

EASTERN WASHINGTON BANKRUPTCY NOTES

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Calendar Call— What does ‘Our’ Bankruptcy Court Do?

In 1999 approximately 7,800 bankruptcy proceedings were commenced in the Eastern District of Washington. Indications are that there will be approximately 8,000 commenced in 2000. Although the number of filings nationally dropped about 10% from 1998 to 1999, in this District the number has remained the same. Nationally, the number of filings in 2000 has also dropped, but in this District will increase. One can only speculate why the trend in this District is contrary to the national trend. Certainly one factor is the depressed agricultural economy. Statistically, the number of persons in the Spokane area employed at minimum or low wages has increased in the past few years which may be another factor. Finally, Washington’s relatively new state law mandating impoundment of vehicles when traffic fines remain unpaid may also be a factor.

As is true nationally, the greatest increase in local filings is in the consumer area. Most filings are Chapter 7 liquidations, many of which are “no asset” cases, *i.e.*, debtors who own no nonexempt property which can be liquidated for the benefit of creditors. Despite this, Chapter 7 Trustees in this District distributed \$4,234,440 of property and proceeds in 1999. In Chapter 13 proceedings, debtors pay a certain monthly amount to the Chapter 13 Trustee over a three- to five-year period for distribution to creditors. During the past twelve months the Chapter 13 Trustee has distributed approximately \$12,000,000, which does not include the amount held by the Chapter 13 Trustee for operation of his office. Thus, the cumulative effect of these consumer filings have a significant economic impact in the District.

Appeals from the Bankruptcy Court may either be taken to the federal District Court or to the Ninth Circuit Bankruptcy Appellate Panel (BAP). In 1999, 60% of the appeals in the Ninth Circuit were to the BAP. This District only generates about 2% of the Ninth Circuit BAP appeals, which is disproportionately small. No statistics are available to determine the number of appeals in this District to the local federal District Court, but that number also appears to be small. The average time for final disposition of an appeal to the BAP is 70 days from oral argument. Both of the full-time bankruptcy judges in this District during the past few years have temporarily been assigned to sit on BAP panels.

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Meetings of Creditors to be Held in Pullman

By Jake Miller, U.S. Trustee’s Office

Beginning after the first of the year, the United States Trustee will schedule meetings of creditors in Pullman, Washington. Until now, creditors and debtors from the southeast corner of the District traveled to Spokane for meetings. Attorneys representing debtors from Whitman, Garfield, and Asotin Counties should check their meeting notices carefully to make sure they are heading their clients in the right direction on section 341 meeting day.

In the past, a number of Washington residents filed for relief in Idaho. The Idaho court holds meetings of creditors in nearby Moscow. Recently, the Idaho Bankruptcy Court began strictly enforcing applicable statutory venue provisions which do not permit a debtor to choose a bankruptcy venue based on convenience. The United States Trustee hopes that the new meeting location in Pullman will promote in Washington debtors a more healthy regard for the statutory venue constraints.

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Tax Issues:

Will Your Clients Be Subject to §523(a)(1)(C)?

By Metiner G. Kimel
Velikanje, Moore & Shore, P.S.

Section 523(a)(1)(C) of the Bankruptcy Code provides that a bankruptcy discharge does not discharge a tax “with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat such tax.”

When potentially negotiating a workout agreement with creditors, the structuring of any such agreement should include consideration of whether the proposed terms of the agreement may expose a client to the risk of subsequently having a tax liability determined to be a nondischargeable tax on the basis of the agreement being used to attempt to evade or defeat a tax.

For example, what happens when a debtor agrees to use unencumbered assets to pay and prefer a creditor ahead of the tax debt that is generated by the sale of those unencumbered assets?

The key cases, and the cases which most of the circuit level authority seem to follow, are two cases out of the Eleventh Circuit: *In re Griffith*, 206 F.3d 1389 (11th Cir. 2000) and *In re Haas*, 48 F.3d 1153 (11th Cir. 1995). In *Haas*, the debtor accurately filed his tax returns for the years at issue, but used his income to pay personal and business debts rather than his tax liability. The bankruptcy court found that, since Haas made no affirmative attempt to evade or defeat the collection of the tax liability, only being guilty of using his income to pay debts other than his tax liability, that the tax liabilities did not fall within the 523(a)(1)(C) exception to discharge. The Eleventh Circuit rejected the IRS argument that willfulness should be read simply as a “voluntary, conscious, and intentional failure to pay taxes,” effectively, a civil tort standard of willfulness, and required that a taxpayer do more than just not have paid taxes. The Eleventh Circuit reasoned that:

every debtor, at least in theory, has the present ability to pay his income or employment taxes; if a debtor did not have positive net income, then he would not have been assessed income or employment taxes in the first instance.

The Eleventh Circuit concluded that the IRS reading of willfulness would “swallow the general rule of discharge for tax liabilities.”

The *Haas* decision has been distinguished or criticized by other circuits.¹ Accordingly, the Eleventh Circuit revisited the issue again in the *Griffith* case, the last circuit level decision interpreting the language of §523(a)(1)(C). In *Griffith*, an IRS audit had revealed that the debtors had substantially underpaid their taxes for

certain years. The matter was litigated in the Tax Court with the IRS prevailing. A month after the Tax Court decision, the debtors incorporated a new entity and transferred various assets into the new entity. The district court, on appeal, found that, unlike the debtor in *Haas*, the debtors in *Griffith* had engaged in a fraudulent transfer of assets in order to prevent collection of the IRS debt. 206 F.3d at 1389.

Then, turning to re-examine its statutory interpretation of §523(a)(1)(C), the Eleventh Circuit re-affirmed its analysis in *Haas* that mere non-payment of taxes is insufficient to result in a tax obligation being excepted from discharge. The Eleventh Circuit then went on to conclude that, “where a debtor engage[s] in affirmative acts seeking to evade or defeat collection of taxes,” that such a tax obligation thereby becomes non-dischargeable pursuant to §523(a)(1)(C). Then noting that other circuits have applied a three-prong test examining whether “(1) the debtor had a duty under the law, (2) the debtor knew he had that duty, and (3) the debtor voluntarily and intentionally violated that duty” to determine whether a debtor’s failure to pay a tax liability is willful, the circuit found that the district court’s findings satisfied this three-prong test.

Most of the other circuit level decisions finding that a debtor has willfully evaded a tax obligation similarly involved affirmative acts to shield assets or income after the tax had been assessed, or also involved histories of non-payment of taxes or failure to file income tax returns. *See: Tudisco*, 183 F.3d 133 (debtor failed to file tax returns, filed false W-4s); *In re Zuhone*, 88 F.3d 469 (after audit and assessment, debtor transfers money and farm land to corporations owned by their children but controlled by them, and intentionally lower their salaries from the controlled corps in order to avoid IRS garnishment, and paid off undue loans); *In re Birkenstock*, 87 F.3d 947 (non-payment coupled with pattern of failing to file tax returns, and attempted to conceal income by forming trust to hold income and property); and *In re Bruner* 55 F.3d 195 (prepetition pattern of failing to file tax returns, transfers to a shell entity for purposes of hiding income and assets, engaging in cash transactions). *See, also, In re Schaeffer*, 201 B.R. 282 (transferring interest in marital residence for no consideration to wife, and actions to shield wife from IRS determined to be willful evasion); *In re Halburg*, 177 B.R. 101 (debtors under reporting of income and failure to report other sources of income determined to be willful evasion); *In re Lewis*, 151 B.R. 140 (debtor engaged in a pattern of concealing assets, dealing in cash, shielding income, and

Bankruptcy Seminar & Letter from the Board Retreat a Success

By Ian Ledlin

The Tenth Annual Bankruptcy Seminar & Retreat, sponsored by the Bankruptcy Bar Association for the Eastern District of Washington, was held on June 9 and 10 at Sun Mountain Lodge in Winthrop, Washington.

The Seminar featured Part IV to A Brief History of Bankruptcy, the new UCC Article 9 law, recent bankruptcy legislation developments, an ethics panel, a case law update, a panel discussion about mediation of bankruptcy cases, Washington Appellate Court news, and a Judge/Clerk/Trustee/Attorney meeting.

The Retreat portion of the program included a hospitality suite that began at noon on Thursday and closed at noon on Sunday, a children's program, a bicycle ride from the top of Washington Pass into Winthrop, a cocktail hour, and a banquet followed by an evening of dancing and socializing.

In addition to the educational and recreational events, the following groups found time to hold meetings: the Bankruptcy Court Advisory Committee, the Bankruptcy Bar Association Board of Directors, and the WSBA Creditor-Debtor Section.

Thanks to the following speakers and organizers that helped make this program a success: Barrie Althoff, Tom Bassett, Jean Campbell, Bonnie Charney, Fred Corbit, Jim Craven, Ford Elsaesser, Gary Farrell, Justice Richard P. Guy, Bill Hames, Jim Hurly, Larry King, Hon. John M. Klobucher, Ted McGregor, Jake Miller, Hon. John A. Rossmessl, Frank Smith, Hon. Lonny R. Suko, George Treister, and Hon. Patricia C. Williams.

The Bankruptcy Bar Association currently has \$22,000 in savings. A committee was formed to decide how to spend the money that the Bar Association has accumulated over the years. The Committee chair person is Bill Hames and members are Jim Hurley, Tom Bassett and Ian Ledlin. This letter is a request for any member who has an idea or an opinion as to where or how the Bar Association should spend the excess over \$10,000 currently held in savings to submit ideas to the committee.

After several meetings the committee has decided the following: The Bar Association should maintain at least a \$10,000 balance in savings to fund Sun Mountain and other educational projects. The money is used to pay up front costs which are later reimbursed by registration fees, etc.

The committee has decided on several projects. First, we have provided funding at the rate of \$1,000 per year to three charitable legal aid organizations and will continue to do so on an annual basis. Second, we propose to fund an extern program at Gonzaga University in an amount up to \$2,500 per year.

Third, we will spend up to \$4,500 for speaker costs at the mediation training seminar, which may have occurred prior to this edition of notes being distributed. Fourth, reduce seminar costs, including Sun Mountain and other seminars, for members only. The committee feels that members who have contributed to this accumulation of funds should benefit from them.

If any member has any worthwhile projects or any other ideas on how to spend down the amount in savings please contact Bill Hames at P.O. Box 5498, Kennewick, Washington 99336.

Will Your Clients Be Subject to §523(a)(1)(C)?

otherwise frustrating collection efforts); *In re Smith*, 202 B.R. 277 (overstated W-4 exemptions resulted in willful evasion); *In re Haines*, 173 B.R. 777 (sham corporation created for purpose of disguising income and concealing debtors assets); *But see, In re Rigney*; 216 B.R. 65 (underrporting income not willful evasion where debtor had good faith belief that transactions at issue were "loans" from debtor's business and not income, and debtor properly relied upon accountant after making all records available); *In re Howard*, 167 B.R. 684 (transfer of assets to debtor's wife prior to the capital transactions which give rise to unpaid tax liability, and absent any showing that Debtor was attempting to shield assets or avoid assessment and collection of taxes, did not result in willful evasion), and *In re Koehl*, 166 B.R. 74 (no willful evasion where debtor's forming of trusts and

transfer of assets to trusts were made for valid estate planning reasons and to raise money to pay off creditors, and where there is adequate consideration for the transfers of the property to the trust).

Particular issues which may require further examination include: where a proposed bulk sale of assets includes an allocation of the sales price between both encumbered and unencumbered assets, the expected tax liabilities to be generated by any sale of assets, and the availability of net operating losses or other tax attributes which may help minimize any tax incurred.

¹ See, *In re Tudisco*, 183 F.3d 133 (2nd Cir. 1999); *In re Zuhone*, 88 F.3d 469 (7th Cir. 1996); *In re Birkenstock*, 87 F.3d 947 (7th Cir. 1996); *In re Bruner* 55 F.3d 195 (5th Cir. 1995); and *In re Sumpter*, 64 F.3d 663 (6th Cir. 1995)(unpublished)

From the Clerk

Filing Statistics

The Eastern District of Washington continues to be one of the few bankruptcy courts reporting an increase in filings. National case filing statistics for 1999 report an overall reduction in filings from 1998 of 6%, with a 7% reduction for Chapter 7 cases, and a 4% reduction for Chapter 13 cases. National Chapter 11 filings actually increased by 2%. Chapter 12 has been unavailable as an operative chapter since June 30, 2000.

For the same period for the Eastern District, there was a reduction of only eight cases. However, for the period from October 1, 1998 to September 30, 1999, 7,740 bankruptcy petitions were filed, and for the same 12-month period ending September 30, 2000, 8,214 petitions were filed, an overall increase of 6%. For calendar year 1999, 7,787 petitions were filed, and projections for calendar year 2000 predict that close to 8,400 petitions will be filed in the Eastern District. The percentage of Chapter 13 cases to all cases filed has also increased in the past two years. For 1998, as well as the preceding several years, the number of Chapter 13 cases as a percentage of total cases filed was approximately 17%. In 1999, the figure had increased to 21%, and for the year 2000 thus far the figure is 24%. Chapter 7s account for the bulk of the remaining cases filed since Chapter 11s and 12s account for less than 1% of the total cases filed in the Eastern District. Over the past ten years, an average of 220 Adversary Proceedings have been filed per year, and projections for this year would indicate that about 288 such cases will be filed, which would be an increase over the 10 year average.

Court's Website

The court's website at www.waeb.uscourts.gov is recording record levels of use. Since its introduction in August of 1998, about 250,000 visits have been made, an average of about 300 visits a day. It is estimated that each visitor accesses approximately 16 items of information during each visit, commonly referred to as a "hit." This results in about 5,000 "hits" each and every day.

The 1.5 million pages of images which are essentially accessible on an immediate basis, and which also represent all documents filed from January 1, 1997, are only a part of the information available at the website. The site also contains information concerning the court's Standing Advisory Committee; Archives; The Bankruptcy Bar Association; back issues of NOTES; Case Filing Statistics; Forms, both national and local; General Orders and Local Rules, including the Notice and Hearing Tables; Mediation Program; Meetings of

Creditors; Judicial Hearing Calendars; Selected Judicial Opinions, both published and unpublished; Master Mailing Lists; and Post Judgement interest rates. In addition, the site also has links to other court sites and national information.

The court also is beginning to introduce electronic filing. Presently, most notices sent by the court are transmitted to the Bankruptcy Noticing Center electronically, and discharges and closings are accomplished virtually automatically. A pilot program is underway for electronic filing between the Chapter 13 office and the court, and other applications are expected to follow.

Processing End of Day Work

The regular business hours of the Office of the Clerk, as set out in LBR 5001-2, are from 9:00 a.m. until 4:30 p.m. all days except Saturdays, Sundays and legal holidays. As in all offices, a certain amount of time is required to finish up a day's business, such as accounting for the money taken in and properly shutting down the computers. Some businesses, as well as some Clerk's Offices, reduce their regular business hours so as to include a closing period at the end of the day to accomplish these tasks. Our office has not initiated such a practice. However, due to the time required for closing up, work received at the very end of the day, although received and filed on that day, is not able to be processed until the following day.

As noted above, all documents presented to the Clerk's Office during the regular hours of operation are received stamped and "filed" on the day presented, even though they may not be processed until the following work day. Processing of such documents includes such actions as the assignment of a case number, entry into the court's data base, and entry on the clerk's docket.

A person filing a document, especially a new petition for relief or an Adversary Proceeding, who wishes to have it processed on the day it is filed, should insure that it is delivered to the Clerk's Office by 4:00 p.m. of that day. In the case of an emergency please refer to LBR 5001-2(b) which requires that, in order to conduct business outside of regular business hours, arrangements must be made in advance.

Adequate Protection Deal or Plan Modification?

A secured creditor who seeks a modification of the automatic stay is required to give notice to the Master Mailing List (MML), in accordance with LBR 2002-1. Frequently, the only objecting party is the debtor, and sometimes the dispute between the debtor and the creditor is resolved by an agreement between those parties.

From the Clerk cont'd

There are times when that agreement may adversely affect other parties in the case and in reality may be a modification of a proposed or confirmed Chapter 13 plan. If such an agreement is included as a part of an ex parte order modifying the automatic stay, the order may be returned unsigned by the court with a note that it amounts to a modification of the plan and requires separate notice pursuant to LBR 2083-1(k).

When parties are negotiating a settlement of a modification of stay issue, they should be careful to ensure that if a plan modification is required, the debtor has agreed to take any necessary action to, in fact, modify the plan. Title 11 U.S.C. § 1323 gives only the debtor the right to modify the plan before confirmation, and 11 U.S.C. § 1329 allows post-confirmation modification to be requested only by the debtor, trustee or the holder of an allowed unsecured claim.

LBR 2083-1(k)(4) permits a modification by stipulation between the debtor and the trustee if no parties are adversely affected, but does not allow such a modification by stipulation between the debtor and a creditor.

Please also remember that LBR 4001-1(e) requires that a motion for relief from the automatic stay or adequate protection shall not be combined with any other motion except a motion for abandonment.

Adversary Proceedings and Contested Matters

Two of the principal forms of action in bankruptcy are Adversary Proceedings and Contested Matters. Adversary Proceedings are relatively easy to identify since they are set out clearly in Federal Rules of Bankruptcy Procedure ("FRBP") 7001. Adversary Proceedings may resemble civil actions, but there are also many important differences. Adversary Proceedings are governed generally by the 7000 series of the FRBP and not the Federal Rules of Civil Procedure (although many, but not all, of the Civil Rules are made applicable to Adversary Proceedings through the FRBP).

Process for Contested Matters is addressed in FRBP 9014, but there is no list categorizing Contested Matters (as is provided under FRBP 7001 for Adversary Proceedings). Most often, the specific rule governing a particular matter will indicate that FRCP 9014 also applies; such as FRBP 6004, which states that an objection to a proposed sale of property "is governed by Rule 9014," and FRBP 4003 providing that avoidance by the debtor of a lien pursuant to 11 USC 522(f), "shall be by motion in accordance with FRBP 9014."

One thing that is clear, however, is that the

parties to a Contested Matter are entitled to service of the notice pursuant to FRBP 7004, which is the same as service of a Summons and Complaint in an Adversary Proceeding. Notice under FRBP 2002 is not sufficient. The court has published Notice and Hearing Tables, available on the court's website at www.waeb.uscourts.gov which provides detailed information concerning whether service under 9014 or notice under 2002 is required in more common matters.

Reaffirmation and Extension of Time to Determine Dischargeability of Debt

Reaffirmation agreements, as described in 11 U.S.C. § 524(c), are agreements between the debtor and a creditor where the consideration, in whole or in part, is based on a debt that is otherwise dischargeable. That Code section sets forth very specific requirements for such agreements to be enforceable, the first of which is that the agreement be made before the granting of the discharge.

FRBP 4004(c) states that in a Chapter 7 case, the court shall forthwith grant the discharge except in certain very specific circumstances. That a motion has been filed or granted to extend the time for the filing of a complaint to determine the dischargeability of debt pursuant to FRBP 4007 is not one of those circumstances, and does not delay the granting of the discharge.

If the debtor and creditor are negotiating a reaffirmation agreement and wish to have entry of the discharge itself delayed so any agreement they may enter into is enforceable, then the debtor may wish to take advantage of FRBP 4004(2) and ask that the court defer the entry of an order granting the discharge. Such a motion may be made on an ex parte basis, and notice is not required.

Objections to Proofs of Claim

LBR 3007-1 is the principal local rule governing the procedure for objections to proofs of claim, and a party filing an objection to a proof of claim should review the rule in its entirety. The rule sets out the following specific information that is to be contained in the objection:

The claimants opportunity to respond;

That if no response is filed, the court may rule on the pleadings;

The time for making a response; and

A sworn statement sufficient to overcome the prima facie effect of the proof of claim.

Follow through by objecting parties continues to be conspicuous by its absence. Once the objection is filed
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From the Clerk cont'd

and served and no response is timely filed, the objecting party has thirty days to present an ex parte order for consideration by the court for resolution of the issue. If no such ex parte order is presented, then any party, including the trustee, on five days notice to the objecting party, may present an ex parte order striking the objection.

The expectation is that the objecting party, where there is no response, will within 30 days of the expiration of the response period, submit an ex parte order on the matter for consideration by the court. Where a response is filed, the court will set a hearing and provide notice to the parties.

It should also be noted that service of an objection to a proof of claim must be in accordance with FRBP 9014, which means that service must be the same as is required for serving an Adversary Proceeding pursuant to FRBP 7004. Particular attention should be paid where the claimant is a corporation (FRBP 7004(b)(3)); the United States or an agency thereof (FRBP 7004(b)(4) or (5)); a state or municipal corporation or other governmental organization (FRBP 7004(b)(6)); or an FDIC insured depository (FRBP 7004(h)). For these kinds of claimants, service only to the name and address given on the proof of claim will generally be insufficient.

Priorities and Proofs of Claim

Title 11 USC 507 establishes the priority of various expenses and claims. The Official Proof of Claim form asks the claimant, in addition to other information, to state:

A. the amount of the claim at the time the case was filed;

B. whether the claim is secured, and if so, the value of the collateral; and

C. whether the claim is entitled to priority, and if so the amount entitled to priority and the specific priority, as set out in 11 USC 507, to which it is entitled.

A review of proofs of claim discloses that often a claimant whose claim is not entitled to priority, will nonetheless check the box indicating that it is a priority claim, but will not specify the priority. Priority, as used in 11 U.S.C. § 507 is a word of art unique to the Bankruptcy Code, and the claimant who applies a non-bankruptcy meaning will, most times, be in error.

A claimant whose claim is entitled to neither secured nor priority status should only indicate the total amount of claim at the time the case was filed.

Tardily Filed Proofs of Claim

FRBP 3002 generally establishes the time for filing proofs of claim in Chapter 7, 12 and 13 cases as 90 days

following the first date for the meeting of creditors, and 180 days for governmental units. 11 USC 726 describes how property of the estate is distributed in Chapter 7 cases, and sub-section (a)(3) generally provides that tardily filed unsecured proofs of claim are paid after timely filed proofs of claim. The Chapter 13 form plan contains similar language concerning tardily filed unsecured proofs of claim. Tardily filed proofs of claim, although allowed, are frequently not paid since timely filed unsecured claims are not paid in full.

Common Notice and Hearing Errors

Title 11 U.S.C. § 102 generally establishes the concept of “notice and hearing”. FRBP 2002 and LBR 2002-1 are the rules that provide information as to when and how “notice and hearing” is to be used. In reviewing proposed ex parte orders where no objection is pending (LBR 2002-1(e)) based on “notice and hearing,” practitioners should take care to avoid the following common errors that can either cause delay in a proposed order being signed, or require a return of the proposed order unsigned:

1. Failure to comply with LBR 2002(b)(3) which requires that “As soon as practicable, a party giving notice pursuant to this rule shall file *as a separate document*, an affidavit of mailing or unsworn declaration under penalty of perjury *to which shall be attached a list containing the names and addresses to who the notice was sent along with a copy of the notice*. (Emphasis supplied);

2. Failure to use an MML current to within 20 days of mailing (LBR 2002-1(d)(1));

3. Failure to provide a sufficient objection period. Twenty days is the standard, unless otherwise indicated, plus three additional days if the notice is mailed (LBR 2002-1(c)(1)). If the mailing date is used as the date from which the objection period is measured, then a failure to actually mail the notice timely can result in the time being too short;

4. Failure to provide a certificate of no pending objections. Even where an objecting party has either withdrawn their objection or signed off on the order, a certificate of no pending objections is still required. (LBR 2001-1(e)); and

5. Failure to provide sufficient information in the notice or motion. General requirements are found in LBR 2001-1(a), and more specific requirements are provided for Objections to Claims (LBR 3007-1), Valuation of Security (LBR 3012-1), Automatic Stay (LBR 4001-1), Lien Avoidance (LBR 4003-1), Reopening Cases (LBR 5010-1), Sale of Estate Property (LBR 6004-1), Executory Contracts (LBR 6066-1),

From the Clerk cont'd

Abandonment (LBR 6007-1), and Redemption (LBR 6008-1). A review of these rules when preparing a notice is helpful.

Miscellaneous Fees

Title 11 U.S.C. § 1930 is entitled "Bankruptcy Fees" and is the statute which establishes the fees that are to be paid to the Bankruptcy Clerk for commencing various actions in a bankruptcy case. Pursuant to subparagraph (b) the Judicial Conference of the United States is allowed to prescribe what are generally known as Miscellaneous Fees. Miscellaneous Fees, like filing fees, are required to be tendered to the Clerk at the time a request for service is made or a motion filed. If the fee is not so tendered, then a statement is sent to the requesting party asking that the fee be remitted. Obviously, for both the court and the requesting party, the most efficient method for paying fees is to simply remit the fee when the service is requested; any other method requires having to deal with the issue more than once by all parties.

A list of the more common Miscellaneous Fees are as follows:

- (1) Amendments to debtor's schedules of creditors or lists of creditors - \$20 for each amendment;
- (2) Adversary Proceedings - \$150, except, no fee is required if the debtor is the Plaintiff;
- (3) A motion to convert a case to Chapter 7 requires \$15 from the moving party;
- (4) A motion to reopen a case - \$155 for Chapter 7 & 13, \$300 for Chapter 9, \$800 for Chapter 11, and \$200 for Chapter 12;
- (5) A request by the debtor for a division of a joint case filed under 11 USC 302 into two separate cases - one half of the filing fee for the chapter under which the joint case was commenced;
- (6) A motion to modify the automatic stay and/or abandonment or a motion to withdraw the reference - \$75.

It should be remembered, that the above are only the most common out of the 22 separate Miscellaneous Fees prescribed by the Judicial Conference of the United States.

Upcoming Changes to Certain Federal Bankruptcy Rules

Changes to five Federal Bankruptcy Rules are scheduled to take effect on December 1, 2000. The following is a brief synopsis of each of the changes:

1. An amendment to FRBP 1017(e) will permit the court to grant a timely request for an extension of time to file a motion to dismiss a chapter 7 case under 11 USC

707(b), whether the court rules on the request before or after the expiration of the 60-day time limit for filing the extension request.

2. An amendment to FRBP 2002(a) will relieve debtors and bankruptcy estates of the expense of sending to all creditors, notice of a hearing on a request for compensation or reimbursement of expenses if the request does not exceed \$1,000. The current rule puts the limit at \$500. The amendment also eliminates certain ambiguities in the current rule. *It should be noted, however, that LBR 2016-1 requires notice to the MML for all applications except for the Chapter 13 exceptions.*

3. An amendment to FRBP 4003(b) now permits the court to grant a timely request for an extension of time to object to a list of claimed exemptions, whether the court rules before or after the expiration of the 30-day time limit for filing an objection. The amendment also extends the rule to apply to an objection filed by any party in interest, instead of limiting it to objections filed by a trustee or creditor.

4. An amendment to FRBP 4004(c) will delay the granting of a discharge in a chapter 7 case while a motion for an extension of time to file a motion to dismiss the case under 11 USC 707(b) is pending.

5. Finally, an amendment to FRBP 5003 will permit the United States and the state in which the court is located, to file statements designating safe harbor mailing addresses for notice purposes. The amendment requires the Clerk to maintain a register of these addresses. Failure to use a mailing address in the register does not invalidate any notice that is otherwise effective under applicable law.

Electronic Bankruptcy Noticing

FRBP 9036 allows an entity to request to receive notices in a specific type of electronic transmission rather than by mail. If an entity so elects in writing, then notice is complete when the sender obtains electronic confirmation that the transmission has been received.

Through contractual relations with the Bankruptcy Noticing Center the bankruptcy court can now provide electronic noticing for notices sent by the court. The principal notices that are presently available to be received electronically are: notices concerning the Meeting of Creditors, Dismissal, Conversion, Discharge, Confirmation of Chapter 11 and 12 Plan, Valuation and Confirmation Hearing in Chapter 12, and Change of Venue. The available methods of transmission are Internet e-mail and Fax.

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From the Clerk cont'd

Notice by electronic transmission is generally faster than the U.S. mail, and can also offer economies in dealing with the information. More information is available on the court's website at www.waeb.uscourts.gov, or by contacting the Clerk of Court at 509-353-2404, extension 228.

Local Form 2016D Modified

At the October 27, 2000 meeting of the court's Standing Advisory Committee, a change to Local Form 2016D was approved. The modifications to the form, which is entitled "Order Awarding Compensation for Services Rendered and Reimbursement of Expenses Pursuant to 11 USC 330 or 331," are designed to make the form clearer by separating the award portion from the summary of disbursement and past activity information.

A copy of the revised form is reprinted in this issue and is also available over the court's website at www.waeb.uscourts.gov.

Proposed Changes to Local Rules

The judges of the Bankruptcy Court have approved changes to two local rules (LBR 1015-1 and 5005-1) and adoption of a new rule (LBR 1017-1). Those changes and additions are reprinted below for the purpose of allowing public comment before they are adopted and become effective. The proposed changes are also available for review over the court's web site at www.waeb.uscourts.gov. The comment period ends on January 31, 2001. Comments should be in writing and sent to: Clerk, U.S. Bankruptcy Court, Eastern District of Washington, P.O. Box 2164, Spokane WA 99210.

RULE 1015-1 - JOINT ADMINISTRATION/ CONSOLIDATION (Amended)

(g) The estates of debtor spouses filing a joint petition shall be jointly administered unless at or before the meeting of Creditors the trustee or other party in interest objects.

(b) A debtor in a joint case desiring that the case be divided shall file a motion, with ten (10) days notice and hearing to a non-joining debtor, attorney for the debtor and the trustee. The motion shall be accompanied by the requisite fee and an affidavit or unsworn statement under penalty of perjury supporting the motion and describing the effect on the administration of either of the cases or estates that the granting of the motion would likely have.

RULE 1017-1 - CONVERSION OR DISMISSAL OF JOINT CASES (New)

(a) A joint case may not be individually converted by one debtor to another chapter unless the case is first divided into two separate cases.

(b) One debtor in a joint case may move for a separate dismissal without need to first have the case divided into two separate cases.

(c) A notice by a debtor to convert a case may be joined with a motion to divide the case.

Clerk's Note: The modification to LBR 1015-1 and adoption of LBR 1017-1 as a new local rule are closely related. When a joint petition is filed, two estates are created, but only one case. Joint administration of the two estates is not automatic, but is ordered by application of LBR 1015-1. The experience is that objections to joint administration are exceptionally rare to the point of being virtually non-existent. However, there are instances where one of the joint debtors wishes to convert the case to another chapter, but only as to him or herself, and most usually from chapter 13 to chapter 7. 11 USC 1307(a) provides that a chapter 13 debtor may convert the case to a case under chapter 7 at any time, and that this right cannot be waived. FRBP 1017(f)(3) provides that the notice of conversion of a chapter 13 case to a case under chapter 7, actually converts the case with no court order required.

The modification to LBR 1015-1 adds sub-paragraph (b) which provides a procedure for dividing of a joint case into two cases. Proposed LBR 1017-1 mandates that in order for a joint debtor to be able to exercise the right to convert a case, the joint case must first be divided into two separate cases. Sub-paragraph (b) of LBR 1017-1 makes clear that dividing the joint case is not required where one of the joint debtors seeks only to have his or her own case dismissed.

RULE 5005-1 - Filing Papers & Requirements (Amended)

(e) Electronic Filing

Documents may be filed, signed or verified by electronic means that are consistent with standards established by order of the court.

Clerk's Note: FRBP 5005 (a)(2) provides that "A court may by local rule permit documents to be filed, signed or verified by electronic means that are consistent with technical standards, if any, that the Judicial Conference of the United States establishes.

The conference to date has not established any such standards, and the "if any" language in this rule was to permit courts to allow electronic filing using standards they might approve.

The court is presently entering the electronic filing arena, certain documents are presently being handled electronically, a project is underway to allow the Chapter 13 trustee to file various documents electronically, and there are plans to include other users as soon as possible. It is the policy of the judiciary to promote and encourage all courts to use electronic means of handling information and data as much as possible. The Administrative Office is presently piloting an electronic filing program called CM/ECF, in one of the pilot courts which is the Bankruptcy Court in the Western District. The purpose of the change to LBR 5005-1 is to permit the court to move electronic initiatives forward, even though the exact technical requirements are not known.

From the Clerk cont'd

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

Local Form 2016D (11/00)

Case Name: _____ Case Number: _____

**ORDER AWARDING COMPENSATION FOR SERVICES RENDERED AND
REIMBURSEMENT OF EXPENSES PURSUANT TO 11 U.S.C. § 330 OR §331**

THIS MATTER HAVING come before the Court on the #___ (interim final) application of _____ dated _____ for an order allowing compensation for services rendered and reimbursement of expenses in the above entitled case; and the court being fully advised in the premises;

NOW THEREFORE the below listed amounts are hereby allowed and awarded as compensation and reimbursement pursuant to 11 USC §330 or §331 to the above-named applicant and are authorized to be disbursed or transferred from funds of the above entitled estate, subject to the availability of funds and the provision of any confirmed plan:

AWARD ON THIS APPLICATION

Compensation ¹ in the amount of <i>(from III of LF 2016)</i>	\$
Reimbursement ² in the amount of <i>(from IV of LF 2016)</i>	\$
TOTAL <i>(from V on LF 2016)</i>	\$

DATED: _____

U.S. Bankruptcy Court Judge

Presented By: _____
Applicant

Reviewing Trustee Raises No Objection to This Order
(U.S. Trustee if Chapter 7 or 11,
Standing Trustee if Chapter 12 or 13)

SUMMARY OF ALL AWARDS AND DISBURSEMENTS

Awards

Total Prior Awards <i>(from "Awarded" Column of Row C on LF2016B)</i>	\$
Amount Awarded by this Order	\$
Total of all Awards	\$

Disbursements

Total Payments other than by Application or Plan <i>(from (b) on LF 2016A)</i>	\$
Total Prior Receipts from Trustee/Estate <i>(through ___/___/___)</i>	\$
Amount to be Transferred from Attorney/Client Trust Account	\$
Balance to be paid by Trustee/Estate	\$
Total of all Disbursements <i>(Must equal Total of All Awards)</i>	\$

¹If this is the Order on first Application, includes compensation earned pre-petition. If this is a Chapter 13 case, and if this is the Order on first Application, also includes any compensation awarded on confirmation of the plan.

²If this is the Order on first Application, includes filing fee and costs incurred pre-petition.

ORDER ALLOWING COMPENSATION AND
REIMBURSEMENT OF EXPENSES

How a Confirmed Plan Affects Claims

By Ian Ledlin

How a creditor's claim is paid is governed by the terms of the confirmed plan. So held the Court in the case of *In re Barton*, 249 B.R. 561 (Bkrtcy E.D.Wa. 2000).

In *Barton*, the debtor filed a plan that proposed to pay Ford Motor Credit as a secured creditor. Ford was owed \$16,000; the debtor valued Ford's collateral at \$15,000 in the plan. The plan provided for the following treatment of Ford's claim:

To creditors whose secured claims will be paid within the term of the plan, each creditor shall retain its security interest/lien and be paid the amount of its secured claim plus interest from the date of petition filing as calculated by the trustee at the interest rate and monthly payment set forth below. *The amount of a creditor's secured claim shall be the amount stated as secured on a proof of claim filed by or on behalf of the creditor unless the court determines a different amount following the filing of a separate motion to value the claim or the filing of an objection to the claim.* To the extent that the amount of a creditor's secured claim is determined to be less than the amount of its total claim, any portion of the claim in excess of the amount of its secured claim will be treated as an unsecured claim and paid as provided in section III.A.6. below, if entitled to priority under 11 U.S.C. § 507, or if not, as provided in section III.A.8. below. An order valuing the secured portion of a claim, at less than the total amount of the claim, voids the creditor's lien to the extent of the unsecured portion of the claim. In the event the case is dismissed prior to discharge, the lien so voided will be reinstated unless otherwise ordered by the court. (Emphasis added.)¹

Ford filed a proof of claim in the amount of \$23,000, and valued the collateral at that amount.² Ford did not object to the confirmation of the plan. The plan was confirmed after Ford's claim was filed. Ford did not appeal from the order confirming the plan. After the plan was confirmed, the debtor objected to Ford's claim, asserting that the value of the collateral was only \$8,500.

Ford contended that *res judicata* barred the debtor from valuing the collateral in any amount less than the \$15,000 value attributed to it in the plan. The debtor contended that, because the plan language states that the value of Ford's collateral would be set by claims allowance process, *res judicata* does not preclude the debtor from asking the Court to fix the value of Ford's collateral in that forum.

The Court cited the recent 9th Circuit decision, *In re Pardee*, 193 F.3d 1083 (1999) for the rule that a confirmed plan is *res judicata* as to all issues that could have been raised or litigated at the confirmation hearing. In *Pardee*, the debtor had filed a plan that proposed to pay a student loan debt without interest. Although the Code provides that a student loan debt is nondischargeable, it is silent about whether the interest is dischargeable. The 9th Circuit BAP, in reliance upon the U.S. Supreme Court's holding in *Brunning v. United States*, 376 U.S. 358 (1964), has held that interest on a student loan survives a bankruptcy discharge. The issue in *Pardee* was whether the interest on the student loan debt was included in the discharge after the debtor completed the plan. The *Pardee* Court held that the provision of a confirmed plan is final, even if it contains a provision that is inconsistent with the Code. The interest was discharged because the student loan creditor did not appeal from the order confirming the plan.

The *Barton* Court cautioned that the principles of *res judicata* must be applied consistent with specific provisions of the Bankruptcy Code and Rules. The Judge observed that the plan confirmation process does not meet procedural and substantive requirements of claims allowance process as provided by § 502(b) & 506(a), and of BR 3007 & 9014.

The Judge distinguished the language in the *Pardee* plan from the language in the *Barton* plan. The *Pardee* plan provided that the debtor would pay a fixed amount on the student loan claim, and the balance, including interest, would be discharged. Because the confirmed *Barton* plan reserved fixing the value of Ford's collateral to the claims allowance process, *res judicata* did not bar the debtor from reducing the value she had placed on the collateral in her plan.

Barton and *Pardee* demonstrate that debtors must exercise care in propounding plan provisions. Likewise, creditors must carefully scrutinize plan provisions to assure their rights will not be impaired when a plan is confirmed.³

¹ This language is part of the mandatory Chapter 13 Plan used in cases filed in the Eastern District of Washington.

² Ford's claim included pre-computed interest.

³ For enlightening articles about the preclusive effect of confirmation orders, see the following published in the ABI Journal: Becket, *Chapter 13 Plan Confirmation: It's Final! — Maybe...* (August 1, 2000) and Cerone, *Res Judicata Revisited by the Fifth Circuit* (June 1, 2000).

Case Notes

Steven Talbot v. Ronald Larry Umland, No. A00-00062-K53

Issue: Preliminary Injunction

The issue was the nature of the parties' respective interest in an airplane. Each party asked that the other be enjoined from operating the airplane during the adversary proceeding.

At the time of purchase, the debtor obtained a loan from Mid Island Air to finance the purchase. Post-petition, the security interest of Mid Island was assigned to Walker Crushing. Mr. Talbot, previously engaged in the private practice of law, represented the debtor defendant in various matters, but since May 1999 had not engaged in the private practice of law except for concluding some then pending matters. Since May 1999, Mr. Talbot has been house counsel and chief financial officer and project manager for Walker Crushing. He referred to Walker Crushing as "my company" and was a shareholder in the company, but stated that he was an independent contractor for the company and not an employee. He claimed an ownership interest in the airplane personally.

At issue was whether the plaintiff and the defendant debtor owned the airplane as co-tenants. Each paid half the down payment on the purchase price and both were involved in the logistics of the purchase. Plaintiff argued that as the defendant debtor had not paid any of his share of the maintenance and other expenses of the airplane, after crediting the plaintiff for paying the defendant's share of those expenses, the defendant debtor's interest in the airplane had de minimus value. Also, plaintiff argued that there was no harm to the defendant debtor if the airplane continued to be used by the plaintiff, but that there was irreparable harm to the plaintiff if he could not continue the use.

The debtor had not used the airplane for several months. His position was that he was merely allowing the plaintiff to use the airplane to satisfy outstanding obligations for attorney fees which the debtor owed for Mr. Talbot's legal services. All maintenance costs were to be borne by Mr. Talbot. The debtor did not testify as to when the arrangement was made, the amount of fees owed, or whether it was for then past due or future fees. Nor were any limits on or terms of the use discussed. The debtor's acquiescence in Mr. Talbot's continued use of the airplane for 4 months post-petition cast doubt on the debtor's claim that the use was to offset the unsecured then past due claim for attorney fees.

The court noted *sua sponte* that the debtor's wife filed

a separate Chapter 13 in 1998 after the purchase of the airplane. Mr. Talbot was listed as an unsecured creditor, but the airplane was not listed as an asset nor Mid Island Air as a creditor. The affidavit filed by the wife in the current proceeding indicated that both she and the debtor partially relied upon Mr. Talbot for bankruptcy advice in 1998, although neither were represented by Mr. Talbot in that bankruptcy proceeding.

The debtor testified that at some point he told Mr. Talbot that if he, Mr. Talbot, wished to continue to operate the airplane, he would have to bear all costs and maintenance. The court held it was likely that the debtor would prevail in convincing the court that the agreement between the parties, at some undetermined point, was that Mr. Talbot was to be responsible for maintenance costs. The debtor argued that irreparable injury would result from Mr. Talbot's continued use of the airplane due to the fact it could not be sold promptly to pay creditors.

The court held that the plaintiff had failed to demonstrate irreparable injury if he were enjoined from using the airplane. The court reasoned that, while it is certainly a reasonable inference from the evidence that an injury may be suffered by Walker Crushing, it was not a party to the Adversary Proceeding. There was no evidence that Mr. Talbot's employment or relationship with Walker Crushing was in any way dependent on access to this or any airplane. He used it to visit sites or projects of Walker Crushing. It was not clear if Walker Crushing or Mr. Talbot paid the expenses of the airplane. The ownership interest was that of Mr. Talbot personally, but there was no evidence that he personally would suffer any injury.

The debtor voluntarily agreed that he would not operate the airplane. The court then entered an injunction prohibiting either party from operating the airplane. The adversary was ultimately transferred to Judge Klobucher for final resolution.

Subsequent to the case being transferred to Judge Klobucher, a trial was held on the merits. To be decided was what ownership interest either of the parties had in the airplane. The court heard testimony of the parties as well as several other witnesses and concluded that the airplane had been in fact purchased as and remained the co-owned property of the plaintiff and the debtor. At the delivery of the court's opinion, the court held that the ownership interests of the two parties were in fact equal, with each party having a 50 percent ownership interest in the airplane. The Court granted an oral motion by Mr. Talbot to allow him to purchase the airplane under 11 U.S.C. § 363(i) for the amount of the debtor's equity in the airplane, noting that a motion by the debtor to sell the airplane was pending.

Continued on Next Page

Case Notes cont'd

Valarie Hartfield, No. 99-07415-W13

Issue: Chapter 13 - Informal Proof of Claim

The claims bar date was April 12, 2000. On February 22, 2000, the ex-husband pro se filed an objection to plan confirmation and in it alleged he was owed \$18,140 from a judgment entered in marital dissolution proceedings, attached a copy of the judgment and requested it be paid. On February 24, 2000, an attorney who had not appeared for the ex-husband, prepared and signed a Proof of Claim, but did not file it. After the attorney appeared at the hearing on the objection to confirmation on August 16, 2000, it was brought to his attention that he had not filed a Proof of Claim. He then caused the Proof of Claim to be filed August 18, 2000.

The question was whether the objection to confirmation was an informal Proof of Claim. *Dicker v. Dye (In re Edelman)*, 237 B.R. 146 (9th Cir. BAP 1999) (Chapter 7 case) and *Gardenhire v. IRS (In re Gardenhire)*, 209 F.3d 1145 (9th Cir. Cal. 2000) (Chapter 13 case) hold that informal Proofs of Claim are recognized and will be allowed if adequate to tell the court the amount and nature of the claim and that the creditor wants to pursue it. The pro se objection to confirmation met those requirements and was an informal Proof of Claim. The formal Proof of Claim filed by the attorney on August 18, 2000 was merely an amendment to the Proof of Claim. The merits of the objection to the Proof of Claim have not been determined.

Francis James and Mary Elizabeth Heidt, No. 99-07169-W1G

Issue: Chapter 12 Eligibility

The applicable federal tax return for the debtors showed total income of \$57,130.00 of which \$25,427.00 or 44.5% was reported as non-farm income and \$31,703.00 or 55.5% was reported as farm income. The court held that the return was not dispositive of the issue of eligibility as both creditor and debtor agreed that the return was not accurate.

First, there was \$7,200.00 of income from a rental property which was not reported on the tax return. This was non-farm income. The debtors total income then became \$64,330.00, of which \$37,627.00 or 50.7% was not farm income. The debtor testified that some portion of the non-farm income had been reported incorrectly and represented income from sales of cattle. The debtor testified he did not know how much of any reported or unreported income during the applicable tax year arose from the sale of cattle. He produced no records of sales. From his testimony, it was apparent that the debtor simply could not determine the source of the \$31,703.00 reported as non-farm income. As the debtor has the

burden of proof on the issue of eligibility, the debtor was not eligible.

Second, the debtor testified that he received \$64,981.05 of unreported income from sales of Anipro, a livestock feed supplement. Debtor tested livestock and their pasture and created special feed mixes based on each herd's need and actually fed some of the cattle. He had minimal sales to feed stores. Anipro is a registered feed name and system of feeding. The debtor had an agreement to distribute the product in a certain geographic area as his exclusive territory and attended conventions of sellers of Anipro products.

The court held that, to determine if activity is a farming operation, it is necessary to analyze the nature of the risk involved in the operation and whether that risk is they type normally taken by those engaged in the first stage of food production. The debtor's activities were conceptually similar to that of a "field man" for a chemical company who exams the crops of farmers, tests soil, and makes recommendations as to fertilizer and chemical applications and may even apply the product. The court determined that the activity constituted an agri-business but was not farming or ranching. The Anipro activities were animal husbandry, not a farming operation. Therefore, the debtor's income from those activities did not change his eligibility for Chapter 12 relief.

Orville Kerlee, No. 00-02145-W11

Issue: Mediation

The court ordered a Chapter 11 debtor and soon-to-be ex-wife who was not a debtor to mediate. The parties were arguing regarding the value of assets which were to be liquidated under the proposed plan. They also argued whether the assets should be liquidated prior to the state court determining the separate or community nature of the obligations to creditors in the pending marital dissolution proceeding. The plan confirmation hearing was continued as was the Motion to Appoint a Chapter 11 Trustee until after the mediation occurred. The mediation, unless otherwise requested by the parties, only concerns the Chapter 11 issues.

Kevin Kirkwood v. AFSA/Data Corp., et al., A99-00171-W1B

Issue: Student Loan Dischargeability

Between 1991 and 1994, the plaintiff incurred four student loan obligations to attend various schools, but did not obtain a degree. The amount due under the obligations as of April 10, 2000 was \$13,338.55. In 1996, and again in 1997, the plaintiff obtained additional student loans to attend Spokane Community College, but did not obtain a degree. The amount due for those loans

Case Notes *cont'd*

was approximately \$9,708.00. Plaintiff has been employed since sometime in 1998 in a position related to the degree he was seeking at Spokane Community College.

In December 1997, plaintiff married his current wife. They have six children ranging from a newborn to a 13 year old. The Chapter 7 schedules indicated that the wife did not receive child support for the older children. Mrs. Kirkwood, who was not a debtor in the Chapter 7, was last employed in 1998 earning a minimum wage and had no training or job skills which indicated an ability to earn a significantly higher income. She was the primary care giver for the children and the costs of day care would equal or exceed any income she could earn at minimum wage. Gross income for the family of eight during 1998 was \$8,711.00 and in 1999 was \$26,809.00, below the federal poverty level guidelines for both years.

The parties cited and argued the factors for student loan dischargeability under 11 U.S.C. § 523(a)(8) adopted by the Ninth Circuit in *United Student Aid Funds v. Pena* (*In re Pena*), 155 F.3d 1108 (9th Cir. 1998) and *Brunner v. New York State Higher Education Services Corp.*, 831 F.2d 395 (2d Cir. N.Y. 1987). Under *Pena*, the first question was whether the debtor, if obligated to repay the student loans, could maintain a minimal standard of living for himself and his dependents. The fact that the plaintiff was housing, feeding and clothing a family of eight on net monthly income of \$1,800.00 was in and of itself sufficient evidence that devoting any monthly income to the repayment of those student loans would constitute an undue hardship.

The *Brunner* decision requires an analysis of whether the situation was likely to continue for the foreseeable future. The language in *Brunner* refers to "a significant portion of the repayment term of the loans." The court distinguished *Brunner* based on the facts of the case, and noted that using the repayment term of the loans as a measure was not provided for in the statute. In the Kirkwood's case, there was no evidence of the applicable repayment period of the loans. The evidence did indicate, however, that this family's financial situation was unlikely to significantly improve for many years, i.e. for the foreseeable future.

The court reasoned that the essential issue in the case involved a balancing between undue hardship and the availability of various student loan deferral programs under the auspice of the William D. Ford Direct Consolidation Loan program. The evidence indicated that the plaintiff would qualify for a deferral of any repayment on those obligations for a period of perhaps as long as 25 years at the end of which, assuming the plaintiff was still unable to repay, the obligations would be forgiven. The plaintiff would be required to make application for those

programs and, assuming the application were approved, plaintiff would be required each year to provide a copy of his federal income tax return to evidence his inability to repay under the then current guidelines of the appropriate program. As one of the factors to be applied under the *Brunner* decision is the debtor's good faith efforts to repay, the student loan creditors argued that plaintiff's failure to apply for and take advantage of the Ford program constituted a lack of good faith.

The court disagreed. First, after noting that the debtor bears both the burden of producing evidence and the burden of persuasion on the entire question of undue hardship, the court found that the plaintiff having made no payments on the loans was not itself determinative of the debtor's good faith effort to repay. From 1991 to some point in 1998, the plaintiff qualified for and received social security disability and was medically unable to work. As that was his sole source of income, he did not have the ability to repay. Second, the fact that the debtor had not chosen to apply for relief under the Ford program was also not conclusive. Rather, the failure of a debtor to apply for administrative relief under the Ford program was only a factor to be considered in determining the debtor's good faith efforts to repay. The court reasoned that the failure to seek administrative relief must be examined in the context of the particular case.

In the Kirkwood's case, there was no evidence that the debtor was even informed about the existence of the Ford program until after the commencement of Adversary Proceeding, and few months before the hearing on the summary judgment motion. More importantly, to obtain relief under the Ford program, the student loan obligations would need to be consolidated into a new post-petition obligation. The student loans at issue were the separate obligations of the plaintiff. Entering into new obligations would, under Washington community property law, presumptively render that new obligation a debt of the marital community. Although that was only a presumption, the possible change of the nature of these obligations as a condition to relief under the Ford program negated any implication that there was a lack of good faith in failing to apply for that relief. The student loans were therefore discharged.

SMLP, No. 97-06464-W1R

Issue: Disgorgement of Attorney Fees

The U.S. Trustee filed a motion to require debtor's counsel to disgorge payments made pre and post-petition as no timely disclosure of post-petition payments was made as required by F.R.B.P. 2016. Some of the post-petition payments were received from the debtor and

Continued on Next Page

Case Notes *cont'd*

some from a third-party. After a lengthy analysis of case law and the circumstances of the particular case, the court required disgorgement.

F.R.B.P. 2016 requires disclosure of all payments and failure to disclose any amount of payment from any source subjects counsel to the risk of disgorging all payments received, disclosed or not. In this particular case, there is no evidence that failure to disclose post-petition payments was willful rather than inadvertent or negligent, and pre-petition payments were disclosed timely. Consequently, it would be inappropriate to require disgorgement of pre-petition payments. As to the post-petition payments, ordinarily the failure to disclose would result in disgorgement of all post-petition fees. However, it has unfortunately been the practice in this District for most debtor's counsel to ignore F.R.B.P. 2016's duty to supplement statements of compensation when funds are placed into a trust account post-petition. Filing of supplemental disclosure statements rarely occurs when post-petition payments are made into a trust account for later application to approved fees.

The practice of disregarding supplemental disclosure requirements under F.R.B.P. 2016 must change, and if it does not, counsel will be required to disgorge all post-petition payments and, in appropriate cases, pre-petition payments. As compliance with supplemental disclosure requirements of post-petition payments has not generally occurred in this District, it would not be fair to impose the full penalty in this case. Disgorgement of \$5,000.00 or roughly one-third of the post-petition fees was required.

This decision has been posted to the court's website. It should be reviewed in its entirety.

Michael A. Miacolo, No. 99-05694-W1B

Issue: "Deconsolidation" of Chapter 13

Husband and wife filed a Chapter 13 and creditors received notice of the filing. Husband then converted to a Chapter 7, but the notice to creditors did not identify which debtor was converting. Instead, the notice merely stated that the "joint debtor" converted to a Chapter 7. No order segregating the estates was entered. A Chapter 13 plan was inadvertently filed in both the Chapter 13 and the Chapter 7 proceeding. Creditors received the plan and, within a few days, the notice of discharge. Some weeks later, they again received the plan as it was then served in the Chapter 13 proceeding. Only two creditors filed Proof of Claims, and they did so in the "no asset" Chapter 7. No creditors filed Proof of Claims in the Chapter 13 proceeding.

The court noted that this is the type of problem which occurs when one of the joint debtors in a Chapter 13

converts to a Chapter 7 without sufficient forethought and planning particularly when no order is entered segregating the estates. The court required debtor's counsel to provide additional special notice to creditors.

Julie Neilson v. John McClendon, No. A00-00065-W1G

Issue: Dischargeability of Interest, Fees, Treble Damages, etc.

The defendant had been the attorney for the plaintiff. The plaintiff sued the attorney in state court and obtained a judgment. In the adversary proceeding, the defendant admitted that plaintiff's state court judgment arose out of a breach of fiduciary duty and defalcation while defendant was acting in a fiduciary capacity and admitted that the sum of \$7,288.34, which was the principal balance remaining due, was not dischargeable.

The defendant argued that interest and attorney's fees on that principal balance were dischargeable. The nature of the obligation in this case was one which was not dischargeable under 11 U.S.C. § 523(a)(4), i.e. it arose from defalcation while acting as a fiduciary. When the nature of the obligation renders it nondischargeable, any ancillary duty to pay which arose solely because of the underlying obligation, i.e. interest and attorney fees, partake of the nature of the underlying obligation. *Florida v. Ticor Title Ins. Co. (In re Florida)*, 164 B.R. 636 (9th Cir. BAP 1994).

The Washington State Bar Association (WSBA) Client Security Fund paid the plaintiff \$6,190.95 as partial compensation for the loss caused by the defendant's breach of fiduciary duty to his former client. It was undisputed that if plaintiff recovered that sum from the defendant, she would be obligated to repay the \$6,190.95 to the WSBA. The defendant would also be obligated to repay that sum to the WSBA prior to being readmitted to the practice of law. The court held that the sum constituted part of the primary obligation to the plaintiff, i.e. the damages caused plaintiff by defendant's defalcation. Even though a third-party may have paid the sum to plaintiff, that third-party may well have the right of repayment from the defendant. As stated in *Florida, supra*, it is the nature of the debt and not the identity of the holder of the claim which determines whether the obligation is dischargeable. This amount is part of the non-dischargeable debt.

Last, the defendant argued that the state court's award of treble damages under the Washington Consumer Protection Act should not be determined to be nondischargeable. In a similar case, the Supreme Court in *Cohen v. De La Cruz*, 523 U.S. 213, 140 L. Ed. 2d 341, 118 S. Ct. 1212 (1998) analyzed a award of treble

Case Notes *cont'd*

damages given under New Jersey's Consumer Fraud Act. Although the Supreme Court's decision in *De La Cruz*, involves an interpretation of § 523(a)(2), the Supreme Court found that the term "debt" has the same meaning under both § 523(a)(2) and (4), and refers to any debt which "is a result of" or "arises from" fraud or defalcation in a fiduciary capacity. The Supreme Court then determined that the treble damages award was related to or arose from or was the result of the underlying fraud and was therefore not dischargeable. Applying *De La Cruz*, the Bankruptcy Court reached the same result and concluded that the award of treble damages under the Washington Consumer Protection Act arose from or related to or was the result of the defendant's defalcation while acting in a fiduciary capacity, and was therefore nondischargeable.

Kathleen A. Flanary, No. 00-00973-W13

Issue: Chapter 13 Treatment for Student Loan

The proposed Chapter 13 plan included a provision providing that confirmation of the plan would constitute a finding of undue hardship. The Trustee objected to confirmation as did the student loan creditor which also submitted a brief on the issue. The debtor voluntarily modified the plan to remove the provision.

Great Lakes Higher Educ. Corp. v. Pardee (In re Pardee), 193 F.3d 1083 (9th Cir. 1999) held that if a Chapter 13 plan states a student is discharged by confirmation, *res judicata* prevents the student loan creditor from collecting the obligation or raising the issue of dischargeability. The case implied that such a provision is contrary to the Code. Cases in other jurisdictions have so held. 11 U.S.C. §§ 1328(a)(2), 1322(b)(2) and 523(a)(8) require an adversary proceeding be commenced to determine dischargeability and an evidentiary hearing to determine undue hardship. It is not appropriate to include in a Chapter 13 plan a provision which indirectly attempts to discharge a student loan and attempts to avoid an evidentiary hearing on the question of undue hardship.

See also In re Webber, 251 B.R. 554 (Bankr. D. Ariz. 2000). This is a recent case that considered a similar issue.

How does Bankruptcy Court process its 8,000 cases?

The two full-time judges in this District along with Judge John Klobucher, who is on senior status, will handle about 8,000 cases in 2000. Judge John Rossmessl sits full-time in Yakima with occasional trips to Richland. Judge Patricia Williams sits in Spokane. Judge Klobucher assists both judges with their regular dockets, handles certain conflict cases, and processes the approximate 120 *ex parte* orders per month submitted in Spokane. The Clerk's Office processes 16,000 pages of pleadings each month.

Nearly all matters not requiring live testimony are heard by telephone. Each judge has a free "meet me" telephone number which attorneys or interested persons may dial into at the time set for the hearing. The court staff calls the role for each case and then the hearing proceeds by telephone. There are very few "motion dockets" as that term is used in state court. Typically, each case is set for a specific time, usually only minutes apart. That allows attorneys to remain in their offices working on other matters and, if the court is running late, they can simply listen on the speaker phone until their specific case is called. Lawyers desiring a hearing to be set contact chambers staff who schedule each hearing. The Chapter 13 Trustee's Office schedules all the Chapter 13 confirmation hearings.

All cases filed since 1997 are available on the Internet. Anyone can read any pleadings in any case from a computer. The Chapter 13 records of payments made by debtors, amounts distributed to creditors, *etc.*, are also available on the Internet.

Certain standard form pleadings prepared and filed by the Chapter 13 Trustee's Office are filed electronically. In early 2001, the court hopes to have certain standard form pleadings prepared and filed by the Chapter 7 Trustee filed electronically. There is a two-year plan in place whereby nearly all pleadings will be filed electronically. The court now offers on a weekly basis a free one-hour training session on use of the court's web site.

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Gary T. Farrell, President

Office of U.S. Trustee
920 W. Riverside, #593, Spokane, WA 99201
(509) 353-2999, Fax (509) 353-3124

Jan R. Armstrong, President-Elect

Armstrong, Klym, Waite & Atwood, P.S.
660 Swift Blvd., Suite A, Richland, WA 99352-3500
(509) 943-4681, Fax (509) 946-3949

Nancy L. Isserlis, Secretary

Columbia Legal Services
1704 W. Broadway, Spokane, WA 99201
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P.O. Box 22550, 450 East Lincoln
Yakima WA, 98907
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