



Dennis LeVine & Associates
Secured Creditor & Bankruptcy News

Volume 3 Issue 5

Summer 2004

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FLORIDA COURT DENIES DEBTOR'S ATTEMPT TO GET AROUND THE "KALTER" DECISION WHERE THE DEBTOR PROVIDED FOR PAYMENT OF THE SECURED CLAIM IN FULL OVER THE LIFE OF A CHAPTER 13 PLAN; ALSO, "KALTER" NOT FOLLOWED IN GEORGIA

In 2002, the Eleventh Circuit ruled in *In re Kalter*, 292 F.3d 1350 (11th Cir. 2002), that the debtor's ownership interest in a vehicle passes to the secured creditor automatically at the time of repossession. As such, the debtor's right to redeem the vehicle (the debtor's only remaining legal right at the time of a bankruptcy filing following repossession) was insufficient to render a car property of the bankruptcy estate under §541, or to compel its turnover back to the debtor under §542 of the Bankruptcy Code.

In *Kalter*, the Eleventh Circuit pointed out that the debtor proposed to cram down and value the creditor's secured claim, which would not result in full payment of the balance due. The *Kalter* case potentially left open the issue of whether a debtor who proposed to fully pay the car lender's secured claim through a Chapter 13 plan could compel turnover of a car lawfully repossessed pre-petition. This issue was addressed by Judge Hyman in *In re Menasche*, 301 B.R. 757 (Bankr. S.D. Fla. 2003), who ruled that such plan treatment did not change the effect of *Kalter*.

In *Menasche*, the debtors proposed to exercise their right of redemption by paying the balance due on

U.S. SUPREME COURT KNOCKS LENDERS FOR A LOOP - REVERSES IN RE TILL, AND FINDS "PRIME PLUS SMALL RISK FACTOR" AS THE APPROPRIATE INTEREST RATE IN CRAM DOWN UNDER CHAPTER 13

In a Chapter 13 case, a debtor may pay the value of a secured claim over time. This is known as a "cram down." The Bankruptcy Code requires a debtor's plan to provide each secured creditor with payments whose total value, as of the plan's date, "is not less than the [claim's] allowed amount." 11 U.S.C. § 1325(a)(5)(B)(ii). When a plan provides for payments to a secured creditor over time, the plan effectively must ensure that the creditor receives payments whose total present value equals or exceeds that of the allowed secured claim. "Present value" contemplates payments over time plus interest. The issue before the Supreme Court was how the "present value" interest rate is determined.

On May 17, 2004, the Supreme Court ruled that the appropriate interest rate for a Chapter 13 plan paying a claim secured by a lien on an automobile over time is the prime interest rate, plus an additional risk factor (perhaps 1% to 3%). *Till vs. SCS Credit Corp.*, 2004 W.L. 1085321. In *Till*, the debtors purchased a truck and financed \$6,400 with SCS Credit Corp. at an interest rate of 21%. The debtors filed Chapter 13, and the parties agreed that the vehicle was worth \$4,000. The debtors' Plan provided to pay the secured claim of \$4,000 over time, with interest of 9.5%. The creditor objected to confirmation of the Plan, and argued that it was entitled to interest at its contract rate of 21%.

The Bankruptcy Court confirmed the Plan and the debtors' proposed 9.5% interest rate. The Court adopted the "prime-plus" or "formula rate" approach, whereby the cram down interest rate is determined by taking the

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national prime rate of interest (8% at the time), and adding 1.5% to account for the risk of nonpayment by borrowers in the debtors' financial position. The District Court reversed, ruling that the 21% contract rate was appropriate because cram down interest rates must be set at the level the creditor could have obtained had it foreclosed on the loan, sold the collateral, and used the proceeds to make equivalent new loans (the "coerced loan rate").

On appeal, the Seventh Circuit affirmed but modified the "coerced loan" approach, holding that the original contract rate was a "presumptive rate" that could be challenged with evidence that a higher or lower interest rate should apply. The dissent in the Seventh Circuit opinion proposed a "cost of funds" interest rate, which simply looks at the rate at which the creditor could borrow funds from another source. Since Circuit Courts around the country had come to different interpretations of this Chapter 13 provision, the Supreme Court agreed to consider the case.

The Supreme Court reversed the Seventh Circuit. Justice STEVENS, joined by Justices SOUTER, GINSBURG, and BREYER, adopted the "prime-plus" or "formula rate" approach. Justice THOMAS concurred in the result.

The majority opinion identified the four approaches used by various courts to determine the cram down interest rate:

- coerced loan approach
- presumptive contract or coerced loan approach
- cost of funds approach
- formula approach

The Supreme Court recognized that a debtor's promise of future payments is worth less than an immediate lump sum payment because the creditor cannot use the money right away, inflation may cause the dollar's value to decline before the debtor pays, and there is a nonpayment risk. The Court rejected the coerced loan, presumptive contract rate, and cost of funds approaches, finding that they are complicated, impose significant evidentiary costs, and aim to make each individual creditor whole rather than to ensure that a debtor's payments have the required present value.

The Court adopted the formula approach. The majority explained that the formula approach looks to the national prime rate, which reflects the financial market's estimate of the amount a commercial bank should charge a creditworthy commercial borrower to compensate for the loan's opportunity costs, inflation risk, and relatively slight default risk. The bankruptcy court then should adjust the prime rate upward to account for the greater nonpayment risk:

"Because bankrupt debtors typically pose a greater risk of nonpayment than solvent commercial borrowers, the approach then requires a bankruptcy court to adjust the prime rate accordingly. **The appropriate size of that risk adjustment depends, of course, on such factors as the circumstances of the estate, the nature of the security, and the duration and feasibility of the reorganization plan. The court must therefore hold a hearing at which the debtor and any creditors may present evidence about the**

appropriate risk adjustment. [emphasis added]. Some of this evidence will be included in the debtor's bankruptcy filings, however, so the debtor and creditors may not incur significant additional expense. Moreover, starting from a concededly *low* estimate and adjusting *upward* places the evidentiary burden squarely on the creditors, who are likely to have readier access to any information absent from the debtor's filing Finally, many of the factors relevant to the adjustment fall squarely within the bankruptcy court's area of expertise."

In the Till case, the issue of the amount of the risk adjustment was not before the Supreme Court. The Court only noted that the interest rate should be "high enough to compensate the creditor for its risk but not so high as to doom the [Chapter 13] plan." The majority found that the Bankruptcy Court's rate of 1.5% above the prime rate was similar to the 1% to 3% increase which other courts adopting the formula approach had used.

In concurring, Justice THOMAS stated that he believed 11 U.S.C. § 1325(a)(5)(B)(ii) does not require the cram down interest rate to reflect any risk of nonpayment at all. Since the proposed 9.5% interest rate in this case was higher than the risk-free prime rate, he concluded it was sufficient to account for the time value of money, which he found was all the statute requires.

Justice SCALIA, joined by Justices REHNQUIST, O'CONNOR and KENNEDY, dissented. The extensive dissenting opinion criticized the formula approach as too low, stating:

"The plurality would use the prime lending rate – a rate we *know* is too low – and require the judge in every case to determine an amount by which to increase it. I believe that, in practice, this approach will systematically undercompensate secured creditors for the true risks of default. I would instead adopt the contract rate – *i.e.*, the rate at which the creditor actually loaned funds to the debtor – as a presumption that the bankruptcy judge could revise on motion of either party. Since that rate is generally a good indicator of actual risk, disputes should be infrequent, and it will provide a quick and reasonably accurate standard."

As a result of Till, much lower cram down interest rates will be imposed in most Districts around the country. The majority opinion states that the formula approach "is a straightforward, familiar, and objective inquiry, and minimizes the need for potentially costly additional evidentiary hearings." Nevertheless, like the infamous footnote 6 in the Supreme Court's decision in Rash, the qualifying language used by the majority (*i.e.* that the appropriate upward adjustment from the prime rate depends on such factors as the estate's circumstances, the security's nature, and the reorganization plan's duration and feasibility) may lead to litigation to determine the amount of this "adjustment" in Chapter 13 cases.



*Kalter case
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their vehicle loan in full, plus interest, costs and attorneys fees, over the course of their Chapter 13 Plan. The debtors, however, did not offer to immediately redeem by tendering the balance due in a lump sum payment. According to Judge Hyman, redemption under Florida Statute 679.623 requires the immediate tender of full payment. The Bankruptcy Court ruled that the debtors could not regain possession of their vehicle unless they redeemed the vehicle in an immediate lump sum payment, as provided by Florida Statute 679.623. Payment over time did not equal a tender of the entire balance as required by Florida Statute 679.623.

The Kalter issue recently was examined by the Eleventh Circuit in a Georgia case. In In re Rozier, 348 F.3d 1305 (11th Cir. 2003), the Eleventh Circuit had before it a lawful pre-petition repossession, the precise issue as Kalter. The Eleventh Circuit found Georgia law was not clear on this issue. Instead of ruling, however, the Eleventh Circuit certified the issue to the Georgia Supreme Court. In June, the Georgia Supreme Court found that the state statute in Georgia regarding vehicle titles differed from the state statute in Florida, thus distinguishing Kalter. As a result, Kalter is not effective in Georgia bankruptcy cases.



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BANKRUPTCY FILINGS SET NEW CALENDAR YEAR RECORD IN 2003

Bankruptcy filings again broke records during 2003, according to data released by the Administrative Office of the U. S. Courts. Bankruptcies filed in the 12-month period ending December 31, 2003, totaled 1,660,245, up 5.2 percent from the previous record of 1,577,651 filed in 2002. The overwhelming percentage of bankruptcy filings were personal (non-business) filings, totaling 1,625,208 in 2003. The number of business filings continued to decline, totaling only 35,037 in 2003, down 9.1 percent from 2002. The top states in total case filings for the year were California (146,130 filings, 35.0 million population), Florida (95,478 filings, 17.0 million population), Texas (89,469, 22.1 million population), Ohio (87,833, 11.4 million population) and Illinois (86,802, 12.7 million population).



BANKRUPTCY PETITION FILED IN CONTRAVENTION OF COURT IMPOSED BARS WITHOUT EFFECT

Pursuant to Section 109(g) of the Bankruptcy Code, a Bankruptcy Court can dismiss a case with prejudice from refiling for up to 180 days. In some Chapter 13 cases dismissed with prejudice, however, the debtor nevertheless refiles a new case during the prejudice period. The issue is whether the subsequent bankruptcy filing is effective to implicate the automatic stay when a new case is filed during the "prejudice period," notwithstanding a court order prohibiting the refiling of a case.

The Ninth Circuit recently ruled that a bankruptcy petition refiled by a debtor during a court imposed prejudice period was without effect. In In re Umali, 345 F.3d 818 (9th Cir. 2003), the debtor had filed two previous bankruptcy cases. When the second bankruptcy case was dismissed, the dismissal order prohibited the debtor from refiling bankruptcy under any chapter for 180 days. Just prior to the rescheduled foreclosure sale, the debtor filed a third bankruptcy petition. The debtor did not advise the bank's counsel, and the foreclosure sale took place. When the creditor learned of the new bankruptcy filing, it filed a motion seeking retroactive annulment of the automatic stay. The Bankruptcy Court denied this motion, but the District Court reversed and held that the filing of the third bankruptcy petition was legally ineffective. The third case did not invoke the automatic stay provisions of 11 U.S.C. §362, since the debtor filed the petition in violation of a court order. Upon remand, the Bankruptcy Court granted the creditor's motion to annul the automatic stay. The debtor again appealed.

The Ninth Circuit held that "a petition filed in contravention of a court imposed bar is without effect," citing In re Casse, 198 F.3d 327, 342 (2nd Cir. 1999) (the subsequent Chapter 13 filing was void *ab initio*, thereby nullifying the automatic stay upon which the debtor relied to vacate the foreclosure). The important point in Umali is the finding that the subsequent bankruptcy petition did not trigger the automatic stay because the previously imposed 180 day bar rendered the debtor **ineligible** for relief during this period of time.



Dennis LeVine is Board Certified in both Business and Consumer Bankruptcy law by the American Board of Certification. Mr. LeVine was admitted to the Florida Bar in 1983, and practices in the federal courts of all three Florida districts. He has concentrated his practice in bankruptcy and collection law for 18 years.



Things I've Learned From Children

1. A king-sized waterbed holds enough water to fill a 2,000 sq. ft. house 4 inches deep.
2. When you hear the toilet flush and the words "uh-oh," it's already too late.
3. Play-doh and microwave should not be used in the same sentence.
4. Always look in the oven before you turn it on. Ovens don't like plastic toys.



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