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DEBTORS HAVE LEGAL DUTY TO MITIGATE DAMAGES TO RESOLVE STAY VIOLATIONS

Creditors have developed sophisticated systems to update their records when advised of a customer's bankruptcy filing. Nevertheless, such systems are not foolproof. Occasionally, a creditor takes action post-petition which a Debtor alleges violates the automatic stay, or takes action against the Debtor following discharge in violation of the discharge injunction. Such alleged violations often lead to Motions for Sanctions being filed against the creditor. Litigation over these Motions can become quite expensive.

Creditors and their counsel need to keep in mind that in sanctions actions, the general law of damages applies, including the duty to mitigate damages. As such, a creditor must take prompt steps when first contacted about a violation of the automatic stay or discharge injunction. For example, a lawsuit inadvertently filed after discharge should immediately be dismissed. On the other hand, the Debtor also has a duty to resolve a stay or discharge violation, and not incur further damages. This article will focus on the Debtor's duty to mitigate damages.

In many cases involving a stay or discharge violation, the Debtor does not even try to mitigate damages, but instead exacerbates the situation by unnecessarily filing a Motion for sanctions. A number of Courts have found that a Debtor who fails to mitigate his damages is not entitled to an award of sanctions/attorneys fees against the creditor, or such an award may be significantly limited. Creditors must keep in mind that under the Federal Rules, the failure to mitigate damages is an affirmative defense which must be pled by the creditor in response to a sanctions action.

In *In re Oksentowicz*, 324 B.R. 628, 630 (Bankr. E.D. Mich. 2005), a Chapter 7 debtor moved for sanctions for an apartment complex's alleged violation of

BANKRUPTCY COURT CAN SANCTION DEBTORS FOR FILING CHAPTER 13 PLANS WHICH DO NOT COMPLY WITH THE BANKRUPTCY CODE

Occasionally, a debtor may place a provision in a Chapter 13 Plan which is contrary to the Bankruptcy Code. It has been a long-held belief that a creditor's failure to object to the confirmation of a Chapter 13 Plan waives any objection to the Plan once the Plan is confirmed. This position is supported by the legal concept of *res judicata* (i.e. the binding effect of a Court order), and the following language in Section 1327:

(a) The provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan.

In order to obtain confirmation, however, the Bankruptcy Code states that a Chapter 13 Plan must comply with all the provisions of Chapter 13 and with the other applicable provisions of Title 11 [1325(a)(1)]. Moreover, the Plan must be proposed in good faith and not by any means forbidden by law. [1325(a)(3)]. Thus, provisions placed in Chapter 13 plans which are contrary to specific sections of the Code *should* doom confirmation of a Chapter 13 Plan.

With the changes recently made by Congress to Chapter 13 in BAPCPA, courts now are dealing with the issue of whether the absence of an objection by a creditor can be deemed implied acceptance of a Plan containing a provision which appears to be contrary to provisions of BAPCPA. This issue came to light in two recent cases where a debtor's Chapter 13 Plan provided to bifurcate a secured claim under Section 506 for a vehicle financed within 910 days of filing.

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Plan Confirmation (Continued from page 1)

Added by BAPCPA, the so-called hanging paragraph found after Section 1325(a)(9) limits the ability of an individual debtor to cramdown a 910-day vehicle loan. In In re Montoya, 341 B.R. 41 (Bankr. D. Utah 2006), the debtor's Plan proposed to cramdown a 910-day vehicle loan. The secured creditor did not file an objection. The Chapter 13 Trustee and the debtor contended that the secured creditor's failure to object to confirmation of a Chapter 13 Plan containing a cramdown of a 910-day claim constituted acceptance of the Plan. The Court in Montoya rejected this argument, stating that a plan should not be used as a sword to change the explicit provisions of the Code to what the Debtor wished Congress had drafted. The Court referenced the case law which considers the absence of a creditor's objection to a Chapter 13 Plan to be implied consent, but found these cases missed the point:

"The concept of implied acceptance of an otherwise compliant plan, or even voting on similar provisions in Chapter 11, however, is quite different from proposing a plan intentionally inconsistent with the Code and then waiting for the trap to spring on a somnolent creditor. Creditors are entitled to rely on the few unambiguous provisions of the BAPCPA for their treatment. They should not be required to scour every Chapter 13 Plan to insure that provisions of the BAPCPA specifically inapplicable to them will not be inserted in a proposed Plan in the debtor's hope that the improper secured creditor treatment will become *res judicata*."

The Court in Montoya supported its denial of confirmation by pointing to Section 1325(a)(1) of the Bankruptcy Code, which provides that "The Court shall confirm a plan if (1) the plan complies with the provisions of this chapter and with the other applicable provisions of this title." The Judge in Montoya found that a Bankruptcy Judge has an affirmative duty to review and ensure that the Plan complies with the Code even if creditors fail to object to confirmation. "This offending provision presents no less a bar to confirmation than failing to pay priority claims in full, proposing a Plan in bad faith, or proposing a Plan that is not feasible." The Court

concluded that trying to insert an impermissible provision into a Chapter 13 Plan (such as the proposed cramdown of a 910-day vehicle claim) is not an option. The Court noted that its opinion did not preclude a debtor and secured creditor from agreeing to a cramdown for a 910-day vehicle claim. The Court also stated in a footnote that it was not addressing the issue of whether a secured creditor's filing of a bifurcated Proof of Claim constituted expressed acceptance or some sort of waiver of the provisions of the hanging paragraph.

The analysis in the Montoya case was followed by a bankruptcy court in Kentucky. In In re Montgomery, 341 B.R. 843 (Bankr. E.D. Kentucky 2006), the secured creditor actually filed an objection to a debtor's Chapter 13 Plan proposing a cramdown of a 910-day vehicle loan, but the objection was not timely filed. The Court nevertheless denied confirmation of the Plan, and adopted the holding in In re Montoya.

One Court has suggested that placing "improper" provisions in a Plan could be sanctionable conduct. In In re Allen, 2006 WL 3953347 (Bankr. E.D. Tex. 10/13/06), the Court did not impose sanctions on the debtor or his counsel, but stated similar actions in the future would not be treated kindly.

In In re Allen, the Court found that the (hanging paragraph) is applicable to all provisions of Section 1325(a), including situations where a creditor has accepted the Plan. Following In re Montoya, the Court stated that implied consent is inapplicable - the affected secured creditor does not have to invoke the protection of the hanging paragraph through the filing of an objection to plan confirmation. The Code invokes the protection on its behalf.

Debtors and their counsel may place provisions into a Chapter 13 Plan which (either implicitly or explicitly) do not comply with the requirements of the Bankruptcy Code (e.g. a provision ignoring In re Till, and providing for an interest rate of 2% on a secured claim paid over time through a Plan). The position taken by Courts in the above two cases has not been followed in a Florida Bankruptcy case. Thus, secured creditors must be vigilant. A thorough review of each Chapter 13 Plan by secured creditors is imperative. ■

BANKRUPTCY FILINGS SOAR IN FIRST QUARTER OF 2007

According to the Administrative Office of the U.S. Courts, bankruptcy filings for the first quarter were 193,641, a 66-percent increase when compared to the 116,771 filings in the first quarter of 2006. In addition, filings in the 12-month period ending March 2007 were higher compared to calendar year 2006 filings that totaled 617,660. The number of filings appears to be increasing at a steady rate.

Looking at filing rates during the last two years is skewed based on the surge in filings which occurred prior to the Oct. 17, 2005 implementation of BAPCPA. For example, for the 12-month period ending March 31, 2007, there were 673,615 personal bankruptcy cases filed. This was down 62 percent from the 1,759,503 personal filings in the 12-month period ending March 31, 2006. ■

FLORIDA ENACTS A NEW PERSONAL PROPERTY EXEMPTION FOR DEBTORS WHO DO NOT OWN A HOME

Florida's personal property exemptions were amended to add a personal property exemption of \$4000, but only for individuals who do not own a Florida homestead. This provision became effective on July 1, 2007. Section 222.25(4), Florida Statutes, now exempts "[a] debtor's interest in personal property, not to exceed \$4,000, if the debtor does not claim or receive the benefits of a homestead exemption under s. 4, Art. X of the Florida Constitution."

This new exemption is in addition to the existing \$1,000 personal property exemption found in the Florida Constitution. Therefore, an individual in Florida who does not own a home can now exempt \$5,000 in personal property from the claims of creditors (and from a bankruptcy trustee). This provision will have a significant impact where a husband and wife who are not homeowners jointly file Chapter 7. Such debtors now will have a combined \$10,000 in personal property exemptions. As a result, distributions to unsecured creditors in Chapter 7 cases, already rare, may become even rarer. ■

Debtors to Mitigate Damages (Continued from page 1)

the antidiscrimination provision of the Bankruptcy Code in declining to rent to the Debtor. The Court stated:

"... [the debtor's] conduct in this matter precludes awarding damages. In cases involving automatic stay violations, in which debtors frequently file motions for contempt or for damages under 11 U.S.C. 362(h), courts have overwhelmingly held that debtors have an obligation to attempt to mitigate damages prior to seeking court intervention. Although the Bankruptcy Code does not require a debtor to warn his creditors of existing violations prior to moving for sanctions, the debtor is under a duty to exercise due diligence in protecting and pursuing his rights and in mitigating his damages with regard to such violations [citing supporting cases]."

In the *Oksentowicz* case, the Court stated that any damages suffered by the Debtor were minimal, and related more to filing the Motion for Sanctions than to the alleged stay violation. The Court found that the Debtor and his counsel were simply setting [the creditor] up for this litigation, and held that the Debtor's damages were caused as much, or more, by his own deliberate strategy as by any alleged violation by the creditor of the Bankruptcy Code.

In *Rosengren v. GMAC Mortgage Corp.*, 2001 WL 1149478 (D. Minn. Aug. 7, 2001), the Debtor filed a Motion for Sanctions because his mortgage company contacted him post-petition about reaffirmation and past due payments. The Court awarded only \$150 in attorneys fees, based on the Court's estimate of the limited legal work actually required to resolve the problem short of litigation. Noting that the Debtor's counsel failed to timely advise opposing counsel of his client's

actual damages, and the damages were *de minimus*, the Court concluded:

"[T]he unnecessary escalation of a matter of somewhat limited consequence which could have been resolved by much less lawyering does not make economic or emotional sense. Such escalation creates damages, magnifies costs, and burdens the system. More significantly, such efforts reveal a lack of perspective [citing *In re Newell* 117 B.R. 323, 325 (Bankr. S.D. Ohio 1990)]. . . . The policy of 362(h) to discourage willful violations of the automatic stay has long been tempered by a reasonableness standard born of court's reluctance to foster a "cottage industry" built around [such] fee litigation."

In *In re Duling*, 360 B.R. 643, 646 (Bankr. M.D. Ohio 2006), the Debtor filed an adversary action, and ultimately requested attorney's fees of over \$4,000 even though the creditor dismissed the post-discharge lawsuit after being advised of the bankruptcy filing. The creditor did not dispute that the post-discharge lawsuit violated the discharged injunction, and that an award of some attorney's fees was appropriate. The creditor contested the reasonableness of the fees sought by the Debtor's counsel, arguing that the Debtor's adversary action was "nothing more than an effort on the part of the Debtor's counsel to generate attorney's fees." The Bankruptcy Court disallowed all attorney's fees related to the Debtor's filing of the adversary action, and limited attorney's fees to only \$525.

In the end, most bankruptcy attorneys are practical, and resolve sanctions matters without much ado. When this does not occur, however, the creditor should remind the Debtor's counsel of the Debtor's legal duty to mitigate damages, and the consequences for failing to do so. ■

APPELLATE COURTS BEGIN TO RULE ON WHETHER THE HANGING PARAGRAPH IN SECTION 1325 ALLOWS A DEBTOR TO SURRENDER COLLATERAL IN FULL SATISFACTION

The debate on whether the hanging paragraph in Section 1325(a) allows a debtor to surrender a "910 car" in full satisfaction of the entire claim is now reaching the appellate courts. Two cases came out in July 2007; of course, they reach contrary conclusions regarding the "hanging paragraph".

On July 3rd, the Seventh Circuit found that the hanging paragraph did not allow the debtor to surrender the collateral in full satisfaction of the debt. *In re Wright*, --- F.3d ---- (7th Cir. N.D. Ill. 2007) (Easterbrook, Chief Judge) ("By surrendering the car, debtors gave their creditor the full market value of the collateral. Any shortfall must be treated as an unsecured debt. It need not be paid in full, any more than the Wrights' other unsecured debts, but it can't be written off in toto while other unsecured creditors are paid some fraction of their entitlements.")

On July 5th, the 10 Circuit Bankruptcy Appellate Panel decided *In re Quick*, --- B.R. ----, 2007 WL 1941749 (10th Cir. BAP (Okla.) 2007). In *Quick*, the Court interpreted the hanging paragraph to allow surrender of a "910 vehicle" in full satisfaction of the entire claim.

The Florida Bankruptcy Judges who have written opinions on this issue have found the hanging paragraph does allow the debtor to surrender a "910 car" in full satisfaction of the entire claim. Dennis LeVine & Associates is currently handling the appeal of one of these cases to the District Court. ■



Dennis LeVine moderated a panel discussion at the American Bankruptcy Institute's 25th Annual Spring Meeting in Washington, D.C. in April, 2007. Here, Attorney Alane Becket discusses Chapter 13 confirmation issues.

Dennis J. 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 22 years.

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Things To Make You Think

A 2006 study found that the average American walks about 900 miles a year. Another study found that Americans drink an average of 22 gallons of beer a year. That means, on average, Americans get about 41 miles per gallon. Not bad.



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Secured Creditor & Bankruptcy News

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