

2005 Bankruptcy Reform—Changes Affecting Secured Creditors In Consumer Cases ©

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The recent amendments to the Bankruptcy Code, signed by the President on April 20, 2005 ("New Law"), made a number of significant changes in the Bankruptcy Code.¹

This article will summarize and highlight provisions of the New Law effecting secured creditors.

CHANGES AFFECTING ALL CONSUMER CASES

1. Effective date.

The new amendments generally are effective for cases filed on or after **Monday, October 17, 2005** (i.e. 180 days after the date of enactment). Certain limitations on home-
stead exemptions, however, became effective on April 20, 2005.

2. Extended time between discharges.

A debtor who received a Chapter 7 or 11 discharge in a case filed within eight (8) years (rather than 6) of filing the pending case cannot obtain a Chapter 7 discharge.² Where a Chapter 13 debtor previously received a discharge in Chapter 7, 11 or 12 case during the 4-year period prior to filing the pending case [or received a discharge in a Chapter 13 case during the 2-year period prior to the filing of the pending case], the Chapter 13 debtor will be not receive a discharge.³

3. Automatic stay.

A. Serial Filings

The automatic stay for a debtor who files a Chapter 7, 11 or 13 within one year of the dismissal of an earlier case will be limited. The stay in the second case will terminate automatically 30 days after the filing. This provision does not apply to a Chapter 11 or 13 case filed after a dismissal order under §707(b).⁴

Where there is a second repeat filing (i.e. the second filing within one year of the dismissal of an earlier case), the automatic stay will not go into effect at all. When this occurs, at the request of any party, the Court must promptly enter an order confirming the inapplicability of the stay.

EXCEPTION: Where the debtor or trustee files a motion and demonstrates that the second case was filed in good
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faith with respect to the creditor sought to be stayed, the stay may be continued as to one or more creditors. As to a third filing, the debtor or a trustee may file a motion to impose the automatic stay by demonstrating that the third filing is in good faith with respect to the creditor sought to be stayed. The extension or imposition of the stay in such cases will be very difficult to obtain. The new provisions describe circumstances which generate a presumption that the new filing was not made in good faith. Moreover, this presumption would be required to be rebutted by clear and convincing evidence.

B. In Rem Relief: Ineligible Debtors

When the stay is lifted in cases involving multiple filings, Courts have granted "in rem" relief to preclude any other related party from filing bankruptcy in an attempt to stop a foreclosure sale. The Code now specifically authorizes "in rem" relief in cases involving either (a) transfers of real property without the consent of the secured creditor or court approval, or (b) multiple bankruptcy filings involving the same real property. The Court order granting "in rem" relief can be recorded in the public records, and binds all owners of the property for two years from the date of the order.⁵

EXCEPTION: A party in interest may file a request for imposition of the stay within 30 days of a subsequent case filing. The Court may impose the automatic stay in such a case only if the party demonstrates that the case was filed in good faith as to the creditors sought to be stayed.⁶

C. Specific Notice to Creditor Address Required

Debtors have been notorious for sending bankruptcy notices to a creditor's payment address, or some other unrelated address. Now, no monetary penalty may be imposed on a creditor for violating the automatic stay or for failing to turn over property unless notice is served at an address filed by the creditor with the Court, or served at an address stated in two communications from the creditor to the debtor within 90 days of the bankruptcy case.⁷ An ineffective notice will only subject the creditor to liability for violating the stay if the notice was "brought to the attention of the creditor" (defined as receipt by a person designated by the creditor to receive bankruptcy notices).⁸ To be effective, the notice also must include the account number used by the creditor in the two relevant communications.

Previously, the debtor's failure to supply notice to creditors in the prescribed form did not invalidate the notice. This provision has been deleted.⁹

4. Dismissal for Failure to Comply with Section 521

Under Section 521, individual debtors are required to file a Statement of Intention with regard to secured claims. There now is an effective consequence to individual debtors who fail to file all of the required information within 45 days after filing the petition. Under the New Law, a debtor who fails to timely file this information will have his case dismissed on the 46th day. Upon request, the Court must enter an order to that effect within five days of the request.¹⁰

EXCEPTION: The debtor or the trustee may file a motion within the original 45-day period requesting the automatic dismissal under this provision be delayed for up to 45 additional days. The motion must show that the debtor attempted in good faith to file the required information, and administration of the estate by the trustee would be in the best interest of creditors.¹¹

5. Limiting definition of household goods for purposes of lien avoidance.

Debtors may still avoid liens on "household goods" subject to a nonpossessory, nonpurchase-money security interest under §521(f)(1)(B). The "household goods" for which a nonpossessory, nonpurchase-money security interest in electronic equipment can be avoided are specifically listed.¹²

EXCEPTION: The definition of "household goods" now excludes, among other things, works of art not created by the debtor (or a relative), jewelry worth more than \$500 (except wedding rings), and motor vehicles.¹³

CHANGES AFFECTING CONSUMER CASES UNDER CHAPTER 7

1. The new § 707(b) means test

The centerpiece of the New Law is the means test. Under the New Law an individual Chapter 7 debtor with primarily consumer debts may have his case dismissed for abuse (or, with the debtor's consent, converted to Chapter 13). The prior standard of "substantial abuse" has been eliminated. Abuse can be found in one of two ways: (1) through an un rebutted presumption of abuse arising under the new means test [§707(b)(2)]; or (2) on general grounds, including bad faith, determined under the totality of the circumstances. [§707(b)(3)]. The New Law contains a long and complex formula for calculating the means test.

WHO CAN CHALLENGE THE FILING: When the debtor's income exceeds the defined state median, any creditor or party in interest (as well as the Court on its own initiative), may file a motion seeking dismissal of a Chapter 7 for abuse.¹⁴ When the debtor's income **does not** exceed the defined state median, however, only the judge or U.S. trustee may file a motion to dismiss the case.¹⁵

EXCEPTIONS: The means-test presumption is completely inapplicable to debtors whose income is below that state median,¹⁶ and certain disabled veterans.¹⁷

2. Ride-through Eliminated

Resolving a split in the Circuits, the New Law specifically precludes a Chapter 7 debtor from retaining collateral without redeeming or reaffirming the debt. In other words, the debtor can no longer simply "retain and pay". The New Law requires the debtor to perform this intention within 30 days of the first date set for the meeting of creditors, unless the Court extends the period for cause during this 30-day period.¹⁸

ANALYSIS: This change is made in two different sections of the Code, with possible inconsistent provisions. Section 521 is amended to require a Chapter 7 debtor to surrender any personal property subject to a purchase money security interest unless the debtor, "not later than 45 days after the first meeting of creditors," either redeems the property or enters into a reaffirmation agreement with respect to the debt secured by the property.¹⁹ In addition, Section 362(b) has been amended to provide that the automatic stay terminates with respect to, and removes from the estate, personal property that is collateral for any secured claim (not just property subject to purchase money security interests) or that is subject to an unexpired lease, where the debtor fails either to file the statement of intent required by §521(a)(2) within 30 days of the case filing, or fails "to take timely the action specified in such statement . . . unless such statement specifies the debtor's intention to reaffirm such debt on the original contract terms and the creditor refused to agree to the reaffirmation on such terms."²⁰

3. Reaffirmation

Here is the "creditor protection" part of the New Law. A debtor now must receive an extensive set of disclosures as an additional condition for a reaffirmation agreement to be legally effective.²¹ Prior to filing the reaffirmation agreement, the debtor must sign a statement disclosing the debtor's income, the debtor's actual current monthly expenses, and the resulting balance available to pay the debt proposed to be reaffirmed.²² In the event this new "§524(k)(6) statement" reflects that the debtor has insufficient income to make the payments set out in the proposed reaffirmation agreement, a presumption will arise that the agreement is an undue hardship on the debtor.

Creditors now will be allowed to receive payments both prior to the filing of a reaffirmation agreement, and under filed reaffirmation agreements, "which the creditor believes in good faith to be effective." Moreover, the creditors' disclosure requirements are satisfied if "given in good faith."²³

4. Redemption

Under Section 722, the value of personal property redeemed in a Chapter 7 will be based on the cost to the debtor of replacing the property – without deduction for costs of sale or marketing. Where the property was acquired for personal, family or household purposes, however, this replacement cost will be the retail price for property of similar age and condition.²⁴ The prior cases interpreting the value of collateral for purposes of redemption as the wholesale value (i.e. what the creditor would receive after repossession and sale) have been specifically overruled.

The New Law also makes clear that redemption requires a lump sum payment of the allowed secured claim at the time of the redemption.²⁵

CHANGES AFFECTING CONSUMER CASES UNDER CHAPTER 13

1. Timing of the confirmation hearing

Waiting 8 to 10 months for a confirmation hearing should become a thing of the past. The New Law requires that confirmation hearing must take place no later than 45 days after Creditors Meeting, and no sooner than 20 days after the date of the creditors meeting unless the Court determines that it would be in the best interests of creditors and the estate to hold an earlier confirmation hearing and there is no objection.²⁶

ANALYSIS: This provision does not specify whether the date of the confirmation hearing is to be measured from the first date set for the meeting of creditors, the first date that the meeting of creditors actually takes place, or the date on which the meeting of creditors concludes. This issue likely will be determined by amendments to the Bankruptcy Rules.

2. Eliminating Strip Down for Certain Secured Loans

The debtor's ability to strip down secured claims to the value of the collateral in Chapter 13 cases, commonly referred to as a "cramdown", has been significantly limited. A cramdown will not be allowed for (1) purchase money security interests in motor vehicles financed within **910 days** of the bankruptcy filing (two days less than 2-1/2 years) or (2) as to all other secured debts (whether or not involving purchase money security interests), incurred within one year of bankruptcy.²⁷

3. Valuation of Secured Claims

The stripped down value of a secured claim now must be based on the cost to the debtor of replacing the collateral – without deduction for costs of sale or marketing. In the event the collateral was acquired for personal, family or household purposes (e.g. car loans), replacement cost is the retail price for property of similar age and condition.²⁸

4. Adequate Protection, and Payments Before and After Confirmation

Two significant changes have been made to require adequate protection payments on secured claims in Chapter 13. First, unless otherwise ordered by the Court, the debtor must make pre-confirmation adequate protection payments directly to the secured creditor. This amount is deducted from the preconfirmation plan payments made to the Chapter 13 trustee. The debtor also must provide the trustee with proof he made these adequate protection payments.²⁹ Second, Chapter 13 plans must provide for payment of secured claims in equal installments "sufficient to provide adequate protection".³⁰

ANALYSIS: The amount required to be paid for preconfirmation adequate protection is not clearly defined. It appears that the debtor might have the choice of paying either the amount called for by the plan or the amount due under the loan.

5. Personal Property Leases

In Chapter 7 cases, when a lease is not timely assumed by the trustee, the lease is deemed rejected and the stay automatically is terminated. In Chapter 11 and 13 cases, when the lease is not assumed in the Plan, the lease is deemed rejected *at the conclusion of the confirmation hearing*, and the stay automatically is terminated.³¹

As to payments, a debtor now must make preconfirmation payments on personal property leases (e.g. auto leases) directly to the lessor, and provide proof to the Chapter 13 trustee (this amount is deducted from the preconfirmation plan payments made to the Chapter 13 trustee).³²

6. Lien Retention

A Chapter 13 debtor can no longer provide for the early release of a lien upon payment of a stripped-down secured claim through the plan. The secured creditor will retain its lien until the full amount of the claim is paid or the plan is completed.³³

7. Plan length

For debtors whose income is equal to or greater than the applicable state median income, the plan must last for five (5) years unless it provides for full payment of all claims in less than five years.³⁴

(Endnotes)

1. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (S. 256), signed into law by President Bush on April 20, 2005, was assigned Public Law Number 109-8.
2. Amending Section 727(a)(8).
3. Adding new Section 1328(f).
4. New §362(c)(3).
5. Where "in rem" relief is effective, there is now an exception to the automatic stay for lien enforcement activity in later cases. [new §362(b)(20)] In addition, there is now an exception from the application of the stay any act to enforce a lien or security interest in real property if the debtor was ineligible or filed the case in violation of an order "prohibiting the debtor from being a debtor" in another case under Title 11. [new §362(b)(21)]
6. New §362(d)(4).
7. New §342(g).
8. Amended §342(c)(2), (e) and (f).
9. Amended § 342(c).
10. New §521(a)(1)(B).
11. New §521(l).
12. New §522(f)(4)(A). For example, electronics are limited to one radio, one television, one VCR, and one personal computer (with related equipment).
13. New §522(f)(4)(B).
14. The applicable median income for Florida residents in 2003 was \$38,934. The median income for a family of four (4) in Florida in 2004 was \$57,473. The median income for each state can be found at <http://www.census.gov/prod/2004pubs/p60-226.pdf>. or <http://www.census.gov/hhes/income/4person.html>.
15. New §707(b)(6).
16. New §707(b)(7).
17. New §707(b)(2)(D).
18. Amended §521(a)(2)(B).
19. New §521(a)(6).
20. New §362(h).
21. New §524(k).
22. New §524(k)(6).
23. New §524(l).
24. New §506(a)(2).
25. Amended §722.
26. New §1324(b).
27. Amended §1325(a)(5).
28. New §506(a)(2) applies in Chapter 13 as well as Chapter 7 cases.
29. New §1326(a)(1)(B) and (C).
30. New §1325(a)(5)(B)(iii).
31. New §365(p).
32. New §1326(a)(1)(B).
33. Amended §1325(a)(5)(B)(i).
34. New §1325(b)(4).

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