

Stream of Commerce

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SUPREME COURT FINDS RIGHT TO CONVERT NOT ABSOLUTE

by:
David Murphree

A Chapter 7 debtor does not have an absolute right to convert a case to Chapter 13, the United States Supreme Court has held.

In *Marrama v. Citizens Bank of Massachusetts*, No. 05-996, 549 U.S. __ (2007), the Court held that a debtor who acts in bad faith prior to filing a Chapter 13 case or converting a Chapter 7 case to Chapter 13 may be denied the ability to continue with a Chapter 13 case and protect his assets.

In 2003, the debtor, Robert Marrama, filed a Chapter 7 case,

claiming that a trust of which he was the sole beneficiary had no value, and that he had not transferred any property within the one year preceding the filing of his Chapter 7 case. Examination by his Chapter 7 trustee revealed that the property held in trust, real estate in Maine, had substantial value, and that Marrama had transferred it to the trust for no consideration seven months prior to filing his bankruptcy case. Marrama also admitted that the purpose of the transfer was to

protect the property from his creditors.

When the Chapter 7 trustee attempted to recover the Maine property, Marrama filed a notice of conversion to Chapter 13, to which the trustee and the Citizens Bank of Massachusetts objected.

The bankruptcy court treated the notice of conversion as a motion to convert, and conducted a hearing. At the hearing, Marrama attempted to argue that the misstatements regarding the property were "scrivener's error,"

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CHAIRMAN'S REPORT

I am pleased to report that the Bankruptcy and Commercial Law Section continues to thrive. The membership of the Section is solid and grows steadily each year. The Section's financial affairs are all in order and we always stay within budget.

For many years the Section has funded scholarships at both the University of Alabama School of Law and the Cumberland School of Law and will continue to do so in the future. The Section also helps fund the expenses of a bankruptcy court moot team that participates on a national level in the Duberstein Bankruptcy Competition and always ranks well. And of course, the annual beach seminar seems to get better each year. In fact, the 2006 seminar had a record number of participants.

Regularly, the staff of the Alabama State Bar comments on how well our Section performs. The level of interest the members have and the amount of activity our Section has compared to other sections of the Alabama Bar certainly sets us apart.

Because the Section has always been blessed with a strong yet diverse board, the job of Chairman of the Section has never been easier. That being said, we can always do better. If you have a suggestion on how to improve something the Section does or think the Section should do something new, let me know.

Finally, I want to publicly thank the bankruptcy judges across the state for their continued commitment to our Section. I feel sure that no other section of the Alabama Bar has a group of judges that not only attend the annual seminar but also participate in such a meaningful way.

I look forward to seeing each and every one of you at the beach seminar beginning May 18th. Should you have any questions or comments about the Section, please do not hesitate to contact me.

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Jeffery J. Hartley is a partner/shareholder of Helmsing, Leach, Herlong, Newman & Rouse, P.C. practicing primarily in the areas of commercial law, reorganization, insolvency litigation and bankruptcy.

BANKRUPTCY AT THE BEACH



DESTIN, FLORIDA

Seminar 6.0 hours CLE
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May 18 & 19, 2007
The Twentieth Annual
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ALABAMA STATE BAR BANKRUPTCY AT THE BEACH FEATURES

The Alabama State Bar Bankruptcy and Commercial Law Section is proud to present the Twentieth Annual Bankruptcy at the Beach seminar. This year's seminar will include the following special events in addition to annual favorites:

- BACPA: It's a Good Thing – Really!
Prof. Todd Zywicki
- Bankruptcy Judges Panel Discussion
- Chapter 11 Breakout Session
- Annual 11th Circuit Update
- Cocktail reception Friday evening
- 6.0 hours CLE credit for seminar including 1.0 hour Ethics (applied for)
- Golf tournament Sat. May 19, 2007 – Links Course - \$106 green fee – Send payment to Section Treasurer – Steven Shaw. Registration deadline – May 1, 2007 - Contact “Golf Czar” Mark Williams (205) 328-6643 – e-mail mpwilliams@nwkt.com

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Bankruptcy at the Beach Program

FRIDAY, MAY 18

1:30–4:45 p.m.

View from the Bench – Judges' panel focusing on attorney professional and ethical issues, including ethical considerations involved with bankruptcy fraud and dual representation of corporate debtor and insiders, and implications of being a debt relief agency. Also, a review of what happens to the property of the estate after conversion.

1.5 hours

Professor Todd Zywicki – Overview of Issues of Which Have Arisen under BAPCPA (Part 1). It's a Good Thing – Really!

1.5 hours

6:00– 9:00 p.m.

Cocktail Reception

SATURDAY, MAY 19

8:30 -11:45 p.m.

Professor Todd Zywicki – Overview of Issues of Which Have Arisen Under BAPCPA (Part 2)

The Intersection of Credit Cards and Bankruptcy

1.5 hours

Jeff Hartley & Judges – Ch. 11 Breakout Session – Special Issues in Individual Debtor Cases

1.5 hours

11th Circuit Bankruptcy Update
Judge Jack Caddell

1.5 hours

PLEASE PRE-REGISTER!

Room reservations can be made by calling the Hilton Sandestin Beach Golf Resort and Spa at (850) 267-9500. Room block will be held until April 16, 2007. Room rates are \$243 per night, single/double, plus tax, plus resort amenity fee.

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and that he was eligible for Chapter 13 relief because he had recently become employed. The bankruptcy court rejected those arguments, and denied the conversion. The First Circuit Bankruptcy Appellate Panel and the First Circuit Court of Appeals upheld the bankruptcy court's ruling.

On appeal, the United States Supreme Court noted that Bankruptcy Code Section 706 allows a debtor to "convert a case under [Chapter 7] to a case under chapter 11, 12, or 13 of this title at any time, if the case has not been converted under section 1112, 1208, or 1307." 11 U.S.C. § 706(a). However, the Supreme Court found that subsection (d) of Section 706, which provides that "a case may not be converted to a case under another chapter of this title unless the debtor may be a debtor under such chapter," limited the right of conversion.

The Court found that Marrama's pre-petition conduct

was sufficient to bar his entry into Chapter 13 under Bankruptcy Code Section 1307(c), which allows for dismissal or conversion to Chapter 7 "for cause." 11 U.S.C. § 1307(c). The type of "cause" contemplated by Section 1307(c), the Court held, includes bad faith.

Essentially, the Court's ruling means that misconduct at any point in a Chapter 7 case may prevent a debtor from remedying such misconduct and protect his assets in a Chapter 13. The Court withheld finding what type of conduct would qualify as "bad faith," saying only that such conduct "must ... be atypical."

The dissent in *Marrama* argues that the majority's reading of Section 1307(c) as "strained," and states that the Bankruptcy Code "does not give the bankruptcy courts the authority to deny conversion based on a finding of 'bad faith.'"

The majority's opinion appears to be limited only to cases in which a debtor intentionally misrepresents the value of a potential asset. Cases involving good-faith beliefs in the value of an asset, for example, a case in which a debtor honestly believes the value of his homestead is considerably less than the Chapter 7 trustee's estimate. In such a case, conversion to save the asset from Chapter 7 liquidation might still be an available remedy.

David Murphree is a sole practitioner in Birmingham, Alabama, focusing primarily on consumer bankruptcy law in the Northern District of Alabama. David currently serves as Technology Chair of the Bankruptcy and Commercial Law Section of the Birmingham Bar Association.

RECENT DECISIONS

Travelers Casualty and Surety Company of America v. Pacific Gas and Electric Company

**United States Supreme Court
549 U.S. _____ (2007)**

Justice Alito

Pacific Gas and Electric Company ("PG&E") filed Chapter 11 bankruptcy and continued to operate its business as a debtor in possession. Although no default occurred, Travelers Casualty and Surety Company of America ("Travelers") asserted a claim in the bankruptcy court, resulting in additional litigation which was eventually resolved. Travelers subsequently filed an amended proof of claim seeking to recover attorneys' fees incurred in the litigation.

PG&E objected, arguing that Travelers could not recover attorneys' fees incurred in connection with PG&E's bankruptcy. The bankruptcy court agreed and rejected Traveler's claim. The Ninth Circuit Court of Appeals affirmed, relying on *In re Fobian*, 951 F.2d 1149 (9th Cir. 1997) which held that where litigated issues are governed entirely by federal bankruptcy law, attorneys' fees will not be awarded absent bad faith or harassment by the losing party. The United States Supreme Court granted certiorari to determine whether federal bankruptcy law precludes an unsecured creditor from recovering attorneys' fees authorized by a prepetition contract and incurred in postpetition litigation.

Writing for a unanimous Court, Justice Alito held that it is generally presumed that claims enforceable under applicable state law will be allowed in bankruptcy unless they are expressly disallowed. Therefore, due to the absence of any support for the

Submissions Wanted

The Stream of Commerce is continually looking for articles on current topics in the areas of creditors rights and bankruptcy law. If you have an article we can review and possibly publish, please contact:

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Fobian rule in the Bankruptcy Code, the Court held the *Fobian* rule invalid.

The Court pointed out that it expressed no opinion regarding whether other principles of bankruptcy law might provide an independent basis for disallowing Travelers' claim for attorneys' fees. Rather, the Court's holding narrowly concluded only that the Ninth Circuit Court of Appeals erred in disallowing that claim based on the fact that the fees at issue were incurred litigating issues of bankruptcy law.

IN RE SALLINGS

**United State Bankruptcy Court
Northern District of Alabama**

Case No. 06-80124-JAC-13

Judge Jack Caddell

2007 WL 412238

The Debtor entered into a Retail Installment Sales Contract with GMAC for the purchase of a new vehicle. When the Debtor filed Chapter 13 bankruptcy, she listed GMAC in her schedules as a creditor and GMAC filed a proof of claim for amounts owed pursuant to the Retail Sales Contract. The Debtor subsequently amended her schedules and Chapter 13 plan to include a potential lawsuit against GMAC for its alleged failure to make proper disclosures required under the Truth in Lending Act ("TILA"). The potential lawsuit was scheduled as an exempt claim with a value of \$0.00.

After the Debtor's Chapter 13 plan was confirmed, the Debtor filed an action against GMAC, demanding statutory and compensatory damages for violations of the TILA. GMAC argued that the TILA claim was time-barred. The Debtor countered that the claim could be maintained defensively based on a theory of recoupment under Section 1640(e) of the TILA. Citing precedent of the Eleventh Circuit Court of

Appeals, Judge Caddell held that the TILA claim was not asserted defensively because it was not "directed at or an answer to the underlying debt." Rather, the Debtor was asserting her claim as an affirmative, independent cause of action on a time-barred TILA claim. Because the Debtor's claim was not asserted as a defense to or denial of GMAC's claim, the court dismissed the action for having been brought affirmatively after the one-year statute of limitations.

IN RE CULVERHOUSE, INC.

**United States District Court,
Middle District of Alabama**

Case Nos. 03-12288-WRS,

1:05-cv-345-MEF

**Chief District Judge William R.
Sawyer**

2006 WL 2456275

In this case the Debtor was an Alabama corporation that purchased a fleet of trucks from an Alabama vendor that immediately were driven out of the state. Shortly thereafter, the Debtor leased the trucks from its Georgia location. The Alabama Department of Revenue ("ADR") issued an audit report and imposed a tax liability on the Debtor for unpaid use taxes, interest and civil penalties. Subsequently, the Debtor filed its Chapter 11 petition.

The ADR filed a proof of claim for the tax liability to which the Debtor objected. The bankruptcy court found that the leases executed by the Debtor triggered tax liability even though the vehicles were located in Georgia at the time the leases were executed. The bankruptcy court additionally concluded that the Debtor asserted sufficient control over the trucks to justify the ADR's exaction of use taxes.

On appeal, the district court explained that under the Alabama use tax statute (ALA. CODE § 40-23-61(c)), the requirement that the use occur "in this state" necessitates the physical presence of the property within the state of Alabama at the time of relevant utilization. Judge Sawyer held that even though the Debtor made decisions concerning the trucks from its place of business in Alabama, the bankruptcy court erred in applying the tax to the Debtor's use of the vehicles when they were not physically located within the state. The Eleventh Circuit Court of Appeals affirmed Judge Sawyer's ruling. *In re Culverhouse, Inc.*, No. 06-15081, 2007 WL 128776, at *1 (11th Cir. Jan. 18, 2007).

Jett v. Lawyers Title Insurance Corporation

Alabama Court of Civil Appeals

Case No. CV-01-5190

Judge Thompson

2007 WL 491034

In this case, the Alabama Court of Civil Appeals held that the Bankruptcy Code bars the application of the doctrine of after-acquired title where title is acquired after the commencement of a bankruptcy case.

The Debtor used real property as security for a loan. The Debtor's deed to the real property later was determined to be null and void, after which the Debtor filed for Chapter 13 bankruptcy. The case was converted to a Chapter 7 case and the Debtor received a discharge. It subsequently was determined that the Debtor held good title to the real property as the result of an inheritance. The mortgagee assigned the mortgage and the assignee instituted foreclosure proceedings.

In reversing the circuit court's summary judgment order for the

assignee, Judge Thompson held that because the deed was null and void at the time of the commencement of the bankruptcy case, the liability on the mortgage was an unsecured debt which was discharged in bankruptcy. Further, the mortgage did not survive the bankruptcy discharge because the deed was void. The court also rejected the assignee's arguments that under the doctrine of after-acquired title, when the Debtor mortgaged land to which she had no right and afterwards acquired good title, it passed instantly to the mortgage holder. As Section 552(a) of the Bankruptcy Code provides, "property acquired by the estate or by the debtor after the commencement of the case is not subject to any lien resulting from any security agreement entered into before the commencement of the case."

In re Electric Machinery Enterprises, Inc.

United States Court of Appeals, Eleventh Circuit

Case No. 06-13733

Judge Wilson

2007 WL 548781

The Debtor entered into a subcontract to provide electrical work in a theme park. Both the general contractor and the Debtor were forced to expend additional costs to accelerate the work, resulting in the general contractor seeking additional payment from the owner of the theme park. After the Debtor filed for Chapter 11 bankruptcy, the general contractor and the owner entered into a settlement agreement in which the owner agreed to pay additional sums to the general contractor.

The Debtor filed an adversary proceeding against the general contractor, alleging that the general

contractor owed a substantial portion of the settlement proceeds to the Debtor. Denying the general contractor's motion to compel arbitration, the bankruptcy court found the matter involved a constructive trust over which it had jurisdiction as a core bankruptcy proceeding since the case involved a disputed and unliquidated claim. The district court affirmed the bankruptcy court's ruling and the Debtor appealed.

The Court of Appeals for the Eleventh Circuit reversed, holding that the dispute was not a core proceeding because it did not involve a right created under federal bankruptcy law and was not a proceeding that would arise only in bankruptcy. The court further held that even if a proceeding is determined to be a core proceeding, the bankruptcy court still must analyze whether enforcing a valid arbitration agreement would inherently conflict with the underlying purposes of the Bankruptcy Code. Because there was no evidence that arbitrating the claims would cause such a conflict, as well as the fact that the dispute was not a core proceeding, Judge Wilson found the bankruptcy court erred in denying the motion to compel arbitration.

In re Miller

United States Bankruptcy Court, Northern District of Alabama

Case No. 06-81889-JAC-13

Judge Jack Caddell

2007 WL 128790

The Chapter 13 trustee objected to confirmation of the Debtor's proposed plan on the grounds that the Debtor had not committed all of their projected disposable income to the proposed plan. The Debtors responded that under the BAPCPA, the proper test for calculating disposable income depends upon whether a debtor's current monthly

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income is above or below the applicable median family income. The Debtors noted that Section 1325(b)(2) of the Bankruptcy Code defines "disposable income" as current monthly income less amounts reasonably necessary for the debtor's support or support of a dependent. Under Section 1325(b)(3), "amounts reasonably necessary" is determined under Section 707(b)(2) of the Bankruptcy Code if the debtor has

monthly income greater than the applicable median income.

The bankruptcy court noted that Section 707(b)(2) of the Bankruptcy Code uses IRS standards to calculate the debtor's applicable monthly expense amounts for certain categories such as housing and uses the debtor's actual monthly expenses for categories of "Other Necessary Expenses" as defined by the IRS.

Judge Caddell held that by tying the phrase "reasonably necessary" to the IRS standards, the BAPCPA limits the judicial discretion that existed prior to the amendments in determining whether the expenses of an above median income debtor are reasonably necessary. Therefore, despite the fact that the Debtors' Chapter 13 payments would have been more under pre-BAPCPA, the bankruptcy court overruled the Chapter 13 trustee's objection and confirmed the Debtors' Chapter 13 plan.

Jeremy L. Retherford and Paul H. Greenwood are associates with Balch & Bingham LLP in Birmingham, Alabama where they are members of the firm's Creditors Rights and Bankruptcy Practice Group.