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Values, Values, Values

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CONCURRENT SESSION

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Valuing Assets in Consumer Cases

By Caralyce M. Lassner

"The worth of a thing is the price it will bring."

-Justice Butler writing on *Standard Oil Co* v *Southern Pacific Co*, 268 US 146, 157 (1925), referencing a case decided in Great Britain. (See *The Clyde*, 1 Swabey 23[1].)

That's kind of a catchy phrase, isn't it? But what does it mean? According to the Oxford Dictionary of Proverbs[2], it is "a warning to would-be vendors that the value of an item that they are intending to sell can only be certainly known by the price that someone is willing to pay for it. Cf. L. *valet quantum vendi potest* [sic], it is worth as much as it can be sold for; 15th-cent. Fr. *tant vault la chose comme elle peut estre vendue* [sic], a thing is worth just so much as it can be sold for."

Great! But, does this apply in bankruptcy? What is a 'thing' worth in bankruptcy? Is it different than when someone isn't in bankruptcy? Is it market price at a retail outlet? Garage sale prices? What avenue of sale must one consider when stating in the pleadings what the worth of a 'thing' is? Is there just one? Is it the same for all 'things' owned by a Debtor? And who decides – the Debtor or the Debtor's attorney?

In evaluating these questions, keep in mind that "[t]he ascertainment of value is not controlled by artificial rules. It is not a matter of formulas, but there must be a reasonable judgment having its basis in a proper consideration of all relevant facts." *The Minnesota Rate Cases,* 230 US 352, 434 (1913), also cited in *Standard Oil Co*, supra.

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[1] This English case is cited in A Treatise on the Measure of Damages by Theodore Sedgwick, Ninth Edition 1912. The principle, as applied in the practice of law, appears to predate 1859 as the case is also cited in The Jurist, Volume 22, Part 1, which was published in or about 1859.

[2] 6th Edition, edited by Jennifer Speake (2015), the origin of the phrase dating from 1596: J. Sanford tr. H. C. Agrippa *Of Vanitie Artes & Sci* xci, '[t]he thing is so muche worthy as it maye be solde for [sic]'.

What Does the Term 'Value' Mean?

While Congress used the word "value" nine times in 11 USC 101 but did not once define it, the term *is* defined in 11 USC 522(a)(2) as the "fair market value as of the date of the filing of the petition or, with respect to property that becomes property of the estate after such date, as of the date such property becomes property of the estate."[3]

What is the Debtor's duty when it comes to setting the value of an asset? While as lawyers and judges, we know that words matter, apparently the drafters of Official Form 106 (Schedules A/B) weren't as concerned about that detail as we have come to expect or perhaps certain terms have become interchangeable. As we will recall, 11 USC 522 requires the "fair market value" of a thing for the purposes of §522, while the Official Form[4] requires a Debtor to list the "current" value of a thing.

Good news! There are instructions! The instructions[5], found on the United States Courts' website, direct a Debtor completing Schedule A/B to "report the current value of the property that you own in each category…"[6] but further advise that "[t]he instructions are designed to accompany the forms and are intended to help you understand what information is required to properly file. You are responsible for properly completing the forms. These instructions are not intended to provide, and should not be understood to provide, legal advice. They are not designed to fully explain, or to be relied upon in interpreting, the law."[7]

The instructions for Schedule A/B further state that "[c]urrent value is sometimes called fair market value and, for this form, is the fair market value as of the date of the filing

[3] Read alone, this seems an incomplete provision. As practitioners we must read §522(a)(2) as a term of art, used to specifically define the term within the section.
[4] http://www.uscourts.gov/sites/default/files/form_b106ab.pdf
[5] http://www.uscourts.gov/sites/default/files/instructions-individuals-2015.pdf
[6] Instructions, Page 14.
[7] Instructions, Page 1.

of the petition. Current value is how much the property is worth, which may be more or less than when you purchased the property." Perfect! Except how many Debtors are reading the instructions for the Official Form much less 11 USC 522? And, how many Debtors are regularly selling houses, cars, household goods, clothing, lawsuit interests, or future tax refunds? So, practically speaking, how does a Debtor even know what to tell their attorney? The simplest answer is: you have to ask.

Who is Responsible for the Value Reported?

The Code and the forms clearly indicate that the information to be disclosed to the Court, Trustee, and creditors is ultimately the Debtor's responsibility; there is no question about that. But does that limit the attorney's responsibility to provide guidance to the client and candor to the Court?

The preamble of the Michigan Rules of Professional Conduct (MRPC) provides, among other things, that as an advisor, a lawyer is responsible for providing the client with an informed understanding of his or her legal rights and obligations and explaining the practical implications of same. Additionally, the lawyer is expected to act as an evaluator by examining a client's legal affairs and reporting about them to the client or to others.[8]

These parallel responsibilities either overlap or conflict as the Debtor's discharge or property may be at risk if property is not valued properly, but an attorney may be in violation of the Rules of Professional Conduct if he or she does not adequately investigate the value assigned to an asset.

[8] Of important note is that the preamble of MRPC also states that "a violation of a rule does not give rise to a cause of action, nor does it create any presumption that a legal duty has been breached. The rules are designed to provide guidance to lawyers and to provide a structure for regulating conduct through disciplinary agencies. They are not designed to be a basis for civil liability." This, however, does not abdicate the attorney's responsibilities under FRBP.

Debtor and Debtor's Counsel: The Duty

So the initial question, in evaluating value, is determining who is best situated to know the value of an item – the Debtor or the Debtor's attorney?[9] Perhaps that depends on the item being valued, or if there has been an appraisal of the item at some point in time, or how general or unique the item may be. Additionally, who is best situated to know what assets require disclosure and therefore a corresponding value? Things like tax refunds, when filing in September, aren't commonly considered assets by a Debtor, nor is the right to sue someone the Debtor isn't considering suing, but these are assets that require further discussion and possible investigation to accurately disclose and value. Later materials by my fellow panelists will address how to best determine value but for now, I'd like to focus on who has the duty to do so.

The Debtor: An Absolute, Unassignable Duty

It is well established that the Debtor has a duty to fully and accurately disclose all assets, liabilities, and other financial transactions as required. That duty is not imputed to Debtor's counsel, nor should it be as the Debtor is in the best position to provide the information necessary to complete the pleadings. This duty is evidenced in the certifying language set forth in the pleadings above the Debtor's signatures.

Page 6 of the Voluntary Petition, immediately preceding the Debtor's signature is the following certification:

> I have examined this petition, and I declare under penalty of perjury that the information provided is true and correct.
>
> If I have chosen to file under Chapter 7, I am aware that I may proceed, if eligible, under Chapter 7, 11,12, or 13 of title 11, United States Code. I

[9] See *In re Edwards*, 10-10435, Doc 113 (ED KY Bankr 06/23/11), https://ecf.kyeb.uscourts.gov/doc1/08018638765; Pro se debtor was denied conversion from Chapter 7 to 13 due to his failure to accurately disclose assets and/or values.

> understand the relief available under each chapter, and I choose to proceed under Chapter 7.
>
> If no attorney represents me and I did not pay or agree to pay someone who is not an attorney to help me fill out this document, I have obtained and read the notice required by 11 U.S.C. § 342(b).
>
> I request relief in accordance with the chapter of title 11, United States Code, specified in this petition.
>
> I understand making a false statement, concealing property, or obtaining money or property by fraud in connection with a bankruptcy case can result in fines up to $250,000, or imprisonment for up to 20 years, or both. 18 U.S.C. §§ 152, 1341, 1519, and 3571.

Official Form 106Dec, Declaration About an Individual Debtor's Schedules also includes a certification paragraph, which reads "[u]nder penalty of perjury, I declare that I have read the summary and schedules filed with this declaration and that they are true and correct."

And lastly, the Statement of Financial Affairs concludes with a variation of the same provisions in that the Debtor certifies that "I have read the answers on this Statement of Financial Affairs and any attachments, and I declare under penalty of perjury that the answers are true and correct. I understand that making a false statement, concealing property, or obtaining money or property by fraud in connection with a bankruptcy case can result in fines up to $250,000, or imprisonment for up to 20 years, or both.
18 U.S.C. §§ 152, 1341, 1519, and 3571."

These three affirmations, as evidenced by a Debtor's signature, seem pretty persuasive in the argument that the Debtor has the sole duty to provide accurate information. Unfortunately, the Courts don't always see it that way and nor should you.

The Debtor Counsel's Duty: In Bankruptcy and as an Attorney

While the Debtor has a duty to full disclose, which in my practice includes the duty to fully cooperate, Debtor's counsel has a duty to a) ask questions designed to elicit full disclosure by the client and b) investigate and evaluate that information. Counsel's duties arise under Federal Rules of Bankruptcy Procedure, Michigan Rules of Professional Conduct, and arguably by way of the petition as well. "Counsel for debtors in bankruptcy have to be particularly mindful of their duty to conduct an inquiry into the facts presented in a bankruptcy petition and schedules that is reasonable under the circumstances." *In re Parikh*, 508 B.R. 572 (Bankr. E.D.N.Y. 2014).

Under FRBP 9011(b)(3), upon the filing of a pleading such as Schedules A/B and C, an attorney is certifying that to the best of his or her knowledge, formed after a reasonable inquiry, that the information set forth therein has evidentiary support or is likely to after further investigation. Failure to do so is quite arguably a violation of not only the rule, but the Rules of Professional Conduct.

For instance, in *In re Jones*, Judge Rhodes found that a failure to adequately investigate and/or evaluate a client's finances is a violation, by the attorney, of FRBP 9011. (339 BR 903 (ED MI 2006))[10] Judge Rhodes' decision was not an isolated or unique situation. While an attorney is not charged with investigating an issue to exhaustion, "he

[10] "This chapter 13 case was dismissed because the debtor had a 45% pay history, the funding of the plan had not been properly calculated and at confirmation there were substantial unresolved objections to confirmation of the debtor's plan. It thus appeared to the Court then, as it does now, that the applicant filed this case without the required regard for whether the chapter 13 case was feasible. Under FED. R. BANKR. P. 9011(b), it is the duty of the attorney for a debtor who seeks to file a chapter 13 case to investigate whether a chapter 13 plan is feasible and to file a chapter 13 case only when the feasibility of such a case is reasonably arguable. Moreover, the debtor's attorney has a duty to exercise independent judgment on behalf of the client, MICH. R. PROF. CONDUCT 2.1, and thus cannot file a chapter 13 case simply because the client so instructs. Indeed, this duty of independent judgment is consistent with, and not in conflict with, the attorney's duty of zealous advocacy under MICH. R. PROF. CONDUCT 1.0, because sometimes zealous advocacy of the client's best interests means that the attorney must advise the client not to proceed with a chapter 13 case. In this case, those obligations were violated….", *In re Jones*; appealed and ultimately upheld findings as to FRBP 9011 on appeal. Findings on MRPC were vacated in a prior order. See 05-40042, Doc 83 (ED MI Bankr 12/10/07).

'must explore readily available avenues of factual inquiry.' The attorney must also independently verify publicly available information to ensure the client representations are objectively reasonable and consistent. If the attorney fails to live up to this duty, courts must exercise discretion to determine which sanction is appropriate."[11] Ms. Bello's article is well worth the read in its entirety as the decision issued *In re Parikh* is comprehensive, but she sums it up well: "Ultimately, the take away from the *In re Parikh* decision is that while an attorney can trust his clients, the attorney has a duty to take reasonable steps to verify the information provided to him by his clients before he files their petitions." (id.) Such verification undoubtedly includes an evaluation of the value a Debtor may place on an asset.

Counsel is also reminded that under 11 USC 707 (b)(4)(C) "[t]he signature of an attorney on a petition, pleading, or written motion shall constitute a certification that the attorney has — (i) performed a reasonable investigation into the circumstances that gave rise to the petition, pleading, or written motion; and (ii) determined that the petition, pleading, or written motion — (I) is well grounded in fact; and (II) is warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law and does not constitute an abuse under paragraph (1)." Failure of counsel to comply with this provision of 707 may result in an order to reimburse the Trustee for reasonable costs or be assessed civil penalties. (11 USC 707(b)(4)(A), 11 USC 707(b)(4)(B)).

Further, attorneys must remain mindful that the MRPC serves as a persuasive guide as to the duties an attorney owes to his or her client as well as to the tribunal. Debtor's counsel's duty is not only to inform a debtor of his or her legal options but to help the debtor put forth accurate information. To meet this duty, Debtor's counsel must be actively involved in evaluating the accuracy of the information provided by Debtor. This requires

[11] Bello, Nancy. "Bankruptcy Attorneys Potentially Face Sanctions for Failure to Reasonably Investigate the Accuracy of Bankruptcy Petitions Prior to Filing", https://www.abi.org/member-resources/blog/bankruptcy-attorneys-potentially-face-sanctions-for-failure-to-reasonably, discussing *In re Parikh*.

counsel to not only draw on his or her own experience but to affirmatively engage in mining information from the Debtor which may impact a value the Debtor puts forth on first blush. One example might be where the Debtor is asked about real property ownership.

Here are some examples of familiar situations:

Example 1:

Attorney: What real property, land, houses, etc., do you own?

Debtor: Just the house I live in.

Attorney: And what is that house worth?

Debtor: Well I paid $90,000 for it, so probably $90,000.

Attorney: OK, when did you buy it?

Debtor: Hmmm….it was either 2010 or 2011.

Attorney: OK, well that was 7 or 8 years ago. Do you think your house has increased in value?

Debtor: No, everyone knows housing prices are down.

Attorney: Do you know what houses in your neighborhood are selling for?

Debtor: No, I have no idea.

Attorney: Do you know what your state equalized value is?

Debtor: What is that?

Attorney: OK, give me a second to check something. (Attorney turns to computer and does a quick and cursory search on either the taxing authority website or just through a real estate site like Zillow.)

OK, it says here that based on your state equalized value, the value the city puts on your house (attorney at least doubles the SEV) is about $150,000.

If you listed your house for sale today, do you think you could get

about $150,000 for it?

Debtor: Yeah, that sounds about right.

Example 2:

Attorney: What real property, land, houses, etc., do you own?

Debtor: Just the house I live in.

Attorney: And what is that house worth?

Debtor: They say it's worth $80,000.

Attorney: Who is "they"?

Debtor: The city or whoever.

Attorney: OK, could you get $80,000 for it?

Debtor: Probably not.

Attorney: Why not?

Debtor: The front windows are broken out, I need a new roof because it's leaking, and I think I need a new furnace because it went out last winter. Plus, none of the houses in my neighborhood are selling.

Attorney: So, you have some maintenance that needs to be done. Is there anything else that needs to be done to the house?

Debtor: (Client gives a laundry list of deferred maintenance).

Attorney: OK, give me a second to check something. (Attorney turns to computer and does a quick and cursory search on a real estate site like Zillow for recent sales and current listings.)

OK, it looks like houses are either sold or listed for sale in the $40,000 - $48,000 range.

If you listed your house for sale today, how much do you think you could get for it?

Debtor: I have no idea.

Attorney: How much would someone have to pay you for you to sell your house to them and feel ok about it?

Debtor: Probably around $45,000 or $50,000.

Example 3:

Attorney: What real property, land, houses, etc., do you own?

Debtor: I have some property up north.

Attorney: Does it have a house on it?

Debtor: Yeah, a big cabin.

Attorney: And how much is it worth?

Debtor: A million dollars.

Attorney: OK, what makes you think it is worth a million dollars?

Debtor: I don't know but I've been going up there since I was a kid.

Attorney: OK, so do you know the state equalized value?

Debtor: No, my sister takes care of all that.

Attorney: Why does your sister take care of it?

Debtor: We inherited it when my grandparents died.

Attorney: OK, so who all owns this house and property?

Debtor: Me and my sister and our 3 aunts.

Attorney: And when did you inherit it?

Debtor: Oh, probably 5 or 6 years ago.

Attorney: Has it been appraised since you inherited it?

Debtor: I don't know, I'd have to ask my sister.

Attorney: OK, and do you know if you all own equal shares?

Debtor: I don't know for sure, but I think so.

Attorney: OK. I need you to get the address for the property and, if you could, the most recent tax bill or a copy of an appraisal if one has been done recently, and we need to review those before we go any further.

Attorney and Debtor at continued appointment.

Debtor: Here is the paperwork my sister gave me.

Attorney: Great, thanks. It says here that the property is worth about $68,000.

Debtor: I don't want to sell it.

Attorney: I understand, but does that price sound about right if you were to list it for sale?

Debtor: Yeah, my sister says the house and property are probably worth about $60,000.

Attorney: OK great.

Now these are just examples of the initial conversation that might take place in helping the client get to an accurate value with regard to real estate, noting that different assets will require drastically different conversations. None of these conversations actually end where they do in the examples as the excerpts are simply illustrating the method and/or direction the active Debtor's attorney is engaging. Each of these examples illustrates that further investigation and/or support is needed to establish value, the likes of which would be dependent on the Chapter or the division the case is being filed in as, practically speaking, either of those factors influence the level of investigation needed to protect the client's rights and interests.

Conclusion

The case law is not hard and fast in this arena, but what has been written on the subject persuades this writer that the bulk of the duty lies within. In addition to those cited

elsewhere in these materials, the following cases, articles, and materials on the subject are interesting and informative:

- *In re Pinks*, 12-00317 (D SC Bankr 1/22/15), LexisNexis #0215-077, http://www.scb.uscourts.gov/sites/default/files/opn1251.pdf
- Ethics in Bankruptcy Practice: Avoiding Conflicts, Problems, and Malpractice. ICLE program, April 2011. Specifically materials of Walter Metzen.
- Herbert G Lindo v. Brian Figeroux et al, 2013cv06918, Doc 11 (SD NY 2015)
- Hon. Cynthia A. Norton, Ethical Implications of Valuing Assets in Bankruptcy, XXXVI ABI Journal 2, 22-23, 68-69, February 2017
- Susan M. Freeman, Are DIP and Committee Counsel Fiduciaries for Their Clients' Constituents or the Bankruptcy Estate? What Is a Fiduciary, Anyway?, ABI Law Review, Vol. 17: 291 (2009).

While these materials are not intended to serve as a directive to Debtor's counsel, they should be regarded as tips for best practices to insure that when you file a bankruptcy case, both you and the Debtor have put forth your best effort in providing accurate information to not only comply with the Code but so you can have confidence that the case will end the way both you and your client intended.

WHAT IS THE "REAL" VALUE OF ASSETS IN CONSUMER CASES? A Practical Approach to Answering the Question of Value

By Ethan D. Dunn and Tierney H. Eaton

The typical Chapter 7 or Chapter 13 consumer bankruptcy case contains a bundle of assets that can be quickly liquidated and the proceeds distributed to creditors. In most cases, the bulk of these assets are exemptible. Less typical are consumer bankruptcy cases (usually chapter 7 or 13 cases) in which the debtor has assets that are more complex such as equity in a business, intellectual property or a particular cause of action based on a debtor's right to sue. Often, these types of complex assets are not easily liquidated and must be looked at more closely in order to derive a good and reliable valuation.

While the Bankruptcy Code contains very little about valuation directly, 11 U.S.C. § 506(a) sheds some light on valuation in the context of determining secured claims. It provides:

> (1) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the

proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.

(2) If the debtor is an individual in a case under chapter 7 or 13, such value with respect to personal property securing an allowed claim shall be determined based on the replacement value of such property as of the date of the filing of the petition without deduction for costs of sale or marketing. With respect to property acquired for personal, family, or household purposes, replacement value shall mean the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time the value is determined.

11 U.S.C. § 527(c) requires consumer bankruptcy practitioners to assist clients in understanding how the 506(a) valuation standard applicable to consumer bankruptcy assets. Specifically, it requires the practitioner to explain the "replacement value" standard. The "replacement value" question is essentially: "How much could a person buy the item for on the date the bankruptcy case is filed?" There cannot be any deduction for costs related to the sale or marketing expense. Although seemingly a simple question, there are several considerations that should be accounted for.

I. There is no "one size fits all" approach to valuation.

The standard of value, although only one element of valuation, is one of the most common elements and is familiar to most practitioners. As a practical matter, consumer bankruptcy practitioners should be wary of simply telling the client to give values for their property based on what the client would pay for it. The standard of valuation is a more technical question that should be explained in more depth and should be tied to a generally acceptable standard – especially if the particular asset type is one that is not usually part of the typical consumer bankruptcy estate. There are several generally accepted alternative standards of value for personal property and, if called on by the trustee to answer how an asset was valued, it can be very important to ensure that a debtor has more than a rudimentary understanding of how the specific item was valued. Some of the most common methods that arise in non-business bankruptcy matters are as follows[1]:

1. *Fair Market Value*: the price agreed upon between a hypothetical (but typical) willing buyer and a hypothetical (but typical) willing seller;
2. *Investment Value*: the price that a particular buyer will pay, given a predetermined set of investment risks and expected return criteria. (e.g. the value of artwork or rare coins to a collector that purchases the items based on their appreciation in value);

[1] See "A Practical Guide to Bankruptcy Valuation, 2nd Ed", ABI (2017)

3. *Collateral Value*: the amount that a lender will loan using the subject asset/equity as collateral. (e.g. the amount a mortgage company will loan against a particular parcel of real estate); and
4. *Use Value:* the price that a buyer will pay to own and operate the subject asset for a specific purpose. (e.g. the tools of a mechanic that works on semi-trucks would have a different value to a small engine repair mechanic and a mechanic that repairs cars – the difference lies in the usefulness for their particular purpose).

These four methods are by no means exclusive. In the event that a debtor is self-employed or holds an interest in a business, there are several other valuation methods that may better answer the question of "WHO will pay WHAT for this asset?".

In any valuation approach there are several questions that debtor's counsel should ask. The level of detail requested should match the type and complexity of the particular asset:

1. What is the debtor's ownership interest? - This question may often be overlooked in the consumer bankruptcy context; especially for lower value items. This is a very important question for real estate matters and higher-value assets. The bankruptcy estate is composed of assets limited to the interest in such asset owned or held by the Debtor…it does not extend beyond what the debtor actually owns.

2. What contractual rights or restrictions exist? – In consumer cases, this commonly arises in the context of a divorce or separation agreement, trust agreement, or small business contractual arrangement (i.e. buy-sell agreement, joint-venture agreements, family ownership restrictions, etc.).
3. What is the level of value? - This question requires examining how marketable the asset is and how quickly it can be converted to cash. As part of the level of value consideration in consumer cases, one must also consider ownership control – i.e. does the owner have the right to control the disposition or use of the particular asset or does someone else have a say?

These questions serve as a good starting point for determining value in the most common consumer bankruptcy matters.

II. Factual and legal contexts are critical to valuation

The valuation of assets will be different depending on the purpose for which the valuation is proffered. A valuation of assets for the purpose of avoiding pre-petition transfers will be different than one given for the purpose of determining reasonably equivalent value in the fraudulent transfer context. In a Chapter 13 case, the value given to a particular asset that would help in successfully confirming a plan of reorganization can also result in a less favorable outcome for the debtor in the context of the court

determining adequate protection and termination of stay matters. This makes it important that the outcome of the case is considered on the front end. Moreover, the consumer practitioner should, at a minimum, value assets in a manner that is both a) consistent and b) gives the debtor the most reasonable expectation of what to expect with respect to the outcome of the case. By using these two points as a guide, the prepared practitioner will help mitigate surprises to the debtor or debtors in any consumer case. The last thing any practitioner wants is to have a trustee try to liquidate an asset of the debtor that was not expected.

> Practice Point: Consistency in valuation is key. Even if you max out the exemption for a particular asset, do not simply value the asset at the exemptible value. If the exemption is intended to protect the entire asset, it is important to disclose in the schedules that the value is the full fair market value of the particular asset - or whichever standard of value is being used. If the property is actually worth more than the amount that can be exempted, it should be disclosed and the debtor should be made aware of it on the front end. Describing the asset standard of value and expressing the intention of the debtor in the schedules gives the trustee notice of the debtor's intent and bolsters the debtor's position in the event of the trustee filing objections to the debtors exemption. If a trustee discovers that the asset is worth more than the exemption, and there is no indication

that the debtor intended to exempt the full value of the asset, the trustee could still liquidate the asset for the benefit of the estate to the extent that the asset exceeds the exemptible value. *See* Schwab v. Reilly, 560 U.S. 770 (2010).

Practice Point: The "replacement value" of the most usual household goods are pretty consistent from household to household with a few exceptions. Be wary of the valuation of personal property of a debtor that either a) has an above-average income, but states that their personal property is less than what you typically see in a household of average or below-average income earners or b) occupies a large home and has very little value attributable to the items of personal property inside the home. Often you will see both a) and b) together in the same bankruptcy case.

Practice Point: In the event that counsel has concerns about valuation, there are several online resources that may be helpful -

a) www.garagesalestracker.com/garage-sales-guide-pricing.asp - This provides some general guidelines for the replacement value of some of the more common used items of personal property.
b) www.valuemystuff.com - For less common physical asset types or for those assets that the practitioner may question the value, this website provide appraisals based on information uploaded to their website, including photos.

c) Debtor's insurance company – In some instances the debtor's insurance company will be able to assist in determining replacement value. For purposes of estimating the "replacement value" in a bankruptcy case you will want to use the insurance company's cash value coverage estimates as opposed to the replacement cost coverage estimate. In insurance, the "replacement cost" is based on the valuation of property based on what it costs at the time of the claim. The "cash value" is based on the valuation of the property at the replacement cost less depreciation. The "cash value" would thus result in a valuation more consistent with the asset in the same condition as that owned by the debtor.

III. Sometimes litigation is inevitable so be prepared.

Fed. R. Bankr. P. 3012 provides that "the court may determine the value of a claim secured by a lien on property in which the estate has an interest on motion of any party in interest and after a hearing on notice to the holder of the secured claim and any other entity as the court may direct."

Under chapter 5 of the Bankruptcy Code, the consumer debtor could end up in litigation with the trustee, creditors or interested parties. Many of the potential chapter 5 claims (and motions for relief under chapter 3) hinge on

elements of valuation. Identifying these potential issues BEFORE you file a case is extraordinarily helpful because you can preemptively discuss the issue with the trustee and/or creditor on the front end and, even more importantly, with the Debtor. Having a debtor who knows what to expect in the case can make your life much easier than if you end up having to explain to the debtor why a trustee or creditor is trying to "take" an asset. A good practice is to memorialize these discussions in writing as a way of protecting yourself in the event you end up with a disgruntled client.

Most consumer bankruptcy practitioners have hired a real estate appraiser to value real property at some point. Also common are auto/jewelry/art appraisers that attorneys hire to appraise assets belonging to the debtor. Less common, though arguably just as important, are the consumer bankruptcy cases in which the debtor holds an interest in more complex assets such as a business or intellectual property. These interests tend to be more fluid with respect to valuation, and often rely on the presumptions that are made.

When encountering these asset types, it may be best to engage a professional to evaluate and prepare a valuation analysis. There are numerous professional organizations that have promulgated standards for valuations applicable to their members. An example of one such standard referenced in bankruptcy valuations is the Uniform Standards of Professional

Appraisal Practice (USPAP). This standard is commonly known by most good valuation analysts.

In the event that you do need to hire a valuation analyst, ensure that the analyst specifically defines the scope of work and the elements applied in completing the valuation. The specificity of the report could mean the difference between having the report admitted or not admitted under Fed. R. Evidence 702 and, in turn, the success or failure of your valuation dispute.

Consumer Debtor Valuations – A Chapter 7 Trustee's Perspective

By Charles J. Taunt and Dean R. Nelson, Jr.

I. Introduction

An honest valuation of assets is one of the most fundamental obligations a debtor has in a bankruptcy case. A debtor's valuation of property is typically one of the first looks a trustee has at a debtor in any case, and first impressions can make or break the tone of any case. Did the debtor disclose a house in Birmingham worth only $35,000? Did the debtor schedule a meager $2,000 of personal belongings to fill a $500,000 house in Detroit's Palmer Woods? While in some cases such valuations may be entirely accurate, such valuations raise red flags and cause a trustee to ask – what else might the debtor have undervalued or failed to disclose? Can I trust this debtor to be honest? Does this debtor deserve the presumption of honest disclosures? Further, if a valuation dispute between the trustee and debtor does exist, what considerations must be given to resolve or litigate it? The following is a list of best practices, considerations, and procedures that may be relevant to the valuation of assets by a debtor, from my point of view as a chapter 7 bankruptcy trustee.

II. Disclose, Disclose, Disclose

The primary purpose of Schedule A/B is for a debtor to disclose and honestly value all of the debtor's property. The purpose of Schedule A/B is *not* to make it appear as if there are no assets for a trustee to administer. Help yourself, your trustee, and your client by disclosing WHY you valued an asset the way you did.

i. *Source of Valuation*. If you or your debtor valued an asset using an independent source, disclose this fact. Whether this source is the County Assessor (2 X SEV), Zillow, Kelly Blue Book, NADA, your local car dealer, an estate sale coordinator (for household goods), or your realtor, let your trustee know how you valued it especially if the value renders the asset anywhere close to being non-exempt. At a minimum, even if this valuation proves incorrect, you have shown the

trustee that you have satisfied your obligations under 11 USC 707(b)(4)(C) and (D) and made some inquiry into the valuation of the asset.

ii. *Factual Variances*. If your valuation varies from standard valuations of similar assets due to the condition of the assets – disclose this fact. If a car bluebooks for $10,000, it is not at all helpful to value it at $5,000 because it has engine trouble without disclosing this trouble on your schedules. Don't give the trustee a reason to think you are purposefully undervaluing assets. Disclose, disclose, disclose. Every cellphone has a camera. Take a picture and email them to the Trustee.

iii. *Legal Positions*. If your valuation assumes a certain legal position, don't presume your trustee knows this fact. You should disclose the legal position on the schedules or risk the trustee thinking you are undervaluing assets. For example, if you take the legal position that a $5,000 bank account titled jointly in the name of the Debtor is not really property of the estate because all the funds legally belong to the other named owner, don't list the value of the account at $0 without explaining WHY you believe the funds in the account are not property of the estate. Present documentation as to the source of the funds. If the dispute leads to litigation you will have to do so anyway.

Similarly, if you believe a debtor's minority interest in a closely held company or LLC should be valued at less than book value in light of certain ownership/control discounts or because an operating agreement provision restricts (or even prohibits) a trustee's ability to sell the interest, let the trustee know that is why you are valuing the interest at less than book value.

iv. *Lawsuits/Injuries Giving Rise to Lawsuits*. These assets are typically the most difficult to value. In fact, from my perspective, they are one of the only asset types where a valuation of "unknown" may be acceptable (so long as it is not coupled with an "unknown" or "100%" exemption). However, if the value of the asset truly is unknown, you

must still disclose the asset with sufficient detail for me to investigate the value. For example, indicate whether or not the debtor has already retained an attorney, indicate the name of the attorney if one has been retained, and indicate the status of the lawsuit if one has been filed. In addition, if an attorney has been retained, counsel should, at a minimum, contact that attorney so that any disclosure on Schedule A/B does not in any way contradict any position being taken in the lawsuit. While such statements likely will not prejudice the trustee from pursuing such claims; if the debtor's exemptions make the claim of inconsequential value to the estate and the trustee abandons it, the debtor could be bound by statements in the bankruptcy schedules. Likewise the schedules could be used to impeach the Debtor at trial or in discovery.

v. *Valuation of Liquid Assets*. The value of physical assets such as a house or car cannot be known precisely until a willing buyer is found, so there is obviously some flexibility in the valuations of such assets. Your trustee realizes this. However, where the valuation of liquid assets is at issue, there is no excuse for not clearly identifying the actual value of the account. A bank value with $5,000 in it on the petition date should NEVER be disclosed with a value of only $25 just because the Debtor says so. Yet, such a situation happens more than you realize. Counsel who fail to verify even these simple valuations repeatedly lose credibility with a trustee. Do not rely on the word of the debtor for such valuations – your trustee will not, and neither should you.

III. Value Disputes - Debtor

Inevitably, a case will arise where a valuation dispute arises between the trustee and the debtor. As the purpose of a chapter 7 is to liquidate non-exempt property of the estate, this necessarily means that the trustee and debtor are disputing either the existence or the extent of non-exempt equity. In these disputes, a number of issues present themselves.

i. *Timing of Valuation.* Appreciation of property of the estate inures to the Bankruptcy Estate, and not the Debtor. *In re Reed*, 940 F.2d 1317 (9th Cir. 1991). As such, while a debtor is initially obligated to value real property at the time the case is filed for purposes of filing Schedule A/B, values at times other than the petition date may be relevant. See, for example, *In re Celentano*, 2012 Bankr. LEXIS 4122 (Bankr. D.N.J. Sept. 6, 2012)(valuation for §554 purposes measured at time of motion; not petition date).

ii. *Process to Resolve the Valuation Dispute.* Once potential non-exempt equity in property of the estate is identified by a trustee, the following procedure likely will take place prior to any attempt by the trustee to sell the asset:

a. The Trustee contacts/hires any relevant professional to investigate the value (realtor, appraiser, auctioneer, etc.).

b. Once this professional gives his/her opinion to the trustee, most trustees will give a debtor an opportunity to settle any non-exempt equity in the asset. A trustee typically will approve a compromise that nets the estate the equivalent amount as a sale, taking into consideration anticipated costs (commissions, closing costs, attorney fees, etc.).

c. In any settlement negotiations, the debtor should obtain an appraisal, BPO, or other evidence to contradict the trustee's information. Even if this is unsuccessful in convincing the trustee to back off his/her asserted value, the information may become necessary for later formal proceedings. Please remember, however, just because you have an appraisal, does not require the Trustee to accept it.

iii. *Litigating Valuation Dispute*. If the debtor and trustee do not settle their valuation dispute, and the debtor opts to litigate (rather than let the Trustee try to sell the asset), the Debtor's primary means of

litigation is to file a motion for abandonment under 11 U.S.C. §554(b), which is discussed in more detail below.

IV. Value Disputes – Secured Creditor

Apart from the debtor, a secured creditor is the second most likely party within a bankruptcy with whom a trustee might have a valuation dispute. Typically, such a dispute arises when the secured creditor seeks to lift the automatic stay in order to enforce state law claims against collateral. Using the same standards identified above for verifying the valuations of assets by debtors, a Trustee may determine that the asset has value to the estate and lifting the stay by a creditor is therefore not appropriate.

Valuations most likely will impact a motion to lift the automatic stay under 11 U.S.C. §362(d)(1) or (d)(2). These allow the bankruptcy stay to be lifted for cause or if there is no equity in property of the estate. Typically, in the chapter 7 context, these motions are determined solely on whether there is equity in the property, a dispute which pits a trustee's valuation against that of a secured creditor. The burden of establishing the lack of equity is on the creditor seeking to lift the automatic stay. 11 U.S.C. §362(g).

If there is a sufficient "equity cushion", courts typically find that a creditor is adequately protected as a matter of law, negating "cause" to lift the stay under §362(d)(1). In re Brown, 78 B.R. 499 (Bankr. S.D. Ohio 1987), citing *In re San Clemente Estates,* 5 B.R. 605 (Bankr. S.D. Cal. 1980); *In re Tucker,* 5 B.R. 180 (Bankr. S.D. N.Y. 1980). Further, if there is sufficient equity, this is sufficient to defeat a motion under §362(d)(2) by its express terms.

V. Abandonment Motion

The most common litigation regarding valuation disputes between a trustee and a debtor arises in the context of abandonment motions. Abandonment litigation also arises in many cases between a trustee and a secured creditor

who might seek abandonment of the property in lieu of (or in addition to) lifting the automatic stay.

i. *Legal Standard*. A motion to compel the trustee to abandon property of the estate is governed by 11 U.S.C. §554(b). This code section requires a finding that 1) the property is burdensome to the estate; or 2) the property is both of inconsequential value and inconsequential benefit to the estate. *In re K.C. Machine & Tool Co.*, 816 F.2d 238, 245 (6th Cir. 1987). The burden of proof rests with the party seeking abandonment. *Alexander v. Jensen-Carter (In re Alexander)*, 289 B.R. 711, 715 (B.A.P. 8th Cir. 2003).

ii. *Practical Consideration*. Prior to filing a motion for abandonment, be prepared to answer the question: *Why am I filing this motion?* Depending on the context of the motion, abandonment motions can easily be perceived as the debtor trying to game the bankruptcy system. The judges of this district are typically quick to pick these motions out and deny them if it is clear the motion was filed in an attempt to limit the trustee's investigation into the value of the asset, rather than to have the Court adjudicate a bona fide dispute in value.

iii. *Adjudication*. While the legal standard for abandonment is relatively straight forward, the manner in which it is applied varies from judge to judge. Specifically, assuming a motion is being filed for legitimate reasons, the first hurdle a debtor needs to overcome is the trustee's inevitable argument that the best way to value an asset is for the trustee to actually try to sell it. In effect, the trustee is arguing the abandonment motion is premature and the trustee needs more time to assess its value (by trying to sell it). So long as the trustee has made a showing supported by some evidence that the value of the asset could be a benefit if sold, some judges will deny the abandonment motion without prejudice (or at least adjourn it) and never reach a conclusion on the actual value of the asset. Some judges, however, believe that if a debtor submits viable evidence that an asset has no value, the trustee has no right to try to sell it prior to the Court holding an evidentiary

hearing on the matter. Some judges make a case specific determination based on the extent of the debtor's evidence, the extent of the trustee's evidence, the amount of benefit/value the asset has to the estate, the length of time the case has been open, the nature of the asset at issue, and any inconvenience to the debtor (usually in the context of listing the debtor's home for sale).

If the judge opts to give the trustee a chance to sell the property (rather than set the matter for evidentiary hearing), the trustee typically has a reasonable amount of time to sell the property for an amount that will benefit the estate. If the Trustee cannot consummate a sale within the given time period, the Court typically will grant the abandonment motion without any further hearing.

If the judge opts to set the matter for an evidentiary hearing, the debtor (or creditor) has the burden of establishing the elements of abandonment by a "preponderance of the evidence." *Lancer Ins. Co. v. Guru Global Logistic, LLC (In re Guru Global Logistic, LLC)*, 557 B.R. 842, 844 (Bankr. W.D. Pa. 2016).

VI. Conversion Motion. As an alternative to an abandonment motion, some debtors (and their counsel) believe that the best way to resolve a valuation dispute with the chapter 7 trustee is to avoid the dispute altogether by converting to chapter 13. However, conversion does not avoid the valuation issue altogether, it merely transfers the dispute to the chapter 13 trustee in the context of the debtor's chapter 7 liquidation analysis. Further, such a motion presumes there is a bona fide dispute as to value, and not merely gamesmanship. If the trustee opposes information and the court perceives the actions of the debtor to be in bad faith, the conversion can be denied. *Marrama v. Citizens Bank of Mass. (In re Marrama)*, 549 U.S. 365 (2007). See also, *Copper v. Copper (In re Copper)*, 426 F.3d 810 (6th Cir. 2005).

In deciding whether to object to a conversion as being in bad faith, chapter 7 trustees typically look to the facts and circumstances that gave

rise to the valuation dispute. Did the debtor disclose a third party basis for the valuation or does it appear the debtor purposefully undervalued the property to try to slip one by the trustee? Did the debtor have open and honest communications with the trustee about the valuation dispute, or did the debtor try to convert the minute the trustee called the debtor out on an improper valuation? Did the debtor fail to disclose other assets? Whether a trustee challenges a proposed conversion may depend heavily on the trustee's perception of the debtor. A debtor that has fully disclosed a reasonable basis for why they valued assets as they did, will certainly be a step ahead of those debtors who present an apparent undervaluation with no explanation.