

Newsletter

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Debtor-Creditor Section, Oregon State Bar

Winter 2010

COMMENTS FROM THE CHAIR

TIME CAPSULE – DEBTOR-CREDITOR STYLE

By Miles D. Monson

Anderson & Monson, PC

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Have you ever been involved in sealing or opening a time capsule? My first experience with one occurred ten years ago. On December 24, 1999, my family gathered for our annual Christmas Eve party. As part of the celebration we created a family time capsule and put in pictures and other miscellaneous family items. There was Y2K talk at the time – anticipation of whatever might come with the year 2000. Placed for safe-keeping in our time capsule were a five-dollar bill someone had won at the annual family bingo game and a candy bar one of the kids slipped in when no one was looking, but mostly the capsule contained single sheets of paper from each family member about what they believed their lives would be like in the year 2010.

On December 24, 2009, we opened the sealed capsule (a two foot long cardboard tube) and read what each person had written. It was interesting and fun to see how close the predictions came to what was really going on in the lives or those who contributed – especially the pre-teens and teenagers of 1999 who were now in their twenties. I learned that the predictions that were the closest to reality had resulted from planning and goal setting. The family members who correctly predicted where they would be in the areas of education, volunteer service, careers, family, etc., had made an effort to achieve the predictions.

This experience sparked my idea that the Debtor-Creditor Section of the Oregon State Bar could use a ten-year time capsule.

Anyone can submit items for the time capsule to the Executive Committee, which will have final say on what actually goes into the capsule. Some ideas for submissions: pictures of members of the Section and predictions from each Section Committee for what the state of the practice area will look like in 2020. Categories for predictions could include: COURTS, FIRMS, ECONOMY, VOLUNTEER SERVICE, BANKRUPTCY.

In the ECONOMY category, for example, the Dow Jones Industrial Average began the year at 10,583.96; what will it be in 2020? The Prime Rate is 3.25% in 2010; where will it be in ten years? What will be the state of the economy nationally and in Oregon? What will be the state of commercial lending and commercial default rates in 2020? Will consumer spending still be the largest part of our economic engine? We had 2.8 million foreclosures in 2009; what will be the number in ten years?

In the BANKRUPTCY category, personal bankruptcy filings hit about 1.41 million in 2009; will there be more or fewer in 2020? How many business bankruptcy filings will we have in ten years? Will pre-packaged chapter 11 cases be the new norm, or will some other angle have emerged?

In the COURTS category: who will be the bankruptcy court judges in our district in 2020? Will we have a new state court house in Multnomah County? What about electronic filing

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in state court? Will bankruptcy court hearings move from "Meet Me" style telephone to video conference in the lawyer's office and if so, what will be the dress code?

Will we still care about CARE in 2020? Which firms will merge, or form, or disappear?

We will gather the submissions throughout the coming months and seal the capsule at our Annual Meeting in the Fall of 2010, to be opened at our Annual Meeting in the Fall of 2020. So open your mind to ideas and submissions

on what we should put in the capsule. Besides having fun and preserving some history, perhaps this will result in long-term planning and goal setting by the Section that we can look back on from a summit. Some things will happen no matter what we do; however, as a section working together we have the ability to make things happen as well.

CARVE OUTS AND CREDITOR LIENS: WHOSE POUND OF FLESH IS IT ANYWAY?

By Andrea Breinholt

"The bankruptcy court is a little like a soup kitchen, ladling out whatever is available in ratable portions to those standing in line; nonetheless, scarcity begets innovation in the hungry creditor's quest to get a little more than the next fellow."
In re Omegas Group, Inc., 16 F3d 1443, 1445 (6th Cir 1994).

Analogizing the bankruptcy court to a soup kitchen is not only clever, but unfortunately apt in this economic recession, when the health of even the most established businesses is threatened. Unlike other chapters of the Bankruptcy Code (the Code), the hallmark of chapter 11 is flexibility – to allow the ailing debtor to reorganize and emerge from bankruptcy healthy and profitable. However, flexibility begets ambiguity, and creative parties test the bounds of the Code with "carve out" agreements. Generally a carve out occurs when a secured creditor allows a portion of the value it is entitled to receive under a plan of reorganization to go to or for the benefit of a junior creditor, with intermediate creditors often receiving little or nothing. Courts are split on whether the Code permits such arrangements, with dissenters arguing that carve outs violate chapter 11's cramdown provisions: the absolute priority rule and the prohibition on unfair discrimination. This article argues that the Code permits secured creditors to do what they wish

with value from their perfected liens, as these liens are independent of the bankruptcy estate and not subject to the restrictions placed on the disposition of estate property. While the Ninth Circuit has not ruled directly on the issue, existing case law suggests it would come to the same conclusion.

I. Contextualizing the Carve Out

a. Chapter 11 Plans and Cramdowns

Consensual plans are common and often include distributions even to equity holders. A consensual plan results if, among other things, the requisite majority of each impaired class of claims accepts the proposed plan. §1129(a). (Statutory references are to the Code unless otherwise noted.) However, if an impaired class rejects a proposed plan, the Code provides a mechanism for resolution of the case. The term "cramdown" is not used in the Code, but is the accepted term for the process of confirming a plan over the objection of impaired classes. A court must confirm a plan over such

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objections if it “does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan.” §1129(b)(1).

The prohibition against unfair discrimination is intended to ensure that similarly situated creditors are treated similarly. It is a horizontal test in which the court compares treatment of different classes of claims with equal priority status. For example, even though the Code would allow a plan to place unsecured creditors with claims for punitive damages in a separate class from other general unsecured creditors, the plan cannot discriminate unfairly between them because the two classes are equal in priority. The court may reject a plan on the basis of unfair discrimination “if similar [classes] are treated differently without a reasonable basis for the disparate treatment.” *In re Union Financial Services Group, Inc.*, 303 BR 390, 421 (Bankr ED Mo 2003).

The rule that plans must be “fair and equitable” with respect to each class of claims is also known as the absolute priority rule (APR). The rule is outlined in §1129(b)(2) and requires that all senior claimants be paid in full before any junior claim receives value. This vertical test gives effect to the Code’s priority scheme for treatment of all claims against and interests in the bankruptcy estate. The priority scheme works as follows: secured creditors receive payment first, then administrative creditors and priority claimants, then general unsecured creditors, and, lastly, equity holders.

b. Carve Out Defined

Parties to chapter 11 cases have employed various tactics to avoid cramdown restrictions. One such tactic is the carve out. Traditionally, a carve out was used to pay professional or administrative expenses of reorganization, usually pursuant to §506(c). More recently, carve outs have been used to allocate value from senior secured creditors to junior creditors or stakeholders. The value the senior receives in exchange may be the junior’s promise to vote for the plan or its relinquishment of a right to challenge the senior’s claim. The terms of the agreement depend upon the parties involved and their goals.

Carve outs are unlike assignments in several ways. The junior does not step into the shoes of the senior. Both the senior and junior claimants remain the holders of their respective claims and the nature of the estate’s obligation to each creditor remains the same.

By way of illustration, assume at the time of its chapter 11 petition Debtor Corp. has one secured creditor, Secured Bank, which holds a perfected lien on all Debtor’s assets. Because Secured Bank’s claims against Debtor total \$1 million and Debtor’s assets are valued at only \$600,000, Secured Bank is undersecured in the amount of \$400,000. The Government holds a priority tax claim against Debtor for \$100,000, and Debtor has unsecured Trade Creditors (creditors necessary to Debtor’s trade) whose claims total \$200,000. Because Secured Bank believes Debtor is still viable, it concludes that the best way to maximize its

recovery is to help Reorganized Debtor succeed, which will require continued support from Trade Creditors. It therefore agrees to carve out \$200,000 from its lien to go to the Trade Creditors. Secured Bank does not care whether the tax claims are satisfied and thus does not provide for these in the carve out. If the carve out is part of the plan of reorganization, the Government would presumably vote against the plan, requiring the plan’s proponents to seek confirmation under the Code’s cramdown provisions. Strict application of the APR would dictate that, because the priority tax claim is not fully satisfied, the Unsecured Trade Creditors cannot receive any value. Although courts do not always reach this conclusion, carve outs are most likely to be approved when they are not part of a plan.

II. Emergence of the Carve Out – *SPM Manufacturing Corp.*

The issue of the validity of carve out agreements first arose in 1993 with *In re SPM Manufacturing Corp.*, 984 F2d 1305 (1st Cir 1993). When SPM filed its chapter 11 petition, Citizens Savings Bank (Citizens) held a perfected security interest in most of SPM’s assets, worth less than Citizens’ debt. *Id.* at 1307-08. SPM owed approximately \$9 million to Citizens and about \$5.5 million to general unsecured creditors; the IRS held a priority tax claim of about \$750,000. Robert Shaine, the president of SPM who continued to serve in that capacity during the pendency of the case, and his wife, chair of the board of SPM, were personally liable for any portion of the tax claim not paid by the estate. *Id.*

The Unsecured Creditors Committee (Committee) did not believe that reorganization was possible under the current management, but did not want to pursue a liquidation in which unsecured creditors would receive nothing. Accordingly, the Committee and Citizens executed a private agreement that provided they would work together to replace Shaine as CEO and share the proceeds from SPM’s operations and the disposition of its assets. The agreement did not provide for payment of the tax claims, which had priority over claims of the general unsecured creditors. *Id.* at 1308.

The case converted to chapter 7, and the debtor’s assets were sold for \$5 million. *Id.* The Committee and Citizens then filed a joint motion requesting distribution of the sale proceeds to Citizens and stating that Citizens would distribute a portion of the proceeds to the Committee, pursuant to their agreement. *Id.* at 1309. SPM and the Shaines objected that the Agreement violated the APR. Citizens and the Committee responded that the entire amount of the proceeds was subject to Citizens’ security interest and that it had a “right to share its proceeds with the Committee” without regard to the IRS or other creditors. The bankruptcy judge rejected this argument as “not in accordance with the priority of the bankruptcy code.” *Id.* The district court affirmed, finding the bankruptcy court’s ruling a proper exercise of the court’s equitable powers under §105(a). *Id.* at 1310.

The First Circuit reversed. It stated that “whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code.” *Id.* at 1311, citing *Norwest Bank Worthington v. Ahlers*, 485 US 197, 206 (1988) (unanimous decision). Further, the Code’s distribution scheme is not relevant until all valid liens on the debtor’s assets are satisfied; the Agreement concerned only the Citizens’ *claims* against the estate, not estate property. *Id.* at 1312-13. “While the debtor and the trustee are not allowed to pay nonpriority creditors ahead of priority creditors, . . . creditors are generally free to do whatever they wish with the bankruptcy dividends they receive, including sharing them with other creditors.” *Id.* (Citations omitted.) The court also said “it is hard to see how the priority creditors lost anything owed them given the fact that there would have been nothing left for the priority creditors after the \$5 million was distributed to Citizens.” *Id.* at 1312.

As a result of the First Circuit’s ruling, the IRS’s priority tax claim was not satisfied out of the bankruptcy estate and the Shaines became personally liable for it. More significantly, however, the First Circuit definitively stated that bankruptcy courts, which generally have a wide discretionary range, lack authority to prohibit parties from making carve out agreements for property not included in the estate.

III. Post-SPM Development of the Carve Out

Parties have since *SPM* proposed various forms of carve out agreements designed to skirt the Code’s distribution scheme. Courts’ treatment of such arrangements has generally been influenced by the context in which the carve out arises. I classify the contexts as follows: separate agreements for carve outs (*ie*, carve outs independent of the reorganization plan or any settlement agreement); carve outs included in the reorganization plan itself; and carve outs in a settlement governed by BR 9019.

a. Separate Agreements for Carve Outs

The first and perhaps simplest carve out is in a contract independent of the Code and not part of any mechanism the bankruptcy court is asked to approve. The carve out in *SPM* was one such agreement, privately negotiated and executed between Citizens and the Committee. Post-*SPM* bankruptcy courts reviewing similar agreements have applied not bankruptcy law but basic contract law. *See, eg, In re California Webbing Industries, Inc.*, 370 BR 480, 489 (Bankr D RI 2007) (acknowledging that *SPM* was “well reasoned and correctly decided,” but finding it not relevant because the secured creditor did not expressly agree to a carve out).

b. Carve Outs Included in the Plan of Reorganization

Strict application of cramdown provisions would seem to prevent inclusion of carve outs within a plan. However, *In re Genesis Health Ventures, Inc.*, 266 BR 591 (Bankr D Del 2001), *appeal dismissed*, 280 BR 399 (D Del 2002), relied on *SPM* to confirm a reorganization plan that contained a carve out. The debtor’s plan proposed two classes of unsecured creditors: one of general unsecured creditors and another of punitive

damage claimants. 266 BR at 598. The former were to receive new common stock (made possible by the undersecured senior lender’s willingness to give up a portion of its distribution), and the latter were to receive no distribution except to the extent covered by insurance. *Id.* Members of the punitive damages class objected. *Id.* at 600. The court agreed with the debtors and held that “[t]he disparate treatment . . . is a permissible allocation by the secured creditors of a portion of the distribution to which they would otherwise be entitled, rather than unfair discrimination.” *Id.* at 612.

Similarly, the court in *In re Union Financial Services Group, Inc.*, 303 BR at 423, found that the proposed plan did not unfairly discriminate even though it provided for full payment of the unsecured claims of certain trade creditors and utilities while other unsecured claims received only a negligible distribution. The court found “no unfair discrimination . . . particularly in the context of a reorganization where continued relations with those unsecured creditors are important to future business of the reorganized Debtor.” *Id.*

In contrast, the Third Circuit, in *In re Armstrong World Industries, Inc.* 432 F3d 507 (3rd Cir 2005), refused to confirm a plan containing a carve out. Armstrong World Industries (AWI) designed, manufactured and sold flooring products, cabinets, and ceiling systems. Several of AWI’s customers brought claims against it for asbestos-related injuries. AWI was found liable and subsequently filed a chapter 11 petition. *Id.* at 509.

AWI’s proposed plan placed general unsecured creditors in one class (Class 6), present and future asbestos-related personal injury claimants in another class (Class 7), and AWI’s sole equity interest holder (AWI’s parent company) in its own class (Class 12). The priority status of general unsecured creditors and the personal injury claimants was the same, and both were senior to Class 12. The plan provided Class 6 creditors would receive about 60% of their \$1.651 billion in claims; Class 7 creditors would become beneficiaries of a trust (with principal of \$1.8 billion) created by AWI, entitled to an initial payment of 20% of their allowed claims; and Class 12 would be issued new warrants to purchase AWI’s new common stock, worth \$35 to \$40 million. If Class 6 rejected the plan, Class 7 would receive the warrants but would be deemed to have waived receipt of the warrants, which would then be issued to Class 12. *Id.* In other words, AWI used the plan to issue to its parent company, the sole equity holder that would otherwise have no right to a distribution, warrants to purchase AWI’s new common stock.

The Third Circuit held the plan violated the APR by distributing warrants to AWI’s equity interest holder, through Class 7’s automatic waiver, in the event Class 6 rejected the plan. *Id.* at 514. AWI argued that the APR is not violated when a senior creditor distributes the property it is to receive under the plan to a junior creditor. *Id.* at 513-14. The court, however, concluded that *SPM* does “not stand for the unconditional proposition that creditors are generally free

to do whatever they wish with the bankruptcy proceeds they receive. Creditors must also be guided by the statutory prohibitions of the [APR].” *Id.* at 514.

Other courts have also held that the Code does not permit plans to include carve out provisions.

c. Carve Outs Included in Settlement Agreements

Carve outs appear most often in the context of settlements among creditors with grounds for challenging the validity, amount, or priority of the others’ claims against the estate. For example, rather than jeopardize its entire claim and bear the cost of protracted litigation, a senior secured creditor claiming priority over a junior secured creditor may agree to carve out a portion of its expected recovery for the junior creditor in exchange for the junior’s willingness to concede the senior’s priority status. If the junior accepts the offer, it is relegated to unsecured status. The issue is whether the Code allows the junior to collect if the administrative and priority claims are not satisfied in full.

Pursuant to BR 9019, settlements must be approved by the bankruptcy court upon a finding that the settlement is “fair and equitable.” *In re Woodson*, 839 F2d 610, 620 (9th Cir 1988). Although the Code does not specify standards for determining whether a settlement is fair and equitable, courts have developed their own standards. The Ninth Circuit uses what are known as the *Woodson* factors: (1) the probability of success in litigation, (2) the likely difficulties in collection, (3) the complexity of the litigation involved, and the expense, inconvenience and delay necessarily attending it; and (4) the paramount interest of the creditors and a proper deference to their reasonable views. *Id.* at 620. Other courts apply similar standards, also reasoning that the APR and prohibition against unfair discrimination are inapplicable outside the context of a cramdown. *See generally In re RFE Industries, Inc.*, 283 F3d 159, 165 (3rd Cir 2002); *In re World Health Alternatives, Inc.*, 344 BR 291, 297-98 (Bankr D Del 2006).

However, courts differ on whether a settlement must also satisfy the more stringent plan confirmation requirements of §1129(b) when it is included in a proposed plan. The court in *In re MCorp Financial, Inc.*, 160 BR 941, 948 (SD Tex 1993), approved a settlement agreement (in a plan) in which the senior secured lender carved out a portion of its undisputed recovery in favor of the Federal Deposit Insurance Corporation (FDIC) in exchange for the FDIC’s agreement to drop its suits against the debtor. Although creditors senior to the FDIC did not receive payment in full, the court approved the settlement, stating that regardless of whether a settlement is proposed as part of a plan, it is evaluated according to its own standard, not that of the plan. *Id.* at 951.

In contrast, some courts conflate the “fair and equitable” standard for settlements with the “fair and equitable” requirement of the APR. These courts reject any settlement, pre-plan or otherwise, that fails to satisfy the APR. The Second Circuit has stated that the APR is “the most important factor” in determining whether to approve a

settlement. *In re Iridium Operating LLC*, 478 F3d 452, 463 n18 (2d Cir 2007). Oregon bankruptcy courts have rejected the *Iridium* approach, stating that the APR is implicated in the consideration of a plan, not a settlement agreement. *In re Cascade Grain Products, LLC*, 2009 WL 2843365 (Bankr D Or 8/31/09)(not for publication). Thus, in Oregon, even if the settlement is contained within the plan, it is evaluated according to the *Woodson* factors. *Id.*

IV. Case Law Review and Analysis

As is evident from the foregoing, courts do not agree on whether and in what context secured creditors may provide carve outs in favor of claimants that are not next in priority. All courts recognize the premise of the *SPM* decision – that secured creditors are free to do what they wish with the distributions they receive. However, courts differ in willingness to acknowledge and give effect to carve out arrangements contained within a mechanism that the court is asked to approve.

This inconsistent treatment may hinge on whether, from the perspective of the court, “carve out” functions as a noun or a verb. A carve out (noun) is a thing (contract) with legal significance independent of the bankruptcy court. In contrast, to carve out (verb) denotes an action that the court orders or approves, as when it operates in a plan or settlement. The verb form implicates the court in ways that the noun does not. This noun-verb distinction was suggested by one bankruptcy court when it stated:

Although this court agrees with the proposition that a creditor receiving a distribution from an estate may do whatever it likes with the money it receives *after* distribution, the court finds it troublesome when the creditor purports to share with other creditors or equity, over the objection of an intermediate class, through the mechanism of a plan in a Chapter 11 that this court is called upon to confirm. *In re OCA, Inc.*, 357 BR 72, 87 (Bankr ED La 2006) (emphasis in original).

However, courts holding that a plan containing a carve out *per se* violates the cramdown provisions overlook the distinction between the creditor’s lien and property of the estate. The bankruptcy estate consists of “all legal or equitable interests of the debtor in property as of the commencement of the case.” §541(a)(1). The filing of a petition does not expand that interest. *United States v. Whiting Pools*, 462 US 198, 204 n8 (1983). A creditor’s lien is not a legal or equitable interest of the debtor in property. *See In re Mahendra*, 131 F3d 750, 755 (8th Cir 1997).

“A right to receive payment is freely transferrable and assignable . . . **without the consent of the debtor** and without affecting the debtor’s obligation to pay the underlying debt.” *SPM*, 984 F2d at 1313 (emphasis added). As the debtor’s successor, the estate (or any stakeholder claiming an interest in the estate) does not have more power than the debtor to restrict a creditor’s right to assign or otherwise dis-

pose of its interest. Because the cramdown restrictions apply only to distributions of property of the bankruptcy estate, the creditor's liens (and, accordingly, carve outs from those liens) fall outside the scope of §1129(b). While the court has authority to oversee the disposition of the collateral itself, the secured creditor retains the right to transfer value from its interest in the collateral.

Moreover, although §105(a) gives the court the power to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions" of the Code, it does not give the court equitable authority to impose the APR and prohibition against unfair discrimination on non-estate interests. Creditors have rights that bankruptcy judges are not empowered to dissolve in the name of equity. *In re Lapiana*, 909 F2d 221, 224 (7th Cir 1990). Because the right to give, assign, or subordinate one's pre-existing contractual rights is independent of the cramdown provisions and does not require court approval, bankruptcy courts needn't feel responsible for the creditor's actions (the OCA court's concern) or obligate themselves, as courts of equity, to correct perceived injury to the Code's priority scheme.

Although the APR looms large in most chapter 11 cases, it is not a constant. Congress assumed most cases would be resolved by consensual plans that deviate from the APR, as evidenced by the flexibility of the chapter 11 framework and the emphasis on negotiation and compromise. In sharp contrast to Chapter X of the Bankruptcy Act, under which the APR was strictly applied, the Code restricts application of the rule to instances where either the plan proponent requests it or there is a dissenting class – in which case the rule applies only from the dissenting class down.

Even in instances where the APR appears to apply, courts have found exceptions to its applicability. Based upon the Supreme Court's ruling in *Bank of America National Trust & Savings Association v. 203 North LaSalle Street Partnership*, 526 US 434 (1999), many courts now recognize a "new value" exception or corollary to the APR. This exception provides that, even in a cramdown where senior classes are not paid in full, junior claim holders may nonetheless retain a property interest in the debtor if they contribute new capital to the reorganized debtor. *Id.* at 442. The Ninth Circuit in *In re Bonner Mall Partnership*, 2 F3d 899, 901 (9th Cir 1993), recognized the new value exception as a "vital principal of bankruptcy law." The new value corollary demonstrates that the APR is not as rigidly applied as suggested by courts holding that carve outs are *per se* violative. Indeed, the corollary requires an examination not of whether equity holders receive value ahead of senior claimants, but rather of *why* the equity holders receive value. It is this inquiry into the **why** that helps courts avoid elevating form over substance.

The unfair discrimination rule is also subject to notable exceptions. For example, courts are increasingly willing to permit carve outs in favor of essential suppliers, employees, or contractors. *See, e.g., In re Union Financial Services Group, Inc.*, 303 BR at 423. The rationale is that special treatment is

required to maintain the business relationship and increase the chances of an effective reorganization. *Id.*

It is important to remember that creditors structure their agreements with debtors in full awareness that many debtors default on their obligations. These agreements, governed by nonbankruptcy law, form the basis of the creditors' claims against the estate. Nonbankruptcy law does not allow a third party to challenge a disposition of property to which it is not entitled unless it is harmed by the disposition. The fact that creditors not party to a carve out agreement are given this right in chapter 11 is an anomaly.

V. In Conclusion: the Ninth Circuit Approach

The viability of the carve out is still in question, and the Ninth Circuit has yet to weigh in. However, the Court's prior rulings suggest it could rule that carve outs are permissible for many of the reasons outlined above. In *In re Debbie Reynolds Hotel*, 255 F3d 1061, 1063 (9th Cir 2001), the secured creditor agreed to surcharge its collateral pursuant to §506 for the benefit of debtor's counsel (a traditional form of carve out). Although the super-priority unsecured lender objected, the court held that the surcharge was an assessment against the secured party's collateral (as opposed to property of the estate) and not subject to the Code's priority scheme. *Id.* at 1067. The court further held that the lender lacked standing to challenge the surcharge because it was not denied anything it was owed. *Id.* at 1066.

Moreover, in holding that the new value exception to the APR is still viable, the court stated that "the very purpose of the Code's cramdown provision is to allow the court, and not the creditors, to decide whether a 'fair and equitable' plan should be confirmed over creditor objections." *In re Bonner Mall Partnership*, 2 F3d at 915. "While the protection of creditors' interests is an important purpose under chapter 11, the Supreme Court has made clear that successful debtor reorganization and maximization of the value of the estate are the primary purposes." *Id.* at 916. Rather than imposing priority rules that are not implicated and have numerous exceptions, now more than ever courts should remember that flexibility is the hallmark of chapter 11 and encourage secured creditors to reinvest in the debtor to effect a successful reorganization.

Section Website

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

NONJUDICIAL TRUST DEED FORECLOSURES UNDER THE NEW LAWS

By Gary Blackledge

Greene & Markley

The last few Legislative Sessions have made changes that affect the procedure for conducting nonjudicial trust deed foreclosures. The 2008 Short Session added the "Danger Notice" to foreclosure of residential trust deeds. The 2009 Session modified the Danger Notice and enacted laws that require the trustee to send out a modification request with the Danger Notice to the trust deed grantor. The 2009 Session also added provisions for the protection of tenants of dwelling units. These new 2009 laws had emergency clauses and have been effective now for months.

This article summarizes our procedure for conducting nonjudicial foreclosures in light of these new laws.

I. Before Recording Notice of Default and Election to Sell

Before initiating the foreclosure, we recommend ordering a trustee's sale guarantee (TSG) from your friendly title company to find out the status of title and what liens are against the property. Make certain that the trust deed and all assignments are recorded so that the chain is complete to your client. ORS 86.735(1). Be sure your client has possession of the original note and there are no actions pending to collect it. ORS 86.735(4). If you are not already the trustee of the trust deed, your client must execute an appointment of successor trustee appointing you as trustee.

Next, obtain a list of all events of default from your client: missing payments; failing to pay taxes, insurance or a senior trust deed; allowing un-permitted encumbrances, etc. Obtain current figures on the principal balance, interest accruals, late charges, and any credits, and prepare a notice of default and election to sell. ORS 86.735(3). Note that the notice of default and election to sell must contain the information required in the notice of sale. *Id.* Therefore, the notice of default must also contain the new notice to tenants that is now required under ORS 86.745. This notice to tenants is required regardless of whether the property being foreclosed is residential or nonresidential real property.

Before recording, determine whether the trust deed is a residential trust deed as defined by ORS 86.705(3) or whether the property contains a dwelling unit occupied by a tenant. As noted below, this is important for sending the Danger Notice and modification request. Many trustees send the Danger Notice to everyone, including junior lien creditors, whether the trust deed is a residential trust deed or not. The Danger Notice found under ORS 86.737 applies to property that is subject to a residential trust deed. A residential trust deed is defined as a trust deed on property with four or fewer residential units, one of which is occupied

by the grantor, the grantor's spouse or grantor's minor or dependant child at the time foreclosure is commenced. ORS 86.705(3). But be careful. Even though ORS 86.737(1) states that the trustee must give the Danger Notice to the grantor on property subject to a residential trust deed, subsection 5 also requires the trustee to give the Danger Notice to the occupant of residential real property if the trustee has actual knowledge that the grantor is not the occupant. "Residential real property" is not defined in the Oregon Trust Deed Act.

Prepare a calendar, or time-line of events and deadlines for the entire nonjudicial proceeding. Refer to the PLF and OSB CLE publications with checklists for nonjudicial foreclosures. The notice of sale must be served at least 120 days before the sale. ORS 86.740(1). The notice of default and election to sell must be recorded before the notice of sale is served and, as stated above, must include the information in the notice of sale. Therefore, we recommend setting the sale out 130 to 150 days from the time of recording the notice of default to allow time for both personal service on occupants, including posting if necessary, under ORS 86.750, and service on any other parties for whom you have not been able to obtain proof of service. All service must be completed at least 120 days before the sale or the sale must be postponed to a date 120 days after the last service is effected.

Once your time-line is set, you are ready to send any assignments of the trust deed, the appointment of successor trustee, and your notice of default and election to sell to the title company for recording. We recommend that instructions to the title company request a date-down endorsement on the TSG through the date of recording the notice of default and election to sell. The notice of default and election to sell must be recorded before the notice of sale is served and, as stated above, must include the information in the notice of sale.

II. After Recording the Notice of Default and Election to Sell

Upon receiving recording information from the title company of the appointment of successor trustee and the notice of default, review the date-down endorsement to the TSG to see if any additional parties have acquired an interest in the property since the effective date of the TSG and may be entitled to notice of foreclosure under ORS 86.740. Prepare the notice of sale, the Danger Notice with the modification request (if you are foreclosing a residential trust deed or against property with a dwelling unit), and all affidavits of mailing required under ORS 86.750. The notice of sale is mailed first class and certified, return receipt requested, to the last known address of all grantors, occupants, junior lien holders and their successors in interest. If the property consists of a condominium unit or lot in a planned unit development, I recommend serving a copy of the notice of sale to the owners association regardless of whether an assessment lien has been recorded or shows on the TSG. (ORS 94.709(2) and 100.450(2) state that recording the declaration constitutes record notice and perfection of

the lien for assessments.) No further recording is required to perfect the association's lien. Send the Danger Notice with the modification request in the same manner to all grantors and occupants. As noted above, send the Danger Notice and modification request at the same time as the notice of sale, if you are foreclosing a residential trust deed or there is a dwelling unit that you know the grantor does not occupy. ORS 86.737(5).

The 2009 Legislature did a curious thing. It changed ORS 86.770(1) to make the sale effective to foreclose all persons who receive notice, rather than all persons to whom notice was given. (Some title companies now require proof that all parties to be foreclosed actually received notice. LC 136 (not yet assigned a bill number) will be introduced in the 2010 Short Session and is intended to correct the problems in ORS 86.770 created by HB 3004.) Therefore, five to seven days before the 120-day service deadline, we recommend confirming all certified mail cards acknowledging receipt have been returned and signed for by the addressee. If not, assess whether personal service by a process server needs to be made so we have proof of service if the title company requires it.

On the 120th day before the sale, confirm that service is complete and that a title date-down endorsement to the TSG has been received showing the recording of the notice of default and no further interests of any person who has not been served. In the days that follow, monitor receipt of proof of service on occupants regardless of who the occupants are. Also monitor receipt of any modification request which is due to be returned within 30 days after mailing the Danger Notice. If no completed modification request is received within that time, prepare an affidavit for the beneficiary or beneficiary's agent reciting the same. If a completed modification request is received, forward it to the client for compliance with Section 3, Chapter 864, 2009 Oregon Laws. (The new ORS Volume 2 does not include Section 3, Chapter 864, Oregon Laws 2009 in ORS 86.737 where one would expect to find it, but shows it instead in the second note after ORS 86.737. CAVEAT: Section 3, Chapter 864, Oregon Laws 2009 is effective now and is repealed January 2, 2012. See Sec 10, Ch 864, Oregon Laws 2009.)

Between 50 and 60 days before the sale date, send the notice of sale for publication to a newspaper of general circulation in the county where the property is located for publication. ORS 86.750(2). Proofread the notice for errors after the first publication. The notice must be published once a week for four successive weeks, the last of which must be more than 20 days before the sale.

Thirty days before the sale, request a federal tax lien search from the title company with a date-down endorsement to the TSG through the 30th day before the sale. If any IRS liens show up, serve the IRS as required by 26 USC §7425(c) at least 25 days before the sale.

If the property contains a dwelling unit that is occupied by tenants, 27 to 25 days before the sale check to see if any rental agreements or leases have been received. This way you know what kind of notice must be given to tenants under 86.755(5) after the sale. If the property is occupied by the grantor or grantor's successor, and the property does not contain a dwelling unit, give these occupants 30 days' notice to vacate. ORS 86.755(5)(b).

When you receive the affidavit of publication from the newspaper, or about two weeks before the sale, send the following to the title company with instructions to record: (1) affidavits of mailing, (2) affidavit of publication, (3) proofs of service, (4) notice of sale, (5) Danger Notice with modification request with affidavit from beneficiary or beneficiary's agent stating how the beneficiary has complied with Section 3(1) and (2), Chapter 864, Oregon Laws 2009, and (6) any notice to the IRS. These items must be recorded before the trustee conducts the sale. ORS 86.750(3), (4) and (5).

Approximately 10 days before the sale, confirm that all affidavits and any other presale documents have been recorded, begin to prepare the credit bid and obtain bidding instructions from the client. The trustee may credit bid on behalf of the beneficiary. ORS 86.790(6). Then, having received no notices that a bankruptcy has been filed, and provided you have complied with any requests for information under ORS 86.757, conduct the sale on the designated date.

III. After the Sale

After the sale has been conducted, promptly prepare the trustee's deed, having reviewed the procedure and confirmed there have been no defects in the process. The trustee's deed must be delivered no later than ten days after the sale. ORS 86.755(3). If the grantors or their successors are individuals, complete an affidavit of nonmilitary service and hold it in the file.

If the property includes a dwelling unit occupied by tenants, send out a notice to vacate, if appropriate, under ORS 86.755(5)(c) – provided the tenant is not a “bona fide tenant” under the federal Protecting Tenants at Foreclosure Act of 2009.

IV. Conclusion

The procedure recommended above is only a suggested guide and a reminder. Practitioners who take on the role of trustee should read the statutes and new laws for themselves and draw their own conclusions about how to proceed. Needless to say, not every scenario that might conceivably arise in a nonjudicial foreclosure will allow the above procedure to be followed as written. Be on the lookout for more changes in the 2010 Short Session that may affect nonjudicial foreclosures.

RESOURCES FOR LAWYERS NEW TO BANKRUPTCY PRACTICE

By **Laura Donaldson**
Kuni Donaldson, LLP

Our economy has created a recent increase in the number of bankruptcy filings. As a result, there are many faces new to the practice of bankruptcy law. Lawyers new to the practice need resources – ways to find answers to their questions or concerns, and/or to learn quickly how to handle a situation never faced before. Will the Trustee take this asset? Is this asset exempt? How do I serve this party? Where do I find bankruptcy forms? Who can I call when I have a question? You have the Oregon State Bar Bankruptcy Law book in your library arsenal, but it isn't giving you the answers you need.

At last year's Saturday Session, we recognized the need for such resources and formed a committee to address that need. The committee focused on what tools could be provided to members of the bar to provide quick answers and reduce the potential for malpractice claims. We then created a resource list of mentors and individuals willing to take a five-minute phone call or answer questions by email. The list includes attorneys from the Portland, Eugene, and Bend areas. The list of names and email addresses is available on the Debtor/Creditor website. If you would like it in advance, please email me at laura@kunidonaldson.com. In addition, Tips and Tricks for new practitioners from the bankruptcy court (ecf tips and tricks), Chapter 13 Trustee's office, and Chapter 7 Trustees themselves, as well as relevant articles from the Professional Liability Fund, will be gathered all in one place.

Here are other valuable links for information. Charlene Hiss and Mike Blaskowsky of the Portland bankruptcy court have developed a link on the bankruptcy court website (www.orb.uscourts.gov) titled "Useful Contact Information" under "Information for Attorneys." This link provides contact information for the Court, Chapter 13 Trustees and US Trustees in the State of Oregon. The Debtor-Creditor website at www.osb-dc.org contains the contact information for each Chapter 7 Trustee and important document production requirements in Chapter 7 cases. Click on "Trustees" to find a list of Trustees and their contact information. The website of Chapter 13 Trustee Fred Long is www.13network.com/trustees/eug/eughome.asp and the site of Chapter 13 Trustee Brian Lynch is www.portland13.com. Each site contains resources and contact numbers for questions you or your clients may have about Chapter 13 issues.

Not sure how to handle a service issue on a Friday afternoon at 4:00 pm? Post the question to the Debtor-Creditor listserve – debcred-discuss@lists.osbar.org – and you'll get the help you need. Members of the list include judges, debtor and creditor lawyers, state agency members, and others throughout the State of Oregon. Attorneys discuss an array

of issues, including exemptions, stay violations, recent case law, service issues, procedural questions, foreclosure issues and more. It is a great resource for obtaining the opinions of members who have practiced in this area for years, as well as those up and comers who have a new outlook on our sometimes confusing Bankruptcy Code. Participation is open to all Debtor-Creditor Section members whose email addresses are registered with the bar. Members are automatically signed up on the list serve; however, your participation is not mandatory.

ORCBA is a listserve for debtor's attorneys only. Discussions focus on representing clients in bankruptcy from the debtor's perspective. Attorneys must ask to be added to the listserve. The request is posted and current members vote on whether to allow the addition of a new member. This procedure is intended to ensure that lawyers who represent creditors or trustees are not privy to the discussion. It is similar to the NACBA (National Association of Consumer Bankruptcy Attorneys) listserve but on a local level. If you are interested, contact Bret Knewtson at bknewtson@yahoo.com or 503-846-1160 to join.

Email is great, but networking is important too. Consider joining a local bar committee. You don't have to do much but attend and take in the fun and informative discussion. The Consumer Section (aka "The Circle of Love") meets every other month to discuss practical bankruptcy issues. Judges, lawyers (creditor and debtor), trustees (7 and 13), US Trustee attorneys, representatives of the IRS and Oregon Department of Revenue, and others address recent events in bankruptcy law, changes in procedure, new case law and comments. Recent speakers have included Tim Zimmerman of Vial Fotheringham and Stuart Cohen of Landye Bennett, who discussed ongoing HOA dues in bankruptcy and PLF issues relating to the same. Practitioners rotate bringing eats for all to munch on while the discussion takes place. Participation by telephone is available for those who cannot attend in person. Eugene has a similar committee. For information about the Portland committee, contact Laura Donaldson at laura@kunidonaldson.com; for the Eugene committee contact Natalie Scott at nscott@mb-lawoffice.com.

The New Lawyers Group is another resource for lawyers new to debtor-creditor practice. It used to be called the "Young Lawyers Group" but a number of individuals new to bankruptcy law didn't meet the criteria (including me – I exceeded the age requirement), so the name was changed. Three times a year the group holds panel discussions with Chapter 7 Trustees, Chapter 13 Trustees, the Professional Liability Fund, and the IRS, among others. The group also holds a social at the end of each year. This group is a great way to network with other attorneys. If you are interested, contact Christopher Coyle at chris@vbcattorneys.com or 503-241-4869 to see when the next meeting will be held.

The WOMBATS group was developed specifically for women in bankruptcy practice. The group meetings provide

an opportunity for informal networking and exchange of information. This is a diverse group, with creditor attorneys, debtor attorneys, judges, members of the US Trustee's office and the like. Interested? Call Laura Walker at 503-224-3092 or email lwalker@cablehouston.com.

Finally, the Oregon State Bar Debtor-Creditor website at www.osb-dc.org should be a link on the desktop of every lawyer who practices bankruptcy law. It contains valuable information for the bankruptcy bar. Thomas Renn, Chapter 7 Trustee and past Chair of the Executive Committee has done a great job keeping the website up to date with relevant information and contacts. One of its features is a calendar of events including meetings of all the committees described above. The site also lists committee chairs and contact information.

NINTH CIRCUIT CASE NOTES

By Ivy B. Grey

Davis Wright Tremaine LLP

“ACTUAL DAMAGES” FOR VIOLATION OF AUTOMATIC STAY

Sternberg v. Johnston, 582 F3d 1114 (9th Cir 2009)

After Johnston failed to pay the spousal support ordered in his divorce, his ex-wife and her attorney, Sternberg, pursued contempt charges in state court. A few months later, before any hearing on the contempt charges, Johnston filed for bankruptcy protection. Johnston did not give notice of his bankruptcy to the family court, his ex-wife, or her lawyer until the contempt hearing was underway.

Because of the court and counsel's uncertainty about the effect of the bankruptcy, the contempt hearing proceeded. Two months later, the court entered a minute order granting judgment against Johnston in the amount of \$87,526.60. Johnston immediately sought relief from the order in state court and also filed an adversary proceeding in his bankruptcy case. Sternberg opposed Johnston's efforts to stay the matter.

The bankruptcy court found that the state court order had violated the stay but that the ex-wife and Sternberg had not. The district court reversed and remanded, and the bankruptcy court ordered Sternberg to pay the following damages for stay violation: \$2,883 because the violation had hindered Johnston's ability to work, \$20,000 for emotional distress, and \$69,986 for attorney fees and costs.

On appeal Sternberg argued that he did not willfully violate the stay. The Ninth Circuit disagreed, noting that he should have “taken corrective action” within a reasonable time after the state court issued its minute order. Sternberg also argued that the attorney fee portion of the damage award should include fees only for remedying the

stay violation, not for the adversary proceeding in which Johnston sought to collect damages for violation of the stay. The Ninth Circuit agreed. It read “actual damages” to compensate only “the injury resulting from the stay violation itself. Once the stay violation has ended, any fees the debtor incurs after that point in pursuit of a damage award would not be to compensate for ‘actual damages’ under §362(l)(1).” Allowing otherwise would be to make the stay a sword, not a shield. This conclusion is also supported by the American Rule. The court affirmed the award of fees for hindered work ability and emotional distress, and remanded to determine the attorney fees portion of “actual damages.”

WHAT CONSTITUTES ACQUISITION OF INTEREST FOR EXEMPTION LIMITATIONS UNDER §522(P)(1)

In re Greene, 583 F3d 614 (9th Cir 2009)

The debtor purchased the property in question some ten years before he recorded a “declaration of homestead” under Nevada law and began to live on the property. He filed his bankruptcy petition within 1215 days of the recording, but well over 1215 days after purchasing the property. Both the bankruptcy court and the district court held that the debtor had not “acquired” his interest in the property for a homestead exemption until within 1215 days of his petition, and thus he was subject to the federal homestead exemption of \$125,000 even though Nevada was an opt-out state.

The Ninth Circuit disagreed. In its analysis, the court followed the approach in *United States v. Craft*, 535 US 274 (2002) (federal tax lien law and state property rights), first looking to state law to determine the individual's rights in the property, then to federal law to determine whether the state-delineated rights qualify as property or rights to property.

Under Nevada law, the debtor's homestead declaration provided legal protection of the debtor's property interest, but was not an acquisition of interest in the equity in or title to the property.

Turning to federal law, the court found the text of §522(p)(1) to be ambiguous, and consulted dictionary definitions of “amount,” “interest,” and “acquire” because those are not terms defined in the Code. It concluded that the “most plausible interpretation of Section 522(p)(1) is that the act of recording a homestead or moving onto the property to establish residency is not an ‘amount of interest acquired’ for purposes of applying the monetary cap in Section 522(p)(1).” 583 F3d at 623.

Legislative history supports this result. Congress enacted §522(p)(1) in part to address the “mansion loophole,” which allowed wealthy individuals to shelter millions of dollars from creditors by purchasing mansions on the eve of bankruptcy. The legislative history of the statute shows concern with ownership of property, not conversion of non-residential into residential property.

CREDITOR'S FCRA DUTIES; DEBTOR'S RIGHTS

Gorman v. Wolpoff & Abramson,
584 F3d 1147 (9th Cir 2009)

Gorman purchased a satellite system and was unhappy with the equipment and installation. He refused to pay the debt and reported the dispute to his credit card company, MBNA, but did not return the goods. Following months of communications between MBNA and Gorman, MBNA reported Gorman's account as "charged off" to the Credit Reporting Agencies (CRAs). Gorman told the CRAs that the "credit reports included inaccurate information" because they did not show the account as disputed. In turn, the CRAs sent notices to MBNA regarding the dispute. MBNA reviewed the records and reported that the delinquency was not an error. This negatively affected Gorman's credit and ability to get credit at the same rate. He sued MBNA for, inter alia, violations of the Fair Credit Reporting Act (FCRA). The district court granted summary judgment to MBNA on two FCRA claims. The Ninth Circuit affirmed on one claim and reversed on the other.

The first question was what sort of "investigation" MBNA was required to make following the CRAs' notice of the disputed report. The court held that the investigation must be "not unreasonable" and that by definition it must be a "'detailed inquiry or systematic examination,' which necessarily 'requires some degree of careful inquiry.'" 584 F3d at 1155 (citing *Johnson v. MBNA Am. Bank, NA*, 357 F3d 426, 429-31 (4th Cir 2004)). A superficial, cursory, sloppy, or unreasonable inquiry would not comport with Congressional intent in enacting the FCRA. The court concluded, however, that MBNA's investigation had been reasonable and it was entitled to summary judgment on the claim.

The second question was whether Gorman had a private right of action against MBNA for its failure to notify the CRAs that he continued to dispute the delinquent charges. The court again followed a Fourth Circuit decision, *Saunders v. Branch Banking & Trust Co. of Va.*, 526 F3d 142 (4th Cir 2008), to conclude that a "decision to continue reporting a disputed debt without any notation of the dispute presents a cognizable claim under §1681s-2(b)." 584 F3d at 1162. The omission alone is not enough, however. "The consumer must still convince the finder of fact that the omission of the dispute was 'misleading in such a way and to such an extent that [it] can be expected to have an adverse effect.'" *Id.* at 1163 (quoting *Saunders*). The court concluded Gorman had a right of action on this claim. Further, he had submitted enough evidence for it to survive summary judgment.

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BAP CASE NOTES

By Chris Parnell
Farleigh Wada Witt

"AWARDED" AS A PAST PARTICIPLE: PREPETITION JUDGMENT NOT REQUIRED FOR NONDISCHARGEABILITY UNDER §1328(A)(4)

In re Waag, 418 BR 373 (9th Cir BAP 2009)

In *Waag*, the BAP decided a chapter 13 discharge issue of first impression in the Ninth Circuit that had previously been addressed in only two published – and conflicting – bankruptcy court opinions. The BAP affirmed Judge Perris's ruling that a prepetition judgment is not required in order to exclude civil restitution or damages from discharge under §1328(a)(4).

Plaintiffs filed a wrongful death action against debtor in state court. Before any trial or judgment, debtor filed his chapter 13 case. Plaintiffs responded with a complaint alleging nondischargeability under §1328(a)(4). Debtor moved to dismiss, arguing that the language of §1328(a)(4) excepting debts for damages "awarded in a civil action" required the existence of a prepetition judgment. The bankruptcy court considered the two published opinions on this issue and sided with the court in *In re Taylor*, 388 BR 115 (Bankr MD Pa 2008), in concluding that the plain language of §1328(a)(4) does not require entry of a prepetition judgment.

The BAP opinion notes that §1328(a)(4) was added by BAPCPA in 2005 in an effort to restrict the "superdischarge" of chapter 13. While similar to §523(a)(6), there are also key differences. Section 523(a)(6) does not apply to chapter 13 and generally provides a broader exclusion from discharge, despite the more expansive "willful or malicious" language in §1328(a)(4). Section 1328(a)(4) is restricted to personal

injuries or death and does not encompass injuries to property; it is limited to restitution and damages awarded in a civil action against the debtor.

Resolution of the issue in *Waag* turned on whether the word “awarded” in §1328(a)(4) should be read as a past tense verb or a past participle. If read as a past tense verb, a prepetition judgment would be a prerequisite to a finding of nondischargeability, as a bankruptcy court in Illinois determined. The BAP instead agreed with the *Taylor* court’s reading of “awarded” as part of a participial phrase modifying “damages,” but not restricting the award to a time in the past. The BAP concluded that “[n]othing in [the] phraseology of §1328(a)(4) requires, either implicitly or explicitly, entry of a prepetition judgment.” 418 BR at 379. The BAP also noted as a policy issue that requiring a prepetition judgment could lead to an absurd result, initiating a race to the courthouse that “would give the debtor a clear advantage since it takes considerably longer to obtain a judgment than it does to file a bankruptcy.” *Id.* at 381.

TRUSTEE’S ALLEGATIONS OF FRAUD, DECEIT PROTECTED UNDER QUASI-JUDICIAL IMMUNITY DOCTRINE

In re Cedar Funding, Inc., 419 BR 807 (9th Cir BAP 2009)

The Bankruptcy Court dismissed a defamation action against the chapter 11 trustee but held the trustee was not protected by quasi-judicial immunity. The BAP affirmed the dismissal, but held the bankruptcy court’s ruling on quasi-judicial immunity was erroneous: quasi-judicial immunity **did** protect the trustee.

David Nilsen was the sole shareholder and president of debtor, a corporation engaged in the mortgage lending business. After debtor ceased making interest payments to investors, a receiver was appointed and Nilsen responded by putting debtor into a voluntary chapter 11. This led to the appointment of a chapter 11 trustee, based on investors’ allegations of a Ponzi scheme. At the 341(a) meeting, trustee stated that Nilsen had lied, played a cruel hoax on them, and committed fraud. After Nilsen wrote a letter to investors accusing the trustee of deceptive statements, trustee responded with a rebuttal letter to investors in which he stated that Nilsen was “knowingly operating a Ponzi scheme,” that investors could lose their savings in a “hopeless vortex of fraud,” that Nilsen was “untruthful” and that he had “misappropriated” funds.

Under the US Supreme Court’s two-part test for quasi-judicial immunity set forth in *Antoine v. Byers & Anderson, Inc.*, 508 US 429 (1993), a court must first inquire into the immunity historically afforded the official at common law, and then examine whether the immunity covers the official’s functions at issue. As to the first prong, the BAP noted that the Ninth Circuit has held that bankruptcy trustees have historically been afforded absolute quasi-judicial

immunity because they perform some functions that are judicial in nature.

The BAP then considered the second part of the *Antoine* test and pointed out that the trustee’s official duties include investigating and reporting functions under §§1106(a)(3) and (4). The court focused on the “ultimate act” at issue: the trustee’s statements to creditors at the 341(a) meeting and in a letter posted on the official website for the bankruptcy estate. The BAP found that trustee’s administration duties were “inextricably intertwined with the court’s functions in the chapter 11 bankruptcy process, which are aimed at preserving the business as a going concern and maximizing the value of assets for creditors.” 419 BR at 823. Such functions are essential to the adjudication of private rights to the estate. In these circumstances the trustee was protected by the absolute quasi-judicial immunity doctrine.

STATE COURT CASE NOTES

By Sean C. Currie
Greene & Markley, PC

REQUIREMENTS FOR FINALITY OF LIMITED JUDGMENT

Interstate Roofing, Inc. v. Springville Corp.,
347 Or 144, 218 P3d 113 (2009)

Roofer sued Developer for foreclosure of a construction lien, breach of contract and quantum meruit. Developer counterclaimed for breach of contract and negligence. The trial court entered a “limited judgment” stating the construction lien was invalid as a matter of law, ruling in favor of Developer on its breach of contract claim and stating that Developer’s negligence counterclaim was “inapplicable.” Neither party appealed, the judgment against Roofer was satisfied, and Roofer later moved to dismiss its remaining claims. Developer objected on the basis that it was entitled to a jury trial on its counterclaims. The trial court held the counterclaims had been resolved by the limited judgment, and entered a general judgment dismissing Roofer’s claims for breach of contract and quantum meruit.

Developer appealed both the general judgment and the previous limited judgment. It argued that the limited judgment was not “final” because it did not contain adjudicative language and the trial court did not expressly determine that there was “no just reason for delay” as required by ORCP 67 B and ORS 18.052(1). The Court of Appeals concluded that the limited judgment had been “final” with respect to the lien foreclosure claim and the breach of contract counterclaim, but not the negligence counterclaim.

The Oregon Supreme Court held that the limited judgment had been final and appealable with respect to all three

claims. No magic words are required to make a judgment final and appealable, as long as the judgment document contains the title "judgment," and as long as the trial court made a "concluding decision" on one or more claims. Although the trial court is required to determine that there is no just reason for delay, "the very act of signing a 'limited judgment' attests to having made that determination." The only adjudicatory term statutorily required to be in a judgment document is the word "judgment" in the title itself.

DEFAULT AND UNTIMELY ANSWER

Hart v. Hill, 230 Or App 612, 216 P3d 909 (2009)

Landlord sued residential tenant for forcible entry and detainer. Landlord, tenant, and tenant's attorney appeared at first appearance. Tenant had not filed an answer as required by ORS 105.113.

The day before trial, tenant filed an untimely answer that raised two affirmative defenses, requested dismissal of the complaint and asked for costs and disbursements pursuant to ORS 90.255. Later that same day, the trial court entered a general judgment by default against tenant for failure to file a timely answer. The judgment awarded landlord restitution of the premises and costs and disbursements. Tenant appealed after the trial court denied tenant's motion to set aside judgment pursuant to ORCP 71 B or C.

The Court of Appeals reversed the judgment of default, reasoning that although tenant's answer was untimely, it was filed before entry of the judgment. A party may file an answer or otherwise plead at any time before a default judgment is entered.

SUBSTANTIAL MODIFICATION OF JUDGMENT ON APPEAL REQUIRED FOR "PREVAILING PARTY" STATUS

Haynes v. Adair Homes, Inc.,
231 Or App 144, 217 P3d 1113 (2009)

Defendant appealed a supplemental judgment awarding plaintiffs attorney fees. The Court of Appeals agreed with defendant that the attorney fee award should be reduced because some of the plaintiffs were children and not parties to the contract under which plaintiffs recovered. The court remanded for reconsideration of the attorney fee award. 227 Or App 536, 206 P3d 1062 (2009).

Defendant thereafter sought an award of attorney fees from the Court of Appeals for having been the prevailing party on its appeal. The court denied any award of attorney fees to defendant, holding that the remand for reconsideration of attorney fees awarded to plaintiffs was not a "substantial modification of the judgment." Plaintiffs even after remand would be entitled to substantial attorney fees, so defendant's success was only "intermediate and, possibly,

temporary." The court therefore did not have discretion to designate defendant the prevailing party on appeal under ORS 20.077(3).

CONSUMER BANKRUPTCY

MEETING OF NOVEMBER 19, 2009

By Britta Warren

Todd Trierweiler & Associates

Thank you to Pamela Griffith and Dan Rosenhouse for providing food.

Judge Brown discussed new forms for Notice, Motion and Order to Value Property Pursuant to 11 USC §506 and Avoid Wholly Lien to be used for stripping liens in chapter 13 proceedings. These forms can be found on the Court's website, www.orb.uscourts.gov. Judge Brown also emphasized that the legal description of the real property must be included in the motion and order. Attorneys can call title companies to obtain this information. Attorneys can also choose to file adversary proceedings to avoid wholly unsecured liens. However, Judge Brown cautioned that judgments filed in any adversary proceedings should be similar in form to the standardized Order.

Thomas Renn announced the formation of a local rules and forms committee. Any interested volunteers should contact Mr. Renn.

Naliko Markel from the Chapter 13 Trustee's office noted that the Trustee's email server will not accept PDF files over five megabytes. Further, attorneys should always use precon@portland13.com or postcon@portland13.com to assure prompt receipt by the Trustee's office. The Trustee's office reminds attorneys to redact social security numbers and dependent information from documents sent to the Trustee. Finally, the Trustee's office will no longer service the feasibility portal online. Naliko can email the program to any interested member. Users will need Microsoft Access and Excel. The Trustee's office encourages all attorneys to run a feasibility and liquidation analysis prior to filing. The Trustee's office is also testing Electronic Funds Transfers for attorney fees paid in chapter 13 plans. Any questions can be addressed to Naliko at NalikoM@portland13.com.

Laura Donaldson clarified with the Trustee's office that all payments on impaired vehicles and rental properties must be made through the plan. Wayne Godare said that "impaired" refers to delinquencies or undersecured status. Wayne suggested that attorneys provide the Trustee additional valuation information in contested cases.

Charlene Hiss, new Clerk of the Bankruptcy Court, announced several new national rules and forms. The Court has also developed new local forms to address the national

rule changes. The new rules and forms can be found on the Bankruptcy Court's website.

Carey Glusenkamp reported on the recent National Association of Consumer Bankruptcy Attorneys (NACBA) convention in Tucson, Arizona. He encouraged attorneys to join by visiting www.nacba.org.

The meeting concluded with Jeff Werstler's report from the IRS. He reminded attorneys to review tax lien priority before filing. He referred practitioners to Jeffrey Wong's article in the winter 2006 issue of this Newsletter. He cautioned that trust fund taxes and unassessed taxes are non-dischargeable under the new law. Judge Brown questioned the IRS's recent inclusion of unassessed liability in proofs of claim. She referred to these claims as "stealth objections" and expressed dislike of this practice. Mr. Werstler reminded members that the IRS, unlike bankruptcy trustees, requires all original documents to contain social security numbers and original signatures.

MEETING OF JANUARY 21, 2010

By Rosemary McIntosh
Todd Trierweiler & Associates

Wayne Godare, of the Chapter 13 Trustee's Office, discussed the Feasibility Program, available in zip file form, and recommended that practitioners try the program. His office can send it to you, and Wayne is available to respond to questions or concerns. You may also contact Naliko Marco in the event of questions: nalikom@portland13.com.

Wayne also recommended checking out the Default Mitigation Management Portal: www.defaultmitigation.com. The Portal is designed to walk you through these issues.

There is a new form to be used in Chapter 13 bankruptcy cases where debtor has a domestic support obligation (DSO). Be sure to use the most recent version. The form should be filled out before and brought to the 341(a) meeting. The Trustee's office sends it out with the initial letter. If clients don't have a DSO, they don't need to fill out the form.

There is still a problem with providing documents to the Trustee's office in a timely manner. Any documents provided after noon on the Wednesday before the 341(a) meeting may not be processed. Everything that comes in after noon will be starred and numbered, and will be processed only if there is time.

Thomas Renn, Chapter 7 Trustee, said that chapter 7 trustees require the DSO form to be sent with the original batch of documents. It must be received by or before the 341(a) meeting. Debtors must provide this form to the trustees even if they are current on their obligation. Please note that the form requires the recipient's address, not that of the State of Oregon. If the obligor is not allowed to have the recipient's address, advise the trustee.

Judge Dunn discussed the recent BAP decision in *In re Herrera*, __ BR __, 2010 WL 144402 (9th Cir BAP Jan 5, 2010). The Bankruptcy Court for the Central District of California adopted optional plan provisions that allow debtors to force secured creditors to provide debtors with monthly statements and to include in those statements all pertinent information about late fees, principal balance, payment dates, etc. The BAP affirmed. Judge Dunn suggested we use *Herrera* as a template for drafting such provisions, and for potential remedies if the provisions are ignored. This will be an effective means of prying information out of reluctant mortgage creditors.

Note about confirmation hearings: Initial case confirmations are reviewed on the Wednesday before the hearing. These cases will be reviewed once. All additional issues and documents will be dealt with at the hearing.

There was an anonymous question about the ODR Tax Amnesty Program. For debtors to participate in certain tax amnesty programs, an order from the Bankruptcy Court may be required. Judge Perris suggested the debtor's attorney draft a motion and submit it ex parte. The judges are approving such motions as noncontroversial matters. The debtor's attorney merely needs to file something with the Court.

Stuart Cohen of Landye Bennett and Tim Zimmerman of Vial Fotheringham made a presentation on Homeowners Association (HOA) issues. The following is a summary of their points.

1. If a debtor lives in a condo unit for which foreclosure was not completed at the petition date (title still in debtor's name), the debtor will be liable for post-petition HOA assessments.

2. In chapter 13 plans, the numbers used for assessments need to be accurate so that the plan is not blown out of the water. For example, you must ascertain whether the payment amount will change at a later date and, if so, account for the change in the plan.

3. A debtor with a legal, equitable or possessory interest in a condominium unit is liable for post-petition assessments. Problems in this area may arise and the HOA may be forced to take action because paying tenants get upset when others are not paying their fair share.

4. In Oregon, assessment liens are automatic. A condominium association can jump in front of the first mortgage holder if notice is given to the mortgage creditor and mortgage creditor fails to complete foreclosure within 90 days. Caveat: the debtor must be in default on the mortgage.

5. In addition, HOA assessment liens are automatically prior to all other liens after the first mortgage and any existing tax lien. This is even true for 80/20 loans.

6. Those who want to resolve the issue before a lien attaches should contact the HOA board or property manager to negotiate.

7. To resolve the issue after the lien has attached, contact the HOA's attorney and ask if the HOA wants a deed. This strategy allows the HOA to rent the property while waiting for the lender to foreclose. In the alternative, the debtor can move out of the unit; this move takes pressure off the HOA board to take action. If there are no complications, the HOA may not pursue post-petition assessments.

8. If the HOA does take action, it will: (1) file a lien, (2) send a notice to lender, (3) record an affidavit of notice to lender, and (4) send notice of intent to foreclose. Depending on the size of the assessment, the HOA may opt to file suit in lieu of foreclosure.

9. Note on the interest rates set by HOA by-laws or the board. Most boards set the rate at 9% - 12%. Some are as high as 18%. Some are floating rates. When drafting a chapter 13 plan, do not put 0% as the rate because the attorney for the HOA will object.

Jeffrey Werstler of the IRS said bankruptcy practitioners should be aware that the IRS has increased monitoring of those who sue the IRS. Filing any type of suit in bankruptcy court counts as "filing suit against the IRS." For example, a lawyer who fails to file or pay personal taxes and who practices in bankruptcy court may be subject to discipline. A lawyer disciplined by the IRS Director of Practice will have to report the action to the Oregon State Bar and may not be allowed to deal with tax issues in Bankruptcy Court.

Pamela Griffith, Assistant US Trustee, announced that the US Trustee's Office is currently looking for a trustee in southern Oregon (Klamath Falls-Roseburg) to replace David Wurst.

Important Upcoming Dates: Saturday Session - March 6, 2010; Pro Bono Reception - March 4, 2010, at 4:30pm in the Judges' Conference Room, 9th Floor of Bankruptcy Court building.

Thanks to Todd Trierweiler for providing food and beverages. The next Circle of Love meeting will be held on March 11, 2010.

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:

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