

Supplement to

Problems and Materials
on Bankruptcy Law and Practice

Sepinuck & Rusch

May 1, 2009

Chapter Two

Page 45:

The last paragraph indicates that all the courts to face the issue have ruled that § 526(a)(4) is unconstitutional. However, at the end of last year, in *Hersh v. U.S. ex rel. Mukasey*, [553 F.3d 743](#) (5th Cir. 2008), the Fifth Circuit narrowed the scope of § 526(a)(4) to avoid potential constitutional questions. In so doing, the court held that the provision prohibits bankruptcy counsel from advising their clients to incur debt in contemplation of bankruptcy when doing so would be an abuse or improper manipulation of bankruptcy system. As so limited, the court also ruled it was neither overbroad or facially violative of counsel's free speech rights.

Page 82:

While the earmarking doctrine may survive, courts strictly enforce the requirement that the debtor have no access to or control over the newly loaned funds. *See, e.g., In re Marshall*, [550 F.3d 1251](#) (10th Cir. 2009) (balance transfer from one credit card issuer to another was a transfer of an interest in the debtor's property during the preference period; the earmarking, even if it extends beyond the co-debtor context, protects the preferred creditor only if the new lender requires the funds be used to pay a specific debt, which was not the case here); *In re Entringer Bakeries, Inc.*, [548 F.3d 344](#) (5th Cir. 2008) (earmarking doctrine did not insulate from avoidance as a preferential transfer a pay off of bank with funds provided by refinancing lender because the debtor had control of the funds before making the payment and because the debtor had never stipulated to the refinancing lender that it would use the funds to pay off the bank).

Chapter Four

Page 127, n.3:

See also In re Urban, [375 B.R. 882](#) (9th Cir. BAP 2007) (the residency requirement in § 522(b)(3) is not unconstitutional even though it requires debtors to use the exemption of laws of a state other than the forum state).

Page 138, n.11:

Add after the citation to *In re Green*, the following:

In re Reilly, [534 F.3d 173](#) (3rd Cir. 2008); *In re Anderson*, 377 B.R. 865 (6th Cir. BAP 2007) (criticized in *In re Cormier*, [382 B.R. 377](#) (Bankr. E.D. Mich. 2008)).

Chapter Six

Page 205, problem 6-1(A):

The citation to § 522 should be to § 552.

Page 206:

The Supreme Court's decision in *Ron Pair Enterprises* was based on the comma before "interest," not the comma after "costs."

Page 217, Problem 6-11(B):

Rephrase the question as follows:

- B. How, if at all, would the analysis in Part A change if both parties intended that Doctor would use the loaned funds to buy some new equipment that would serve as collateral for the loan, Doctor did so use the funds, and Doctor received the new equipment on April 10? See § 547(c)(1),(3), (e)(2), (3).

Chapter Seven

Page 266, n.12:

Cf. In re Holcomb, [380 B.R. 813](#) (10th Cir. BAP 2008) (§ 362(c)(3)(A) terminates the stay only with respect to actions against the debtor, not actions as against property of the estate).

Page 280:

Note, cable television is apparently not a utility service. *See in re Darby*, [470 F.3d 573](#) (5th Cir. 2006); *In re Moorefield*, [218 B.R. 795](#) (Bankr. M.D.N.C. 1997).

Chapter Eight

Page 296, n.15:

See also *In re Johnson*, [501 F.3d 1163](#) (10th Cir. 2007) (treating a refusal to return property repossessed prepetition as a stay violation but focusing on the willfulness of the violation).

Page 308, n.32:

Add to the beginning of the footnote:

Coastal Fed. Credit Union v. Hardiman, [398 B.R. 161](#) (E.D.N.C. 2008).

Page 308, n.33:

Revise the footnote to read as follows:

See *In re Visnicky*, [401 B.R. 61](#) (Bankr. D.R.I. 2009) (indicating that Rhode Island's recent enactment of the Uniform Consumer Credit Code, specifically R.I. Code. § 6-51-3(a), made a default-on-filing clause unenforceable); *In re Rowe*, [342 B.R. 341](#) (Bankr. D. Kan. 2006) (ruling that a default-on-bankruptcy clause was unenforceable under the Kansas version of the Uniform Consumer Credit Code and that the 2005 revisions to § 521 merely relegated secured creditor to nonbankruptcy rights). See also *In re Steinhaus*, [349 B.R. 694](#) (Bankr. D. Id. 2006) (suggesting that a default-on-filing clause is unenforceable under Id. Stat. § 28-45-107); *In re Riggs*, [2006 WL 2990218](#) (Bankr. W.D. Mo. 2006) (suggesting that a default-on-filing clause may not be enforceable in Missouri under Mo. Stat. § 408.552). Compare *In re Anderson*, [384 B.R. 652](#) (Bankr. D. Del. 2006) (ruling that a default on bankruptcy clause is valid in Delaware), with *In re Baker*, [390 B.R. 524](#) (Bankr. D. Del. 2008) (disagreeing with *Anderson*).

If repossession occurs after the debtor has received a discharge and the case is closed, the bankruptcy court has no jurisdiction to determine whether state law

invalidates a default-on-bankruptcy clause, and thus renders the repossession improper. *In re Dumont*, [383 B.R. 481](#) (9th Cir. BAP 2008).

Chapter Ten

Page 381:

At the end of the page, add the following:

Recently, the Fourth Circuit took *Ellison* a step further. In *In re Strack*, 524 F.3d 493 (4th Cir. 2008), the debtor was the CEO and majority shareholder of a corporation that had borrowed money on a secured basis. The security agreement required the corporation to segregate proceeds of collateral and “hold them in trust” for the secured party, but the debtor failed to comply. The Fourth Circuit, reversing lower court rulings, held that the debtor had breached a fiduciary obligation to the secured party, thereby making his obligation on a guaranty nondischargeable under § 523(a)(4) as a defalcation while acting in a fiduciary capacity. The case is particularly interesting for two reasons. First, most nondischargeability complaints dealing with sales out of trust are brought under § 523(a)(6) and generally fail, but the Fourth Circuit expressly declined to reach that issue, choosing instead to base its analysis on § 523(a)(4). Perhaps, therefore, creditors should re-evaluate their strategy. Second, the court emphasized the language in the security agreement and the fact that it was the failure to remit the proceeds, not the unauthorized sale of the collateral, that constituted the breach of a fiduciary duty. Accordingly, secured parties may wish to make sure their security agreements have similar language.

Should parties be able to make the relationship a “fiduciary” relationship merely by having “trust” language in the contract documents? Why are some contractual relationships deemed to be fiduciary in nature and not others?

Page 388, n. 79:

Cf. McKay v. Ingleson, 558 F.3d 888 (9th Cir. 2009) (allowing student to attend classes without prepayment was an advance that qualifies as a “loan”).

Page 391:

Delete the reference to § 523(a)(15) in the first sentence of the first full paragraph. The 2005 amendments to the Bankruptcy Code deleted the reference in § 523(c)(1) to § 523(a)(15).

Chapter Eleven

Page 430:

At the end of the page, insert the following:

Courts are finding it extremely difficult to harmonize the rules that require:

- (i) adequate protection payments to be within 30 days of the petition, § 1326(a)(1)(C), and to continue after confirmation, § 1325(a)(5)(B)(iii)(II);
- (ii) payments to be made in equal monthly amounts, § 1325(a)(5)(B)(iii)(I); and
- (iii) administrative expenses to be paid in full, with priority over other claims, § 1326(b)(1).

Consider the following recent case.

IN RE BUTLER

2009 WL 674010 (Bankr. W.D. Ark. 2009)

BEN T. BARRY, Bankruptcy Judge.

Before the Court is the Objection to Confirmation filed by Ford Motor Credit Company LLC [FMC] on October 1, 2008. The gravamen of the creditor's objection is that upon confirmation, the payments to FMC would cease for approximately seven months while the trustee is paying the administrative costs and attorney fees under the plan. * * *

Background

The debtors filed their Chapter 13 Narrative Statement of Plan on August 22, 2008, in which they proposed to pay \$185 per month to the trustee for 60 months. The plan proposed to pay FMC \$116 per month for a vehicle with a listed value of \$5700, but did not provide for any adequate protection payments to be paid to FMC. The proposed plan also included administrative costs for an attorney fee "to be paid \$1,000 from funds paid in by the debtor." * * * The initial \$1,000 payment to the attorney is referred to as a "kicker fee." FMC objected to the proposed plan. Prior to the hearing, on December 30, 2008, the debtors filed a Modification of Chapter 13 Plan, in which the debtors proposed to pay FMC adequate protection payments

in the amount of \$116 per month beginning 30 days after the date of filing and continuing until confirmation of the debtors' plan. The next day, the Court entered its Agreed Order Granting Adequate Protection Payment reflecting the terms provided for in the modified plan. The remaining unresolved objection for hearing was that,

[t]he plan is not feasible, in that the proposed plan payments to the trustee are insufficient to allow the trustee to make distributions to Creditor in equal monthly installments sufficient to provide Creditor adequate protection during the plan. The initial payment (kicker fee) paid to debtors' attorney at confirmation may cause an interruption in Creditor's disbursements.

Stipulations

* * *

9. Solely for the purposes of pre-confirmation adequate protection monthly payment determination, the parties agree that \$116 is acceptable. * * *

10. Upon confirmation of the plan, Debtors and Ford Credit project that the Chapter 13 Trustee intends to make the following disbursements, assuming there are sufficient funds on hand to do so: first, administrative costs for Trustee's fees and expenses; second, Debtors' attorney will receive \$1,050, (commonly referred to as the "kicker fee"). * * * Finally, after Debtor's attorney receives \$1,050 for his kicker fee, Ford Credit will begin receiving its specified monthly payment in the amount of \$116.00 per month (again, assuming there are sufficient funds on hand to do so).

* * *

Discussion

The issue before the Court concerns the conflict between the code requirement of equal monthly payments to secured creditors under the plan pursuant to § 1325(a)(5)(B)(iii) and the plan provision that allows the trustee to pay a "kicker fee" to the attorney before making any payments to the secured creditor. According to the stipulations of the parties, this practice of paying the kicker fee first would result in FMC not receiving *any* payments for approximately seven months once the plan is confirmed. Although it seems a simple issue to state, resolution requires a close look at four code provisions.

Section 309 of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 [BAPCPA] amended the key code provisions related to the issue before the

Court. Specifically, § 1325(a)(5)(B) was amended to provide equal monthly payments to secured creditors under a plan, and § 1326(a) was amended to provide adequate protection directly to a secured creditor not later than 30 days after the order for relief. These code sections, which are relevant to this Court's decision, must be read together * * *.

Adequate Protection

A debtor is required to make payments beginning not later than 30 days after the order for relief in an amount proposed by the debtor's plan. 11 U.S.C. § 1326(a)(1). Included in this amount are payments that provide adequate protection to creditors holding allowed claims secured by personal property. Adequate protection is compensation paid to the creditor for the depreciation of its collateral. According to the code, unless otherwise ordered by the court, payments related to the lease of personal property and that provide adequate protection to a secured creditor are to be made directly to the holder of such claims. 11 U.S.C. § 1326(a)(1)(B), (C). The balance of the required payment is to be paid to the trustee. However, in Arkansas, in accordance with General Order 32, all payments under this section are required to be made directly to the trustee prior to confirmation. The trustee then makes the adequate protection payments to secured creditors that have filed a proof of claim.

Congress added § 1326(a)(1)(C) to the code under BAPCPA. Before the enactment of BAPCPA, some courts held that adequate protection payments ended upon confirmation of a plan, presumably because a confirmed plan would satisfy any requirement of adequate protection to the creditor. If the creditor was not adequately protected, it could object to confirmation of the plan or obtain relief from stay and acquire its collateral. Now, because there is a specific code provision requiring a debtor to pay adequate protection payments beginning within 30 days after the order for relief, creditors holding allowed claims secured by personal property are protected if their collateral is depreciating, regardless of any proposed plan provision or payment scheme. In other words, adequate protection is required before *and* after confirmation of the debtor's plan.

Even after the enactment of BAPCPA, under § 1325(a)(1) a plan must still comply with the provisions of chapter 13 in order to be confirmed. As stated, one of the "new" requirements under chapter 13 is the specific requirement that a debtor pay to a secured creditor adequate protection beginning not later than 30 days after the order for relief. 11 U.S.C. § 1326(a)(1)(C). To meet this requirement, some courts allow a debtor's plan to provide for the payment of adequate protection after

confirmation until the payments provided for in the plan begin. *See, e.g., In re Hill*, 397 B.R. 259 (Bankr. M.D.N.C. 2007); *In re DeSardi*, 340 B.R. 790 (Bankr. S.D. Tex. 2006). Other courts look to another “new” requirement—equal monthly amounts for periodic payments—to ensure that payments in an amount sufficient to provide adequate protection are made beginning with the debtor’s first payment after confirmation. *See, e.g., In re Sanchez*, 384 B.R. 574, 579 (Bankr. D. Or. 2008) (stating that “during the period of the plan” under § 1325(a)(5)(B)(iii)(II) means that equal monthly payments to secured creditors must start with first payment after confirmation); *In re Denton*, 370 B.R. 441, 446 (Bankr. S.D. Ga. 2007). It is this requirement of equal monthly payments that causes the most disagreement between courts, and upon which FMC’s objection is based.

Equal Monthly Payments

* * * When read together, § 1325(a)(5)(B)(iii)(I) and (II) merely requires the debtor to propose a plan that provides for payments to secured creditors to be made monthly, in equal amounts. Further, if the creditor’s claim is secured by personal property, the proposed payment to the creditor cannot be less than the amount required to provide adequate protection to that creditor. The purpose of the second part of this provision is to make sure that creditors whose claims are secured by personal property remain adequately protected during the period of the plan or until the creditor’s claim is paid in full. For example, if adequate protection is determined to be \$200 per month and the balance of the debt is \$2000, the debtor cannot confirm a plan unless he proposes to pay that creditor at least \$200 per month. The debtor is precluded from proposing a payment of less than \$200 per month over a longer period of time.⁵

The purpose of the new provisions of BAPCPA relating to equal monthly payments was to restrict the types of payments that debtors had previously proposed to secured creditors with depreciating collateral. For instance, some debtors attempted to “backload” plans by proposing plans that call for a secured creditor to receive a large balloon payment at the end of the plan, or that provided for graduated or step-up payments during the life of the plan. Other examples include debtors not providing for equal monthly payments, such as reduced payments during certain months of the year, or payments that are made quarterly or semi-annually. The requirement of equal monthly payments whenever periodic payments are due eliminates this concern.

⁵ Unless, of course, the creditor otherwise accepts the plan under § 1325(a)(5)(A).

Although courts may agree about the general purpose behind § 1325(a)(5)(B)(iii)(I) and (II), the concept of periodic payments in relation to equal monthly amounts has resulted, basically, in two lines of cases. The first line of cases find that “periodic payments . . . in equal monthly amounts” refer to *all* payments made on allowed secured claims after confirmation, and those payments must begin with the trustee’s first distribution under a confirmed plan. *See, e.g., Denton*, 370 B.R. at 446; *Sanchez*, 384 B.R. at 578. These courts conclude that equal monthly payments must begin with confirmation and continue until the secured claim is paid in full. *Denton*, 370 B.R. at 443. According to these courts, the periodic payments contemplated under the code refer to all “regularly-recurring post-confirmation payments on an allowed secured claim.” *Id.* at 446. Because the code states that the periodic payments shall be in equal monthly amounts, the courts conclude that all periodic payments after confirmation must be in equal monthly amounts. *Id.*

The second line of cases find the equal monthly payment provision requires payments to be equal *once they begin* and to continue to be equal until the claim is paid in full. There is no requirement in the code that the payments begin with the first payment after confirmation. *See, e.g., DeSardi*, 340 B.R. at 805; *Hill*, 397 B.R. at 268-69. This provision was explained by the *DeSardi* court:

The equal payment provision does not state that its requirements must be met beginning in month one of the plan. Nor does the section state that payments must be equal “as of the effective date of the plan.” In contrast, the immediately preceding section of § 1325(a)(5)(B)(ii) does use such language. That section states that “Except as provided in subsection (b) the court shall confirm a plan if . . . with respect to each allowed secured claim provided for by the plan . . . the plan provides that . . . the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim.” 11 U.S.C. § 1325(a)(5)(B)(ii). While perfectly aware of its drafting options, Congress wrote “[I]f . . . property to be distributed pursuant to this subsection is in the form of periodic payments, such payments shall be in equal monthly amounts.” 11 U.S.C. § 1325(a)(5)(B)(iii)(I). Most importantly, subsection 1325(a)(5)(B)(iii)(II) explicitly requires that payments be not less than the amount to provide adequate protection “during the period of the plan.” No similar language exists in subsection (I). The Court understands this clause to require payments to be equal once they begin, and to continue to be equal until they cease.

DeSardi, 340 B.R. at 805. This Court believes that the reasoning behind the second line of cases as stated by the *DeSardi* court more accurately describes the proper interpretation of this code provision, especially considering the requirement of adequate protection and the trustee's duties described below.

Confirmation

According to the code, after a plan is confirmed, the trustee shall distribute *as soon as practicable* the payments made by the debtor to the trustee pursuant to § 1326(a)(1). 11 U.S.C. § 1326(a)(2). The timing and the amount of payments to specific creditors is determined by the trustee in accordance with the bankruptcy code. However, the trustee is not bound by the equal payment provision of § 1325(a)(5)(B)(iii). Sections 1322 and 1325 concern the contents of a plan and what a *debtor* must do to have a plan confirmed. The debtor is required to propose a plan that provides for equal monthly payments to secured creditors. The directives relating to the trustee's administration of the debtor's confirmed plan are contained in § 1326 and are few, indicating "an intent to repose broad discretion in trustees for the administration of plans." *In re Erwin*, 376 B.R. 897, 902 (Bankr. C.D. Ill. 2007). Part of this code driven discretion concerns the timing of when the equal monthly payments to secured creditors would begin. And that determination must take into account another trustee requirement under § 1326:

Before or at the time of each payment to creditors under the plan, there shall be paid –

- (1) any unpaid claim of the kind specified in section 507(a)(2) of this title;
- (2) if a standing trustee appointed under section 586(b) of title 28 is serving in the case, the percentage fee fixed for such standing trustee under section 586(e)(1)(B) of title 28.

11 U.S.C. § 1326(b). The trustee must make payments as soon as practicable after confirmation, but either before or at the same time of each payment, the trustee must pay certain administrative claims.

Payments of Administrative Claims

Upon confirmation, the code requires the trustee to pay unpaid claims for administrative expenses allowed under § 507(a)(2), which refers to § 503(b), and the trustee's percentage fee. 11 U.S.C. § 1326(b). Section 503(b) includes compensation awarded under § 330(a), which includes allowed attorney fees in a chapter 13 case. These payments must be made either before or at the same time

as payments to creditors under the plan. Some courts, and a leading bankruptcy treatise, hold that the requirement to pay any unpaid claim means that the administrative claims must be paid in full before any creditors receive payment. *See, e.g., In re Bishop*, 101 B.R. 185, 186 (B.A.P. 9th Cir.1989). Presumably, for these courts, the use of the word “or” in the phrase “before *or* at the time of each payment to creditors under the plan” does not allow flexibility in the payment of administrative claims at confirmation. Rather, it is to allow the payment of administrative claims that arise after confirmation and *ongoing* trustee percentage fees concurrent with the ongoing distributions to creditors.

Other courts find that the statute permits a court the option of “ordering complete payment of allowed administrative expense claims in front of other creditors, or ordering their payment ‘at the time of’ payment to other creditors.” *In re Balderas*, 328 B.R. 707, 717 (Bankr. W.D. Tex. 2005). These courts recognize that while administrative fees cannot be deferred, they do not have to be paid in full prior to the distributions to creditors under the plan. This would allow a plan to be confirmed, for instance, that proposes to pay the attorney fee over a one year period, rather than having to pay the fee in full prior to the payment of other creditors. This interpretation of § 1326(b) would allow attorneys to continue to offer their services to debtors with the debtors continuing to pay little or no money to the attorneys prior to filing, while still allowing creditors to begin receiving payments concurrent with the payment of attorney fees over time. * * *

The requirement to pay administrative fees – either in full before or concurrent with payments to creditors – when read in conjunction with the requirement to make adequate protection payments within 30 days of filing, dictate that equal monthly payments may not necessarily occur until some time after confirmation. For instance, in the case before the Court, the debtors have proposed a monthly payment of \$185. If the adequate protection payment after confirmation remains \$116, the same amount as preconfirmation adequate protection payments, then after the adequate protection payment is made, \$69 would remain. If the adequate protection payment continues to be made through the trustee’s office (as is required for preconfirmation payments under General Order 32), the current trustee fee of 5% would have to be deducted (\$5.80), leaving \$63.20 to pay the remaining administrative fees, which include the attorney “kicker fee.” In this case, the kicker fee is \$1,000. This is the amount that would need to be paid before any payments were made to creditors under the plan. At \$63.20 per month, the kicker fee would be paid in approximately 18 months, at which time the regular monthly payments to the creditors could begin. In the mean time, payment for the depreciation of the

creditor's property is provided by the adequate protection payments that are required by the code. The Court finds that this is the proper application of § 1326(b) with regard to the timing of the trustee's requirement to pay certain administrative claims before or at the time of payments to creditors.

* * *

Conclusion

Reading the sections together, the Court finds that in order for a plan to be confirmed, the plan must include certain provisions and adhere to the strictures of the code. First, pursuant to § 1326(a)(1)(C), the debtor must pay adequate protection to a creditor holding an allowed secured claim secured by personal property beginning 30 days from the order for relief. Second, the debtor must propose a plan that provides for equal monthly payments to that secured creditor. Those proposed plan payments cannot be less than an amount sufficient to provide adequate protection to the creditor during the period of the plan. Third, pursuant to § 1326(b), upon confirmation of the plan the trustee must pay administrative claims and the trustee's percentage fee before or at the same time as each payment to creditors under the plan. However, confirmation of a plan does not obviate the requirement for adequate protection. If adequate protection payments are made through the trustee's office, the adequate protection payments must be paid prior to any unpaid claim of the kind specified in § 507(a)(2) and the percentage fee fixed for the chapter 13 trustee. As soon as the administrative fees are paid (including the "kicker" fee), the trustee shall begin paying the equal monthly payments proposed in plan.

NOTE

The court in *Butler* was willing to allow the debtor's plan to provide for monthly adequate protection payments of one amount followed later by payments of the debt in a different (and presumably higher), monthly amount. While several other courts agree, *see e.g., In re Marks*, 394 B.R. 198 (Bankr. N.D. Ill. 2008); *In re DiSardi*, 340 B.R. 790 (Bankr. S.D. Tex. 2006), others do not, *see, e.g., In re Sanchez*, 384 B.R. 574 (Bankr. D. Or. 2008); *In re Denton*, 370 B.R. 441 (Bankr. S.D. Ga. 2007).

Page 455, n.84:

In re Mersmann, [505 F.3d 1033](#) (10th Cir. 2007) (overruling *Anderson*).

Page 481:

Note 3 following the *Kmart* case indicates that § 546(c) authorizes vendors who sold goods to the debtor in the ordinary course of business to reclaim the goods if they were delivered within 45 days before the petition. While the provision certainly does *permit* creditors to reclaim goods under such circumstances, it remains unclear whether the provision is an independent source of such a reclamation right or whether it merely allows the vendor to exercise such a right that exists under nonbankruptcy law. Prior to the 2005 amendments, the provision expressly referenced reclamation rights under nonbankruptcy law and was generally not regarded as creating a right to reclaim. The 2005 amendments may have been an attempt to change that, but if so, early cases indicate it may have failed. See *In re Magwood*, [2008 WL 509635](#) (Bankr. M.D. Ala. 2008) (§ 546(c) does not create a reclamation right, it merely imposes a limit on the trustee's avoiding powers); *In re Dana Corp.*, [367 B.R. 409](#) (Bankr. S.D.N.Y. 2007) (§ 546(c) does not create a federal reclamation right, it merely permits enforcement of some reclamation rights available under nonbankruptcy law). The issue is important because the most common nonbankruptcy source of a right to reclaim – U.C.C. § 2-702 – generally requires that the seller exercise the right within ten days, not 45 days.