hypothetical asked whether a nonfiling spouse's income should be included in household income if the couple had been married for less than six months. Ms. Geiger's position is that such contributions should be counted as income, on the theory that the goal is to calculate household income, and that any actual contributions to household income should therefore be included. Following this rationale, also included in income were the debtor's late wife's mother's retirement income as well as the debtor's new wife's income from wages.

However, the income of a nonfiling spouse that was not contributed to the household should be subtracted in Part IV of the Form. Subtracted, therefore, were the debtor's late wife's mother's retirement income not contributed to the household, as well as the debtor's new wife's income not contributed to the household.

Another issue in calculating the debtor's gross income was the treatment of his unemployment benefits, which were included in income. Because line 9 of the Form asks for an average monthly income figure for unemployment benefits, the total amount of benefits received, even though all were received in one month under the hypothetical (total amount received: $1,950), is divided by 6, to arrive at the average monthly figure (figure entered on line 9 of the Form: $325).

In the second hypothetical, the debtor or debtors received income both from outside employment and from providing child care in the home. Regardless of whether the debtors in this case filed jointly (which the facts did not state), all income from both debtors was included in monthly income because all the income was contributed to the household.

A second income-related issue in the second hypothetical was the effect on the monthly income calculation of an $8,000 loan against the debtor's 401(k) plan. The loan netted only $2,000, so it could be argued that this produced either no income, $2,000 income, or $8,000 income. Because the transaction was a loan, it very likely produced no income: tax law does not recognize loans as income, since loan income is set off against the obligation to repay the loan. Had the transaction been a simple distribution from a 401(k) plan, however, it would have resulted in at least $2,000 of income.

The third and final income-related issue in the second hypothetical was the effect on the income calculation of liquidating a $5,000 IRA. This amount should be included in the monthly income calculation.

## PART V: CALCULATION OF DEDUCTIONS ALLOWED UNDER §707(B)(2)

While food, clothing, household supplies, personal care and miscellaneous expenses are governed by a national standard, the amounts a debtor is allowed to deduct for housing and utility expenses vary depending on what state and county the debtor lives in. Another difference between these two categories of allowable deductions is that with the former (but not the latter) an additional deduction is allowed for more than four persons.

Several points were made regarding vehicle and transportation cost deductions. Judge Perris noted that allowable deductions for two vehicles are available, but in separate amounts - it can make a difference which vehicle is listed as vehicle 1 and which as vehicle 2. Because the deduction allowed for the first vehicle is $475 and the deduction allowed for vehicle 2 is $338, if one of these vehicles costs a debtor more than $338 per month, but less than $475 per month, the debtor would do better to list the more expensive vehicle as vehicle 1.

There are also allowable deductions for taxes paid. The amount deducted for income taxes should be the amount actually paid, not any amount over-withheld or under-withheld. Also note that debtors will have to make the short tax year election and count it as not yet due.

Property taxes and home insurance costs should be deducted under mortgage expenses in line 42 unless the home is owned free and clear, in which case they would be deducted in line 20, for housing and utility expenses.

The final allowable tax deduction question was whether §1305 debts are priority debts. While the consensus seemed to be that there is no clear answer yet, it was noted that if the debtor makes the short tax year election, they likely will count as priority debts.

## PART VI: DETERMINATION OF §707(B)(2) PRESUMPTION

After monthly income and allowable deductions are calculated, monthly disposable income is arrived at by subtracting the allowable deductions from the monthly income. This number is then multiplied by 60. If the result is less than $6,000, the presumption of abuse does not arise. If it is greater than $10,000 the presumption does arise. If it is between $6,000 and $10,000, the total amount of the debtor's nonpriority unsecured debt is multiplied by 0.25, and if this number is less than disposable monthly income, the presumption does not arise. If the number is greater than monthly disposable income, the presumption does arise.

# WOMBATS GROUP

**By Laura J. Walker**
Cable Huston Benedict Haagensen & Lloyd LLP

The Women Bankruptcy Attorneys ("WOMBATS") group held a meeting on January 18, 2006. Gail Geiger of the Office of the U.S. Trustee made a presentation on means testing and creditor counseling programs under the recent amendments to the Bankruptcy Code.

Ms. Geiger identified some common errors that she sees in the information submitted on the Statement of Current Monthly Income and Means Test Calculation (SCMI):

1. The U.S. Trustee reviews both the SCMI and Schedule J when reviewing cases for abuse under § 707(b)(2) and (3). Several expenses on the SCMI should be the debtor's actual expenses. For expenses that are actual, the amounts listed in the SCMI and the amounts on Schedules I and J should be very similar. For example, withholding tax should generally be similar whether listed on Schedule I or the SCMI. This is also true of mandatory payroll deductions. When the amounts are inconsistent, the U.S. Trustee's office will ask for an explanation.

2. Child support is omitted from the calculation of income.

3. Overtime compensation is omitted from income.

4. A different six-month period than that required by the statute is used (possibly due to delay in filing the petition after it is prepared).

5. Retirement account disbursements that should be considered income are omitted.

6. The wrong amount is used for determining median income. The U.S. Trustee's web site (http://www.usdoj.gov/ust/) contains the median income data for each district. The median income on this web site may be different from that available from the Census Bureau, but for purposes of the SCMI, debtors are to use the median income figures available from the U.S. Trustee's website.

7. Contributions to the debtor's household from individuals who are cohabiting with the debtor should be considered in income and expense calculations.

8. Payroll deductions that are voluntary (such as repayment of 401(k) plan loans) should not be deducted on line 26 of the SCMI (B22A which is the chapter 7 form). This expense includes only mandatory items such as union dues, uniform costs, etc.

9. Information in the debtor's statement of intent should be considered for budget purposes. For example, if the debtor indicates an intention to surrender the collateral, such as a car, boat, or travel trailer, the monthly payment on the loans secured by such collateral should not be included in the expense portion of the SCMI. If the debtor plans to surrender the house, the IRS local housing ownership expense is allowed as a substitute for the housing expense.

Ms. Geiger also offered tips for completing the SCMI, income and expenses, on the form:

1. If the debtor owns a car that has over 75,000 miles or is over six years old, the debtor is allowed an additional $200 per month in operating expenses to cover the estimated increased maintenance and operating expenses under the IRS standard. Look for updated information on the U.S. Trustee's website regarding this expense.

2. Keep in mind that the expense amounts will be adjusted each year. The adjusted expense items should be posted on the U.S. Trustee web site.

3. The U.S. Trustee's office will consider the totality of circumstances under §707(b)(3), even if no presumption of abuse arises under §707(b)(2). The primary factor in analyzing a case under the totality of the circumstances is the debtor's ability to pay.

4. In every case where the presumption of abuse arises, the U.S. Trustee must either file a motion to dismiss the case, or file a 30-day declination statement stating the reasons why the U.S. Trustee is not pursuing dismissal under §707(b)(2).

5. Tax returns should be sent to the panel trustee's office and not to the U.S. Trustee. Under §521, the debtor must provide a copy of the tax return for the most recent year for which a return was due. If the debtor has never filed tax returns due to lack of income (not required to file), a cover letter explaining the situation would be helpful.

6. The Census Bureau's median family income data, the IRS's National Standards for Allowable Living Expenses and Local Standards for Transportation and Housing and Utilities Expenses, and the schedules of actual administrative expenses for administering a chapter 13 plan on the "Means Testing Information" page have been updated. The U.S. Trustee Program will apply the updated data to all cases filed on or after February 13, 2006.

Ms. Geiger stressed the importance of complying with the credit counseling requirement of §109(h). The bankruptcy case may be dismissed or stricken if the debtor fails to obtain credit counseling prior to the filing and (1) fails to file the certificate of credit counseling as required by §521, or (2) does not move for extension of time to obtain credit counseling, or (3) does not seek a

waiver of the requirement. There are several recent bankruptcy decisions on this issue, including *In re Hubbard*, 332 BR 285 (first case) and 2005 WL 3117215 (second case) (Bankr SD Tex 2005).

The U.S. Trustee's office is interested in feedback about different credit counseling firms. If you have problems with particular programs or difficulty obtaining the certificates to prove compliance, you should report the problems to the US Trustee.

The recent amendments to the Bankruptcy Code also require debtors to attend debtor education within 45 days after the §341(a) meeting. 11 USC §727(a)(11)The bankruptcy case may be closed without a discharge if the debtor fails to comply with this requirement.

WOMBATS meetings are scheduled for the following dates:

March 15, 2006
May 17, 2006
September 13, 2006
November 15, 2006

The Oregon State Bar will be discontinuing support of the WOMBATS listserve group. If you would like to be on the email list for notifications about WOMBATS meetings, send your email address to lwalker@chbh.com.

## SUPREME COURT CASE NOTE

**By Douglas Pahl**
Perkins Coie

### SUPREME COURT UPHOLDS OFFSET OF SOCIAL SECURITY BENEFITS TO PAY DELINQUENT STUDENT LOANS

*Lockhart v. U.S.*, 126 SCt 699 (2005)

Between 1984 and 1989, James Lockhart borrowed approximately $80,000 under the Guaranteed Student Loan Program to attend various college programs. Lockhart did not graduate and failed to repay about $77,000 of these federally reinsured loans. In 2002, the government began withholding 15 percent of Lockhart's Social Security payments in an effort to collect the debt, some of which had been delinquent for more than 10 years. Lockhart, a 67-year-old living in Seattle, challenged the government's action. The United States District Court for the Western District of Washington dismissed Lockhart's complaint and the Ninth Circuit affirmed. In light of a contrary ruling by the Eighth Circuit, *Lee v. Page*, 376 F3d 1179 (8th Cir 2004), the United States Supreme Court granted certiorari.

Lockhart cited provisions in the Social Security Act designed to protect Social Security benefits from "execution, levy, attachment, garnishment, or other legal process." 42 USC §407(a). The following subsection provides an additional layer of protection for the anti-attachment rule: "No other provision of law, enacted before, on, or after April 20, 1983, may be construed to limit, supersede, or otherwise modify the provisions of this section except to the extent that it does so by express reference to this section." 42 USC §407(b). Lockhart also argued the government's offset was time-barred due to the ten-year limitation period in the Debt Collection Act of 1982. 31 USC §3716(e)(1).

Speaking for a unanimous Court, Justice O'Connor rejected Lockhart's contentions that the two statutes prevented the government from withholding a portion of his Social Security payments. The Court noted that in 1991 the Higher Education Technical Amendments eliminated statutes of limitation as to certain loans, including Lockhart's. "Notwithstanding any other provision of statute . . . no limitation shall terminate the period within which suit may be filed, a judgment may be enforced, or an offset, garnishment, or other action initiated or taken" for collection of enumerated loans. 126 SCt at 701, quoting 20 USC §1091a(a)(2). Lockhart argued, and the Court agreed, that the 1991 amendment lacked the specificity to nullify §407(a)'s anti-attachment protections.

The Court was convinced, however, by the government's argument that the 1996 Debt Collection Improvement Act operated to expose Social Security benefits to governmental offset. The 1996 statute provides that, "[n]otwithstanding any other provision of law (including [§407]) . . . all payment due an individual under . . . the Social Security Act . . . shall be subject to offset under this section." 31 USC §3716(c)(3)(A)(i). The Court concluded that the Debt Collection Improvement Act "provides exactly the sort of express reference that the Social Security Act says is necessary to supersede the anti-attachment provision." 126 SCt at 702. The Court further concluded that, in addition to allowing a Social Security offset, the 1996 statute removed the Debt Collection Act's 10-year limitation period, allowing the offset for delinquencies exceeding 10 years. Quoting *Union Bank v. Wolas*, 502 US 151, 158, 112 SCt 527 (1991), the Court stated: "The fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning." 126 SCt at 702.

Justice Scalia, concurring in the decision, wrote separately to present his view that the 402 U.S.C. § 407(b) is not binding. Justice Scalia argues that the provision, which purports to limit the power of a future Congress to modify it, runs afoul of the longstanding rule that one session of Congress may not bind a future session of Congress.

## NINTH CIRCUIT CASE NOTES

**By Matthew A. Goldberg**
Preston Gates & Ellis, LLP

### FEDERAL BANKRUPTCY LAW PREEMPTS STATE LAW ACTIONS SEEKING DAMAGES FOR BAD FAITH INVOLUNTARY FILINGS

*In re Miles*, 430 F3d 1083 (9th Cir 2005)

Following the dismissal of ten involuntary bankruptcy petitions against members of their family, appellants filed three tort actions in California state court. Appellants alleged claims against petitioning creditors and their attorneys based on negligence, defamation and infliction of emotional distress. The defendants removed the state court cases to bankruptcy court pursuant to 28 USC §1452(a), and moved to dismiss on the theory that federal bankruptcy law preempted appellants' state law tort claims. Appellants moved to remand, alleging that the bankruptcy court had no jurisdiction over tort claims by third parties stemming from involuntary bankruptcy petitions. Finding that the alleged state law tort claims were completely preempted by §303(i), the bankruptcy court refused to remand the cases. The bankruptcy court then dismissed all the tort actions, holding that § 303(i) did not create a cause of action for third parties seeking damages arising from an involuntary bankruptcy petition. The BAP affirmed.

The Ninth Circuit affirmed, holding that third parties do not have standing under §303(i) to recover damages for bad faith involuntary filings. The court found the language of §303(i) ambiguous as to whether third-party standing was permissible, and turned to legislative history, case law and public policy. Based mostly on House and Senate reports and a concern for possible abuse of the involuntary bankruptcy system, the court decided that Congress's intent was to limit relief under §303(i) to debtors.

Before affirming the bankruptcy court's holding, however, the Ninth Circuit had to address whether removal to the bankruptcy court of the state court actions was proper. Section 1452 permits removal when the district court for the district where the state court actions were filed would have jurisdiction under 28 USC §1334(b), which creates district court jurisdiction in "all civil proceedings arising under title 11, or arising in or related to cases under title 11." Despite the general proposition that a cause of action "arises under" federal law when the plaintiff's complaint raises federal law issues, the court found that appellants' state law claims "arose under" the Bankruptcy Code. The court relied on the doctrine of "complete preemption," which states that "the preemptive force of some federal statutes is so strong that they completely preempt an area of state law." 430 F3d at 1088. Thus, any claim based on the preempted state law arises under federal law, regardless of how the plaintiff frames its pleading.

To establish that complete preemption applied in this case, the court addressed whether Congress intended §303(i) to provide the "exclusive cause of action" for damages related to involuntary petitions. Referencing its previous decision in *MSR Exploration, Ltd. v. Meridian Oil*, Inc., 74 F3d 910 (9th Cir. 1996), the court reiterated its view that the "complex, detailed and comprehensive" Bankruptcy Code "create[d] a whole system under federal control which is designed to bring together and adjust all of the rights and duties of creditors and embarrassed debtors alike." 430 F3d at 1089. Allowing individual states to determine the "potential costs" of filing an involuntary petition, the court reasoned, would impede the uniformity of the bankruptcy system specifically provided for in Article I, §8 of the US Constitution. Because complete preemption applied to appellants' claims, the claims "arose under" Title 11, giving the bankruptcy court the removal jurisdiction it exercised when it dismissed the state court actions.

### "DEPOSIT" UNDER §507(A)(6) INCLUDES FULL PAYMENT FOR CONSUMER GOODS AND SERVICES MADE PREPETITION

*In re Salazar*, 430 F3d 992 (9th Cir 2005)

Prior to the debtors' chapter 13 filing, the creditors hired debtors to build them a swimming pool; when the creditors entered into the contract, they paid the full purchase price of $30,829. By the time of debtors' filing, the pool was between 50 and 70 percent completed. The creditors sought to have their claim treated as secured. The bankruptcy court instead classified the claim as a priority claim under §507(a)(6), which protects consumer deposits. At the time of the case, consumer deposits were given priority status to the extent of $2,100 for an individual creditor's claim. The BAP affirmed.

The Ninth Circuit affirmed, holding that the word "deposit" in §507(a)(6) includes full payment for consumer goods and services made prior to a debtor's bankruptcy filing. The court engaged in an extended plain-language analysis, citing no less than five dictionaries in an attempt to discern any reason why a "deposit" need be limited to partial, rather than full, payment. While many definitions incorporated the concept of partial payment, the court observed, none limited the definition to partial payments. Moreover, there is a public need to protect full payments as deposits under §507(a)(6) because "it is not unusual to

see requests for the full price where unique or personalized goods are to be made . . . or where a contract for services to be performed over time . . . is involved." 430 F3d at 995. The court stated that protecting consumers' expectations was Congress' express intent when drafting § 507(a)(6). Reasoning that Congress limited the extent of the protection by regulating the amount of the priority, the court declined to read into the statute an additional limitation not supported by the plain meaning of the language or its underlying policy justification.

### CLAIMS FOR POSTPETITION ATTORNEY FEES NOT DISCHARGED WHEN DEBTOR VOLUNTARILY CONTINUES LITIGATION COMMENCED PREPETITION

*In re Ybarra*, 424 F3d 1018 (9th Cir 2005)

Debtor sued her employer, Rockwell, for employment discrimination, then filed a chapter 11 bankruptcy petition but omitted the cause of action from her schedules. Once Rockwell learned of the bankruptcy, it successfully moved to convert the case the chapter 7. The chapter 7 trustee and Rockwell agreed to settle the discrimination case by having Rockwell purchase the claim for $17,500. Over debtor's objection, the bankruptcy court approved the settlement and the state court dismissed the original lawsuit.

Debtor subsequently amended her schedules to include the discrimination suit as exempt. The bankruptcy court gave Debtor the choice between receiving an award of $17,500 from Rockwell or taking ownership of the lawsuit. Debtor chose the latter, and convinced the state court to vacate the dismissal and allow the case to proceed. Rockwell ultimately prevailed and was awarded $456,884.03 in attorney fees and costs. In the interim, debtor had been granted a discharge under §727. On a motion from Rockwell, the bankruptcy court held that the portion of the attorney-fee award incurred after debtor filed for bankruptcy was not discharged and could be pursued by Rockwell. The BAP reversed in a divided decision, relying on precedent holding that claims for postpetition attorney fees are not eligible for administrative expense priority when they stem from prepetition lawsuits.

The Ninth Circuit reversed, holding that claims for postpetition attorney fees are not discharged when the debtor "voluntarily commences litigation or otherwise voluntarily returns to the fray." 424 F3d at 1026. The court criticized the BAP for looking to administrative-expense law instead of the law regarding discharge. The court found that Rockwell's claim for postpetition attorney fees was not discharged even though the underlying lawsuit had been commenced prepetition. Though a claim, for purposes of discharge, arises at the time of the events giving rise to the claim, the court stated that debtor's affirmative resurrection of the lawsuit postpetition militated against allowing debtor to discharge a claim for fees in a case that Rockwell "had no choice but to defend." The court held that Debtor was personally liable for the postpetition fees and that Rockwell was not prevented by the discharge injunction from seeking reimbursement.

## BAP CASE NOTE

**By Doug Pahl**
Perkins Coie

### CLAIM OBJECTIONS MUST CHALLENGE LIABILITY OR AMOUNT OF CLAIM, NOT MERELY CITE LACK OF SUPPORTING EVIDENCE

*In Re Campbell*, __ BR __ (9th Cir BAP 2005)

After including a number of creditor claims in their schedules as undisputed, chapter 13 debtors objected to the claims citing the creditors' failure to include supporting documents (including contracts, proofs of purchase and statements). Debtors further alleged that they "had no way to verify the amount of or the validity of the interest being charged, the amount [or] validity of other charges, or the validity of any other term of the account because [debtors] did not have copies of the writings on which the account was based."

The creditors subject to the objections neither filed oppositions nor attended the hearing set by the bankruptcy court. The court advised the debtors that they must be prepared to come forward with independent evidence for why they do not owe the debt asserted in the proof of claim. "The Court will not sustain an objection based solely on an alleged technical defect in the proof of claim, where the debtor has a good faith belief that, as of the petition date, there was a legitimate debt owed the creditor." At the hearing, the debtors rested on the previously filed pleadings. The court overruled their objections. The debtors appealed.

The debtors argued that their objections should have been sustained pursuant to Rules 3001(c) and (f) because the proofs of claim lacked prima facie validity. They also argued that it would be unfair and violate due process to require debtors to investigate possible grounds for objection when creditors have not supplied even minimal supporting documentation for their claims, as required by the Bankruptcy Rules.

The creditors argued that §502 sets forth the grounds of well-stated objections. Those grounds do not include lack of compliance with Rule 3001(c). Creditors also argued §502(a) deems claims allowed and that debtors cannot overcome that presumption if they do not dispute the validity of the claim. Verizon, one of the participating creditors, noted that compliance with Rule 3001 would have required attachment of over 65 pages of charges that would have to have been heavily redacted to comply with federal regulations and the debtors' privacy rights.

The BAP rejected the debtors' strained reading of the objection and supporting declarations to contain substantive challenges to the liability asserted in the claim, concluding that the objections were to the claims' lack of supporting documents. The court noted that a creditor who files a claim lacking supporting documentation "does so at its own risk." Such a claim lacks prima facie validity. However, the court, consistent with its recent decision in *In re Heath*, 331 BR 424 (9th Cir. BAP 2005), concluded that "[o]bjections without substance are inadequate to disallow claims, even if those claims lack the documentation required by Rule 3001(c)." Debtors must show some "actual disagreement as to their liability or the amounts claimed by their creditors."

## LOCAL BANKRUPTCY COURT

**By Matthew A. Goldberg**
Preston Gates & Ellis, LLP

### PLAN PAYMENTS IN TRUSTEE'S POSSESSION MUST BE RETURNED TO DEBTORS WHEN PLAN IS NOT CONFIRMED

*In re Bailey*, 330 BR 775 (Bankr D Or 2005)

Confirmation of debtors' chapter 13 plan was denied and debtors moved to dismiss their case. Before dismissal, the chapter 13 trustee had collected $4,800 in plan payments. A prepetition judgment creditor served the trustee with a garnishment under Oregon law before the trustee could return the collected plan payments to debtors pursuant to §1326(a)(2). The trustee sought instructions from the court. Finding that the language of §1326(a)(2) was clear and unambiguous, the court held that the payments had to be returned to debtors notwithstanding the attempted garnishment.

When plan payments are made to the trustee but the proposed plan is not confirmed, §1326(a)(2) provides that "the trustee shall return any such payment to the debtor." The court noted a split of authority on the question of whether such funds are subject to levy or garnishment under state law while still in the trustee's possession. Cases finding that such funds are subject to forced collection from the trustee under state law, including *In re Doherty*, 229 BR 461 (Bankr ED Wash 1999), are based on the premise that following dismissal, there is no longer a bankruptcy estate and, hence, no automatic stay to protect the funds in the trustee's possession from garnishing creditors.

The court rejected this line of cases and followed instead authorities holding that the language of §1326(a)(2) is unambiguous and must be followed according to its plain meaning. When a federal statute such as §1326(a)(2) conflicts with state law - in this case Oregon's garnishment statute - the Supremacy Clause of the US Constitution requires state law to give way to federal law. Moreover, the court stated, policy reasons support a decision to return such funds to debtors. Debtors who attempt to pay their creditors through chapter 13, the court reasoned, should not be penalized for unconfirmed attempts to do so. The court also noted that it would be inefficient to keep unconfirmed cases open, forcing bankruptcy courts to adjudicate disputes between trustees and creditors, when the money simply could be returned to the debtors and any claims thereto resolved outside the jurisdiction of the bankruptcy court.

## COMING ATTRACTIONS:

At the end of 2005, the bankruptcy court in Portland issued three opinions in *In re Roman Catholic Archbishop of Portland*, Case No. 04-37154. These opinions can be found on the court's website, www.orb.uscourts.gov. One or more will be summarized in the next Newsletter issue.

## SECTION WEBSITE

The Debtor-Creditor Section website, http://osb-dc.org, is now accepting postings for job vacancies.

## STATE COURT CASE NOTES

**By Heather E. Harriman**
Greene & Markley PC

### NO BREACH OF WARRANTY CLAIM WHERE BUYER REVOKED ACCEPTANCE OF GOODS

*Kelly v. Olinger Travel Homes, Inc.*
200 Or App 635, 117 P3d 282 (2005)

Plaintiffs sued a seller of a motor home and the manufacturer of the motor home alleging that the motor home was defective. Plaintiffs and seller arbitrated the claims against the seller; the arbitrator found that plaintiffs had justifiably revoked their acceptance of the motor home and awarded plaintiffs damages against the seller. Plaintiffs' claim against the manufacturer – breach of express warranty under ORS 72.7140 – went to trial. Plaintiffs argued that they were entitled to recover the purchase price (which plaintiffs, in fact, recovered from the seller), plus damages for breach of warranty and incidental and consequential damages. The Court of Appeals, affirming the trial court, held: (1) ORS 72.7140 does not incorporate a claim under the Oregon Consumer Warranty Act (ORS 72.8010 et seq.) because the Legislature did not make the OCWA part of ORS Chapter 72, and (2) ORS 72.7140 only applies to buyers who have accepted goods and does not allow a buyer who has revoked acceptance of the goods to recover damages for breach of warranty.

### DEBT COLLECTION ON A STOPPED PAYMENT

*Pro Car Care, Inc. v. Johnson*
201 Or App 250, 118 P3d 815 (2005).

Plaintiff sued under ORS 30.701 (actions against maker of dishonored check) after defendant stopped payment on a check she wrote to plaintiff to pay for services plaintiff performed on her motor home. Defendant counterclaimed, asserting a violation of ORS 646.639 (Unfair Debt Collection Practices Act). The trial court ruled in defendant's favor on both plaintiff's claim and defendant's counterclaim. First, it concluded that defendant had good cause to stop payment on her check because a reasonable person in her situation could believe that the services she received from plaintiff were not adequately or completely performed. Therefore, plaintiff could not recover under ORS 30.701; *i.e.*, plaintiff could recover only if the check payment was stopped "without good cause." Second, the trial court awarded defendant damages and attorney fees on her UDCPA claim, concluding that plaintiff had engaged in unlawful debt collection practices by sending defendant a demand letter concerning the stopped payment. Plaintiff appealed both rulings.

The Court of Appeals affirmed the ruling on the dishonored check claim, agreeing that under the facts and circumstances of this case, it was reasonable for the defendant to believe that the plaintiff had performed faulty repair services on her motor home.

The Court of Appeals reversed the ruling that plaintiff had violated the UDCPA. Plaintiff sent defendant a demand letter that demanded payment in full, plus a $25.00 returned check charge, plus the $500 statutory penalty under ORS 30.701(1); the demand letter also threatened to file a lawsuit and seek attorney fees if the money was not paid. Defendant argued that plaintiff's demand letter had violated the UDCPA in three particulars: (1) unlawful threat to enforce a right or remedy with knowledge or reason to know that the right or remedy does not exist, (2) unlawful representation that the debt would be increased by attorney fees when such fees may not legally be added to the debt, and (3) unlawful attempt to collect other charges in excess of the actual debt. Relying upon the cases of *Porter v. Hill*, 314 Or 86, 838 P2d 45 (1992), and *Hedrick v. Spear*, 138 Or App 53, 907 P2d 1123 (1995), the Court of Appeals concluded that defendant's first two UDCPA claims were unfounded. On defendant's third UDCPA claim, the Court of Appeals concluded that plaintiff's demand letter did not seek charges in excess of the debt even though plaintiff knew that defendant had made partial payment on the debt after stopping payment on the check. ORS 30.701 "permits an action for 'the amount for which the check was drawn' - not, as defendant appears to maintain, for the amount for which the check was drawn minus any partial payments - as well as statutory damages and reasonable attorney fees.

### SPECIFIC PERFORMANCE MAY BE AVAILABLE EVEN AFTER A RESCISSION

*Patterson v. Amundson*
201 Or App 486, 119 P3d 264 (2005).

On complicated facts, the Court of Appeals held that purchasers in a land sale contract with a lease-to-purchase agreement were entitled to specific performance. Defendant, the seller, argued that the trial court's award of specific performance was wrong for three reasons: (1) plaintiffs did not close the sale at the time specified in the agreement and therefore breached the contract, (2) plaintiffs revoked and rescinded the contract and so could not now seek specific performance, and (3) plaintiffs' claim was barred by laches. In an opinion founded upon equitable principles, the Court of Appeals rejected all three of defendant's arguments.

First, the defendant waived the time-of-the-essence provision by his conduct and his failure to demand timely closing. Further, defendant accepted plaintiffs' monthly lease payments for nearly seven years. Second, plaintiffs did not rescind the contract because even if the court construes a letter from plaintiffs as unequivocal and unconditional notice of rescission, plaintiffs' overall conduct was ambiguous. After sending the letter to rescind, plaintiffs failed to vacate the house, continued to make monthly lease payments and continued to negotiate with defendant. Third, and finally, plaintiffs' claim for specific performance was not barred by the doctrine of laches because defendant was not substantially prejudiced by plaintiffs' delay in bringing the action.

### A BRIEF STATEMENT ON ORS 20.082

*McGarry v. Hansen*
201 Or App 695, 120 P3d 525 (2005)

In this case, the court carefully examined ORS 20.082, which provides for an award of attorney fees in claims on a contract for $5,500 or less. Defendant argued that the statute applies only to contracts "evidencing a debt," and that breach of warranty claims are excluded. After a lengthy discussion and exploration of the legislative history, the court concluded that ORS 20.082 applies to all types of contract claims so long as they are $5,500 or less. No categories of contract are excluded from the statute's purview and the contract need not be one "evidencing a debt."

### NONCOMPETITION AGREEMENTS ENFORCEABLE IF THE EMPLOYMENT RELATIONSHIP SUBSTANTIALLY CHANGES

*McGee v. The Coe Mfg. Co.*
203 Or App 10, 125 P3d 26 (2005)

Ordinarily, a noncompetition agreement is unenforceable in the context of an employment relationship unless the employer and employee entered into the agreement at the time of the "initial employment." ORS 653.295; *Pacific Veterinary Hospital v. White*, 72 Or App 533, 696 P2d 570 (1985). Where, however, the employment relationship changes so substantially that it can be said to be new employment, a noncompetition agreement is enforceable.

Here, plaintiff worked for defendant employer for over 20 years as an engineer. After 23 years, plaintiff informed defendant of his intention to retire and defendant offered plaintiff a part-time position as a consultant. The parties entered into an employment contract whereby plaintiff would work up to 300 hours per year and receive a significantly reduced salary. Plaintiff's scope of work was reduced to services as a consultant and specifically excluded engineering work. At the time of entering into the part-time employment contract, plaintiff executed a noncompetition agreement. Defendant was to pay plaintiff $30,000 per year for a period of ten years as consideration for the noncompete agreement. Defendant stopped paying, asserting that the noncompetition agreement was "void and not enforceable" under ORS 653.295.

Affirming the trial court, the Court of Appeals held that the noncompetition agreement was enforceable because plaintiff's new part-time employment as a consultant created a new employment relationship. The Court further noted that its conclusion is consistent with the legislature's intent to protect employees from the coercive effect of employers requiring a noncompetition agreement as a condition of continued employment. Here, plaintiff's intended retirement removed the taint, *i.e.*, defendant lacked the leverage of a continuing employment relationship.

## CONSUMER COMMITTEE

**By Michelle Freed**
Todd Trierweiler & Associates

The Consumer Bankruptcy Committee meets the third Thursday of the month in the 8th floor conference room at the United States Bankruptcy Court at 1001 SW Fifth Avenue, Portland Oregon 97204. The next meeting will be February 16, 2006, at 4:30 p.m. The Committee is chaired by Laura Donaldson, who can be reached at (503)257-8900 or lldonaldson@comcast.net. To learn more about the Committee or to be added to the mailing list, please contact Michelle Freed, Todd Trierweiler & Associates, at (503)253-7777 or michellefr@bankruptcylawctr.com.

Minutes from the Consumer Bankruptcy Committee meetings in October and November are summarized below.

### OCTOBER 13, 2005

Chapter 13 Trustee Brian Lynch took suggestions on scheduling §341(a) meetings. The meetings will begin at 8:30 a.m. to accommodate a proposed debtor education course. Mr. Lynch plans to apply to become a provider of debtor education classes. If approved, he will provide classes at no additional charge to debtors from 11:30 am to 2:00 pm.

When filing a proof of claim, remember that the court will scan only the first six pages. It is important that the pages you would like the trustee's office to see be among the first six pages.

When emailing documents to the trustee's office, use the preconfirmation (precon@portland13.com) and postconfirmation (postcon@portland13.com) addresses.

Jeffrey Werstler of the IRS encouraged the Bar to use online requests for tax transcripts. The IRS link will be on the Bankruptcy Court's website soon. Debtors can also request tax transcripts over the telephone. Mr. Werstler reminded the committee to use the IRS's Philadelphia address on the mailing matrix for both chapter 7 and chapter 13 cases.

The IRS's insolvency department has been directed to examine debtors who continue to accrue income tax debt while in a bankruptcy. The IRS may instruct the debtor's employer to reduce the debtor's exemptions.

The IRS will also look more closely at exempted and excluded property as a source for payment of prepetition tax liability. If the IRS determines that a taxpayer has been flagrant, it may try to collect against the exempt and excluded assets - such as a retirement plan, after considering how much of the plan the debtor is expected to need.

Please remember to check the Bankruptcy Court's website for updated forms: http://www.orb.uscourts.gov.

## NOVEMBER 17, 2005

Pam Griffith announced that under state law consumer credit counseling agencies cannot charge for services in Oregon until the first of the year. The U.S. Trustee's office has asked debtor's counsel to report any problems with consumer credit counseling agencies to the U.S. Trustee's office.

Chapter 13 Trustee Brian Lynch provided a handout that his office will be using for calculating disposable income for the below-median-income debtor. He encourages use of this form to check feasibility.

Mr. Lynch also announced that his office wants to see how the current monthly income calculation was done, including providing pay stubs and tax returns. If there are no issues with regard to CMI, no further documentation will be required.

A new general order requires a debtor's attorney to file a wage order within seven days of the §341(a) meeting. Debtor's counsel may request a waiver for cause at the §341(a) meeting. Postconfirmation, the trustee's office will coordinate any changes that need to be made to these wage orders. The wage order the debtor's counsel prepares needs to list only the initial payment amount.

Under BAPCPA, if a debtor has not lived within the state for the last three years consecutively, debtor's counsel must use exemptions for the state that the bebtor lived in during the last two to two and a half years.

One week before the §341(a) meeting, the debtor or debtor's counsel should provide the trustee's office with the debtor's last year's tax return. Tax returns can be sent to the chapter 13 preconfirmation email address. The new bankruptcy law requires debtors to fulfill additional requirements before they may receive a discharge. Debtors must have filed all their tax returns, be current on domestic support obligations, and complete a post-filing debtor education class.

Finally, the committee discussed changes to the automatic stay under the new bankruptcy law. If a debtor has a bankruptcy dismissed within one year of filing a new case, the automatic stay will be in place only for thirty days. Debtor's counsel can file a motion within ten days requesting that the stay be extended. Hearings will be held on the Tuesday calendar at 2:00 pm. If the debtor has had two dismissed cases within one year of filing, debtor's counsel can use the same procedure; however, no stay will be in effect until it is granted by the court. Debtor's counsel can use the expedited hearing calendar if necessary. For more information, refer to the Bankruptcy Court's General Order No. 50-1.

### You Too Can Be An Author

If you would like to write an article, or would like to read an article on a particular topic, please contact:

**Deborah S. Guyol**

5161 NE Wistaria Drive, Portland, Oregon 97213
Tel: 503-281-2466 / Email: Dguyol@aol.com

Your letter should include the topic for the article and indicate whether you are willing to be the author.

## LEGISLATIVE COMMITTEE

The section's Legislative Committee held its first meeting of the 2006-07 Oregon legislative cycle on February 1, 2006. The committee's work will initially focus on legislation to propose to the 2007 Oregon Legislative Assembly. Topics the committee is considering for proposed legislation include: (1) clarifying the rights of a lienholder to execute on property of a decedent's estate, (2) considering whether a writ of garnishment served on an employer who uses a third-party payroll service should be deemed to be effective only if served before it becomes difficult or impossible for the employer to interrupt payroll that is in process, (3) adopting a receivership statute modeled on Washington State's, and (4) prohibiting collusive bidding at a trust deed foreclosure sale.

All section members are welcome to join the committee, and members may propose legislation without joining the committee. The committee's next meeting is set for March 1, 2006, at the office of Miller Nash LLP in Portland. In order to meet the April 1, 2006, deadline for bar bills to be submitted to the Public Affairs Committee of the Board of Governors, the committee will attempt to forward its proposals to the section's Executive Committee by March 15, 2006.

After submitting its own proposals, the committee will be available to comment on other bar sections' proposals, and while the legislature is in session, the committee will review and consider taking positions on debtor-creditor bills proposed by others and testifying on behalf of the section's bills.

For further information, or to suggest legislation to the committee, email or call committee chair Dave Hercher, dave.hercher@millernash.com, 503-205-2628.

**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**

5161 NE Wistaria Drive, Portland, OR 97213

## NEW LAWYERS COMMITTEE

The New Lawyers Committee meets once a month on the first Thursday of the month at the Eugene and Portland Bankruptcy Courts in the Judges' conference rooms from 12:00 to 1:00. The committee does not meet in July and August. The committee's goal is to provide educational opportunities in an informal setting where participants can find answers to their questions. The committee also provides a means to meet other members of the Debtor-Creditor Section.

We encourage anyone to drop in for the regular meetings and the panel discussions are also open to all. If you employ a "new" bankruptcy lawyer (5 years or less as a bankruptcy lawyer) please give the lawyer the opportunity to attend our meetings.

We have three events planned for this Spring. On March 14, the committee will host a discussion about issues that arise when your clients are not fluent in English. We will also hold another Judges' panel; we encourage practitioners to submit their questions in advance to the committee. The last event will be a social. Dates for the last two events have not been set.

Questions? Contact either Eugene Co-chair Julia Manela, manela@mb-lawoffice.com, 541-868-8005, or Portland Co-chair Bret Knewtson, bknewtson@yahoo.com, 503-846-1160.

***19th Annual***

**Northwest *Bankruptcy* Institute**

Cosponsored by the Debtor-Creditor Section of the Oregon State Bar and the Creditor-Debtor Section of the Washington State Bar Association

**Friday, April 14 &**
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