Contra Costa Lawyer Online

June 2017

The Contra Costa Lawyer magazine is the official publication of the Contra Costa County Bar Association (CCCBA), published 12 times a year - in six print and 12 online issues.

Contents

Not Eligible to File Bankruptcy? An Analysis of What is Required

Thursday, June 01, 2017

The most common types of bankruptcy filings are under Chapters 7 and 13 of the Bankruptcy Code. Chapter 7 bankruptcy is sometimes referred to as the "liquidation" bankruptcy as all property of the debtor becomes the bankruptcy estate. A bankruptcy trustee then liquidates the non-exempt property of the estate and distributes the resulting proceeds according to certain priorities to creditors. Most cases, however, do not result in any liquidation and distribution to creditors and are labelled "no asset" cases. In comparison, Chapter 13 is a debt adjustment plan under which the debtor may keep property while repaying creditors, at least in part, over a period of time, between 3-5 years depending on the debtor's income.

The Bankruptcy Code authorizes a "person" that resides or has a domicile, a place of business, or property in the United States, or a municipality, to be a "debtor," and thus be able to file for bankruptcy protection. A " person" may be a Chapter 7 debtor. "Person" is defined to include individuals, partnerships, and corporations. A corporation may file bankruptcy only with the proper authorization. Without the requisite authorization, the bankruptcy court can dismiss a corporate bankruptcy. Proper authorization means a valid resolution of the board of directors that is adopted before the case is filed. Absent some contrary provision in the corporate by-laws, a majority of the directors is necessary to constitute a quorum and thereby authorize a bankruptcy filing. Shareholders of a corporation in their capacity as shareholders have no authority to initiate voluntary bankruptcy proceedings for a corporation as they do not have the power of management.

For individuals, the means test is their biggest barrier to filing for Chapter 7 bankruptcy relief. In Chapter 7, the means test applies to individual debtors whose debts are primarily consumer debts. Analyzing how the means test works is beyond the scope of this article but it is comprised of several stages. First, the debtor's "current monthly income" must be determined. It is comprised of the debtor's average monthly income in the six-month period before he or she filed for bankruptcy relief. The "current monthly income" is then compared to the median income for a family of comparable size in his or her state. If a debtor's current monthly income is below-median, no additional calculations are needed, and the debtor is eligible to file chapter 7. If above-median, additional calculations are required to determine chapter 7 eligibility.

Chapter 13 is available only to " individual(s) with regular income." Corporations cannot file for Chapter 13 bankruptcy relief. "Individuals with regular income" is defined to be individuals " whose income is sufficiently stable and regular to enable such individual to make payments under a plan." Debtors with regular income not only include those that are salaried but also those that are self-employed, those that receive government benefits, and those that receive alimony or support payments.

Chapter 13 eligibility is also based on certain debt limits. Eligibility debt limits are strictly construed. [1] Chapter 13 is not available to debtors with over $394,725 of non-contingent, liquidated, unsecured debt or over $1,184,200 of non-contingent, liquidated, secured debts. [2] These amounts do not change for debtor couples. Eligibility is determined by reference to a debtor's originally filed schedules, checking only to see if the schedules were made in good faith. [3]

Secured versus Unsecured: The unsecured portion of an undersecured debt must be deducted from the "secured debt" total and added to the "unsecured debt" total. [4] A debt is undersecured when the amount of the debt exceeds the value of the collateral that secures the debt.

Liquidated versus Unliquidated: Debt is liquidated if the amount is readily ascertainable, notwithstanding the fact that the question of liability has not been finally decided. [5] An example of a liquidated debt is a collection judgment. An example of an unliquidated debt is a tort claim for personal injuries and pain and suffering which has not been reduced to a judgment.

Contingent versus Non-Contingent: A debt is non-contingent if events giving rise to liability occurred before the bankruptcy case was filed. [6] If "the debtor will be called upon to pay [it] only upon the occurrence or happening of an extrinsic event which will trigger the liability of the debtor to the alleged creditor" then the debt is contingent and not counted for eligibility purposes. [7]

So what happens if a Chapter 13 debtor runs afoul of either the regular income requirement or the debt limits? The debtor is then faced with either dismissal of the case or the conversion of the case to Chapter 7.

Successive filings also pose an eligibility issue. A debtor can file a Chapter 7 petition at any time after a previous filing, but will not be eligible for another discharge if the second filing is less than eight years after a preceding Chapter 7 filing or six years after a previous Chapter 13 filing. A debtor can similarly file a Chapter 13 petition at any time after a previous filing, but will not be eligible for another discharge if the second filing is less than four years after a preceding Chapter 7 filingor two years after a previous Chapter 13 filing. Successive filings also may result in the automatic stay being terminated. The stay is automatically terminated 30 days after the petition was filed if an individual was a debtor in a previously dismissed case which was pending within the preceding year. The bankruptcy court, however, can continue the automatic stay after notice and a hearing completed prior to the expiration of the 30 day period if there is a finding that the latter case was filed in good faith as to the creditors who are stayed by the filing. If two or more cases were pending within the previous year and were dismissed, the stay does not even go into effect upon the filing of the latter case. In that situation a party in interest can request that the court promptly enter an order confirming that no stay is in effect.

Eligibility issues are real and can force a debtor to properly plan a bankruptcy filing. Various considerations come into play before the case should be filed.

David A. Arietta *is a certified specialist in bankruptcy law with an office in Walnut Creek. He has extensive experience representing debtors in Chapters 7, 11, and 13 and is a* *past president of the Bankruptcy Section of the Contra Costa County Bar Association.*

[1] *In re: Soderlund*, 236 B.R. 271, 274 (9th Cir., BAP 1999)
[2] 11 U.S.C. Section 109(e). Amounts periodically adjust for inflation. See 11 U.S.C. Section 104
[3] *In re: Scovis,* 249 F. 3d 975, 982 (9th Cir. 2001)
[4] See *Scovis*, supra, at 983
[5] See *In re: Castellino* Villas, AKF, LLC, 836 F.3d 1028 (9th Cir. 1016)
[6] See *In re: Knight*, 55 F.3d 231 (7th Cir. 1995)
[7] Id

Lien Strips Revisited

Thursday, June 01, 2017

Often, a particular motivation for filing a Chapter 13 bankruptcy is the desire to strip off junior deeds of trust and other junior liens on residential real property. However, there are limitations on the amount of secured debt and unsecured debt that a Chapter 13 debtor is allowed to have. When a debtor has debts exceeding those limitations, he or she is not permitted to utilize Chapter 13 bankruptcy. In such a case, a debtor may choose initially to file a Chapter 7, and obtain a discharge of debts to the extent available in Chapter 7. If he or she thereby is able to reduce his or her debts below the limitation amounts, he or she can then file a Chapter 13. This is the so-called "Chapter 20" which is discussed in detail in " Lien Strip Basics and the Evolving Law on 'Chapter 20'" in the June 2012 issue of Contra Costa Lawyer magazine.

At the time of the prior article, the law was unsettled as to whether or not lien strips were available in the Chapter 20 context. Since that time, the Ninth Circuit has weighed in, holding definitively that lien strips are available in Chapter 20 (subject to the requirement that the filing be in good faith). *In Re Blendheim,* 803 F.3d 477 (9th Circuit, 2015) [1] the *Blendheim* court held: "that Chapter 20 debtors may permanently void liens upon the successful completion of their confirmed Chapter 13 plan irrespective of their eligibility to obtain a discharge." Id. at 497.

The argument against allowing lien strips in Chapter 20 typically centered on the provision in 11 U.S.C. §1328(f) that denies a discharge to a Chapter 13 debtor if he or she has received a Chapter 7 discharge within the preceding four years. Also, the previous Ninth Circuit case of *In Re Leavitt* 171 F.3d 1219 (9th Cir. 1999) had stated:

A Chapter 13 case concludes in one of three ways: discharge pursuant to §1328, conversion to a Chapter 7 case pursuant to §1307(c) or dismissal of a Chapter 13 case "for cause" under §1307(c)." *Leavitt*, 171 F.3d at 1223.

Some bankruptcy court opinions, such as *In Re Victorio*, 454 B.R. 759 (2011) had relied upon this statutory provision and this case language to find that, while a Chapter 20 debtor could obtain a lien strip, he or she could not obtain a "permanent" lien strip. The argument went that since discharge and conversion were unavailable, the bankruptcy case could only conclude with a dismissal and that the lien would spring back to life upon dismissal. Of course, a lien strip that is not permanent is the same as no lien strip at all.

Blendheim expressly ruled that the language in Leavitt that states that a Chapter 13 case can end only in one of three ways is *dictum* and further states: "Our statement in *Leavitt* should not be read to describe an exhaustive list of ways in which a Chapter 13 case may conclude." The *Blendheim* opinion states that there is another possibility: when a plan is completed in a successful Chapter 20, the bankruptcy case can be closed pursuant to 11 U.S.C. §350(a) without conversion, dismissal or discharge. *Blendheim* 803 F.3d at 493.

The court in *Blendheim* found it significant that while Congress saw fit to deny a further discharge to Chapter 20 debtors, it did not prohibit outright the filing of a Chapter 13 after a Chapter 7. Thus, the *Blendheim* court reasons, Congress clearly intended that Chapter 20 debtors could avail themselves of Chapter 13 tools, except where prohibited. While Congress expressly prohibited further discharge, it could have (but did not) prohibit lien strips in the Chapter 20 scenario.

The *Blendheim* opinion indicates that there is no logical reason to infer a prohibition on Chapter 20 lien strips based upon the prohibition on discharge. A discharge only extinguishes the right to pursue collection against an individual *in personam;* the discharge has no effect on the *in rem* right to pursue property pursuant to a lien, which is left in place. (After all, that is the reason lien strips are sought, i.e., the liens would otherwise survive the bankruptcy discharge.) Therefore, the court explained, because discharges have no effect on liens anyway, there is no reason to infer from the prohibition of further discharge a Congressional intent to deny lien strips to the Chapter 20 debtor. The *Blendheim* court states:

We take Congress at its word when it said in §1328(f) that Chapter 20 debtors are ineligible for a *discharge*, and only a discharge. Had Congress wished to prevent Chapter 7 debtors from having a second bite at the bankruptcy apple, then it could have prohibited Chapter 7 debtors from filing for Chapter 13 bankruptcy entirely. *Blendheim* 803 F.3d at 495 (emphasis in original).

The opportunity for lien strips has diminished in the current housing market. However, the housing market is notoriously cyclical and the *Blendheim* case provides clarity regarding an important tool for bankruptcy debtors for the next time the housing market turns again.

A housekeeping note: Most of the links and references to the Northern District of California's website in the prior article are no longer valid. Currently, extensive guidance on pursuing a lien strip in the Northern District can now be found at http://www.canb.uscourts.gov/procedure/guidelines-valuing-and-avoiding-liens-individual-chapter-11-cases-and-chapter-13-cases

Steven T. Knuppel *practices civil litigation, primarily focused on representing real property owners. He is an active member of the Real Estate section of the Contra Costa County Bar Association and a prior board member of the Bankruptcy section.*

[1] *Blendheim does not represent the classic lien strip scenario in that it involves the stripping of a* ***first*** *deed of trust after a lender had failed to respond to the debtors' objection to its claim. Because of the unusual fact pattern, Blendheim contains a lot of discussion early in the opinion that is not relevant to the typical lien strip situation. After*

other arguments, not relevant here, failed, the lender tried to preserve its lien by arguing that a lien strip was not available where a debtor was ineligible for a Chapter 13 discharge, because of the preceding Chapter 7 bankruptcy. This latter discussion is highly relevant to the typical scenario.

You Did What to my Claim? Capping a Commercial Landlord's Attorney'...

Thursday, June 01, 2017

After many months, a commercial landlord successfully ousts a non-paying tenant and recovers an award for past and future rent and contractual attorney's fees. So far, so good. The tenant files a bankruptcy case. Unfortunate, but at least the landlord will be paid from available assets *pro rata* on the same basis as other unsecured creditors, right? Wrong. In bankruptcy, a landlord's claim for damages resulting from lease termination is capped. This means that the landlord's claim for future rent is first reduced to the cap and then paid *pro rata* with other claims. But the landlord's claim for attorney's fees is not capped, is it? Well, yes and no. The United States Court of Appeals for the Ninth Circuit's recent decision in *In re Kupfer,* 852 F.3d 853 (9th Cir. 2016) clarifies the line between capped and un-capped claims other than claims for future rent.

Kupfer involved a business reorganized in a Chapter 11 bankruptcy case. Among the contested issues was the commercial landlords' claim for about $200,000 in attorney's fees and costs incurred in an earlier arbitration awarding some $1.3 million in damages. The landlords conceded that the cap applied to their claim for future rent but contended that the attorney's fees were not capped. The debtor argued that all elements of a landlord's claim are capped. The bankruptcy court declined to apply the cap. On appeal, the district court affirmed. Both courts applied an "all or nothing" approach. On further appeal, the Ninth Circuit reversed and remanded.

The issue was whether such attorney's fees constitute damages resulting from lease termination. Bankruptcy Code Section 502(b)(6) caps a landlord's claim for "damages resulting from termination of a lease" pursuant to a certain formula. Under the Ninth Circuit Bankruptcy Appellate Panel's decision in *In re McSheridan,* 184 B.R. 91 (9th Cir. BAP 1995), the cap was applied broadly to include virtually all claims. The Ninth Circuit narrowed the cap in *In re El Toro Materials Co.*, 504 F.3d 978 (9th Cir. 2007), in which a tenant deposited one million tons of hazardous wet clay goo on the property before vacating. The court held that the landlord's claim was a tort arising independently from the lease and therefore was not capped.

In *Kupfer,* the landlords argued that their attorney's fees for evicting the tenant, recovering an award of past and future rent and defending against certain counterclaims were not capped because they arose independently of the lease, like the tort claim in *El Toro*. The debtor argued that the contractual attorney's fees had no source other than the lease and arose from the landlords' efforts to recover rent and other termination damages.

The Ninth Circuit agreed that attorney's fees arising from litigation surrounding termination of the lease are capped. Attorney's fees for litigation arising from other sources, such as independent torts or breaches of contract unrelated to termination, are not capped. The court disagreed with the lower courts' all-or-nothing approach and remanded for further factual findings in apportioning attorney's fees between termination-related efforts and work unrelated to termination.

This opinion clarifies a murky issue for commercial landlords and tenants, and so far the Ninth Circuit is the highest court to address the issue. Both landlord and tenant counsel are well advised to consult *Kupfer* in drafting leases, litigating termination and handling claims in bankruptcy.

Reno F.R. Fernandez, III *is a partner with Macdonald Fernandez LLP, focusing on litigation arising from insolvency matters like bankruptcies, receiverships, assignments for the benefit of creditors, fraudulent-transfer lawsuits and Ponzi schemes.*

Mortgage Modifications in Wonderland: Conquering the Red Queen

Thursday, June 01, 2017

Mortgage Modification in Chapter 13 through Mediation

Loan modification, the systematic alteration of mortgage loan agreements that help those having problems making the payments by reducing interest rates, monthly payments or principal balances, have been utilized by lending institutions to relieve financial pressure on borrowers to prevent foreclosure since the 1930s. During the so-called "Great Recession" of the early 21st century, beginning in 2007-2008, loan modifications became a matter of national policy, with various actions taken to alter mortgage loan terms to prevent further economic destabilization.

Stemming from the “Great Recession,” and related mortgage meltdown, the Federal Government established the Troubled Asset Relief Program (“TARP”) (which was part of the Emergency Economic Stabilization Act of 2008). Under TARP, the Making Home

Affordable ("MHA") program was established. This Making Home Affordable program sought to help homeowners by making their home mortgages affordable through the "Home Affordable Modification Program" ("HAMP"). HAMP was designed to help financially struggling homeowners avoid foreclosure by modifying loans to a level that could be sustained over the long term. The goal of the program was to provide clear and consistent loan modification guidelines that the entire mortgage industry could use. The Home Affordable Modification Program included incentives for borrowers, servicers and investors. See Fannie Mae's website for HAMP. The available incentives included interest rate reductions, fixing interest rates that had been variable, principle reductions or forbearances, and term extensions. Despite very rocky beginnings, HAMP proved to ultimately be a valuable tool in helping borrowers, servicers and investors make headway in resolving the mortgage crisis.

Not all borrowers were eligible for HAMP. In order to be eligible, among other requirements, the loan could not have been guaranteed by Fannie Mae, Freddie Mac, FHA, VA or USDA, the loan had to have originated before January 1, 2009, the unpaid principal balance prior to capitalization had to have been less than or equal to $729,750 for a single family home, the home had to have been the borrower's primary residence and the borrower had to be able to establish a verifiable financial hardship.

Once a loan was determined as being eligible, HAMP utilized a "waterfall" technique in order to determine whether a loan modification was possible. The Standard Modification Waterfall is a stated order of successive steps that must be applied until the borrower's target monthly mortgage payment ratio (for monthly principal, interest, taxes, insurance and HOA dues combined) is reduced to 31% of their gross monthly income. The steps, which had to be performed in sequence, were as follows: capitalization, interest rate reduction, term extension, principal forbearance. Once a borrower's target monthly mortgage payment ratio was reduced to 31% of their gross monthly income, the waterfall would stop.

HAMP expired as of December 31, 2016, with the result that its mortgage modification provisions and incentives are no longer available to borrowers. The HAMP program generally worked well in saving homes of troubled borrowers. Both the mortgage industry and troubled homeowners benefitted from application of the HAMP program. Recognizing that without HAMP many more loans of troubled borrowers would likely end up in foreclosure, some bankruptcy courts throughout the country began exploring the possibility of proactively working with lenders, servicers and investors in an effort to try to preserve home loans for borrowers who could make their house payments if their loans were modified (as had been done under HAMP). Fortunately, the economy has stabilized since HAMP was first introduced.

Following the expiration of HAMP, many lenders still offer "proprietary" programs that are either strictly or loosely based on the prior HAMP guidelines. However, application processing problems are common. These issues, such as claimed loss of documents, document expiration, or lack of communication often lead to frustration among both borrowers and lenders.

Bankruptcy provides a means of either avoiding the loan modification morass altogether or streamlining it. Avoidance comes in the form of troubled borrowers who file Chapter 13 bankruptcy petitions who are able to cure their mortgage arrearages within the sixty (60) months as provided by their plans. Streamlining comes in the form of the Mortgage Modification Mediation ("MMM") Program, which was adopted by the United States

Bankruptcy Court for the Northern District of California in August 2015.

To that end, Hon. Roger L. Efremsky, a United States Bankruptcy Court Judge in the Northern District of California, recognized very early that, as the "Great Recession" progressed, an increasing number of borrowers were at risk of losing their homes, either inside or outside of Chapter 13, and especially after the expiration of HAMP. At the time, Chapter 13 plans were being confirmed conditioned on borrowers' loans being modified but, following confirmation, the modifications fell through with the result that the Chapter 13 failed and the bankruptcies being converted to Chapter 7 proceedings. Many times borrowers were trying diligently to achieve modifications so that their Chapter 13 plans would work, but they met difficulties that they could not, on their own, overcome: there was no single point of contact with the lenders or servicers, documents were being lost or were expiring, and often nobody – including the borrower and the court – knew whether or not the lender would actually agree to a modification, or on what terms. In some instances Chapter 13 plans were being conditionally approved based on the lender agreeing to a loan modification but then, a year after confirmation, the court would discover that the lender had denied the debtor's loan modification application.

Judge Efremsky became aware that several bankruptcy courts throughout the United States had adopted differing programs designed to facilitate workouts between lenders, servicers and borrowers that would greatly improve the possibly of achieving successful mortgage modifications that would allow borrowers to stay in their homes. Judge Efremsky surveyed several of these programs, determined that the MMM Program was among the best, and then spearheaded the program in the Northern District of California that facilitated achieving loan modifications between lenders and servicers.

The goal of the MMM Program is to facilitate communication and the exchange of information in a confidential setting and to encourage the parties to finalize a feasible and beneficial agreement under the supervision of the United States Bankruptcy Court for the Northern District of California. Options available under the MMM Program include modification of a mortgage or surrender of real property owned by an individual debtor.

The MMM Program establishes a "single point of contact," an internet portal created by Default Mitigation Management LLC (the "DMM Portal") where borrowers, servicers, and a "mediator" could upload and track all required documentation. In addition to serving as a repository for lender and servicer paperwork, the DMM Portal also serves as a tracking mechanism so that no documents are ever "lost"and no paperwork ever needs to be resubmitted. The loan for each borrower has a specific location on the portal, and borrowers, servicers and the mediator all have equal access to the uploaded documentation.

The MMM Program also provides an online set of required documents for all lenders that have agreed to participate in the program. The provision of these documents (generated by docUmods™, another Default Mitigation Management LLC creation) allow the creation of complete and accurate loan modification packages via a customized set of online questions. docUmods™ also indicates exactly what supporting documentation is needed. docUmods™ reduces both common errors and the time required to complete a package.

The MMM Program is completely voluntary. Either a debtor or a lender may seek a referral to the MMM Program. If a party desires to participate in the MMM Program, that party files the appropriate motion with the bankruptcy court. (All MMM Program procedures and forms can be found here.) The moving party proposes a mediator (from a registry of approved mediators) in the motion seeking referral of the case to the MMM Program, and if the moving party fails to propose a mediator in the motion, the clerk of the court randomly assigns a mediator for the case from the register of mediators.

The issuance of an order referring the case to the MMM Program triggers many requirements. Within seven (7) days after entry of an order referring the case to the MMM Program or lender's registration on the MMM Portal, whichever occurs later, the debtor must upload to the MMM Portal: (i) the Debtor's Prepared Package; (ii) a copy of the order referring the case to the MMM Program; and (iii) all additional documents and information specified by lender on the MMM Portal (collectively, these documents and information are referred to as the "completed package.") The debtor also designates the selected mediator on the MMM Portal and pays the following non-refundable fees: (i) the MMM Portal submission fee ($40) directly to the MMM Portal vendor; and (ii) one-half (1/2) of the applicable mediator fee ($300) directly to the mediator. Within fourteen (14) days after entry of an order referring the case to the MMM Program, the lender and the lender's California counsel (if any) are required to register on the MMM Portal (if not already registered). The parties then exchange documents under the watchful eye of the mediator until an initial decision regarding the modification is reached. Once an order of referral is entered, the parties have a total of 150 days to get a modification completed. If the modification is not completed within 150 days, the bankruptcy trustee may file a motion to dismiss. However, extensions can be granted for good cause shown. If the parties agree on a loan modification, then they must file a report with the court, and the debtor must file an amended plan within 14 days after filing the report with the court.

No later than seven (7) days after the mediator determines that lender has received and reviewed all of the required information transmitted through the MMM Portal, the mediator schedules the MMM Conference (i.e., mediation).

The reason that the meeting between borrower, lender and mediator is termed a "conference" is that the "Mortgage Modification Mediation" program is not a true "mediation" in the traditional sense. It is a facilitation. Lenders and borrowers need to be able to have a complete and consistent set of documents in order to be able to apply for, review for, and discuss a potential modification. However, the court recognizes that borrowers may not be likely to willingly share all relevant income and other information unless confidentiality is preserved (from both the outside world and the court itself). As a result, the program was designated as a "mediation" program so that if no modification is granted, the parties' confidentiality is preserved in any subsequent litigation or proceedings. Despite this moniker, however, the MMM Conference acts mainly as a means of discussing the details of a loan modification approval or denial, the reasons therefor, and possible reapplication or other alternative means of avoiding foreclosure (deed-in-lieu, short sale, etc.).

The approved and designated "mediators" are not court employees, but are private attorneys listed on the court's registry of approved MMM Program mediators. Their fees are paid one-half by the debtor and one-half by the lender. In addition to conducting the MMM Conference, the mediator oversees the loan modification application process and follows up with the borrower and lender to make sure all of the necessary documentation and information is uploaded to the "portal" within a reasonable time. The mediator also assists in resolving possible roadblocks that may arise during the process.

For the borrowers, the MMM Program can be handled by either the debtor's bankruptcy counsel or by specially-designated MMM Program counsel. Some bankruptcy attorneys may elect to handle the MMM Program on their own, but many bankruptcy attorneys prefer to hire outside special counsel. This is because outside counsel often specialize in loan modifications, increasing the chance of success for borrowers and allowing the program to be more cost effective for bankruptcy counsel. Fees charged by MMM Program counsel are currently set by the court at $2,500 and they are paid through the borrower's Chapter 13 plan.

Some attorneys attempt to seek loan modifications outside of this Mortgage Modification program. The court, however, believes this is a difficult approach. Unless the debtor elects to use the program, the court doesn't give the debtor any special time allowances to seek a modification and, because modifications often take additional time, these time considerations can cause problems in the Chapter 13 proceedings. Further, modifications obtained outside the MMM Program often do not receive a court order approving and confirming the modification, whereas modifications obtained through the MMM Program receive a court order. In the event that a modification is not approved in the program, the borrower can still utilize their bankruptcy counsel to amend the plan in an effort to cure pre- and post-petition arrears.

As mentioned above, some lenders now have in-house mortgage modification programs that mirror HAMP. These programs seem to be working well, and the court believes these programs are likely here to stay. However, if housing continues to appreciate to the point where it makes more financial sense for a lender to foreclose rather than modify, some lenders may begin to elect that option over modification. Until then, lenders are most likely to grant modification requests when the borrower submits an organized, complete, and timely set of documents. Additionally, borrowers have the greatest chance at success when their current income is at a level or has recovered to the point where they can afford a mortgage equal to 31% of their gross income, and the current unpaid principal balance plus arrearages allows for the creation of a reasonable mortgage under those guidelines.

The MMM Program has been extremely successful in obtaining loan modifications for qualifying borrowers.

Nathan Scheg *of Ironhorse Law Group PC, represents clients in a broad spectrum of areas focused on and related to real estate and construction law. He also provides mediation, special master, and discovery referee services throughout the San Francisco Bay Area.*

Robert B. Jacobs, Esq. *is a mediator/arbitrator in the East Bay. He helps parties settle real estate, business and construction disputes.*

Life After Debt: Rebuilding After Bankruptcy

Thursday, June 01, 2017

Once a consumer has made the difficult decision to file bankruptcy, gone through the bankruptcy process, and received their discharge, it can often feel like they are on their own to figure out what to do with their financial life after debt.

There are all kinds of myths, misconceptions, and misunderstandings surrounding what happens after someone files bankruptcy. Many people think that bankruptcy means that one cannot buy a house for ten years or that bankruptcy ruins your credit for life. The good news is that there is life after bankruptcy and it comes around much quicker than many think. The not-so-good news is that rebuilding takes effort and knowing one's rights. A key to rebuilding is a proactive approach with credit reports and knowing how debts are reported post discharge.

Credit Reporting Issues During and After Bankruptcy

One of the biggest issues that comes up after bankruptcy (and even during bankruptcy in a Chapter 13) is how debts are reported on the debtor's credit report. Should the debts show with a balance of $0?Does a mortgage company have to report payments made after filing? What does a debtor need to do after bankruptcy to find and fix errors?

Should Debts Show with a Balance of $0? Fair Credit Reporting Act Issues

A debt that has been included in a bankruptcy discharge should show up on the credit report with a zero balance and language such as, "discharged" or "included in bankruptcy." Under the Fair Credit Reporting Act, it is a violation to report incorrect information, including discharged balances as currently past due, late, charged off, etc. [1]

Does a Mortgage Company Have to Report Payments Made After Filing?

No, a mortgage company does not have to report any payments that are made after the bankruptcy filing, unless there is a reaffirmation agreement signed and approved by the court. On the flip side, they also do not report missed or late payments either. This often comes up because a debtor is keeping their primary residence and continuing to make payments, even though their personal liability on the mortgage was discharged in the bankruptcy. This problem rears its ugly head when the debtor tries to refinance or get a new mortgage because there is no recent payment history on the loan and many automated underwriting programs deny the application. Unless the mortgage was reaffirmed, the payments will not be reported because the mortgage companies have reason to believe that they could be held liable for trying to collect on a discharged debt through the reporting process.

There are a couple of cases discussing this issue with debtors trying unsuccessfully to get mortgage companies to report post-petition payments. In one case, a mortgage creditor's failure to report a Chapter 7 debtor's post-discharge voluntary payments on the mortgage, in the absence of a reaffirmation of the mortgage, was not a violation of the Fair Credit Reporting Act. The creditor reported the debt as discharged in bankruptcy with a zero balance instead of showing the voluntary payments made. [2]

In another case, a home mortgage creditor's reporting of the Chapter 7 debtor's loan as having a zero balance and no payment activity, even though the debtor had continued making mortgage payments to avoid foreclosure, was not false or inaccurate, and therefore did not violate the Fair Credit Reporting Act. Since the debtor's personal obligation to pay the debt was discharged in bankruptcy, and the fact that the creditor accepted the debtor's voluntary payments and refrained from foreclosing on his home did not suggest that any new debtor-creditor or similar relationship arose between the two parties. See *Schueller v. Wells Fargo & Co.*, 559 Fed. Appx. 733 (10th Cir., May 22, 2014) (case no. 13-2057); *Horsch v. Wells Fargo Home Mortgage,* ––F.Supp.3d –––, 2015 WL 1344836 (E.D. Pa., March 25, 2015). [3]

One solution for the refinance or new loan option where mortgage payments are not being reported is to obtain a written history of payments from the mortgage company through a written request for information. [4]That payment history can then be provided to the mortgage underwriter as proof of on-time payments.

Fixing the Problem and Rebuilding: Best Practices

After discharge, there are several steps a debtor can take to rebuild:

1. Debtors should run their credit reports about 60 days after discharge to see if there are any errors that need correcting. Using AnnualCreditReport.com allows debtors to receive a credit report from each of the three major credit reporting agencies on an annual basis. The Fair Credit Reporting Act requires each of the nationwide reporting agencies to provide a free copy annually, upon request. [5]
2. If there are errors, the debtor needs to dispute those errors with each of the credit reporting agencies. Ideally, these disputes are made in writing and include copies of evidence showing the erroneous entry and the correction that needs to be made.
3. Other strategies for rebuilding after bankruptcy include obtaining a secured credit card, making on-time payments for any active accounts, and keeping the debt ratio on revolving lines of credit below 30%.

Understanding the problems debtors face after bankruptcy and developing a proactive plan for rebuilding really helps combat the myths and misconceptions out there about bankruptcy. There is life after debt and getting that concept out to debtors before and after the bankruptcy process will help more debtors be financially successful after a tough decision.

Jen Lee *is the managing attorney at Jen Lee Law in San Ramon. She focuses her practice on helping individuals and business owners come up with effective legal and financial strategies to deal with debt and credit issues. She is the co-author of Preventing Credit Card Fraud: A Complete Guide for Everyone from Merchants to Consumers, published by Rowman & Littlefield in March of 2017.*

[1]15 U.S.C. § 1681s-2(a)(1)(A)
[2]Dixon v. Green Tree Servicing, LLC, 2015 WL 2227741 (N.D. Ind., May 11, 2015), appeal filed, Case No. 15-2269 (7th Cir., filed June 12, 2015).
[3]Groff v. Wells Fargo Home Mortgage, Inc., F.Supp.3d, 2015 WL 2169811 (E.D. Mich., May 8, 2015).
[4]12 C.F.R. § 1024.36
[5]Fair Credit Reporting Act, 15 U.S.C. § 1681.

Broke But Not Broken: Private Workouts in Lieu of Bankruptcy

Thursday, June 01, 2017

Once a company acknowledges it is in financial distress, a fork in the road appears: either 1) seek bankruptcy protection; or 2) try to negotiate a private work-out. Each option carries certain advantages and disadvantages but they also share many common traits concerning general insolvency.

First, what is insolvency? A debtor is “insolvent” if its debts exceed its assets (excluding assets that have been transferred, concealed or removed with intent to hinder, delay or defraud creditors). The above definition is generally known as the “balance sheet” test. See 11 USC § 101(32)(A); In *re Sierra Steel, Inc.* (9th Cir. BAP 1989) 96 BR 275, 277. For municipalities, the Bankruptcy Code defines insolvency as the inability of the entity “. . . to pay its debts as they become due.” 11 USC § 101(32)(C).

Insolvency is not required to file bankruptcy. To afford the bankruptcy courts maximum flexibility, Congress did not expressly limit Chapter 11 protection to debtors who are insolvent or who suffer any other particular form of financial distress. *In re SGL Carbon Corp.*, 200 F.3d 154, 163 (3rd Cir.1999). An individual or corporate Chapter 11 debtor may, under certain circumstances, prosecute a reorganization case when the entity is not insolvent under the balance sheet test. In sum, solvent debtors, generally, can survive motions to dismiss the Chapter 11 cases where they face an existing and worsening litigation crisis of massive dimensions (*In re Johns-Manville Corp.*, 36 B.R. 727, 741) (Bankr. S.D.N.Y. 1984), an imminent undoing of an essential support for their ongoing businesses (*Fields Station LLC v. Capital Food Corp. of Fields Corner*) (*In re Capital Foods Corp. of Fields Corner*), 490 F.3d 21 (1st Cir. 2007)), or a portentous wave of debt maturities under conditions of severe credit uncertainty (In re General Growth Properties, Inc., 409 B.R. 43) (Bankr. S.D.N.Y. 2009). The general condition pre-requisite is that the petition be filed in good faith. In re Marsch, 36 F.3d 825, 828 (9th Cir.1994); In re Sylmar Plaza, L.P., 314 F.3d 1070, 1075 (9th Cir.2002).

In light of the above, when, then, should an individual or corporate debtor consider a private workout in lieu of a bankruptcy filing? The answer usually turns on two factors: 1) access to available cashflow and whether the “burn rate” and amount of available cashflow will allow the debtor sufficient time to propose and consummate a private work-out arrangement with creditors; and 2) the extent of urgency to obtain the protections afforded by a bankruptcy filing under the general principles of the automatic stay.

With enough time, foresight, and yes, cashflow, a debtor may be able to avoid a bankruptcy filing and access certain advantages that a “private workout” holds over a “public workout” (bankruptcy filing), as follows:

1. ***Less costly:*** A bankruptcy filing oftentimes can increase the cost of a restructuring via the increased fees and expenses of professionals, secured lenders, an indenture trustee, a collateral agent, and/or an administrative agent, as well as the costs necessary to prepare the filing.
2. ***Less disclosure:*** In exchange for the protections of the automatic stay, the Bankruptcy Code and related Federal Rules of Bankruptcy Procedure require significant disclosure from a company regarding its finances, operations, transfers, and payments to insiders. Such disclosures may not be required in an out-of-court workout, though a diligent creditor certainly can and may seek to require the same level of disclosure in any workout, in or out of court, as a condition pre-requisite to any workout.
3. ***Less disruption:*** a bankruptcy filing may disrupt relationships with vendors, public perceptions, employees, and even property sales, especially if a debtor must sell property quickly and is unable to locate to locate a “stalking horse” bidder to test the waters and maximize true market price.

Should a company decide to attempt a private/out-of-court workout, it is critical to initiate and maintain an open and constant dialogue with creditors regarding workout plans. Doing so may run contrary to a longstanding belief to not consult creditors about a company’s internal financial situation until it is absolutely necessary to do so. A solid and open-ended working relationship with creditor groups is the sine qua non of a successful workout – whether in or out of court.

Lastly, and especially in the case of a private work-out, it is important to remember that the constructive trust doctrine applies to an insolvent entity, even out of bankruptcy. Under a long-standing principle of corporate law, corporate officers and directors generally occupy a fiduciary relationship only towards their corporation and shareholders; however, in the event of insolvency, the fiduciary relationship is expanded to include the corporation’s creditors. *See Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.*, 1991 WL 277613, 1991 Del. Ch. LEXIS 215 (Del. Ch. Dec. 30, 1991). In *Berg & Berg Enterprises LLC*, the California Court of Appeal analyzed and recognized this relationship, but held that, under California law, there is no broad, paramount fiduciary duty of due care or loyalty that directors of an insolvent corporation owe to its creditors. 178 Cal.App.4th at 1041. Rather, the extra-contractual duty owed by corporate directors to an insolvent company’s creditors is a “constructive trust,” “. . . consistent with the trust-fund doctrine, to the avoidance of actions that divert, dissipate, or unduly risk corporate assets that might otherwise be used to pay creditors claims.” Id. at 1040. Thus, even when structuring a private workout, pro-rata to all!

Matthew D. Metzger (“Matt”) *focuses on bankruptcy, bankruptcy-specific litigation, corporate reorganization, out-of-court workouts, and related litigation. He has worked on numerous Chapter 11, Chapter 7, and Chapter 13 cases and has represented both debtors and certain creditors. Matt has extensive litigation experience before judges and* *juries in both the California State Courts and the Federal Courts of the United States of America. Matt is the founder of Belvedere Legal, PC (www.belvederelegal.com).*

Interview with US Bankruptcy Judge, Hon. Roger Efremsky

Thursday, June 01, 2017

The Honorable Roger L. Efremsky has served as a United States Bankruptcy Judge for over 10 years in the Northern District of California and is now serving as Chief Judge. The Contra Costa Bar Association is extremely pleased to present the following interview with Judge Efremsky conducted by Mary Ellmann Tang, a board member of the Bankruptcy Law Section of the Contra Costa County Bar Association.

Q: How do your duties as Chief Judge differ from those of other bankruptcy judges?

A: In addition to carrying a full caseload, I work closely with Eddie Emmons, the Clerk of the Court, who is wonderful. We work on budget, human resources, security and facility issues, to name a few. I meet semi-annually with the other chief judges of the Ninth Circuit. I also have the pleasure of working with Chief Judge Phyllis Hamilton of the Northern District to develop a unified plan for the district and bankruptcy courts, as well as EDR/EEO issues.

When Judge Jaraslovsky retires on July 1 after 30 years of service on the bench, the Ninth Circuit is not filling his position. Several of us will take on his caseload, but since filings have decreased, it should be manageable. Similarly, there was no replacement for Judge Weissbrodt when he retired in 2016. If another judge retires, that position will also likely not be filled, leaving six judges to cover the area from the Oregon border down to San Benito County. In anticipation of these changes, the District has been building smart courtrooms to maximize the potential for fewer judges to handle the workload. When the San Francisco Bankruptcy Court was moved from 235 Pine to 450 Golden Gate, the courtrooms were built out to have cameras, video equipment, and documents that come up on screens electronically. Now Judge Montali sitting in San Francisco can manage calendars in the new courthouse in Eureka using the videoconferencing equipment. The Santa Rosa courthouse is being built out in March, then we will finalize Oakland in May. Funds have been approved for San Jose and we hope these changes will be complete in the next year or two. Judges will make an effort to be in the courtroom physically, but if we have a short calendar or weather conditions are a problem, we can rely on the smart courtrooms.

Upon Judge Jaraslovsky’s retirement, Judge Montali will take over the Chapter 13s and 12s in Santa Rosa, Judge Novack and I will take over the Chapter 7s and 11s in Santa Rosa, and Judge Lafferty will take over everything in Eureka. Marin bankruptcy cases have been assigned to the Santa Rosa court since 1978. Prior to that they were in San Francisco. I'm sensitive to the potential for Chapter 7 trustees in Santa Rosa to lose business with the Marin Chapter 7 cases moving back to San Francisco, so I asked Tracy Hope Davis to let the Santa Rosa trustees continue to handle those cases. We are also concerned about the financial well-being of the bar that represents the trustees as well as individuals.

Q: What do you know now as a judge that you wish you knew when you were an attorney?

A: I have a much greater appreciation for the importance of due process. As an attorney, I would be frustrated when I would see another attorney misbehaving and wonder why the judge did not immediately discipline the attorney. As a judge, I make sure that I afford each person the time and opportunity to respond before leveling sanctions or disciplinary action. This requires patience.

Q: What is the most difficult aspect of being a bankruptcy judge?

A: The toughest thing for me to deal with in bankruptcy court are the family disputes. Married couples going through a separation or divorce may file bankruptcy. Add to that a nondischargeability action and there is the potential for a family to be torn apart. I've had situations where debtors or their parents are crying at the end when I'm giving a decision. After the recession and the slow recovery, money got very tight with the banks, and people had to be more careful with their money. They weren't buying a new car every 5-7 years. In the Bay Area it seems that many couples feel pressured to stay together because it takes two incomes to survive here.

Q: In your time on the bench, you have seen bankruptcies increase in 2006 due to BAPCPA which was followed by the Great Recession wave. What is happening now?

A: When I came on the bench in August of 2006, we had the BAPCPA rush. Then in my second year in San Jose, in 2008 with the Great Recession, we saw a massive increase in case filings through 2010/2012. Then case filings started to drop dramatically. Last year, for the entire district, we didn't even reach 10,000 cases. It used to be that Oakland, on its own, would reach 10,000 cases 3/4 of the way through the year. The Administrative Office of the U.S. Courts predicts that bankrutptcy cases will continue to decline through mid-2018.

Q: How is the new model Chapter 13 plan working?

A: We are looking at revising the model plan for the Northern District. Right now Oakland and San Francisco have been using it since August 2013. San Jose went live last year in February. Santa Rosa will go mandatory in July so we will have one plan for the District. The Bench Bar Committee is seriously considering a conduit/non-conduit plan. Also, the judges are looking at a uniform way of paying attorneys in Chapter 13 cases. It costs attorneys more to handle cases now than the $4-6,000 provided for in the current Guidelines. We would like to have "no look" fees for all divisions, based most likely on some sort of cafeteria plan.

Thank you very much. We appreciate your time and your work on the bench.

Mary Ellmann Tang *has been representing creditor clients in solving problems related to bankruptcy and commercial litigation, loan workouts, restructuring, collections and other creditor/debtor matters for over 25 years.*

The Personal Injury Case and the Automatic Stay

Thursday, June 01, 2017

One of the trickiest snares that can spring up in the middle of a personal injury case is a bankruptcy stay. With a bankruptcy filing, all collection activity is stopped and litigation grinds to a halt. If the filer is the plaintiff, the ownership and control of the plaintiff's action is transferred in an instant from an empathetic debtor to a cold bankruptcy estate. [1] If the filer is the defendant, then he may have just stolen the plaintiff's bacon.

The automatic stay is an injunction that prevents creditors from seizing property of the estate or taking actions to seize such property. [2] The automatic stay generally goes into effect upon the filing of a bankruptcy petition. [3] The primary goals of the stay are to allow the equitable administration of available assets [4] among creditors by preventing creditors from unfairly corralling assets for themselves to the detriment of similarly-situated creditors, and to provide the debtor with breathing room from collection activities during the administration of the estate.

All the assets of the bankruptcy estate are protected against creditor actions. Most creditors cannot proceed with service, discovery, litigation, trial, enforcement of judgments, or perfection of liens against a debtor who has filed bankruptcy unless they receive court permission. [5] Action taken against a debtor in violation of the stay is usually voidable.

Representing a Debtor with a Personal Injury Claim

Personal injury actions brought by the debtor are not stayed in bankruptcy. Counterclaims against the debtor are stayed. If your client holds a personal injury claim, it may still be litigated. Upon the bankruptcy filing, the claim is included as part of the bankruptcy estate. The continued representation of the debtor must be approved by the bankruptcy court if the litigation is ongoing during the bankruptcy.

In Chapter 7 filings, a trustee will be appointed. The trustee becomes the party in interest, with the power to pursue the litigation and negotiate settlement subject to approval of the bankruptcy court. An injured debtor has standing to object to any settlement, to claim settlement proceeds exempt as allowed by state law [6], and to seek abandonment of the personal injury suit back to the debtor. [7]

As counsel for a bankrupt debtor plaintiff, you will want to communicate with the debtor and the trustee to determine if the estate would like to pursue the claim. Often the bankruptcy trustee will seek to hire the same personal injury counsel that filed the case.

If the injury occurred prior to filing, the debtor must list the asset. If the personal injury claim is not listed in the bankruptcy schedules the debtor may lose standing to sue or may be judicially estopped from doing so.

Representing a Claimant with a Personal Injury Claim Against a Debtor

To preserve your client's right to receive a payment from the estate, be sure to file a proof of claim, together with supporting documentation. If a complaint regarding the personal injury claim is already on file, submit the summons and complaint as the supporting documentation. If the claim has not yet been brought, submit a supporting declaration laying out the basis of the personal injury claim.

Any attempt to collect from the debtor will be subject to the automatic stay. As soon as a claimant or their attorney is on notice, formal or informal, that the defendant has filed for bankruptcy, the automatic stay operates as an injunction and allows the imposition of sanctions for attempting to collect from the debtor. Any actions taken in a case already on file will violate the automatic stay, including service of the summons and complaint, initiating and commencing discovery or going to trial.

There are ways to preserve a personal injury claimant's rights to receive distributions from a debtor's bankruptcy estate and to proceed against the debtor. The stay can be lifted to allow liquidation of the personal injury claim, either through mediation or in state court. [8] A claimant can also move the court to modify the automatic stay to proceed against the debtor's insurance company while the bankruptcy case is still pending. [9] If a debtor has sufficient third-party commercial coverage with no deductible (or a deductible that has already been met) and if the insurance carrier is responsible for all defense costs with no premium adjustment, it is possible that a bankruptcy court would lift the automatic stay as the main purposes of the stay, as discussed above, would not be affected.

Depending on the chapter under which a debtor filed for bankruptcy, a claimant may be able to pursue claims against non-filing co-debtors without violating the automatic stay, and without requesting relief from stay. A Chapter 12 or 13 debtor's non-filing, individual co-debtors enjoy the benefits of the co-debtor stay that shields them from collection on consumer debts. [10] However, there is no co-debtor stay in Chapter 7 or 11 bankruptcy cases. So, if there are two potential defendants, and only one files for Chapter 7 bankruptcy, a claim may be pursued against the non-filing co-debtor.

Finally, if your client has a personal injury claim against a Chapter 7 debtor that arises from "the debtor's operation of a motor vehicle, vessel or aircraft if such operation was unlawful because the debtor was intoxicated from the use of alcohol, drugs or other substances," the claim and consequent debt will not be discharged. This exception to discharge is self-executing and the debtor will remain responsible for your client's injuries without any action on your client's part to establish non-dischargeability. [11] In such circumstances the automatic stay is imposed, but it only means delay, not loss of an injured party's recovery.

In contrast, intentional torts causing personal injury or death, are not dischargeable, but require an injured claimant to open an adversary proceeding in the bankruptcy case within a strict timeline to preserve the cause of action. [12] The automatic stay still applies for personal injury cases based on intentional torts. Thus, the claimant cannot just wait out the bankruptcy, but must become an active participant to keep their bacon.

The Bright Side

Bankruptcy's automatic stay can relocate the already complicated landscape of litigation into a minefield of extremely short timelines and exaggerated consequences. If there's no money to be had, it can dramatically shorten the lifespan of a personal injury claim by revealing the ending before the game is played in earnest. But if there is a prize, the claimant that survives the automatic stay and the discharge may find himself in an unobstructed playing field in the aftermath of the bankruptcy with all of the treasure clearly marked and ready for collection.

Carl Gustafson, Esq. *is a Partner at Lincoln Law, LLP, where he has been practicing exclusively in the area of consumer and small business bankruptcy for nine years in Pleasant Hill and Hayward. Carl is a Certified Bankruptcy Law Specialist with the California Board of Legal Specialization. In 2003, Carl graduated from UCLA Magna Cum Laude with a B.A. in History. Carl went on to graduate with honors from the University of California, Berkeley School of Law in 2007. Since 2011, Carl has been an annual presenter on Practicing Law Institute's seminar and webcast for pro-bono attorneys, "Bankruptcy Basics for Low-Income Clients." Carl is fluent in Spanish and Portuguese. He raises his three daughters just a short walk from his office in the heart of Contra Costa.*

[1] A bankruptcy estate is formed upon filing which includes essentially all of the assets of the debtor. 11 U.S.C. § 541
[2] 11 U.S.C. § 362
[3]I say generally because the stay is shortened or not invoked in certain instances of multiple filings with regards to the debtor. But the bankruptcy estate is protected by the stay as well, so in some cases of multiple filings where the Debtor does not invoke a stay, the estate will still be protected.
[4] Whether assets can be distributed from the bankruptcy estate is generally determined by comparing the liquidation value of the asset to the exemptions that the debtor are allowed.
[5]Most of the exceptions deal with family and criminal matters.
[6] 11 U.S.C. § 522
[7]11 U.S.C. § 554
[8]Personal injury and wrongful death claims cannot be tried in bankruptcy court. 28 USC § 157(b)(5)
[9] 11 U.S.C. §362(d)
[10] 11 U.S.C. §1301. However, even if the codebtor stay doesn't apply, beware of issues in collecting against community property subject to the estate during pendency of the bankruptcy and subject to the community discharge following it.
[11] 11 U.S.C. 523(a)(9)
[12]11 U.S.C. 523(a)(9) and (c)(1)

How Bulletproof are Spendthrift Trusts in Bankruptcy?

Thursday, June 01, 2017

What is a trust?

A trust is a document that places ownership of an asset in a separate entity – also called a trust –for the benefit of the trust's beneficiaries. [1] The assets are managed by a trustee, who invests and distributes funds according to the trust's instructions. Often a trust is created by a parent for the benefit of the parent and his or her children simply to avoid probate. As such, many trusts do not include a spendthrift provision and instruct the trustee to distribute a certain amount per year until the principal is consumed.

What is a spendthrift trust?

A spendthrift trust is defined as "a trust that prohibits the beneficiary's interest from being assigned and also prevents a creditor from attaching that interest." [2] It is primarily used to protect the trust from the reach of the beneficiaries' creditors. California generally allows the use of spendthrift provisions in Probate Code §§ 15300 and 15301(a), while allowing creditors to reach part of the trust in related sections. [3] For example, normal judgment creditors may reach 25% of the funds that are payable to the debtor, unless the debtor needs those funds for their support or the support of their dependents. [4] Once funds are in the debtor's possession, they are reachable like any other asset. [5]

What happens when a debtor files a bankruptcy?

When a debtor files a bankruptcy, a bankruptcy estate is created. [6] This estate includes "all [the] legal or equitable interests of the debtor," which includes a debtor's interest in a trust." [7] If the debtor files a Chapter 7 bankruptcy, a trustee is appointed to administer the estate's assets and maximize revenue for the benefit of the debtor's creditors. [8] As such, the bankruptcy trustee has broad authority to reach all of the debtor's assets. [9]

However, there are a few limitations. First, the trustee is required to administer the estate "as expeditiously as is compatible with the best interests of parties in interest." [10] Therefore the trustee cannot keep a case open indefinitely, waiting for payments to come in. Second, an asset protected by a spendthrift provision is generally excluded from the bankruptcy estate, to the extent recognized by nonbankruptcy law. [11] After *In re: Neuton*, it was understood that a trustee could only reach up to 25% of the spendthrift trust's funds, when paid out by the trust's trustee. [12] That amount was further lowered by debtors claiming the "necessary for support" protection of Probate Code § 15306.5(c). Finally, debtors often limited their requests for disbursements, allowing the funds to remain in the trust or to go to another beneficiary.

In re: Reynolds

Rick H. Reynolds filed a Chapter 7 bankruptcy in the Central District of California on March 4, 2009. [13] In his initial petition and schedules, he listed over a million dollars in assets and almost two million dollars in debts. [14] In response to question 20 on his

Schedule B regarding “contingent and noncontingent interests in estate of a decedent … or trust” he checked the box for “none.” [15] However, at the time of filing he was a contingent beneficiary under several spendthrift trusts, worth at least one million dollars.

Not long after, on April 28, 2009, the trustees of the Reynolds Family Trust asked the bankruptcy court to decide how much of the trust the bankruptcy trustee could reach. Following *In re: Neuton*, the bankruptcy court held that the estate’s interest was capped at 25%. The bankruptcy trustee appealed, first to the Bankruptcy Appellate Panel, which affirmed, then to the 9th Circuit Court of Appeals, that certified a question to the California Supreme Court. Did the 25% cap under Probate Code § 15306.5 apply to Probate Code § 15301(b)?

Carmack v. Reynolds- S224985

The California Supreme Court issued a unanimous ruling on March 23, 2017. It held that the 25% cap under § 15306.5 did not apply to judgment creditors seeking access to principal payments under § 15301(b). [16] Thus, bankruptcy trustees now have two different ways to reach a spendthrift trust – all principal currently due and payable to the debtor and 25% of all future payments. However, debtors are still entitled to exclude some or all of those proceeds, to the extent needed for support. [17]

The court also mentioned a non-bankruptcy scenario, where a hypothetical judgment creditor could come in annually when payments were due and payable and petition the court for the remaining 75% under § 15301(b). [18] The court did not explicitly state whether a bankruptcy trustee had that ability or whether the estate could potentially include those funds. If so, the bankruptcy estate could now include the debtor’s entire interest in a spendthrift trust. Regardless, to the extent *In re: Neuton* capped the estate’s interest at 25%, it is no longer good law.

Future *Reynolds* litigation

The matter now returns to federal court, with the 9th Circuit likely to explicitly overturn *In re: Neuton* before sending the matter back to the Bankruptcy Court for further hearing. Hopefully the 9th Circuit will also resolve the discrepancy in the Supreme Court’s opinion – whether the estate’s § 15301(b) interest is capped at the principal due and payable at the time of filing or whether it includes amounts that come due later.

What this means for debtors:

1. Be prepared for bankruptcy trustees to be more aggressive in going after spendthrift trusts.
2. Examine the spendthrift provisions of a trust carefully before filing a bankruptcy petition, as well as the language terminating the trust. Know what is protected (principal, interest, or both), what mandatory payments are being made when, and when the trust ends. The sooner it ends, the more likely creditors and bankruptcy trustees will be able to reach the entire amount. You may want an estate planning attorney to assist you with this.
3. A bankruptcy estate contains (a) all of the principal currently due and payable, excluding the amount necessary for the support and education of the debtor, and (b) at least 25% of the future payments to be made, excluding the amount necessary for the support of the debtor and the debtor’s dependents. List this amount on Schedules A/B and expect to prove those expenses. [19]
4. Next, exempt the proceeds as allowed under whichever code provision you are claiming your exemptions (ie., wildcard under Cal. Civ. Proc. § 703.140(b)(5))

5. If there are nonexempt funds, bankruptcy may not be the right road for that debtor.

MCLE Self Study Test

Download the test form and instructions for this Self Study MCLE article, here. Send your answers, along with payment ($30 for CCCBA members) to the address on the test form.

Corrine Bielejeski *is the owner of East Bay Bankruptcy Law & Financial Planning. She served as law clerk to the Hon. Edward D. Jellen (ret.) in the Oakland Bankruptcy Court, before entering private practice. She served a 4-year term on the Bankruptcy Court's Bench-Bar Liaison Committee and is President-Elect of the Earl Warren American Inn of Court.*

[1] *See also Black's Law Dictionary* 1513 (7th ed. 1999). "A property interest held by one person (the trustee) at the request of another (the settlor), for the benefit of a third party (the beneficiary).
[2] *Id.* at 1518.
[3] Including Cal. Prob. Code §§ 15301(b), 15305, 15305.5, 15306, & 15306.5.
[4] Cal. Prob. Code § 15306.5
[5] Cal. Prob. Code §§ 15300 and 15301(a)
[6] 11 U.S.C. § 541(a)
[7] 11 U.S.C. § 541(a)(1)
[8] 11 U.S.C. § 704
[9] 11 U.S.C. § 541(a)(1) and § 704(a)(1)
[10] 11 U.S.C. § 541(a)(1)
[11] 11 U.S.C. § 541(c)(2)
[12] In re: Neuton, 922 F.2d 1379 (9th Cir. 1990)
[13] In re: Reynolds, 6:09-bk-14039-MJ (Bankr. C.D. Cal – matter still pending)
[14] In re: Reynolds, docket #1, page 1
[15] Id. at 14.
[16] "In sum, after an amount of principal has become due and payable … a creditor can petition to have the trustee pay directly to the creditor a sum up to the full amount of that distribution (§ 15301(b)) unless the trust instrument specifies that the distribution is for the beneficiary's support or education and the beneficiary needs the distribution for those purposes (§ 15302). If no such distribution is pending or if the distribution is not adequate to satisfy a judgment, a general creditor can petition to levy up to 25 percent of the payments expected to be made to the beneficiary, reduced by the amount other creditors have already obtained and subject to the support needs of the beneficiary and any dependents. (§ 15306.5). Carmack v. Reynolds, S224985 at 14.
[17] Id. at 16.
[18] Id. at 15.
[19] Cal. Prob. Code §§ 15302 and 15306.5(c), 11 U.S.C. § 541(c)(2), and either Cal. Civ. Proc. Code § 703.030(b) or § 704.120

Bankruptcy: What Goes Up Must Come Down

Thursday, June 01, 2017

Just a few years ago I did a presentation to a group of realtors entitled “Bankruptcy, Foreclosures and Shorts Sales: the New Fad.” That would have been about 2008 when the economy started to stutter and the financial markets seized up. Contra Costa County was at the forefront of the volatile real estate market as we witnessed prices rise sky high and then crash back down to earth. For sale signs littered corners, especially in Eastern Contra Costa County. Lawns went dry and houses stood empty. People stopped paying their mortgages and filed bankruptcy. People would come into my office and plan to walk away from multiple rental properties. We all witnessed the effects as foreclosures skyrocketed. Instead of selling houses in the normal fashion, realtors had to learn how to do a “short sale.”

A look at the bankruptcy filings gives us a snapshot of what happened. In 2007, a total of 12,448 bankruptcies were filed in the Bankruptcy Courts for the Northern District of California [1]. By 2008, those filings increased to 21,011. Filings peaked in 2010 when 38,586 individuals and businesses filed for bankruptcy relief. The “what goes up must come down” theory applies to real estate and stock markets and it certainly applies to bankruptcy filings. Starting with 2011 and each year since, we have witnessed a dramatic drop off in bankruptcy filings. In 2001, filings dropped 11%; in 2012, filings dropped 32%. Even this last year, filings dropped another 11%. In 2016, a total of only 9,724 bankruptcies were filed in the entire Northern District, which in the last 15 years was only eclipsed by 2006. The year 2006 was an anomaly as it was the year after the passage of BAPCPA (Bankruptcy Abuse Prevention and Consumer Protection Act). A surge in bankruptcies occurred before the effective date of the law in late 2005. A stronger economy, continued low interest rates and low unemployment are some of the reasons for our current down cycle. I personally think that the real estate crisis flushed out everyone who was going to file bankruptcy or was thinking of filing bankruptcy. The prediction is that number of filings is finally bottoming out.

You must understand that bankruptcy practitioners are optimists. What comes around goes around. Ads are appearing again on the radio about taking equity out of your house to consolidate credit card bills. High interest unsecured loans are touted as the remedy of all ills. Refinance companies beg Americans to refinance before rates go up further. Student loan debt and credit card debt are at all time highs. Time is tempering the Great Recession. As we wait for the time when bankruptcies will be fashionable again enjoy the articles we have collected for you.

We are fortunate to have some of the best local bankruptcy attorneys contribute to this month's edition. First, Mary Ellmann Tang interviews the Honorable Roger L. Efremsky, Chief Judge of the Bankruptcy Courts for the Northern District of California. Next, Matthew D. Metzger compares bankruptcy filings to private workouts. Reno F.R. Fernandez III highlights the Ninth Circuit's views on capping commercial lease claims in bankruptcy. Corrine Bielejeski looks at the recent litigation over how spendthrift trusts are treated when a bankruptcy is filed. Carl Gustafson addresses how the automatic stay impacts personal injury claims. Jen Lee provides some guidance on dealing with debt after a bankruptcy filing. Steven T. Knuppel revisits an article he presented a few years ago and gives us the current caselaw on stripping liens in bankruptcy. Nathan L. Scheg and Robert B. Jacobs teamed up to give us a thorough analysis of the Mortgage Modification Mediation program. Lastly, I address eligibility issues for those contemplating filing for bankruptcy.

[1]. The Northern District of California Bankruptcy Courts include the following divisions: San Francisco, Santa Rosa, San Jose, and Oakland. The filings include all consumer and business filings in all chapters of bankruptcy.

American Inns of Court – March Program

Thursday, June 01, 2017

Inspired by the Broadway hit Hamilton, Judge Clare Maier's pupilage group rapped its way through recent developments in family and internet law. The tone was set by Judge Maier's limerick-styled introductions of her group. Scott Lantry (for example) was introduced:

If family law makes you irate
Call Scott Lantry, your troubles he'll mitigate.
He emphasizes settlement
'Cause that's for your betterment
But disputes he is not afraid to litigate.

Are debts community or separate?

The first skit of the evening, set in dystopian "Blunderland," considered whether its First Lady--Oceana Rump--is liable for loans her husband took from the Russian dictator Sadimir Brutin, as she considers divorce. Relying on In re Marriage of Bonvino (2015) 241 Cal. App. 45th 1411, 1423, Mrs. Rump's lawyer informed her that in determining liability for assets acquired on credit during the marriage, the court determines whether the lender intended to rely on separate or community property for repayment. In general, loan proceeds acquired during marriage are presumed to be community property. This presumption can be rebutted by showing the lender intended to rely on the spouse's separate property alone. Loan proceeds secured by separate property are also separate property.

Can we review the venire's social media postings?

The next skit moved to Blunderland's courthouse where Oceana Rump's attorney, in a civil matter, was asking for three days to review the venire's social media postings prior to jury selection. Should the judge grant the request? Within limits, it is ethical to conduct internet searches on prospective jurors (ABA Formal Opinion No. 466). Moreover, “passive review” of a juror's website or social media that is available without making an “access request” and of which the juror is unaware is permissible within ABA Model Rule 3.5(b). It is, within limits, ethical to conduct internet searches on prospective jurors (ABA Formal Opinion No. 466). There is no hard and fast rule; however, the court could look for guidance to Oracle Am., Inc. v. Google Inc. (N.D. Cal. 2016) 172 F. Supp. 3d 1100.

In that high-profile case, Judge William Alsup denied a similar request and crafted a workaround to, in part, ensure the venire's privacy concerns were addressed. Judge Alsup informed the parties that they could either consent to a ban on such internet searches or abide by his proposed rule. He proposed that at the outset of jury selection, each side was to inform the venire of the specific extent to which it would use internet searches to investigate and monitor jurors, including specifically searches on Facebook, Linkedin, Twitter, and so on. The venire persons were then given a few minutes to use their mobile devices to adjust their privacy settings, if they wished, to limit the parties' access to their postings.

The case also summarized alternative accommodations to venire persons' privacy concerns, such as empaneling an anonymous jury (United States v. Norwood, No. 12-

CR-20287, 2014 WL 1796644 (E.D. Mich. May 6, 2014), preventing any internet searches because one side failed to notify the other of such searches (Carino v. Muenzen, No. A-5491-08T1, 2010 WL 3448071, at *10 (N.J. Super. App.Div. Aug. 30, 2010).

What are the rules for internet advertising?

The skit then followed unhappy Oceana Rump as she wrote glowing reviews on her attorney's website. Unfortunately, the review is loaded with "alternative facts" and several outright lies, which come to the lawyer's attention when she is swamped with potential clients. What rules and statutes govern this situation?

Rules of Professional Conduct, Rule 1-400(D) requires truth in advertising, especially whether the attorney is a certified specialist, and in the Standards Adopted by the Board of Governs, the attorney may not guarantee an outcome, and testimonials must include a disclaimer that the attorney does not guarantee similar outcomes. Bus. & Prof. Code § 6157 & 6158 similarly prohibit false or misleading statements.

Lawyers should also keep in mind that the source of reviews should be real clients. The Federal Trade Commission recently prosecuted the public relations firm Reverb Communications Inc. with violating the Fair Trade Commission Act and deceptive advertising for having its employees pose online as happy consumers of an application bought from Apple's ITunes Store. Similar prosecution of an attorney is certainly possible for such "AstroTurfing."

Swapping a legal opinion for advertising?

The last (and funniest) skit of the evening harkened back to President Nixon's Checkers speech, in which Nixon recited a section of Gibson Dunn and Crutcher's opinion letter absolving Nixon of wrong-doing. In this case, President "Rump,"having been exposed as the recipient of a foreign loan, and potentially violating the Constitution's emoluments clause. President Rump offers to speak glowingly of a law firm in exchange for an opinion letter absolving Rump of wrong-doing. It smells bad, because it is bad.

Rule 1-320(B) of the California Rules of Professional Conduct states "“[A lawyer] …shall not compensate, give, or promise anything of value … for the purpose of recommending or securing employment … by a client, or as a reward for [such employment]. A member's offering of or giving a gift or gratuity to any person or entity having made [such] a recommendation … not of itself violate this rule, provided that the gift or gratuity was not offered or given in consideration of any promise, agreement, or understanding that such a gift or gratuity would be forthcoming or that referrals would be made or encouraged in the future.” Rump's quid pro quo is unethical.

The Hon. Clare Maier Players were: Hon. Clare Maier, Delia Isvoranu, Jamie Retmier, Patricia Kelly, John Warnlof, Scott Lantry, Mukesh Advani, Jonathan Babione, Angelica Lopez and yours truly, Joseph Nykodym.

Joseph Nykodym *is a family and general civil litigator, and teacher, in Moraga.*

New Member Information Series Announced

Thursday, June 01, 2017

Did you know that this summer the CCCBA is sponsoring a series of Member Information Programs? While not primarily legal in focus, these seminars cover topics (social security, healthcare during retirement, student loan debt repayment and finally, identity theft/credit bureaus and collections) that are important to many of us in our personal and professional lives.

Download the flyer here.

The first seminar is coming up! On Tuesday, June 27 we will be discussing “ Maximizing Your Social Security Benefits.” Most of us are paying into Social Security but know little about how to maximize our benefits, which can be worth over $1 million for a couple retiring today. The most commonly used strategy of starting benefits at age 62 may not be optimal. Yet, the mis-perceptions about the program often lead people to make that choice. Attendees will walk away with a greater understanding of Social Security that will help them:

1. Avoid mistakes that leave money on the table
2. Learn strategies to maximize your benefits
3. Effectively use Social Security to help prevent outliving your assets

This is just the first in this series. Over the summer we will be hosting similar programs on topics such as

“ Understanding Retirement Healthcare” on Wednesday, July 19, 12:00 pm – 1:30 pm

" Student Loan Debt Repayment Strategies" on Tuesday, August 8, 6:00 pm – 7:30 pm

and finally on Tuesday, August 29 we will finish up with “ The Smart Consumer: A Bullet-Train Presentation On Identity Theft, Credit Bureaus, Collections And More!”

Estate Planning Symposium [photos]

Thursday, June 01, 2017

The 24th Annual Estate Planning Symposium on May 2, 2017 was well received with over 110 attendees. The Symposium featured two sessions:

- End of Life Liberty: Evolving Law and Policy in the U.S.
- Ten Things Estate Planning Attorneys do that Drive Trust Administration Attorneys Nuts!

Featured speakers included: Frank R. Acuna, Esq. - Partner, Acuna Regli; Kathryn L. Tucker J.D. - Executive Director, End of Life Liberty Project; Dr. Lonny Shavelson, M.D. - Bay Area End of Life Options; and Tracy S. Regli, Esq. - Partner, Acuna Regli

Thank you to our co-sponsor, Wealth Management at Mechanics Bank and all who attended.

[Best_Wordpress_Gallery id="22" gal_title="Estate Planning Symposium"]


them to lose their benefits
Special Needs trust provisions are too limiting and do not allow Trustee discretion
Conditions are not realistic (e.g. drug testing)

Not for Resale