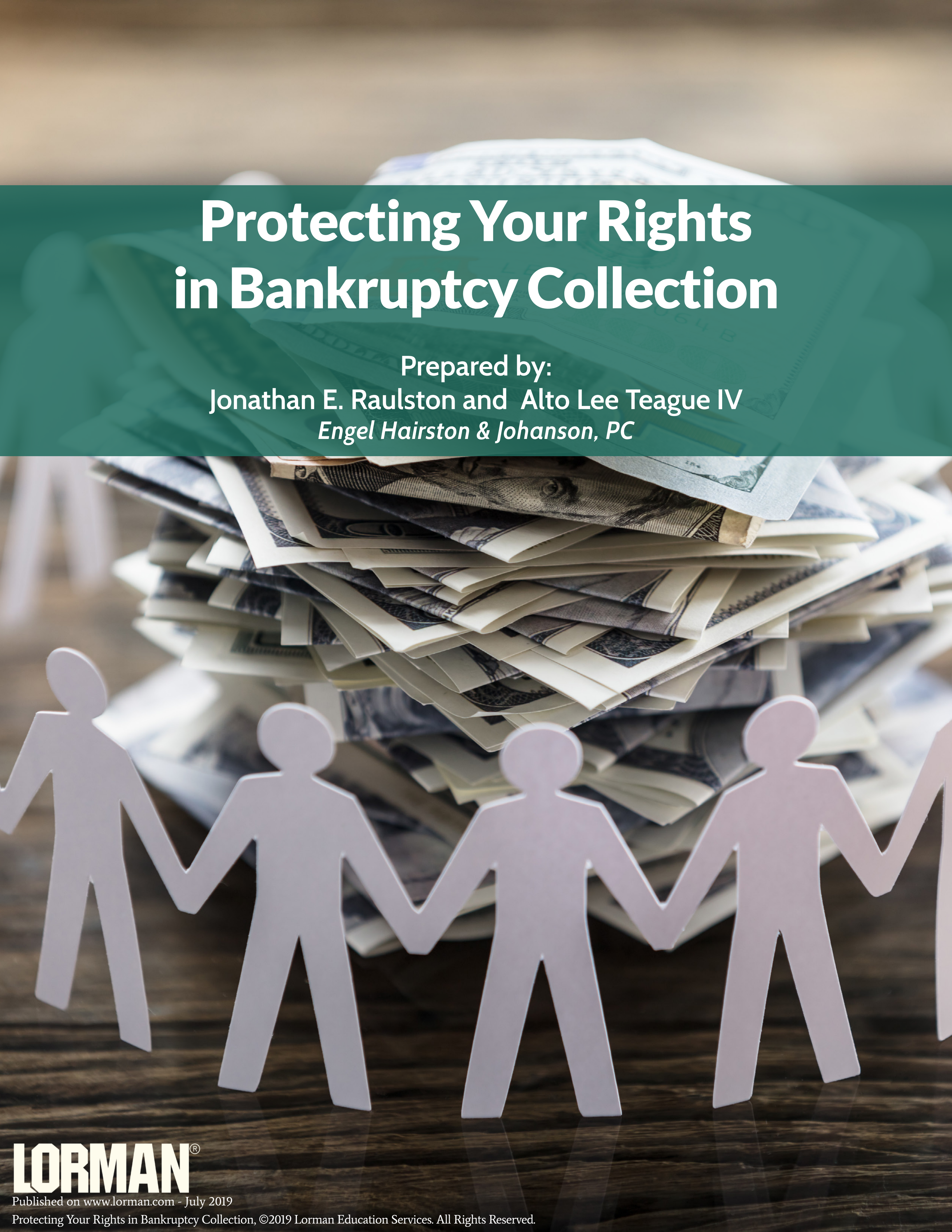

Protecting Your Rights in Bankruptcy Collection

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Protecting Your Rights.

A. The Creditor's Meeting.

Anyone who files for bankruptcy protection must appear for a creditor's meeting (as required by Section 341 of the Bankruptcy Code (which is why you may see these terms used interchangably.) This meeting allow the trustee to verify the accuracy of the debtor's bankruptcy petition and schedules. Creditors have the right to ask questions of the Debtor at the 341 meeting as well. This presents a good opportunity to inquire about your specific collateral, its location, insurance status, and condition as well as the debtor's intentions regarding the same.

B. Proofs of Claim.

As a creditor in an asset case you must file a proof of claim before you will receive a distribution from the bankruptcy trustee. Under the bankruptcy system, some debts have a higher "priority" status and are paid before other claims. For example, post-petition rent for a real property being leased may be filed as an administrative expense. The proof of claim essentially lets the bankruptcy trustee or the debtor in possession know more about the type of claim, as well as how much a creditor is owed. Unless objected to by the debtor or trustee, this will establish the amount you are paid, if anything. A sample POC form is attached as a part of your materials.

In each case, a deadline (termed the Bar Date) is set for filing claims to allow the trustee to determine the distribution of any funds obtained from the liquidation of the estate. Claims are paid out first to administrative creditors (including expenses of administration and attorney fees), then secured creditors (unless the collateral is surrendered in satisfaction of the secured claim), then to priority unsecured creditors according to their statutory priority (i.e. IRS, child support payment, some criminal fines), and finally to the non-priority unsecured creditors, with all claims paid *pro rata* with other members of the class.

C. Reaffirmation Agreements.

Notwithstanding the filing of bankruptcy, secured creditors retain their right to foreclose and take possession of property securing an underlying debt even after discharge is granted. A debtor seeking to retain the secured property may decide to reaffirm the debt. A reaffirmation agreement is negotiated between the debtor and creditor and provides that the debtor will remain liable on the debt and will pay all or a portion of the balance owed (typically by resuming monthly payments) even though the debt would otherwise be discharged in bankruptcy. The creditor typically agrees that it will not repossess the property as long as the debtor continues to pay under the terms of the agreement.

A reaffirmation agreement must be filed before the discharge is granted. Reaffirmation agreements are required to contain an extensive set of disclosures found in 11 USC § 524(k). These include the amount of the debt, how the debt was calculated, and that the debt will not be discharged in bankruptcy. The debtor must sign the agreement and a disclosure as to his or her current income and expenses and provide to the court a showing that debtor can afford to make the payments on the debt reaffirmed. If the debtor cannot meet this requirement, there is a presumption that the agreement would create an undue hardship, and the court may not approve the reaffirmation agreement.

Debtor's counsel must also sign the reaffirmation agreement certifying that they have advised debtor of the legal effect of the agreement, that the debtor is fully informed, that the debtor voluntarily made the agreement, and that reaffirmation of the debt will not create an undue hardship. The debtor retains the right to rescind the agreement upon notice to the creditor at any time before a discharge or is granted or within sixty days of the filing of the agreement with the court.

D. Relief from the Automatic Stay

If you are a secured creditor, upon receipt of notice of a bankruptcy filing and confirming that the filing stays your pending foreclosure, your next step is often to assess whether there is a possibility that you can obtain relief from the bankruptcy court to allow you to proceed. The bankruptcy code does allow creditors, in certain circumstances, to obtain relief from the automatic stay and proceed with foreclosure or repossession after a bankruptcy filing. As set forth in 11 USC §362(d):

> On request of a party in interest and after notice and a hearing, the court **shall** grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay--
>
> (1) for **cause**, including *(but not limited to)* the lack of adequate protection of an interest in property of such party in interest;
>
> (2) with respect to a stay of an act against property under subsection (a) of this section, if--
>
> **(A)** the debtor **does not have an equity** in such property; **and**
>
> (B) such property **is not necessary to an effective reorganization**; *(comment added by author)*
>
> (3) with respect to a stay of an act against **single asset real estate** under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period) or 30 days after the court determines that the debtor is subject to this paragraph, whichever is later--
>
> **(A)** the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or
>
> **(B)** the debtor has commenced monthly payments that--

> **(i)** may, in the debtor's sole discretion, notwithstanding section 363(c)(2), be made from rents or other income generated before, on, or after the date of the commencement of the case by or from the property to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien); and
>
> **(ii)** are in an amount equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor's interest in the real estate; or
>
> **(4)** with respect to a stay of an act against real property under subsection (a), by a creditor whose claim is secured by an interest in such real property, if the court finds that the filing of the petition was part of a **scheme to delay, hinder, or defraud creditors** that involved either--
>
> **(A)** transfer of all or part ownership of, or other interest in, such real property without the consent of the secured creditor or court approval; or
>
> **(B)** multiple bankruptcy filings affecting such real property.
>
> If recorded in compliance with applicable State laws governing notices of interests or liens in real property, an order entered under paragraph (4) **shall** be binding in any other case under this title purporting to affect such real property filed not later than 2 years after the date of the entry of such order by the court, except that a debtor in a subsequent case under this title may move for relief from such order based upon changed circumstances or for good cause shown, after notice and a hearing. Any Federal, State, or local governmental unit that accepts notices of interests or liens in real property shall accept any certified copy of an order described in this subsection for indexing and recording.

"Cause" sufficient to modify the automatic stay is not defined in the Bankruptcy Code or detailed in applicable legislative history, but is not limited to lack of adequate protection as set out in (d)(1). *In re M.J.& K. Co., Inc.,* 161 B.R. 586, 590 (Bankr. S.D.N.Y. 1993). What constitutes "cause" for stay relief purposes "… is an intentionally broad and flexible concept which must, of necessity, be determined on a case by case analysis." *Matter of Holly's Inc.,* 140 B.R. 643, 687 (Bankr. W.D. Mich. 1992). Cause can exist for the granting of relief from stay when "the value of the secured party's interest in the property" is not being adequately protected. *In re*

Hagendorfer, 42 B.R. 13 (Bankr. S.D. Ala. 1984). Cause can exist where the collateral has and continues to decline in value and, absent the contractually scheduled payments, the movant's interest is not adequately protected. See, e.g., *In re Ocasio*, 97 B.R. 825 (Bankr. E.D. Pa. 1989). ("[A]dequate protection may include providing proof of an enforceable insurance policy on the collateral and /or proof of proper maintenance of the property. See *American Honda Finance Corp. v. Littleton*, 220 B.R. 710 (Bankr. M.D. Ga. 1998); *Carteret Sav. Bank v. Nastasi-White, Inc*. (*In re East-West Assocs*.), 106 B.R. 767, 773 (S.D.N.Y. 1989); *In re MGN Co., III*, 116 B.R. 654 (Bankr.S.D. Ind. 1989)." *In re Powell*, 223 B.R. 225, 234 (Bankr. N.D. Ala. 1998).) Cause may exist because there is no equity in the subject collateral. For example, when the amount due under a note exceeds the fair market value of the property securing that obligation, bankruptcy courts generally have held that the debtor has no equity in the property. *See, e.g., In re Prestwood*, 185 B.R. 358, 361 n.6 (M.D. Ala. 1995).

The moving party has the burden to make an initial showing of "cause" for relief from the stay. *See*, *In re Sonnax Industries, Inc*., 907 F.2d 1280, 1285 (2nd Cir. 1990). Once there has been a showing of cause to support and establish relief from the automatic stay, the burden then shifts to the debtor to establish why the automatic stay should not be lifted. 11 U.S.C. § 362(g)(1) and § 362(g)(2). ("Once cause is shown to exist, the debtor must prove that it is entitled to the protections afforded by the stay*." In re M.J. & K. Co., Inc*., 161 B.R. at 590.) Further, pursuant to §362(g), the moving party bears the burden of proof on the debtor's equity in the property but the debtor bears the burden of proof on all other issues. As a general rule "a secured creditor has the right to receive protection for any decline in the value of the collateral during an automatic stay." *United Saving Association of Texas v. Timbers of Inwood Forest Assoc.*, 484 U.S. 365, 370 (1988).

E. Post-Foreclosure Sale Bankruptcy Filing

In Alabama, a bankruptcy filed after the foreclosure sale is conducted does not impact the foreclosure. *In re Cottrell*, 213 B.R. 378 (Bkrtcy. M.D. Ala. 1996). This is because the foreclosed property is no longer property of the estate after the sale is completed, and is true even if the foreclosure deed has not been recorded at the time of filing. *In re Morgan*, 06-30531 DHW, 2006 WL 2338147 (Bankr. M.D. Ala. Aug. 9, 2006). The one-year statutory right of redemption belonging to the debtor, however, would become property of the estate and could be exercised by the trustee or DIP.

F. Cram Down Issues for Automobile Loans.

This is seen in the context of a chapter 13 bankruptcy generally in the context of an automobile loan. Generally what the debtor will try and do is "cram down" the value of the vehicle and get a stepped down basis or value upon which they can pay and still get to keep the vehicle. However, pursuant to the final paragraph of 11 U.S.C. §1325(a), Section 506 does not apply to PMSI's in vehicles acquired for personal use and purchased within 910 days of the filing of petition for relief. Section 506 (2) provides as follows:

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

Unless the creditor objects to the debtor's proposed plan this reduced valuation of the secured portion of the creditor's collateralized claim may be reduced and the creditor's claim bifurcated into a secured and unsecured portion. Unfortunately the courts have held that the interest rate originally agreed to in the contract may be crammed down but it is the debtor's burden to produce evidence that the rate claimed by the creditor in the contract is not reasonable.

G. Non-dischargeability and Objection to Discharge.

Discharge is the Chapter 7 debtor's goal. Discharge absolves the debtor from personal liability for discharged debts and stops creditors from taking action against the debtor or his property to collect the debts. A discharge of all pre-petition debt will be granted unless a debtor fails to meet the basic requirements set out in the bankruptcy code, an adversary proceeding (basically, a lawsuit within a bankruptcy case) is filed objecting to the discharge or the dischargeability of a particular debt, or the debtor has debts falling into a category of debts that have been determined to be nondischargeable.

The grounds for denying an individual debtor a discharge in a Chapter 7 case are fairly narrow and are typically construed in favor of the debtor. They fall into two basic categories: exceptions to discharge of specific debts under §523 and objections to discharge in general under §727. The creation of exceptions to discharge reflects Congress' policy decision that in certain cases, the "creditors' interest in recovering full payment of debts […] outweigh[s] the debtors' interest in a complete fresh start." *Grogan v. Garner*, 498 U.S. at 287. Accordingly, if a creditor proves one of the exceptions to discharge contained in 11 U.S.C. § 523 by a preponderance, the creditor "is entitled to collect the whole of any debt he is owed by the debtor." *St. Laurent v. Ambrose (In re St. Laurent)*, 991 F. 2d 672, 679 (11th Cir. 1993)(internal quotations omitted).

Grounds for denying a discharge under §727 include:

- transfer or removal of property of the estate,
- failure to produce adequate financial records;
- the making of false statements in connection with the bankruptcy filing;

- failure to adequately explain loss of assets;
- commission of a bankruptcy crime such as perjury;
- failure to obey a lawful order of the bankruptcy court;
- fraudulently transferring, concealing or destroying property that would be property of the estate; and
- that the recent grant of a discharge to the debtor in another case where the majority of creditors were not paid.

Specific debts that may be excepted from discharge under §523 include debts:

- for certain taxes;
- for money obtained through fraud or the use of false statements (such as a fraudulent credit application); not disclosed at the time of filing;
- for fraud while the debtor was acting in a fiduciary capacity;
- for child or domestic support; for certain willful and malicious injury by the debtor to another entity or to the property of another entity;
- for certain governmental fines and penalties; student loans;
- for deaths caused by debtor's operation of a motor vehicle while intoxicated;
- for alimony; or
- for criminal restitution and certain other governmental obligations.

Three of the types of debts set out in §523 as exceptions to discharge can still be discharged unless the creditor timely files an adversary proceeding in bankruptcy before the deadline for doing so and requests a determination by the court that the debts should not be discharged. Those exceptions are: (a)(2) for money obtained through fraud or use of false statements regarding the debtor's financial condition; (a)(4) for fraud or defalcation while the debtor was acting in a fiduciary capacity; and (a)(6) for willful and malicious injury.

A creditor must establish the elements of nondischargeability by "the ordinary preponderance-of-the-evidence standard". *Grogan* at 291. (See also *In re Louis S. St. Laurent,* II, 991 F. 2d 672, 677 (11th Cir. 1993)) This is a lesser standanrd than the old basis of "clear and convincing evidence." If the creditor establishes the elements of any subsection of §523, then that crteditor "is entitled to collect the whole of any debt he is owed by the debtor." *St. Laurent v. Ambrose (In re St. Laurent)*, 991 F. 2d 672, 679 (11th Cir. 1993)(internal quotations omitted).

Proof by a preponderance of the evidence means "'an amount of evidence that is enough to persuade [the trier of fact] that the Plaintiff's claim is more likely true than not true.' Eleventh Circuit Pattern Jury Instructions (Civil Cases), Basic Instruction 6.1(2005)." *Weathers v. Lanier*, 280 Fed. Appx. 831 *, 2008 U.S. App. LEXIS 11750 (11th Cir. Ga. June 2, 2008) (See also *Blossom v. CSX Transp.*, 13 F. 3d 1477, 1480 (11th Cir. 1994), holding that the analogy of slightly tipping scales as being appropriate for a description of the preponderance of the evidence standard, noting that: "[t]he Ninth Circuit even includes the "tipping the scales" language in its pattern jury instruction, which reads:

> The plaintiff has the burden of proving the case by what is called the preponderance of the evidence. That means that plaintiff has to produce evidence which, considered in the light of all the facts, leads you to believe that what plaintiff claims is more likely true than not. To put it differently, *if you were to put plaintiff's and defendant's evidence on opposite sides of the scales, plaintiff would have to make the scales tip slightly on that side*

Blossom v. CSX Transp., 13 F.3d 1477 *, 1994 U.S. App. LEXIS 2449, 7 Fla. L. Weekly Fed. C 1221 (11th Cir. Ala. Feb. 10, 1994).)

For a debt to be nondischargeable under § 523(a)(2)(A) for false representation or false pretenses, the creditor must prove that (1) the debtor made a false representation to deceive the creditor; (2) the creditor relied on the misrepresentation; (3) the reliance was justified; and (4) the misrepresentation damaged the creditor. *Sears v. United States (In re Sears)*, 533 Fed. Appx. 41 (11th Cir. 2013). Justifiable reliance is means that the creditor's conduct, gauged by "an individual standard of the plaintiff's own capacity and the knowledge which he has," is not "so utterly unreasonable" that "his loss is his own responsibility." *Stewart Title Guar. Co. v. Roberts-Dude (In re Roberts-Dude)*, 597 Fed. Appx. 615, 617-18 (11th. Cir. 2015)(internal quotations omitted). The debtor's silence regarding a material fact can constitute a false representation for the purposes of §523(a)(2)(A). *Van Horne*, 823 F. 2d at 1288 (affirming the finding that debtor's concealment of his intent to divorce his wife was false representation in his request for this mother-in-law to renew loans she made to him and that the debtor's obligations under the renewed loan was nondischarageable). When a creditor introduces circumstantial evidence of a debtor's intent to deceive, the debtor's "unsupported assertion of honest intent" does not overcome the circumstantial evidence. *Cunningham*, 482 B.R. at 448; *Van Horne*, 823 F. 2d at 1287.

With respect to the term "actual fraud" the U.S. Supreme Court has stated that it means something else other than a false pretense or a misrepresentation. As the Court has stated, "[i]t is sensible to presume that when Congress amended the Bankruptcy Code in 1978 and added to debts obtained by "false pretenses or false representations" an additional bankruptcy discharge exception for debts obtained by "actual fraud," it did not intend the term "actual fraud" to mean the same thing as the already-existing term "false representations." See *United States v. Quality Stores, Inc.*, 572 U.S. ___, ___, 134 S. Ct. 1395, 188 L. Ed. 2d 413." *Husky Int'l Elecs., Inc. v. Ritz*, 136 S. Ct. 1581, 1584 (U.S. May 16, 2016).

"Actual fraud" as used in the context of § 523(a)(2)(A) means "any fraud that involves oral turpitude or intentional wrong" which is "done with wrongful intent." *Husky Int'l. Elecs., Inc. v. Ritz*, 136 S. Ct. 1581, 1586 (2016). For example, actual fraud can be "deception or trickery committed with wrongful intent." *Croasmun v. Utter (In re Utter)*, 2017 Barkr. LEXIS 766 *at 9 (Bankr. M.D. Fla. March 22, 2017)(*citing Husky,* 136 S. Ct. at 1586. A false representation is therefore not required for a finding of actual fraud. *Id.* Even an innocent debtor can be precluded from discharging debt for the fraud of the debtor's agent or partner regardless of the debtor's knowledge or participation. *Lioce v. Heinz (In re Heinz)*, 501 B.R. 746 (N.D. Ala. 2013).

Debts for "fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny" are not dischargeable. 11. U.S.C. § 523(a)(4). "Defalcation" means a "failure to produce funds entrusted to a fiduciary." *Kern v. Taylor (In re Taylor)*, 551 B.R. 506, 520 (Bankr. M.D. Ala. 2016) (quoting *Quaif v. Johnson*, 4 F. 3d 950, 955 (11th Cir. 1993)). Defalcation requires intentional conduct which either the fiduciary knows is improper or, if the fiduciary lacks actual knowledge of the impropriety of the conduct, the fiduciary "consciously disregards" a "substantial and unjustifiable risk" that the conduct will violate a fiduciary duty. *Bullock v. BankChampaign, N.A.*, 133 S. Ct. 1754, 1759 (2013). The risk must constitute a "gross deviation from the standard of conduct that a law-abiding person would observe in the [fiduciary's] situation." *Id.* (internal quotations omitted). Express trusts created by contracts create the fiduciary capacity required for the "fraud or defalcation" portion of § 523(a)(4). *Guerra v. Fernandex-Rocha (In re Fernandez-Rocha)*, 451 F. 3d 813, 816 (11th. Cir. 2006).

The distinction between larceny and embezzlement is that the initial taking of the converted property is lawful in embezzlement and unlawful in larceny. *In re Cunningham*, 482 B.R. 444, 447 (Bankr. N.D. Ala. 2012) (citation omitted). "Embezzlement" means "the fraudulent appropriation of property by a person to whom such property has been entrusted, or into whose hands it has lawfully come." *Fernandez v. Havana Gardens, LLC*, 562 Fed. Appx. 854, 856 (11th Cir. 2014) (quoting *United States v. Sayklay*, 542 F. 2d 942, 944 (5th. Cir. 1976)). "Larceny" means "the fraudulent taking and carrying away [of] property of another with intent to convert such property to the taker's use without the consent of the owner." *Cunningham*, 482 B.R. at 447.

In order to prove that a debt for embezzlement or larceny under § 523(a)(4) is nondischargeable, a creditor must prove (1) that the creditor entrusted property to the debtor; (2) that the "debtor appropriated the property for a use other than that to which it was entrusted"; and (3) that the "circumstances indicate fraud." *Kern*, 551 B.R. at 520 (quoting *Brady v. McAllister (In re Brady)*, 101 F. 3d 1165, 1173 (6th Cir. 1996)). "A showing of embezzlement under § 523(a)(4) of the Bankruptcy Code does not require a showing the existence of a fiduciary capacity." *In re Tarrant*, 84 B.R. at 833. If the creditor presents circumstantial evidence that debtor intended to deceive the creditor, the debtor must present something more than "an unsupported assertion of honest intent" to overcome the inference that the debtor acted with fraudulent intent. *Cunningham*, 482 B.R. at 448; *In re Van Horne*, 823 F. 2d 1285, 1287 (8th Cir. 1987).

"The elements of a claim under 11 U.S.C. § 523(a)(6) are that: '(1) the debtor's conduct was willful and malicious, (2) [the creditor] suffered an invasion of [its] legal rights or to the legal rights to [its] property, and (3) the invasion was caused by the debtor's conduct.' *National Sign and Signal v. Livingston, 422* B.R. 645, 653 (W.D. Mich. 2009) (citing *CMEA Title Agency, Inc. v. Little (In re Little),* 335 B.R. 376, 383 (Bankr. N.D. Ohio 2005))." *Rice v. Morse (In re Morse),* 524 B.R. 774, 796 (Bankr. E.D. Tenn., 2015).

The Eleventh Circuit has explained the language of 11. U.S.C. § 523(a)(6) as follows:

> The Bankruptcy Code excludes from discharge a "willful and malicious injury by the debtor to another entity or to the property of another entity." 11 U.S.C. § 523(a)(6). "[A] debtor is responsible for a 'willful' injury when he or she commits an intentional act the purpose of which is to cause injury or which is substantially certain to cause injury." *In re Walker,* 48 F.3d 1161, 1165 (11th Cir. 1995). Malice can be implied when a debtor commits an act that is "'wrongful and without just cause or excessive even in the absence of personal hatred, spite or ill-will.'" *Id.* at 1164 (quoting *In re Ikner,* 883 F.2d 986, 991 (11th Cir. 1989) (internal quotation marks omitted)).

Thomas v. Loveless (In re Thomas), 288 Fed. Appx. 547, 549, (11th Cir. Ala. Apr. 18, 2008).

A willful act is "one that is done intentionally and voluntarily." *Chrysler Credit Corp. v. Rebhan*, 842 F. 2d 1257, 1262 (11th Cir. 1988) (*rev'd on other grounds by Grogan,* 498 U.S. 279 (1991) (holding that the burden of proof in nondischargeability actions is a preponderance of the evidence, rather than that clear and convincing evidence standard in *Rebhan*). Malice can be established by "implied or constructive malice" which "can be found if the nature of the act itself implies a sufficient degree of malice." *In re Ikner*, 883 F. 2d 986, 991 (11th Cir. 1989) . Constructive or implied malice does not require a finding of a specific intent to harm another. *Id.* In fact, the U.S. Supreme Court has held that a "willful disregard of what one knows to be his duty, an act which is against good morals, and wrongful it and of itself, and which necessarily causes injury and is done intentionally" constitutes a "willful and malicious" injury. *Tinker v. Colwell*, 193 U.S. 473, 24 S. Ct. 505 (1904) (quoted in *Rebhan*, 842 F. 2d at 1262). Although "a willful and malicious injury does not follow as of course from every act of conversion," *Davis v. Aetna Acceptance Co*., 293 U.S. 328, 332 (1934), a debtor's intentional conversion with knowledge of the creditor's certain, or nearly certain, injury is willful. *In re Roden,* 488 B.R. 736, 746 (Bankr. N.D. Ala. 2013) .

We often this claims under this subjection with car dealerships. In the automobile sales world, the sale of a vehicle financed and floor planned by a secured lender is known as "selling out of trust." *Auto. Fin. Corp. v. Penton (In re Penton),* 299 B.R. 701, 706 (Bankr. S.D. Ga. 2003), quoting *In re Moody*, 277 B.R. 865 (Bankr. S.D. Ga. 2001). "[A] sale out of trust is a conversion of the collateral. Because it is the intention to act, and not the intention to do harm that is relevant for the 'willful' prong of § 523(a)(6), a sale out of trust is a willful act." *Penton,* 299 B.R. at 706. "Such act will be 'malicious' if a debtor consciously disregarded his duties and had substantial certain knowledge that he was violating the rights of the secured creditor." *Id*.