Current Hot Topics in Chapter 7

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Current Hot Topics in Chapter 7
Reaffirmation Agreements

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Reaffirmation Agreement Hot Topics

Creditors and debtors continue to litigate issues related to reaffirmation agreements. Courts are being asked to decide whether an agreement was "made" before the granting of the discharge, whether a case can be reopened to permit the filing of the agreement, what remedies the parties have once the discharge has been entered without an agreement being made or filed, and whether the debtor may exercise the "ride through" option. Although the law varies by jurisdiction, there are a sufficient number of decisions in this Circuit and elsewhere to assist practitioners in advising their clients when issues arise related to reaffirmation agreements.

When is a Reaffirmation Agreement "Made"?

First, it is important to identify when a reaffirmation agreement is "made." By its plain terms, 11 U.S.C. § 524(c) provides that a reaffirmation agreement is enforceable only to the extent it was *made* before the granting of the discharge. 11 U.S.C. § 524(c) (emphasis added). "Although § 524 requires that a reaffirmation agreement be made before a discharge is granted to a chapter 7 debtor, the Bankruptcy Code does not define 'made.'" *In re Giglio,* 428 B.R. 397 (Bankr. N.D. Ohio 2009). Most courts hold that the agreement is not "made" until both parties have executed it.

In re Reed, Case No. 10-66892 (Bankr. E.D. Mich. 2010). Debtor signed the reaffirmation agreement prior to entry of his discharge, and creditor did not sign it until one day after the entry of discharge; the reaffirmation agreement was not "made" before the entry of the discharge and therefore was not enforceable.

In re Huston, Case No. 12-65087 (Bankr. E.D. Mich. 2013). Where creditor did not sign the reaffirmation agreement until after the discharge entered, the agreement was not "made" before the discharge was entered and the agreement was not enforceable.

In re Piontek, Case No. 09-70632 (Bankr. E.D. Mich. 2010). Debtor signed the reaffirmation agreement but did not date it and did not return it to creditor until after his discharge was issued, and creditor did not sign it until its return from debtor; court held that the agreement was not "made" prior to the debtor's discharge and therefore was not enforceable.

In re Giglio, 428 B.R. 397 (Bankr. N.D. Ohio 2009). Where debtor signed the reaffirmation agreement prior to entry of her discharge, but creditor did not sign it until after entry of the discharge, the agreement was not "made" prior to entry of the discharge.

But see In re Davis, 273 B.R. 152 (Bankr. S.D. Ohio 2001). Where creditor prepared reaffirmation agreement, debtor husband and the debtors' attorney signed it prior to entry of the debtors' discharge, and creditor later signed the agreement and promptly forwarded it to the court for filing, court concluded that the facts all indicate "its" (sic) intent to reaffirm, and held that agreement was "made" prior to discharge.

Can the Court Set Aside the Discharge or Reopen the Case to Permit the Filing of an Agreement?

Where the reaffirmation agreement was not "made" before the discharge was entered, courts are not inclined to set aside the discharge or reopen the case to permit the debtor to enter into an agreement, essentially holding that to do so would be a futile exercise, as the agreement would not be enforceable.

In re Carey, Case No. 12-42052 (Bankr. E.D. Mich. 2013). Where debtor alleged that a signed reaffirmation agreement was sent to the creditor prior to entry of his discharge, but it was never filed prior to the case closing, and the motion did not allege or demonstrate that the creditor signed the reaffirmation agreement before the discharge was entered, the debtor failed to show there was an enforceable agreement and no purpose would be served by reopening the case. The motion to reopen was denied.

In re Russell, Case No. 11-61160 (Bankr. E.D. Mich. 2011). Debtor's motion to vacate his discharge, which motion was filed less than an hour after the court entered his discharge, was denied. Debtor had filed motion for purposes of allowing late filing of reaffirmation agreement; however, the motion failed to allege that reaffirmation agreement had been executed prior to entry of discharge, which precludes enforcement of the agreement.

In re Smith, 467 B.R. 122 (Bankr. W.D. Mich. 2012). Debtors' motion for an order setting aside their discharge to permit them time to negotiate, sign, and file a reaffirmation agreement was denied; any agreement reached at that point would not be enforceable under a plain reading of the statute.

In re Ocheltree, Case No. 11-60316 (Bankr. N.D. Ohio 2011). Court denied debtors' motion to temporarily revoke their discharge (and keep the case open for an additional 90 days) in order to permit them to negotiate a reaffirmation agreement. In this case, debtors had filed, and then rescinded, a reaffirmation agreement before the discharge was entered, and obtained an extension of the time to file an agreement but took no further action before their discharge was entered.

In re Cottrill, Case No. 06-00819 (Bankr. N.D. W.Va. 2007). Debtors filed a statement of intention indicating they would reaffirm a debt but they failed to sign an agreement prior to entry of the discharge. Thereafter, they filed a motion to waive the requirements of 11 U.S.C. § 524(c)(1) to approve two untimely reaffirmation agreements, or to vacate their discharge, approve the agreements, and then re-enter their discharge. Debtors argued that they did not require the protection of § 524(c)(1), because they voluntarily consented to the agreements and no party objected, and that therefore there was no reason to bind them to the requirements of that subsection. Finding that the timing requirement was mandatory and not subject to waiver, the court denied the motion to waive the requirements. The court further interpreted the remainder of the debtors' motion as invoking Rule 60(b) or 11 U.S.C. § 105(a), which was predicated on an assumption that the court retained jurisdiction after the discharge to approve entry of untimely made reaffirmation agreements. The court disagreed, holding that it did not have jurisdiction over such agreements pursuant to 11 U.S.C. § 1334(b) once the discharge order was entered.

What if Debtor Does Not Sign a Reaffirmation Agreement?

Nothing contained in 524(c) or (d) prevents a debtor from voluntarily repaying any debt. 11 U.S.C. § 524(f). However, with the enactment of BAPCPA, section 521(a)(6)[1] was added to the Code for the purpose of eliminating the "ride-through" option, whereby a debtor retains personal property, continues to make payments, but does not reaffirm the debtor or redeem the collateral. *In re Baker*, 390 B.R. 524, 528 (Bankr. D. Del. 2008). In practice, though, there are still debtors who manage to exercise the "ride-through" option. The debtor's ability to successfully elect the "ride-through" option will depend on the court, the state law, and the underlying contract. In this cases, the courts often focus on the interplay of sections 521 and 362 of the Bankruptcy Code (which require debtors to file and perform their stated intentions and which dictate the legal effect of the failure to do so) and the law of the jurisdiction regarding *ipso facto* clauses.

In re Dumont (Dumont v. Ford Motor Credit Co.), 581 F.3d 1104 (9th Cir. 2009). Prior to BAPCPA, the Ninth Circuit held that the "ride-through" option, pursuant to which the debtor continued to make payments on the vehicle as required by the contract but did not reaffirm the debt, was available to debtors, as did the Second, Third, Fourth and Tenth Circuits.[2] The Ninth Circuit reversed course, holding in this case that BAPCPA does not provide the debtor with the option to retain personal property subject to a security interest by continuing to make payments under the contract. Here, the debtor had stated her intention to "retain and pay," but refused to sign a reaffirmation agreement. After her discharge was entered, the creditor repossessed the car. The debtor reopened the case and filed a motion for damages on account of the alleged violation of the discharge injunction.

The court denied the debtor's motion, holding that the debtor's failure to sign a reaffirmation agreement terminated the automatic stay. Therefore, there was no violation. But the inquiry did not end there, as the termination of the stay was not sufficient to permit the repossession; and the Code itself did not provide a basis for it. "The removal of the automatic stay merely lifted one obstacle

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[1] 11 U.S.C. § 521(a)(6) provides:

> in a case under chapter 7 of this title in which the debtor is an individual, not retain possession of personal property as to which a creditor has an allowed claim for the purchase price secured in whole or in part by an interest in such personal property unless the debtor, not later than 45 days after the first meeting of creditors under section 341(a), either-
> (A) enters into an agreement with the creditor pursuant to section 524(c) with respect to the claim secured by such property; or
> (B) redeems such property from the security interest pursuant to section 722 . . . .

[2] "The Sixth Circuit rejected a proposal similar to ride-through in *General Motors Acceptance Corp. v. Bell* (*In re Bell*), 700 F.2d 1053, 1056-58 (6th Cir. 1983). However, that decision predated the 1984 amendments to the Bankruptcy Code, which "include[d] the language that gave rise to the ride-through dispute." *Coastal Fed. Credit Union v. Hardiman*, 398 B.R. 161, 171 n.8 (E.D.N.C. 2008)." *Dumont*, *supra*, n. 6.

to its doing so." *Dumont*, 581 F.3d at 1114. The court was bound to inquire further, and to review the underlying agreement and state law. The court found that subsection 521(d) trumped subsection 365(e)(i)(B), which renders *ipso facto* clauses unenforceable. Because the debtor failed to take the action required by section 362(h), nothing in the Code prevented the *ipso facto* clause in the parties' agreement from being effective, under which the debtor's filing was a default under their agreement, permitting Ford to repossess the vehicle.

Daimler Chrysler Fin. Servs. Americas LLC v. Jones (In re Jones), 397 B.R. 775 (S.D. W. Va. 2008), *aff'd*, 591 F.3d 308 (4th Cir. 2010). Ride-through no longer valid, and "ipso facto" clause was enforceable where debtor merely indicated his intention to "continue payments" on the vehicle but did not state whether he intended to redeem the vehicle or reaffirm the debt.

In re Beard, Case no. 10-51592 (Bankr. M.D.N.C. 2012). Debtor's statement of intention indicated her intent to retain her vehicle and reaffirm her debt with the creditor. The creditor sent a reaffirmation agreement which required payment, in a lump sum, of $16,149.46. Debtors counsel responded with correspondence indicating that he could not recommend the proposed agreement, but that the debtor was interested in negotiating if the creditor was interested in proposing payment terms. Creditor did not respond and debtor's counsel did not send a signed agreement which provided for the original contract terms. Without relief from stay, the creditor repossessed the vehicle. Court held that debtor did not specify her intention to reaffirm on the original contract terms; as a result, section 362(h)(1)(B) was not applicable and the automatic stay terminated upon expiration of the section 521(a)(2) time periods.

In re Waters, Case No. 00-04305 (Bankr. M.D. Fla. 2000). Debtor's statement of intentions for six items they wish to retain simply indicated "other." At the hearing on the creditor's motion to compel the debtor to reaffirm, redeem, or surrender collateral, debtor's counsel indicated that debtors wanted to continue to make payments and retain the collateral, without signing an agreement. Court granted creditor's motion.

In Re McFall, 356 B.R. 674 (Bankr. N.D. Ohio 2006). Debtor's statement of intention indicated his desire to "retain collateral and continue to make regular payments." Debtor did not reaffirm the debt or redeem the vehicle, and the creditor repossessed the vehicle more than 30 days after his statement was filed. Debtor then filed a motion to impose sanctions on the creditor for violating the automatic stay. The court held that the stay was terminated as to the vehicle thirty days after the bankruptcy filing due to debtor's failure to comply with the requirements of §362(h)(1)(A) and therefore there was no violation of the stay.

For a unique set of circumstances, where it appears everyone was willing to sign the agreement but no one was willing to prepare it, *see In re Schwass,* 378 B.R. 859 (Bankr. S.D. Ca. 2007). In that case, the debtor filed a statement of intention indicating her plan to reaffirm the debt, but both debtor's counsel and the secured creditor's counsel refused to prepare the agreement, each contending that the other should bear the burden. Thirty days passed after the date set for the first meeting of creditors and the creditor sought relief from stay under 11 U.S.C. § 362(h)(1)(B). Finding that the creditor was in the best position to prepare the agreement, and that the debtor was "standing ready and willing to execute the reaffirmation agreement prepared by the secured creditor," the court determined that relieve from the stay under § 362(h) was not warranted.

What if Debtor Signs the Reaffirmation but the Creditor Refuses to Sign or the Debtor's Counsel Refuses to Certify that it does not Impose a Hardship?

In re Nuckoles, Case No. 15-50904 (Bankr.W.D. Va. 2016). Debtor filed a statement of intention indication her intention to reaffirm the debt and signed a reaffirmation agreement. Debtor's counsel also signed the agreement but refused to certify that it did not impose an undue hardship on the debtor; for that reason the creditor refused to endorse or file the agreement. Debtor retained the vehicle and stayed current on her payments. Relying solely on the *ipso facto* provision contained in the parties' original agreement, the creditor repossessed the vehicle. The court held the creditor was in violation of the discharge injunction, for the reason that debtor's compliance with her statutory obligations pursuant to sections 362(h) and 521(a) rendered the *ipso facto* clause unenforceable.

In re Perez, Case No. 7-10-11471 JA (Bankr. D.N.M. 2010). Where the debtor signed the reaffirmation agreement, and her attorney signed Part C but crossed out the second certification concerning whether the agreement imposes an undue hardship on the debtor, the court determined the agreement was not enforceable for the reason that her counsel did not make the required "no undue hardship" certification under Part C of the agreement. Nonetheless, "by signing a statement of intention to reaffirm the debt, timely filing the statement in her case, and thereafter timely entering into the reaffirmation agreement, the Debtor has complied with the requirements of 11 U.S.C. § 521(a)(6) and 11 U.S.C. § 362(h). Consequently, the Court concludes that the Creditor may not exercise remedies under 11 U.S.C. § 521(d) or 11 U.S.C. § 362(h)." This included any *ipso facto* clauses, as the automatic stay remained in place. The court did not decide the question of when the stay terminates and is replaced by the discharge injunction, and the vehicle is no longer property of the estate, what the creditor's rights may be.

In re Baker, 390 B.R. 524 (Bankr. D. Del. 2008). Where both creditor and debtors signed the reaffirmation agreement and filed it with the court, but the debtors' attorney refused to certify that the agreement did not present an undue hardship on the debtors, and the court entered an order declining to approve the agreement, and the creditor repossessed the car within days after the case was closed, debtors argued that the car loan "passed through" their case unaffected because they met their obligations under the code. The court held the debtors were entitled to retain their vehicle while staying current on their loan payments, and a default based upon the debtors' bankruptcy filing was an unenforceable *ipso facto* clause because the debtors timely entered into the agreement. Accordingly, the creditor's repossession of the vehicle was in violation of the discharge injunction. *See also In re Chim*, 381 B.R. 191 (Bankr. D. Md. 2008) (similar); and *In re Moustafi*, 371 B.R. 434 (Bankr. D. Ariz. 2007) (similar).

Practical Considerations

Keep in mind that if the reaffirmation agreement fails for any reason, the creditor will likely require the debtor negotiate a new loan agreement.

If your client is unable to reaffirm a debt, and is in a district where the *ipso facto* clause in the underlying contract will permit the creditor to repossess the collateral, you may want to consider conversion to chapter 13 to permit the debtor the opportunity to retain the car.

Also, consider the practical effect of not reaffirming a debt as it impacts credit reporting and refinancing or modifications. The lender may not report payments on the mortgage loan to credit reporting agencies if a reaffirmation is not done, due to concerns about violating the stay. If the debtor gets behind on payments, and there is no reaffirmation agreement in place, the lender may have fewer options. One positive effect of reaffirming debt is that it will allow the lender to report payments to the credit agencies and modify or refinance the note.

Remember that a debtor's failure to reaffirm may affect other loans they have with a credit union (which has a right of offset).

Reaffirmation Agreements
Relevant Portions of Bankruptcy Code and Rules

11 U.S.C. § 362(h)
(1) In a case in which the debtor is an individual, the stay provided by subsection (a) is terminated with respect to personal property of the estate or of the debtor securing in whole or in part a claim, or subject to an unexpired lease, and such personal property shall no longer be property of the estate if the debtor fails within the applicable time set by section 521(a)(2)—
(A) to file timely any statement of intention required under section 521(a)(2) with respect to such personal property or to indicate in such statement that the debtor will either surrender such personal property or retain it and, if retaining such personal property, either redeem such personal property pursuant to section 722, enter into an agreement of the kind specified in section 524(c) applicable to the debt secured by such personal property, or assume such unexpired lease pursuant to section 365(p) if the trustee does not do so, as applicable; and
(B) to take timely the action specified in such statement, as it may be amended before expiration of the period for taking action, unless such statement specifies the debtor's intention to reaffirm such debt on the original contract terms and the creditor refuses to agree to the reaffirmation on such terms.
(2) Paragraph (1) does not apply if the court determines, on the motion of the trustee filed before the expiration of the applicable time set by section 521(a)(2), after notice and a hearing, that such personal property is of consequential value or benefit to the estate, and orders appropriate adequate protection of the creditor's interest, and orders the debtor to deliver any collateral in the debtor's possession to the trustee. If the court does not so determine, the stay provided by subsection (a) shall terminate upon the conclusion of the hearing on the motion.

11 U.S.C. § 521
(a) The debtor shall–

* * *

(2) if an individual debtor's schedule of assets and liabilities includes debts which are secured by property of the estate-
(A) within thirty days after the date of the filing of a petition under chapter 7 of this title or on or before the date of the meeting of creditors, whichever is earlier, or within such additional time as the court, for cause, within such period fixes, file with the clerk a statement of his intention with respect to the retention or surrender of such property and, if applicable, specifying that such property is claimed as exempt, that the debtor intends to redeem such property, or that the debtor intends to reaffirm debts secured by such property; and
(B) within 30 days after the first date set for the meeting of creditors under section 341(a), or within such additional time as the court, for cause, within such 30-day period fixes, perform his intention with respect to such property, as specified by subparagraph (A) of this paragraph;
except that nothing in subparagraphs (A) and (B) of this paragraph shall alter the debtor's or the trustee's rights with regard to such property under this title, except as provided in section 362(h);

* * *

(6) in a case under chapter 7 of this title in which the debtor is an individual, not retain possession of personal property as to which a creditor has an allowed claim for the purchase price secured in whole or in part by an interest in such personal property unless the debtor, not

later than 45 days after the first meeting of creditors under section 341(a), either-
(A) enters into an agreement with the creditor pursuant to section 524(c) with respect to the claim secured by such property; or
(B) redeems such property from the security interest pursuant to section 722;

11 U.S.C. § 524(c)
An agreement between a holder of a claim and the debtor, the consideration for which, in whole or in part, is based on a debt that is dischargeable in a case under this title is enforceable only to any extent enforceable under applicable nonbankruptcy law, whether or not discharge of such debt is waived, only if—
(1) such agreement was made before the granting of the discharge under section 727, 1141, 1228, or 1328 of this title. . . .

11 U.S.C. § 524(f)
Nothing contained in subsection (c) or (d) of this section prevents a debtor from voluntarily repaying any debt.

Rule 4004(b)
(1) On motion of any party in interest, after notice and hearing, the court may for cause extend the time to object to discharge. Except as provided in subdivision (b)(2), the motion shall be filed before the time has expired.
(2) A motion to extend the time to object to discharge may be filed after the time for objection has expired and before discharge is granted if (A) the objection is based on facts that, if learned after the discharge, would provide a basis for revocation under § 727(d) of the Code, and (B) the movant did not have knowledge of those facts in time to permit an objection. The motion shall be filed promptly after the movant discovers the facts on which the objection is based.

Rule 4004(c)
(1) In a chapter 7 case, on expiration of the times fixed for objecting to discharge and for filing a motion to dismiss the case under Rule 1017(e), the court shall forthwith grant the discharge, except that the court shall not grant the discharge if:
* * *
(E) a motion to extend the time for filing a complaint objecting to the discharge is pending;
* * *
(J) a motion to enlarge the time to file a reaffirmation agreement under Rule 4008(a) is pending;
* * *
(K) a presumption is in effect under §524(m) that a reaffirmation agreement is an undue hardship and the court has not concluded a hearing on the presumption; or

(2) Notwithstanding Rule 4004(c)(1), on motion of the debtor, the court may defer the entry of an order granting a discharge for 30 days and, on motion within that period, the court may defer entry of the order to a date certain.

Rule 4008(a)
A reaffirmation agreement shall be filed no later than 60 days after the first date set for the meeting of creditors under §341(a) of the Code. The reaffirmation agreement shall be accompanied by a cover sheet, prepared as prescribed by the appropriate Official Form. The court may, at any time and in its discretion, enlarge the time to file a reaffirmation agreement.

Rule 4008 Committee Notes on Rules – 2008 Amendment
Any party may file the agreement with the court. Thus, whichever party has a greater incentive to enforce the agreement usually will file it. In the event that the parties are unable to file a reaffirmation agreement in a timely fashion, the rule grants the court broad discretion to permit a late filing. A corresponding change to Rule 4004(c)(1)(J) accommodates such an extension by providing for a delay in the entry of discharge during the pendency of a motion to extend the time for filing a reaffirmation agreement.

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION – DETROIT

IN RE:

DEBTOR,

Case No.
Chapter 7
Honorable

Debtor.
_____/

DEBTOR'S EX-PARTE MOTION TO DELAY THE ENTRY OF DEBTOR'S DISCHARGE

_____ (the "Debtor"), through his/her undersigned counsel, _____, hereby moves this court for a delay in entry of the Debtor's discharge, on an ex-parte basis. In support of his/her Ex-Parte Motion, the Debtor respectfully states as follows:

Jurisdiction

1. This Court has jurisdiction over this Motion under 28 U.S.C. §1334. This matter is a core proceeding within the meaning of 28 U.S.C. § 157(b)(A) and (O). Venue of the Motion and the Ex-Parte Motion is proper in this District pursuant to 28 U.S.C. §§ 1408 and 1409.

2. The statutory basis for the relief requested herein is Rule 9006(b) of the Federal Rules of Bankruptcy Procedure (the "Bankruptcy Rules"), and Rules 9006-1 and 9014-1 of the Local rules of the Bankruptcy Court for the Eastern District of Michigan (the "Local Rules").

Factual Background

3. On _____, the Debtor filed a voluntary petition under Chapter 7 of the United States Bankruptcy Code.

4. The Debtor's discharge deadline is currently _____.

5. The purpose of the adjournment is to allow sufficient time for the Debtor to file a reaffirmation agreement with [CREDITOR NAME] regarding [Description of Property to be Retained]. The Debtor has been in the process of completing the reaffirmation agreement with the respective creditor but such agreement has not yet been filed.

6. As such, the Debtor and the undersigned believe there is good cause to enter an ex-parte order delaying the entry of the Debtor's discharge.

7. The Debtor's do not expect the delay of this Ex-Parte Motion to adversely or materially impact any party.

8. As such, for all the reasons as stated above, the Debtor believes good cause exists for the Court to grant this ex-parte motion.

WHEREFORE, the Debtor respectfully requests the Court to enter the order attached as Exhibit 1, delaying the entry of discharge.

Dated: September 21, 2015

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION – DETROIT

IN RE:

DEBTOR,

Case No.
Chapter 7
Honorable

Debtor.
_____/

ORDER GRANTING DEBTORS' EX-PARTE MOTION TO DELAY THE ENTRY OF DEBTOR'S DISCHARGE

THIS MATTER having come before the Court on the Ex Parte Motion of the Debtor to Delay the Entry of the Debtor's Discharge; the Court having jurisdiction over this matter, and after due deliberation and sufficient cause appearing therefore:

IT IS ORDERED that the Ex Parte Motion is GRANTED;

IT IS FURTHER ORDERED that the discharge deadline is extended to _____ for the sole purpose of allowing the debtor and/or creditor referenced in the Motion to file a reaffirmation agreement.

CURRENT HOT TOPICS IN CHAPTER 7
TRUSTEE'S REMEDIES FOR NONCOMPLIANCE WITH 11 U.S.C. § 521

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CURRENT HOT TOPICS IN CHAPTER 7

I. What are the debtor's core filing requirements under 11 U.S.C. § 521 with which trustees are primarily concerned?

A. a list of creditors;

B. a schedule of assets, a schedule of current income and current expenditures, and a statement of financial affairs;

C. copies of all payment advices or other evidence of payment received within 60 days before the filing of the petition, by the debtor from any employer of the debtor;

D. a statement of the monthly net income, itemized to show how the amount is calculated;

E. a statement disclosing any reasonably anticipated increase in income or expenditures over the 12-month period following the date of the filing of the petition;

F. the debtor must also cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties under Title 11;

G. surrender to the trustee all property of the estate and any recorded information, including books, documents, records, and papers, relating to property of the estate, whether or not immunity is granted under § 344 of Title 11;

H. perform the obligations of the administrator of an employee benefit plan if at the time of the commencement of the case the debtor or any entity designated by the debtor served as administrator.

II. What are the local requirements in the Eastern District of Michigan which supplement the debtor's core filing requirements under § 521?

LBR 2003-2-

a. To extent they are in the debtor's possession or are readily available – have available at the meeting of creditors –

i. Documents for one year pre-petition to support all entries on Schedule I, other than previously provided payment advices and tax return.

ii. Documents for one year pre-petition to support all entries on Schedule J, including canceled checks, paid bills or other proof of expenses;

iii. Copies of life insurance policies either owned by the debtor or insuring the debtor's life;

iv. Keys to non-exempt buildings and vehicles;

v. Divorce judgments and property settlement agreements;

vi. Documents establishing the scheduled amount of joint debts, if the debtor claims an entireties exemption;

vii. The name, address and telephone number of each holder of a domestic support obligations; and

viii. Any other specific document requested by the trustee relating to the schedules of statement of financial affairs if requested in writing at least seven days before the first meeting of creditors;

b. To extent they are in the debtor's possession or are readily available – no later than 7 days prior to the meeting of creditors, neatly arranged

i. Certificates of title (originals if available) for currently owned titled assets, including vehicles, boats and mobile homes (regardless of when acquired);
ii. a current statement from each secured creditor stating the amount owed;
iii. originals of bank books, check registers, other financial accounts, bonds, stock certificates and bank, brokerage and credit card statements for one year pre-petition;
iv. copies of leases, recorded mortgages, recorded and unrecorded deeds and recorded land contracts for the time period six years pre-petition;
v. current property tax statements;
vi. asset appraisals;
vii. casualty insurance policies;

viii. if the debtor owns a business, business financial statements and business tax returns for the past three years and business bank statements for the past six months.

III. What are a trustee's core duties under § 704 that are negatively impacted by a debtor's failures to discharge their duties under § 521?

A. collect and reduce to money the property of the estate for which such trustee serves, and close the estate as expeditiously as is compatible with the best interests of parties in interest;

B. be accountable for all property received;

C. investigate the financial affairs of the debtor;

D. if a purpose would be served, examine proofs of claims and object to the allowance of any claim that is improper;

E. if advisable, oppose the discharge of the debtor;

F. continue to perform the obligations of the administrator of an employee benefit plan if at the time of the commencement of the case the debtor or any entity designated by the debtor served as administrator.

IV. What remedies does a trustee have when a debtor breaches his duties under § 521?

A. Administrative procedures related to the Meeting of Creditors

Oftentimes, trustees will either refuse to conduct the 11 U.S.C. § 341 Meeting of Creditors until the debtor complies with the core requirements of § 521, such as filing the required schedules and statements and providing supporting documents like payment advices and tax returns, or at the very least, not conclude the meeting until the debtor complies with those requirements. The advantage in not holding the meeting until the debtor complies with the filing requirements is that the trustee can conduct a thorough review of the debtor's petition, schedules, statements, and supporting documents prior to questioning the debtor and make an informed judgment at the § 341 meeting about whether the debtor has made a full and appropriate disclosure of his assets and liabilities, whether non-exempt assets

exist, or whether it would be appropriate under the circumstances to object to the debtor's discharge.

The faster the trustee can make his assessment the faster the trustee can close the truly "no asset" cases and concentrate on the cases that have assets or are subject to dismissal or objections to discharge. The disadvantage in not holding the meeting is the disruption to the trustee in having to reschedule the meeting, prepare to question the debtor a second time or multiple times, and in fact hold a second meeting or multiple meetings, the disruption to the creditors in having to review the case and prepare questioning a second time or multiple times and appear at a second or multiple meetings, and to the debtor for the same reasons, especially in cases that have few if any assets and which will be closed as soon as the trustee can verify the accuracy of the debtor's financial condition by comparing the debtor's disclosures to traditional supporting documents.

B. Motions to Dismiss pursuant to 11 U.S.C. § 707 (A)

In those cases in which the debtors continually fail, refuse, or neglect to comply with the requirements of § 521, including failing to cooperate with the trustee, many trustees file motions to dismiss those debtors' cases for cause based on unreasonable delay to the creditors pursuant to 11 U.S.C. § 707 (A). The advantage of the motion to dismiss is the speed of the resolution. The motions require a notice period of only 14 days, hearings are usually held within 30 to 45 days if the debtor responds, and the filing of the motion usually motivates the honest but unfortunate debtors to comply with § 521 and further cooperate with the trustee in the discharge of his duties. The disadvantage of this approach is courts are generally reluctant to dismiss a debtor's case upon the first or even the second motion to dismiss if the debtor agrees to provide the missing documents and otherwise comply with § 521 within a reasonable time subsequent to the hearing on the motion.

As a result, the trustee and even the debtors are spending time and incurring expenses related to motions that more often than not do not result in a dismissal of the case. Moreover, even when the case is dismissed for failure to provide documents, the debtors usually promptly file motions to reinstate the case or file new cases. However, more courts, especially in the Eastern District of Michigan, have become much more amenable to ordering debtors who repeatedly fail to comply with § 521 or otherwise fail to cooperate with the trustee to pay costs to the trustee in amounts generally not exceeding $100.00, except in unusual

circumstances. For a case that ultimately turns out to be a "no asset" case, filing and arguing motions to dismiss over failures to file schedules or provide documents even when costs of $100.00 are ordered result in losses to the trustee, the honest but unfortunate debtor, and the bankruptcy system as a whole.

C. Motions to Conduct Fed. R. Bankr. P. 2004 Examinations and for Production of Documents

In those cases where the trustee is reluctant to bring a motion to dismiss the debtor's case because he firmly believes that the debtor has valuable disclosed or undisclosed assets that the trustee might administer for the benefit of creditors and that it would be in the best interest of the estate's creditors to administer the assets, many trustee's file motions for authority to conduct 2004 examinations and for production of documents with proposed orders that detail the documents the debtors are required to produce in advance of the 2004 examinations. Under those circumstances, if the debtor fails to appear for the examination or fails to provide the documents specified in the order, the debtor will be in direct violation of an order of the court and subject to having the court deny his discharge pursuant to 11 U.S.C. § 727 (a) (6) (A).

The foregoing approach is even more effective in motivating debtors to comply with their obligations under § 521, including cooperating with the trustee in the discharge of his duties, because failing to do so might more directly put their discharges in jeopardy. The added cost of preparing and filing a motion for authority to conduct a Rule 2004 examination and for production of documents and actually conducting the examination and reviewing the documents is offset if the examination and production of documents leads to valuable assets the trustee can liquidate for the benefit of creditors. As a last resort, the trustee can attempt to interview other parties who might information about the debtor's assets, such as creditors, disgruntle ex-wives, business partners, and others who might have information about the extent of the debtor's assets and liabilities and who might have an adversarial relationship with the debtor. The trustee can also subpoena relevant documents from sources other than the debtor, such as banks, businesses in which the debtor has an interest, and credit card companies. However, trying to piece together the debtor's financial picture without the debtor's assistance can be inefficient, time consuming and expensive.

D. Adversary Proceedings to Deny the Debtor's Discharge

neither honest nor unfortunate, or actively engaged in evading the requirements of § 521, including the obligation to cooperate with the trustee in the discharge of his duties, the most appropriate remedy for the trustee might be to commence an adversary proceeding to deny the debtor's discharge or recommend that the United States Trustee commence an adversary proceeding for that purpose. The court in Morton v. Dreyer (In re Dreyer), 127 B.R. 587, 593 (Bankr. N.D. Tex. 1991) (citing Hudson v. Wylie, 242 F.2d 435 (9th Cir.) cert. denied, 355 U.S. 828; 78 S. Ct. 39; 2 L. Ed. 2d 41 (1957) made clear:

> "The bankruptcy system relies on a debtor to deal honestly with his creditors by making full, complete and honest disclosure in his statements and schedules."

Likewise, it has been settled law for decades that "a debtor's cooperation is prerequisite to granting a discharge." In re McDonald, 25 B.R. 186, 189 (Bankr. N.D. Ohio 1982). In 1999, Judge Steven Rhodes cited the *McDonald* case as a basis for his holding in the case of Gold v. Guttman, 237 B.R. 643, 650 (1999) where he entered an order denying the debtor's discharge pursuant to 11 U.S.C. §§ 727 (a) (4) (D) and (a) (5) based on the debtor's failure to provide documents that it was his duty to provide, or maintain the records he was required to maintain, even though the records requested were created by someone else, were not in his possession. Moreover, he cited the debtor's failure to satisfactorily explain the loss of certain assets as an additional basis to deny the debtor's discharge. The court quoting Nof v. Gannon (In re Gannon), 173 B.R. 313, 320 (Bankr. S.D.N.Y. 1994) explained:

> The focus of *§ 727 (a) (4) (D)* is on the debtor's duty to maintain and turn over recorded information which bears on the debtor's financial condition and business affairs…
>
> The Court concludes that Guttman's failure to produce these documents after repeated requests by the trustee was knowing and fraudulent and thus constitutes grounds for denial of the discharge under § 727 (a) (4) (D)…
>
> § 727 (a) (5) is broad enough to include any unsatisfactorily explained or shortage of assets. See Chalik v. Moorefield (In re Chalik, 748 F.2d 616 (11th Cir. 1984). The initial burden is on the objector to introduce some evidence of the disappearance of substantial assets or of unusual transactions

> (Citations Omitted). The debtor must then satisfactorily explain what happened. "'To be satisfactory "'an explanation must convince the judge."' Hawley v. Cement Indus., Inc. (In re Hawley), 51 F.3d 246, 249 (11th Cir. 1995) (quoting *Chalik,* 748 F.2d at 619 (internal citation omitted).

See also;

Sheehan & Associates v. Lowe, 2012 U.S. Dist. LEXIS 105871; Bankr L. Rep. (CCH) P82,322. (Court denied debtor's discharge pursuant to 11 U.S.C. § 727 (a) (3) because the debtor failed to keep and maintain records of money he borrowed from his parents, which exceeded $100,000.00.)

In re Royce Homes, LP, 2009 Bankr. LEXIS 2986; 41 Bankr. Dec. 41(Court concluded that debtor has a duty to locate and turn over to the trustee particular documents the trustee requested and to create charts showing the relationship among the various entities associated with the debtor.)

In re William Dolin, 799 F.2d 251; 1986 App. LEXIS; 14 Bankr. Ct. Dec.1325; Bankr. L. Rep. (CCH) P71,431. (Court held that debtor who withdrew in excess of $20,000.00 from his business over time to pay for his drug habit but did not keep records of the transactions. Therefore, his discharge was denied pursuant to 11 U.S.C. §§ 727 (a) (3) and (a) (5)

Trustees should exercise care in determining which remedies to utilize in which cases. Obviously, some remedies are more expensive and time consuming to pursue than others.

A Lawyer's Duty to Advise Clients regarding the Consequences in Bankruptcy of Preferential & Fraudulent Transfers

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I. Introduction

Many bankruptcies are the result of a long period of financial stress for the debtor due to unemployment, medical problems, divorce and/or other family issues. During this time, debtors often do whatever is necessary to survive day-to-day, to avoid utility shut off, to avoid litigation, to make child support payments, etc. Debtors may borrow money from family and friends and may feel bound to repay those obligations. Debtors may support a family member during difficult times, or agree to obtain or give away assets. Debtors may make college tuition payments or provide other support for their adult children. All of these actions feel right and just to the debtor at the time. A bankruptcy alters the treatment of these common occurrences and allows avoidance by the Trustee of many of these transfers as preferences and fraudulent transfers.

Of course some debtors manipulate the system, and transfer funds out to avoid collection and repossession by creditors. These clients find their way to our conference rooms as well.

In a perfect world, the debtor would know exactly the information needed to assess their exposure and risk regarding preferences and fraudulent transfers before a Chapter 7 is filed. This is seldom the case.

When an attorney is aware of transfers made by the debtor, counsel has an obligation to advise about the consequences a Chapter 7 filing may have on debtor's case, assets, discharge and also the impact on the transferees. In addition, an attorney has a duty to inquire whether transfers were made.

II. Michigan Rules of Professional Conduct

Michigan Rules of Professional Conduct: **Rule: 1.1 Competence**

> A lawyer shall provide competent representation to a client. A lawyer shall not:
> (a) handle a legal matter which the lawyer knows or should know that the lawyer is not competent to handle, without associating with a lawyer who is competent to handle it;
> (b) handle a legal matter without preparation adequate in the circumstances; or
> (c) **neglect a legal matter entrusted to the lawyer.**

In addition, the notes to MRPC 1.1 require a lawyer to thoroughly analyze the circumstances:

> THOROUGHNESS AND PREPARATION Competent handling of a particular matter includes inquiry into and analysis of the factual and legal elements of the problem, and use of methods and procedures meeting the standards of competent practitioners.

III. Elements of Legal Malpractice in Michigan

In an action for legal malpractice, "the plaintiff has the burden of proving (1) the existence of an attorney-client relationship; (2) negligence in the legal representation of the plaintiff; (3) that the negligence was the proximate cause of an injury; and (4) the fact and extent of the injury alleged. *Manzo v. Petrella*, 261 Mich. App. 705, 712, 683 N.W.2d 699, 703-04 (2004)

In examining the attorney's duty in the context of the negligence element of a legal malpractice claim, the Supreme Court of Michigan in *Simko v. Blake,* 448 Mich. 648, 532 N.W.2d 842 (1995) held:

> Whenever an attorney or solicitor is retained in a cause, it becomes his implied duty to use and exercise reasonable skill, care, discretion and judgment in the conduct and management thereof. . . . It is well established that an attorney is obligated to use reasonable skill, care, discretion and judgment in representing a client. Further . . . all attorneys have a duty to behave as would an attorney "of ordinary learning, judgment or skill . . . under the same or similar circumstances . . . ."
>
> An attorney has the duty to fashion such a strategy so that it is consistent with prevailing Michigan law. However, an attorney does not have a duty to insure or guarantee the most favorable outcome possible. An attorney is never bound to exercise extraordinary diligence, or act beyond the knowledge, skill, and ability ordinarily possessed by members of the legal profession.

Simko v. Blake, 448 Mich. 648, 655-56, 532 N.W.2d 842, 846 (1995)(internal citations omitted).

Preferences and fraudulent transfers are common bankruptcy issues, which must be disclosed very early in the case under the penalty of perjury signed by the debtor. It is in the realm of ordinary care for debtor's counsel to advise the debtor regarding the pre-petition transfers and to devise a strategy to address the consequences of such transfers.

IV. Counsel's duty to inquire; Debtor's duty to disclose.

Debtor's counsel is obligated to inquire about transactions of the debtor for the purposes of completing the Statement of Financial Affairs, Official Form B107. Most often, this will occur prior to the bankruptcy filing, unless the bankruptcy is filed on an emergency basis. Law offices vary in procedures for the intake of information for completion of the Schedules and Statement of Financial Affairs, but the duty rests squarely on the attorney – and not on the staff – to ask appropriate questions and ensure the pleadings are accurately completed.

MRPC Rule: 5.3 Responsibilities Regarding Nonlawyer Assistants

> With respect to a nonlawyer employed by, retained by, or associated with a lawyer: (a) a partner in a law firm shall make reasonable efforts to ensure that the firm has in effect measures giving reasonable assurance that the person's conduct is compatible with the professional obligations of the lawyer; (b) a lawyer having direct supervisory authority over the nonlawyer shall make reasonable efforts to ensure that the person's conduct is compatible with the professional obligations of the lawyer; and (c) a lawyer shall be responsible for conduct of such a person that would be a violation of the rules of professional conduct if engaged in by a lawyer if: (1) the lawyer orders or, with knowledge of the relevant facts and the specific conduct, ratifies the conduct involved; or (2) the lawyer is a partner in the law firm in which the person is employed or has direct supervisory authority over the person and knows of the conduct at a time when its consequences can be avoided or mitigated but fails to take reasonable remedial action.

It is the debtor's duty to complete and file the Statement of Financial Affairs under 11 U.S.C. §521(a)(1)(B)(iii). The debtor signs the Statement of Financial Affairs under the penalty of perjury pursuant to 18 U.S.C. §1621 and can be subject to criminal liability for false statements pursuant to 18 U.S.C. §§152 and 3571, among other consequences. In addition, the debtor's discharge may be barred for concealment or a false oath pursuant to 11 U.S.C. §§727(a)(3) and (4).

There are few cases which directly address an attorney's liability for failing to advise a claim regarding the consequences of preferential or fraudulent transfer prior to the bankruptcy. In *In re Dow,* 132 B.R. 853 (Bankr.S.D.Ohio, 1991), the trustee brought a fraudulent transfer claim against debtor's counsel alleging that counsel was negligent in advising and representing the debtor and that if counsel had represented the debtor in a skillful and diligent manner, the debtor would not have engaged in certain transactions and would not have prepared and filed incomplete and inaccurate schedules and statements with the bankruptcy court. *Id.,* 132 B.R. at 856. As to the trustee's claim regarding advising prior to the petition, the court found that there were genuine issues of material fact that required trial and denied counsel/defendants' motion to dismiss, in part based upon the court's inability to address whether the doctrine of *in pari delicto* should be applied to bar the claim. As to whether counsel was liable for negligence or misrepresentation as to the contents of the schedules and statements, the court dismissed the claim, but only on the basis that the trustee's pleadings alleged damage to the trustee (as opposed to the estate or creditors). *Id.*

V. Denial of Discharge - §727(a)(2)

Transactions by the debtor prior to the bankruptcy may expose the debtor to denial of the debtor's discharge. If the debtor has made a fraudulent transfer within one year prior to the petition date, the debtor's discharge may be subject to denial under §727(a)(2) depending on the circumstances:

> **(a)** The court shall grant the debtor a discharge, unless . . .
> **(2)** the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed,

> destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed--
>
> **(A)** property of the debtor, within one year before the date of the filing of the petition . . .

In *Lambert v. Stark,* 484 N.E.2d 630 (Ind. App. 1985), the Indiana Court of Appeals dismissed a claim for malpractice where debtor's attorney had advised the debtor to make certain transfers, filed a bankruptcy on debtor's behalf, and a secured creditor barred debtor's discharge due to the timing of the transfer. The court concluded that the malpractice claim was barred due to the expiration of the statute of limitations based on the timing of the debtor's suit, and did not reach the underlying issue of malpractice.

In the same vein, counsel must be careful when advising clients to acquire assets and how those assets should be titled. "[B]ankruptcy lawyers can face a dilemma in advising clients whether to acquire exempt assets. As one commentator observed, '[T]he same conduct can be malpractice *not* to advise in one jurisdiction, but voidable and grounds for denial of discharge and possibly for disbarment in another . . . .'" *OTE Dev. USA, Inc. v. Warren (In re Warren),* 512 F.3d 1241, 1249 (10th Cir. 2008) citing John D. Ayer, *How to Think About Bankruptcy Ethics,* 60 Am. Bankr. L. J. 355, 374 (1986).

VI. Preference Consequences

The consequences of failing to review and advise a debtor regarding a potential preference can be severe. In some cases, the recording of a mortgage can be considered a preference avoidable by a Chapter 7 trustee, leaving a house unencumbered and subject to sale by a Trustee. Debtor's counsel should examine all mortgages as to the date of recording, and also examine both the deed to real property and corresponding mortgage to make sure that the legal description matches[1]. While the latter is not in the nature of a fraudulent transfer or preference, the trustee may be able to avoid a mortgage through the trustee's strong arm powers under §544 and Michigan law if the mortgage does not meet recording requirements. Debtor's counsel should also examine the bank statements provided to the trustee for potential preferential transactions.

In addition, if there was a preference or an avoidable transfer, the debtor's counsel may have an obligation to advise the debtor to delay filing a bankruptcy in order to allow the statute of limitations to run.

Does a preference or fraudulent transfer satisfy the elements for damages to the client for legal malpractice? Neither a preference nor a fraudulent transfer impact the debtor client (unless subject denial of discharge under §727(a)(2)), only the transferee is affected.

VII. Michigan statute of limitations on malpractice claims

As of January 2013, the Michigan Legislature extended the statute of limitations for pursuing a legal malpractice claim from 2 years from discovery of the incident to 6 years from the date of the act which is the subject of the claim.

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[1] Even if the legal descriptions in the deed and mortgage match, the legal description in the deed may still be incorrect.

600.5838b Action for legal malpractice; commencement; limitation; definitions.
(1) An action for legal malpractice against an attorney-at-law or a law firm shall not be commenced after whichever of the following is earlier:
(a) The expiration of the applicable period of limitations under this chapter.
(b) ***Six years*** after the date of the act or omission that is the basis for the claim.
(2) A legal malpractice action that is not commenced within the time prescribed by subsection (1) is barred. . .

VIII. Pre-Petition Legal Malpractice Claim as Property of the Estate

A malpractice claim in general requires that a party realize that a claims exists. Debtors may be frustrated by the bankruptcy process but may not realize that their lawyer has served them improperly.

However, the debtor may not be the proper party to bring a malpractice action. If the lawyer's action or inaction in advising the debtor arose prior to the petition date, the claim may be property of the bankruptcy estate and the Chapter 7 trustee has a right to pursue the claim. *Helbling v. Josselson (In re Almasri)*, 378 B.R. 550, 556 (Bankr. N.D. Ohio 2007).

Other courts have found that the claim arises when the harm occurs to the debtor, and that as long as the harm remains hypothetical, no harm to the debtor has occurred. In *In re De Hertogh*, 412 B.R. 24, 28-29 (Bankr. D. Conn. 2009), the harm to the debtor was a denial of the debtor's homestead exemption, which occurred during and as part of the bankruptcy case – after the petition date and not as part of the bankruptcy estate. The Court in *De Hertogh* compared the application of two United States Supreme Court cases and their progeny that examined whether, as of the petition date, the cause of action accrued under applicable state law, *Butner v. United States*, 440 U.S. 48, 99 S.Ct. 914, 59 L. Ed. 2d 136 (1979) and *Segal v. Rochelle*, 382 U.S. 375, 380, 86 S.Ct. 511, 515, 15 L. Ed. 2d 428 (1966), which questioned whether a cause of action that accrued post-petition was nevertheless "sufficiently rooted in the pre-bankruptcy past and so little entangled with the bankrupt's ability to make an unencumbered fresh start that it should be regarded as 'property' under § 70(a)(5) [of the former Bankruptcy Act]."

Student Loan Obligations
Consumer or Non-Consumer Debt for 707(b)(1) Dismissal?

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I. Introduction

Several bankruptcy courts have recently addressed the issue of whether student loan obligations are to be classified as consumer debts or non-consumer debts for purposes of §707(b). Under this section, the United States Trustee may file a motion to dismiss a Chapter 7 bankruptcy for abuse – but only where the debtor has primarily consumer debts.

The cases center primarily around student loans incurred for professional degrees where the debtor subsequently filed Chapter 7. These cases do not include those debtors who have extensive other obligations stemming from their failed businesses, otherwise the debtors would have primarily non-consumer debt and §707(b) would not apply.

II. Section 707(b) Dismissal

This issue arises in the context of a motion to dismiss by the United States Trustee (UST) under 11 U.S.C. §707(b)(1), which provides (in pertinent part) as follows:

> (b)(1) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, trustee (or bankruptcy administrator, if any), or any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts, or, with the debtor's consent, convert such a case to a case under chapter 11 or 13 of this title, if it finds that the granting of relief would be an abuse of the provisions of this chapter.

"There are two prerequisites to dismissal under § 707(b)(1): 1) the debtor has primarily consumer debt; and 2) the bankruptcy court finds that granting the debtor's petition would be an abuse of chapter 7." *Aspen Skiing Co. v. Cherrett (In re Cherrett)*, 523 B.R. 660, 668 (B.A.P. 9th Cir. 2014)

III. Definition of Consumer Debt: A consumer debt is defined in 11 U.S.C. §101(8) as a "debt incurred by an individual primarily for a personal, family or household purpose."

One of the earliest courts to address this issue was the United States Bankruptcy Court for the Northern District of Oklahoma in *In re Stewart (Stewart I),* 201 B.R. 996 (1996). In *Stewart I,* the debtor had incurred extensive educational expenses to attend medical school. Some of the expenses were obligations to individuals or other lending institutions which were not a typical

"student loan" and were found to be given for the purpose of "keeping the debtor in a comfortable lifestyle" while he was attending school, as opposed to institutional purposes such as books or tuition.

There is no per se rule that student loans are consumer debt. *Stewart II,* 215 B.R. 456 (10th Cir. BAP, 1997). See also *In re Ferreira,* 549 B.R. 232, 237 (Bkrcy E.D.Ca. 2016), citing *In re Rucker,* 454 B.R. 554 (Bankr. M.D.Ga. 2011). However the court in *Stewart I, supra,* held that "student loans in general should be treated as 'consumer debt' at least absent unusual facts or factors of which this Court is not presently aware". *Stewart I,* at 1005.

But non-consumer debt doesn't necessarily mean business debt. Tax debts are incurred for a public purpose. (*IRS v. Westerberry*, 215 F.3d 589, 590 (6th Cir.2000)(deciding whether debts were non-consumer debts for the purpose of enforcement of the co-debtor stay under 11 U.S.C. §1301). "[U]nlike taxes, consumer debt normally involves the extension of credit." *IRS v. Westerberry*, 215 at 591.

IV. Burden of Proof

Generally, the moving party – the United States Trustee in this instance - would have the burden of supporting its motion by a preponderance of the evidence. *In re Weixel*, 494 B.R. 895, 901 (B.A.P. 6th Cir. 2013).

The *Ferreira* court is unclear on the burden. The court states early in its opinion that "if the debtor is correct, the [UST] will have failed to satisfy its burden of demonstrating the debts in this case are 'primarily consumer debts' . . ." *In re Ferreira,* 549 at 235. But the opinion later states that "the debtor, however, bears the burden of demonstrating that a debt is nonconsumer or a business debt." *In re Ferreira,* 549 at 237. Which is it? Based upon the language, does the UST have the obligation to prove that the dollar amount at issue is more than 50% (relying on the use of the word "primarily" in the opinion) and the debtor the burden of proof regarding the classification of each debt as consumer or non-consumer? Such an approach would shift the burden to the debtor.

V. The Profit Motive Test

The 6th Circuit Court of Appeals has adopted – like many courts – the profit motive test as a partial test for determining whether the debt was a consumer debt. *IRS v. Westerberry*, 215 at 593. The profit motive test determines that debt is not consumer debt if the debt was "incurred with an eye toward profit." *Id*., citing *In re Booth*, 858 F.2d 1051, 1055 (5th Cir. 1988).

To determine whether to dismiss a case under Section 707(b), the court must look to the totality of the circumstances. *In re Krohn,* 886 F.2d 123, 126 (6th Cir. 1989).

But even in *Westerberry, supra,* the 6th Circuit held that the profit motive test was not determinative of the issue. *Id.,* at 593. The Court of Appeals held that the profit motive test does not define the only category of non-consumer debt. *Id.*

Other courts have required that the debt be "motivated for ongoing business requirements." *In re Cherrett*, *supra*. In addition, the debtor must "demonstrate a tangible benefit to an existing business, or show some requirement for advancement or greater compensation in a current job or organization." *In re Palmer,* 542 B.R. 289, 297 (Bankr. D. Colo. 2015), see also *Ferreira,* at 240 (stating that a "narrow standard that looks to an 'existing' business or 'current' employment also places debtors on equal footing").

The evidence required to establish a "profit motive" seems to stem from the debtor's own intentions, which has led some courts to question whether such evidence can be relied on at all. In *In re Millikan,* 2007 Bankr. LEXIS 4696 at *16 (Bankr. S.D. Ind. 2007), the court noted that "[t]he difficulty with the profit motive test is that it places in the hands of the debtor the means to characterize the debt. If a debtor testified that he or she had attended school for humanitarian reasons or just for the personal satisfaction of learning, the student loan could be considered a consumer debt. If the debtor testified that he or she had attended school primarily to earn a large income, the same loan could now become a non consumer debt. The result of applying the "profit motive test" allows a debtor to tailor his or her testimony to determine if a debt is to be considered a consumer or non consumer debt." *Id.*

The "profit motive test" should be interpreted narrowly. *In re Palmer,* 542 at 295. A narrow standard "tied to an existing business, or to some requirement for advancement in a current job or organization is necessary to avoid a student's aspirational goal, or a wished-for 'hope and dream' being the focus, as opposed to the advancement of a tangible opportunity." *Id.,* at 297.

Not all courts agree. At least one bankruptcy court has held that certain student loans satisfied the profit motive test and are non-consumer debts. In *In re De Cunae,* 2013 Bankr. LEXIS 5128 at *9-10, the United States Bankruptcy Court for the Southern District of Texas stated as follows:

> The evidence presented in this case is that the Debtor set out on a course of action to obtain a skill that would improve his ability to earn future income. The Court can think of no better example of incurring a debt with an eye toward profit. With respect to the UST's argument that the Debtor's personal benefit creates a consumer debt, the Court finds that the collateral self-enrichment is not the type of "consumption" that is the trademark of a consumer debt.
>
> The Court finds that student loan proceeds that are used for direct educational expenses with the intent that the education received will enhance the borrower's ability to earn a future living are not consumer debts.

VI. Bifurcation of the Loan Amount (Living Expenses v. Tuition)

The student loan obligation may be subject to apportionment into a consumer and non-consumer component, with only the consumer portion counted as consumer debt for purposes of 707(b)(1).

A least one court has declined to apportion student loan debt. In *Hopkins v. Marble (In re Kempkers),* 2012 Bankr. LEXIS 4878, at *2 (Bankr. D. Idaho 2012), the court held that the language of §101(8) in defining "consumer debt" was clear that a debt is either entirely consumer or not. The *Kempkers* court held that a debt should be considered consumer debt even if a portion of it was incurred for a business purpose. *Id.*

Many other courts have been willing to apportion the debt or have agreed to allow the parties' stipulated apportionment control. *In the Matter of Booth, supra*, the Fifth Circuit split the debt where a portion was used by the debtor for a business venture.

Where the debtor is unable to document how the student loan funds were used, the court relied on debtor's "estimate" of what portion was used for "direct education expenses" and which portion was used for "travel and child care expenses". *In re Ferreira,* 549 B.R. at 236.

VII. Types of Student Loans

Does the type of degree or education the debtor was seeking effect the Court's decision? There are no reported cases regarding a general bachelor's degree or an associate's degree. The cases center mostly on professional degrees as follows:

Nursing Degree: *In re Ferreira,* 549 B.R. 232; 2016 Bankr. LEXIS 622 (Bkrcy E.D.California, February 29, 2016). The court found that the debtor "did not meet her burden of demonstrating that she incurred her student loans for an existing business or for current job advancement." *Id.,* at 240.

Medical Degree: *In re Grenardo,* 2012 Bankr. Lexis 6302 (Bankr. D. Colo., 2012). The Court held that a student loan debt incurred in order to attend medical school was consumer debt. "[w]here student loans result in tangible benefits that are assimilated to the debtor's person, thereby enhancing the debtor's personal qualities, the Court concludes that the loans are properly characterized as consumer debts." *Id,* at *29.

See also *In re Stewart (Stewart I),* 201 B.R. 996 (Bankr. N.D. Okla., 1996), which also held that medical school debts were consumer debts. Note that there were egregious and peculiar facts in this case – even as noted by the court in its opinion – which may limit this opinion's applicability.

Doctorate in Business Administration: *In re Palmer,* 542 B.R. 289 (Bankr. Colo. 2015). The Court held that a student loan incurred to obtain a doctorate in business administration was a consumer debt even though the debtor and his wife "always wanted to be business owners" and the debtor began his failed business (a sports bar) while he was pursuing his education.

Dental School: *In re Millikan,* 2007 Bankr. LEXIS 4696 (Bankr. S.D. Ind. 2007). The Court held that student loan debt for attending dental school was consumer debt, and that the "'profit motive test' works to the benefit of those who are most likely to have the ability to pay their creditors and to the disadvantage of those who are least able to pay their creditors. Those with a large amount of student loan debt and the greatest amount of education and, who, in turn, have the greatest earning potential can invoke the profit motive test and essentially fly under the §707(b) radar screen while the factory worker with an extra $ 100 a month and little or no student loan debt is forced to pay his creditors in a chapter 13 plan." *Id.,* at *16-17.

But the United States Bankruptcy Court for the Southern District of Texas held that a student debt incurred for dental school did qualify as a non-consumer debt and denied the UST's motion to dismiss under 707(b)(1). *In re De Cunae,* 2013 Bankr. LEXIS 5128 (2013).

VIII. Practical Effect

If the Court determines that the debts are primarily consumer debts, the case may be dismissed if the income and expense elements of §707(b) are satisfied – finding that the Debtor could make meaningful payments to creditors over time.

However, a case with primarily non-consumer debts is not the subject of a §707(b) dismissal according to the terms of the statute. *In re Bell*, 65 B.R. 575, 578 (Bankr. E.D. Mich. 1986). Courts rely instead on the provisions of §707(a):

> (a) The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including—
> (1) unreasonable delay by the debtor that is prejudicial to creditors;
> (2) nonpayment of any fees or charges required under chapter 123 of title 28; and
> (3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521(a), but only on a motion by the United States trustee.

The 6th Circuit Court of Appeals has read the word "including" in §707(a) broadly, so as not to be a limiting word. *In re Zick*, 931 F.2d 1124, 1126 (6th Cir. 1991)(holding that a Chapter 7 petition can be dismissed for lack of good faith under 707(a)).

Other courts have followed this approach, allowing §707(a) to be utilized for dismissal of Chapter 7 petitions where the court finds a lack of good faith.

A debtor's ability to pay is an appropriate factor to consider when determining whether a debtor lacks good faith in applying for Chapter 7 relief of its non-consumer debts. *Rahim v. Pacifica Loan Four, LLC (In re Rahim)*, 2011 U.S. Dist. LEXIS 55369, at *18 (E.D. Mich. 2011), citing *Perlin v. Hitachi Capital Am. Corp. (In re Perlin)*, 497 F.3d 364, 371 (3d Cir. 2007).

Section 707(a) is not an exhaustive list of "for cause" reasons to dismiss a Chapter 7 case. *In re Rahim*, at *18, citing *In re Zick, supra.*

If the debtor's income and expenses support filing a Chapter 7 – if they are truly needy - the debtor is unlikely to face dismissal under §707(b). If the non-consumer debtor faces a §707(b) challenge because they would fail the Means Test if their debts were primarily consumer debts, then the non-consumer debtor would likely fail to meet the Court's requirement for a "needy" debtor and face dismissal pursuant to §707(a).

The Debtor's debt burden of being pushed into a Chapter 13 actually increases over time. The student loans cannot be separately classified in a Chapter 13, yet are non-dischargeable and continue to accrue interest during the life of the plan.

However some debtors may not qualify for a Chapter 13 given the debt cap in Section 109(e). These debtors would be left with Chapter 11 as the only option.