Bankruptcy and its Impact on Foreclosures

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Table of Contents

1. Bankruptcy - General Overview of Bankruptcy System and the Automatic Stay
2. Determination of Secured Status and Valuation of Security Interest
3. Adequate Protection of Secured Creditors Interest
4. Obtaining Relief from the Automatic Stay
5. Reaffirmation of Debt
6. Treatment of Secured Claims in Bankruptcy Plans

1. Bankruptcy - General Overview of Bankruptcy System and the Automatic Stay

1.1 General Overview.

The Bible tells us:

> At the end of every seven years you shall grant a release of debts. And this is the form of the release: Every creditor who has lent anything to his neighbor shall release it; he shall not require it of his neighbor or his brother, because it is called the Lord's release.

Deuteronomy 15:1. In the United States, we believe in a separation of church and state. So, we have not adopted the "Lord's release." Instead, debtors are given the next best thing, the federal government's release.

The Constitution empowers Congress to establish "uniform laws on the subject of Bankruptcies throughout the United States." Constitution, Article 1, Section 8, Clause 4. Congress has enacted the bankruptcy laws found in Title 11 of the United States Code of Laws. The present Bankruptcy Code was enacted in 1978 and it replaced the Bankruptcy Act of 1898. The Bankruptcy Code is amended by Congress periodically with the most recent significant amendments being enacted in 1984 and 2005.

As stated by the Supreme Court, "[o]ne of the primary purposes of the bankruptcy act is to 'relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh ...." *Local Loan Co. v. Hunt*, 292 U.S. 234 (1934). Bankruptcy seeks to accomplish this

primary purpose through two general forms of bankruptcy relief: (1) liquidation and (2) rehabilitation or reorganization.

Further, one of the primary tools of bankruptcy is the automatic stay. When a bankruptcy case is filed, all actions (with limited exceptions) against the debtor are stayed. This stay is to give the debtor an amount of "breathing room" in an effort to help him figure out what he is going to do next. When any bankruptcy is filed, the automatic stay is put in place. All actions taken in violation of the automatic stay are void ab initio. Further, any action taken in violation of the automatic stay is punishable by sanctions and the Bankruptcy Courts are not shy about punishing violators through monetary sanctions in the amounts of thousands, tens of thousands and even hundreds of thousands of dollars. As will be seen in the following materials, a creditor's reaction to the automatic stay depends upon whether the relief sought is through liquidation or reorganization.

In a foreclosure setting, the creditor's reaction is largely dependent upon the debtor's intent. There is a single bankruptcy chapter dealing with liquidation (Chapter 7). So, if the debtor has filed for protection under Chapter 7 of the Bankruptcy Code, he has given up, wants the trustee to liquidate his assets, allow him the ability for a fresh start, and allow him to retain only his homestead exemptions.

There are several chapters of the bankruptcy code that deal with reorganization: (1) Chapter 9 (governmental reorganizations); (2) Chapter 11 (complex and business reorganizations); (3) Chapter 12 (farmer reorganization); and (4) Chapter 13 (consumer reorganizations). If the debtor files for protection under one of these chapters, the debtor is seeking to protect and keep some asset. In the consumer context, the debtor is usually seeking to protect his home. In exchange for keeping his assets, the debtor has to commit to making

payments (proposed through a plan of reorganization) to his creditors from future income and is not given his fresh start until the completion of his plan. So, you will note in the materials a dichotomy. If you are dealing with reorganization, the Bankruptcy Code and case law want to give the debtor a chance to protect and keep his assets. In liquidation, the case law is less concerned about the debtor and more concerned about the estate and the liquidation of the assets for the benefit of the creditors of the estate.

In the materials that follow, we hope to address: 2. Determination of Secured Status and Valuation of Security Interest; 3. Adequate Protection of Secured Creditors Interest; 4. Obtaining Relief from the Automatic Stay; 5. Reaffirmation of Debt; and 6. Treatment of Secured Claims in Bankruptcy Plans.

2. Determination of Secured Status and Valuation of Security Interest

2.1. Amount of Secured Claim

Under the Bankruptcy Code, the Bankruptcy Court has the ability to determine whether a creditor is secured and the amount of his security interest. Section 506 of the Bankruptcy Code governs the amount of a secured claim.

Section 506(a)(1) provides that a creditor with a right of setoff or a lien has a secured claim ONLY to the amount subject to setoff or the value of the collateral. So, the issue has always been how do you value the collateral. The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "BAPCPA") changed some of the provisions relating to the issue of how to value the collateral. In South Carolina, this issue and the BAPCPA's modification was addressed in the case of *In re Brown*, C/A No. 06-00197-jw, slip op. (Bankr. D.S.C. Apr. 25, 2006) (determining the proper valuation standard to be utilized under 11 U.S.C. § 506 for purposes of redemption under 11 U.S.C. § 722)). Prior to BAPCPA, the court would value

personal property with the replacement cost for the collateral, minus the costs of selling the collateral. In *Brown*, the Court found that the retail price, minus repair costs, was the correct way to value the secured creditor's collateral. The Court did not deduct any of the potential costs for selling the collateral.

Section 506(b) provides that if the collateral's value is greater than the amount of the claim, then the amount of the secured claim is the amount of the setoff or that amount of the collateral along with any interest or expenses of the creditor. Under Section 506(c) the trustee may recover from the collateral the reasonable and necessary costs of securing the estate, like insurance. Finally, Section 506(d) voids liens that are secured by claims that are not properly allowed in bankruptcy proceedings. But see *In re Virello*, 98-03751-W (Bkrtcy.D.S.C. 1999) (a Chapter 7 debtor does not have standing to use 506(d) to void a lien on real property which is abandoned or likely to be abandoned and therefore of no benefit to the estate).

2.2. Valuation Hearing or Confirmation Hearing

Creditors can call for a Section 506(a) valuation hearing, or the hearing may accompany the confirmation hearing as long as Bankruptcy Rule 3012 is properly followed. If value in collateral is greater than the amount on lien, then the creditor is in good shape and is oversecured. If the value of the collateral is less than the amount of the debt, the creditor is undersecured. For oversecured creditors, Section 506(b) permits post-petition interest and the recovery of costs and fees when they are reasonable and are provided for in the agreement under which the claim arose. *See Rake v. Wade*, 508 U.S. 464 (1993) (Chapter 13 debtor required to pay post-petition, preconfirmation interest to oversecured creditor holding mortgage on principal residence regardless of whether mortgage provides for such interest).

If the valuation process occurs as part of a proposed Chapter 13 Plan, the Creditor must

be diligent to examine the Plan and make the necessary objection, in the event that the Plan under values the collateral. In the foreclosure process, a creditor is usually dealing with the debtor's residence. As such, Chapter 13 Plans have a limited ability to modify the contracted agreements relating to the obligation. If the debt is only secured by an interest in the Debtor's primary residence and the last payment to be made on the debt is not within the 60 month period of a possible plan, the plan can only cure the arrears over a period of time and require regular payments to commence two months after the filing of the bankruptcy.

This limitation to cure the arrearage and make payments contractual payments is not included into Chapter 11 plans in the individual context. So, if the individual is in a Chapter 11 bankruptcy, there are many more possible permutations that the debtor can propose for handling the claim of the secured creditor. Because of this fact and because the failure to object could result in an Order that is binding upon the creditor, in a Chapter 11 bankruptcy it is wise for the creditor to receive advice from competent bankruptcy counsel.

2.3. Value is the Replacement Value

The value used by the Courts is the replacement value pursuant to Section 506(a)(2). *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997). The Rash Court suggested valuation be determined by the price a willing buyer in the debtor's business would pay a willing seller for property of like age and condition. Courts have adopted different valuation determination standards based upon the rule established by the Rash Court. Many jurisdictions use the average of the wholesale and retail values as a starting point in determining value. *In re Getz*, 242 B.R. 916 (6th Cir. 2000); *In re Marquez*, 270 B.R. 761 (Bankr.D.Ariz. 2001). Others use strictly the retail value or a discounted retail value. *In re Gray*, 285 B.R. 379 (Bankr.N.D.Tex. 2002); *In re Renzelman*, 227 B.R. 740 (Bankr.W.D.Mo. 1998). The minority

approach is a strict interpretation of the *Rash* rule whereby the court bases valuation upon the type of debtor and the nature of the property on a case by case basis. *In re Gonzalez*, 295 B.R. 584 (Bkrtcy.N.D.Ill. 2003).

A majority of courts have distinguished the *Rash* rule in a Chapter 7 claim. The courts rationalize that collateral in a Chapter 7 redemption context differs the Chapter 13 cram down context discussed in *Rash*, therefore using a liquidation value in place of the replacement value. *Triad Financial Corp. v. Weatherington (In re Weatherington)*, 254 B.R. 895 (6th Cir. 2000); *In re Donley*, 217 B.R. 1004 (Bankr.S.D.Ohio 1998). However, there is a recent line of cases rejecting the notion that the *Rash* standard does not apply to Chapter 7 claims, arguing instead that both Chapter 7 and Chapter 13 claims fall under the newly adopted Section 506(a)(2). *In re Maryland* 2006 WL 1476927 (Bkrtcpy.M.D.N.C. 2006); *In re Smith*, 307 B.R. 912 (Bkrptcy.N.D.Ill. 2004).

The *Rash* standard may be applied to a Chapter 12 claim where the disposition or use of the property proposed by both parties is relevant in determining value, as set forth in Section 506 (a). *In re Bishop*, 339 B.R. 595 (Bkrtcy.D.S.C. 2005).

Valuation of collateral securing a creditor's claim is flexible and is not limited to a single point in time for purposes of determining whether a creditor is entitled to accrue interest under 506(b). *In re T-H New Orleans Ltd. Partnership*, 116 F.3d 790 (5th Cir. 1997).

Again, the BAPCPA weighed in on this subject. In South Carolina, this issue and the BAPCPA's modification was addressed in the case of *In re Brown*, C/A No. 06-00197-jw, slip op. (Bankr. D.S.C. Apr. 25, 2006) (determining the proper valuation standard to be utilized under 11 U.S.C. § 506 for purposes of redemption under 11 U.S.C. § 722)). Prior to BAPCPA, the court would value personal property with the replacement cost for the collateral, minus the costs

of selling the collateral. In *Brown*, the Court found that the retail price, minus repair costs, was the correct way to value the secured creditor's collateral. The Court did not deduct any of the potential costs for selling the collateral.

2.4. Valuation of Collateral v. Valuation of Security Interest

Section 506 determines the actual amount of a secured claim, but does not govern if the claim itself is specifically allowed. A creditor is secured if it has a lien on the property or if the property is subject to setoff pursuant to Section 553. The creditor is secured to the value of the creditor's interest in the property or the extent of the amount of setoff. If the amount of the collateral is less than the claim, then the creditor is unsecured for the remainder of the claim. Section 506(b) states that if the value of the collateral exceeds the amount of the creditor's claim, then the creditor's claim can be increased by expenses and interest incurred by the creditor.

Section 506(c) requires that the Trustee charge the secured creditors for certain necessary expenses to preserve the property, 506(d) summarily voids liens secured by claims that are not properly allowed claims.

Valuation of collateral securing a creditor's claim is flexible and is not limited to a single point in time for purposes of determining whether a creditor is entitled to accrue interest under 506(b). *In re T-H New Orleans Ltd. Partnership*, 116 F.3d 790 (5th Cir. 1987).

Under Section 506(b) recovery exists for post-petition interest on an oversecured claim, as well as recovery of reasonable fees and costs. *United States v. Ron Pair Enterp. Inc*., 489 U.S. 235 (1989). A secured claim may only be extended with fees and costs if the underlying agreement provides for them. Furthermore, post-petition interest and expenses must be reasonable. *In re Pearson*, 2001 WL 1699657 (Bkrtcy.M.D.N.C. 2001); *Best Repair Co., Inc. v. U.S.*, 789 F.2d 1080 (4th Cir. 1986).

As it relates the ability of a Trustee under Section 506(c) to surcharge the secured creditors collateral, this section only applies to the Trustees and Debtors-in-Possession. Further, the Chapter 11 debtor in possession may not surcharge an oversecured bank's collateral to pay debtor's attorneys if the services are not necessary and do not confer a benefit to the banks. *In re Compton Impressions, Ltd.,* 217 F.3d 1256 (9th Cir. 2000).

2.5. Attorney Fees are Reasonable Attorney Fees

As it relates to attorney fees awarded in a foreclosure action, in the case of *In re Epps*, 99-00026-W (Bkrtcy. D.S.C. 7/9/99), the Court held that the debtor was precluded from challenging a pre-petition state court award of attorney's fees pursuant to the Rooker-Feldman Doctrine. Nevertheless, Court allowed the Chapter 13 Trustee to challenge the reasonableness of the attorney's fees. So, in some instances, the Court will hold a hearing and require a foreclosure attorney to present evidence that the legal fees he charged were necessary and reasonable.

2.6. Setting aside a security interest when there is no value to attach.

Certain security interests can be set aside in their entirety making the secured creditor, unsecured. Generally, these types of security interests fall into two categories. Security interests in property that has no value and security interests that impair a debtor's exemptions.

As it relates to security interest in property that has no value, this situation usually arises in second or third mortgages. If the value of the property is only sufficient to cover the first mortgage, then there is no value in the property for the second or third mortgage to attach. Thus, these types of security interests can be set aside in their entirety, leaving the creditor with only an unsecured claim. We discuss how the security interest can be valued and eliminated in the section of this discussion relating to reorganization plans.

The second category of security interests that can get set aside are judicial liens or non-

possessory, non-purchase money security interests. If the judicial lien or non-possessory, non-purchase money security interest impairs an exemption, than the security interest can be set aside. If the judicial lien impairs any exemption, then it can be set aside. If the non-purchase money security interest impairs an exemption in personal property, tools of the trade or health aids, then these security interests can be set aside. See 11 U.S.C. Section 522. In discussing this area, the first thing you need to understand is the exemptions and South Carolina has radically increased the exemptions available in the last two years.

2.6.1. South Carolina Exemptions

The first exemption relates to real property owned in South Carolina. The exemption relating to property used as residence or burial plot is expressed as the total net value not to exceed $5,000.00 per debtor. S.C. Code Ann. §15-41-30(1) (Law. Co-op. 2005). On May 18, 2006, the South Carolina General Assembly passed the Home Security Act amending this homestead exemption and because the Governor took no action, the Home Security Act became law on May 25, 2006.

Through this Act, the homestead exemption has increased to $50,000 per person with the possibility of a total of $100,000 exemption being applied to a "living unit." The homestead exemption only applies to the debtor's residence. Of course, if two people are using the home as their residence, they can aggregate the exemptions to the total amount of $100,000. If more than two people are using the home as a residence, the total aggregate homestead exemption cannot be more than the $100,000. This amount will be adjusted by the consumer price index each July to take into consideration inflation issues.

As for the use of the term "living unit," the homestead exemption can be applied to "real property or personal property" that the "debtor uses as a residence." The personal property

referred to in the statute is likely to be manufactured houses that are not permanently affixed to the real property. If a manufactured house is not affixed to the real property so as to become an integral part of the real property, then in some instances, that manufactured home could still be considered personal property. Because of this situation, the General Assembly likely wanted to include in the homestead exemption whatever type of structure a person was using for their residence: whether that structure was a stick built home or a home that is manufactured and then moved onto the real property.

The remaining exemptions under South Carolina law were amended in 2008 by Act 225 of the South Carolina Legislature. These exemptions went into effect on May 22, 2008 when the legislature overrode the Governor's veto.

The second exemption relates to motor vehicles. Only one vehicle per debtor is allowed to claim an exemption against and the exemption relates to the net equity and cannot exceed $5,000.00 per debtor.

The third exemption for a debtor relates to personal property used for household and personal property Again, the exemption is against net equity and is in the amount not to exceed $4,000.00 for each debtor. The following is generally included in personal property: Clothing and personal apparel, Kitchenware items, Stove, Refrigerator, Freezer,Washing machine, Dryer, Living room furniture, Den furniture, Bedroom furniture, Dining room furniture, Lawn furniture, Television, Stereo, Radio, Musical instruments, Air conditioner, Paintings and art, Lawn mower, Yard tools, Crops and Animals.

The fourth exemption relates to jewelry. The total net value of the exemption cannot exceed $1,000.00 for each debtor.

The fifth exemption provided by South Carolina law relates to cash and other liquid assets. A debtor cannot claim this exemption if he is claiming the first exemption in real property. Here the total value of the claimed exemption cannot exceed $5,000.00 per debtor. Generally, this exemption is used to exempt a checking account, deposit account or some type of negotiable account at a financial institution.

The sixth exemption relates to tools of the trade. Basically, these are the tools that the individual needs in his business. We have seen regular tools be claimed under this exemption and even, in some unique situations, a pickup truck, a computer and other items not usually considered as a tool. Here, the total net value cannot to exceed $1,500.00 for each debtor.

The seventh exemption is a spill over type exemption. It provides that the debtor can exempt "an aggregate interest in any property, not to exceed five thousand dollars in value of an unused exemption amount to which the debtor is entitled pursuant to subsection A, items (1) through (6)." Simply, if the debtor hasn't fully used one of the other exemptions, he can use the seventh exemption to claim $5,000 from that exemption to protect any property of his choosing.

The eighth relates to a claim involving unmatured life insurance contracts. The life insurance contract can be a whole life policy or term policy and the entire amount of the insurance contract is exempt. The only limitation is that the policy cannot be a credit life policy. Previously, the beneficiary under the policy must be someone other than the insured and other than the insured estate. Section 38-63-40 of the S.C. Code of Laws also deals with this exemption and also suggests that the entire value of these policies is exempt. However, Section 38-63-40 suggests that if the insured files a petition in bankruptcy within two years of purchasing

the insurance, the policy might not be exempt if the premiums are paid with the intent to defraud creditors.

The prior limit of $4,000 seems to have been incorporated into the ninth paragraph of this code section. Again, if you file bankruptcy within two (2) years of purchasing a whole life policy, the amounts contributed to the policy might be set aside and your exemption may be reduced to $4,000. If you avoid filing bankruptcy for two years, this may be an unlimited exemption. The specific reference to Section 542 of the bankruptcy code seems to incorporate the two year limitation period found in that statute.

The tenth exemption relates to professionally prescribed health aids and the statute provides for an unlimited value or number of items.

The eleventh exemption is in the debtor's right to receive the following benefits:

A. A social security benefit, unemployment compensation or a local public assistance benefit.

B. A veteran's benefit.

C. A disability, illness or unemployment benefit.

D. Alimony, support or separate maintenance.

E. A payment under a stock bonus, pension, profit sharing annuity or similar plan or contract on account of illness, disability, death, age or length of service unless,

(i) such plan or contract was established by or under the auspices of an insider who employed the debtor at the time the debtor's rights under such plan or contract arose;

(ii) such payment is on account of age or length of service; and

(iii) such plan or contract does not qualify under §§401(a), 403(a), 403(b), 408 or 409 of the Internal Revenue Code of 1954 [26 U.S.C. §§401(a), 403(a), 403(b), 408 or 409.]

Again, this right to receive the benefits appears to be an unlimited right. The entire amount is exempt from creditors. As long as the plan qualifies under the Internal Revenue Code, the Bankruptcy Court usually does not go beyond this qualification.

The twelfth exemption relates to the debtor's right to receive, or property that is traceable to:

A. An award under a crime victim reparation law.

B. A payment on account of the bodily injury of the debtor or of the wrongful death or bodily injury of another individual of whom the debtor was or is a dependent.

C. A payment under a life insurance contract that insured the life of an individual of whom the debtor was a dependent on the date of such individual's death, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.

The thirteenth exemption deals directly with individual retirement accounts and may have the unintended consequences of confusing what was in the past an unlimited exemption. Here IRA accounts are included in a list of items that are qualified by the statement "to the extent reasonably necessary for the support of the debtor or any dependent of the debtor." It is likely that the legislature meant for this qualification to only qualify the last item in the series but because of the placement of the common, one could argue that it qualifies IRA accounts as well.

The fourteenth exemption is an unlimited exemption and provides that all pension plans

qualified under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") are exempt from creditors.

Lastly, under South Carolina law, are the following other exemptions that are located in other areas of the South Carolina Code of Laws:

A. Fraternal benefit association benefits under §38-37-870.

B. The right to an annuity or a retirement allowance or to the return of contributions, an annuity or retirement allowance itself, any optional benefit or other right accrued or accruing from the South Carolina Retirement System (§9-1-1690), the Retirement System for Judges and Solicitors (§9-8-190), the Retirement System for the General Assembly (§9-9-180), the Police Officers Retirement System (§9-11-270) or any private retirement system operated by a municipality as provided for under §9-1-1680.

C. Any pension fund either before or after distribution under Firemen's Pension Funds held by any municipality (§9-13-230).

D. Worker's compensation benefits, §42-9-360.

E. Public aid and assistance benefits, §43-5-190.

F. Crime victim's compensation, §16-3-1300. and

G. Partnership property, §33-41-720.

This last section deserves some exploration especially as it relates to the partnership established with children. For a proper analysis, each partnership document should be reviewed to make sure that the partnership property issue is fully resolved.

In addition to the state laws on exemptions, federal law provides the following additional exemptions:

A. Social security paid or payable, 42 U.S.C. §407.

B. Veteran's benefits, 38 U.S.C. §3101.

C. Disability or death compensation for government employees, 5 U.S.C. §1830.

D. Civil service retirement annuity, 5 U.S.C. §8346.

E. Armed services retirement or retainer pay annuity, 10 U.S.C. §1440.

F. Military survivor annuity, 10 U.S.C. §1450(i).

G. Foreign service retirement and disability, 22 U.S.C. §4060.

H. Annuities for survivors of judicial officials, 28 U.S.C. §376.

I. Longshoremen's and harbor worker's compensation and benefits, 33 U.S.C. §916.

J. Benefits from Servicemen's or Veteran's Group Life Insurance, 38 U.S.C. §770(g).

K. War risk hazard compensation benefits, 42 U.S.C. §1717.

L. Railroad retirement annuity for supplemental annuity, 45 U.S.C. §231(m).

M. Railroad workers unemployment compensation, 45 U.S.C. §352(e).

N. The clothing of a seaman, 46 U.S.C. §1110. and

O. CIA retirement, 50 U.S.C. §403.

So, if a judicial lien impairs any of these exemptions, a bankrupt debtor can set it aside pursuant to Section 522. If a non-possession non-purchase money security interest impairs the exemptions in the debtor’s personal property, tools of the trade or health aids, the bankrupt

debtor can set aside these non-possessory non-purchase money security interests.

2.6.2. Transforming a purchase money security interest into a non-purchase money security interest

Non-purchase money security interests in personal property are rare. However, a purchase money security interest can be transformed into a non-purchase money security interest during a refinancing. Under Section 36-9-103(h) of South Carolina's adoption of the Uniform Commercial Code, it is left up to the courts as to whether a refinance has transformed the type of security interest. South Carolina has adopted the transformation rule in *Rosen v. Assoc. Fin. Serv. Co.*, 17 B.R. 436 (D.S.C. 1982) and *Haus v. Barklays Amer. Corp.*, 18 B.R. 413 (Bankr. D.S.C. 1982). In *Haas* the court suggested that the tracing of payments and their allocation among different debts could leave a PMSI in existence, but to this author's knowledge, this burden has not been carried by any reported decisions.

Also, the inclusion of other items in the security interest may have an impact on whether the security interest is considered to be a purchase money security interest. In the case of *In re Macon*, 376 B.R. 778 Bankr. D.S.C. 2007), the court examined whether the inclusion of items altered the nature of the interest and found that the inclusion of a service contract and gap insurance did not result in the transformation of the security interest into something other than a purchase money security interest. *See also, In re: Vinson*, C/A 07-04893-HB, 2008 W.L 319678 slip op. (Bankr. D.S.C. June 25, 2008) (negative equity on trade-in being rolled into purchase price did not destroy purchase money security interests in vehicle). Simply, the determination of whether the purchase money nature of the security interest will be transformed depends upon a

totality of the circumstances. *See In re: Matthews*, 378 B.R. 481 (Bankr. D.S.C. 2007).

3. Adequate Protection of Secured Creditor's Interests

3.1. Secured Creditors are entitled to Adequate Protection

Adequate protection is protection afforded to the holders of secured claims. The concept of adequate protection preserves the secured creditor's position at the time of bankruptcy. Section 361 provides three ways to provide adequate protection over a property interest. Adequate protection may be achieved by using cash payments, replacement liens, or any other method that provides an equivalent of the entity's interest in property.

3.2. Relief from the Automatic Stay for Lack of Adequate Protection

Section 362(d)(1) states that a party in interest (a creditor) can move to lift the stay for cause, including a lack of adequate protection in the property. Section 506 is intertwined with Section 361 as the valuation of the collateral is very important in determining if the creditor is adequately protected. Section 363(e) provides that the court will stop or restrict the use, sale, and/or lease of property to maintain adequate protection. Finally, Section 364(d) allows a second lien to be given to obtain additional credit as long as adequate protection is given to the existing lien holder.

3.3. What Constitutes Adequate Protection?

The following could provide adequate protection: a large equity cushion, requirement of payments to the creditor, or an interest in a stream of future rents. Section 361 protects a broad range of creditor interests and will depend on the factual situation in each case concerning both

the nature and the use of the collateral. A substantial equity cushion can obviate the need for any other adequate protection. *In re Mellor,* 734 F.2d 1396 (9th Cir. 1984).

The statutory scheme of Section 361 indicates that adequate protection is intended to encompass a broad range of creditor interests and does not mandate an interpretation of the creditor's interest as a whole of the economic bargain. It is clearly susceptible to differing applications over a wide range of fact situations and will depend on the nature of the collateral and the proposed use of the collateral. *In re Briggs Transp. Co.*, 780 F.2d 1339 (8th Cir. 1985).

On September 15, 2006, the Bankruptcy Court for the District of South Carolina answered a long standing question. The question presented was whether a debtor's failure to make payments pursuant to the plan of reorganization was sufficient to warrant relief from the automatic stay. In the case of *In re Anderson*, 05-07387-D (Judge David R. Duncan, September 15, 2006), the court held that failure to make post-confirmation payments was cause to grant relief from the automatic stay.

In that case, the debtor had fallen two months behind in post petition payments, but that the debtor also had an equity cushion in the property. In pre-confirmation motions for relief from the stay, equity cushions have been found to provide adequate protection and have been found to be a reason to deny the creditor relief from the automatic stay. Some courts have held that such an analysis, although a defense pre-confirmation is not a defense post-confirmation. The South Carolina bankruptcy court had not ruled on this issue until *Anderson*.

While the Court did not grant an unconditional relief from the automatic stay, the Court provided a timetable upon which the debtor was to “cure” the default under the terms of the plan. Failure to make these payments would result in the termination of the automatic stay. After the court entered in September 15, 2006 Order, the debtor requested that the Court reconsider the Order. That motion was denied on November 10, 2006. The Debtor has subsequently appealed and that appeal is still pending.

Generally, the Court is making the debtors live up to the provisions of their plan. The plan is binding on creditors and similarly should be binding on the debtors. That is exactly what the bankruptcy court held.

4. Obtaining Relief From the Automatic Stay

4.1. General Rules for Relief

Relief from the automatic stay is governed by Section 362(d). A party in interest may move for relief of the stay, which the court will properly grant after notice and a hearing. To get relief from the stay the creditor must satisfy both parts of the Section 362(d) test; the stay may be lifted (1) for cause (including a lack of adequate protection), and (2) if the debtor does not have equity in the property and the property is not needed for an effective reorganization. Section 362(d)(3) then provides specific rules when the bankruptcy concerns a single asset real estate case. Section 362(e) provides that thirty days after the motion for relief, the stay shall be lifted unless the court after both notice and a hearing orders the stay to continue in effect pending the conclusion of or as a result of a final determination of Section 362(d).

All liens, including those senior and junior to the movant's lien, are considered in determining whether the debtor has equity in the property. *In re Indian Palms Assoc.*, 61 F.3d 197 (3d Cir. 1995).

For property to be necessary for an effective reorganization, there must be reasonable possibility of a successful reorganization within a reasonable time. *United Savings Ass'n of Texas v. Timbers of Inwood Forest Assoc., Ltd.*, 484 U.S. 365 (1988).

Specific rules regarding the automatic stay apply to repeat filers pursuant to the Bankruptcy Abuse Prevention and Consumer Protection Amendments added to Title 11 in 2005. Section 362(c)(3) applies to one-time repeat filers who have had only one bankruptcy case dismissed within the previous year. The automatic stay terminates on the thirtieth day post-petition unless an interested party files a motion that is noticed and heard by the court prior to the thirty day ending period. Section 362(c)(4) applies to multiple repeat filers, which are defined as those who have had two or more bankruptcy cases dismissed within the previous year. The automatic stay does not go into effect upon the filing of the later case. An interested party may file a motion requesting an automatic stay within thirty days of filing the later case. For one-time repeat filers, the automatic stay terminates as a matter of law after the thirty day filing period and the court will not consider an untimely filed motion to extend the stay. *In re Michelle D. Tubman, Debtor*, 364 B.R. 574 (Bkrtcy.D.Md. 2007).

In the case of *Cherett Lenora Jupiter*, bankruptcy case number 06-00963 (June 21, 2006, John E. Waites), the South Carolina bankruptcy court was dealing with the termination of the

automatic stay. Several other jurisdictions had held that the automatic stay was terminated only as to the debtor, it remained in effect as to the estate. Therefore, in these other jurisdictions, creditors were required to seek relief from the stay, even in situations where it had been terminated as to the debtor. In *Jupiter*, Judge Waites disagreed with these other jurisdictions and held that when a serial filer's motion to continue the automatic stay is denied, the stay is terminated "as to the Debtor and property of the Debtor's estate." Thus, the Bankruptcy Courts of South Carolina will provide a comfort order and will allow creditors to proceed with their state court actions when the automatic stay is terminated..

To be extra cautious, Judge Waites included a footnote that says that all of the Judges in the bankruptcy court of South Carolina were consulted on this ruling and that all of the Judges agree with Judge Waites' reasoning and opinion. A word of caution needs to be mentioned about this opinion. While the ruling is not qualified, Judge Waites does discuss the fact that a pre-petition foreclosure action was pending in this matter. Further, Judge Waites seems to refer, at least in part, to a case that held that when a pre-petition foreclosure action is pending, the failure to get the stay extended results in the foreclosure action being allowed to proceed.

Judge Waites believed that if the automatic stay continues as to the estate, even though the motion to continue the stay is denied, such a holding would render the amendments provided for in the BAPCPA meaningless and Judge Waites was unwilling to so rule, even though other bankruptcy judges in other districts have so ruled.

4.2. Automatic Stay and Marital Disputes

The bankruptcy court may properly lift the automatic stay in an equitable distribution suit if (1) the state court has special expertise in handling domestic matters, (2) judicial economy is promoted because the state proceedings may be completed quickly and inexpensively, and (3) the entry of the judgment in state court does not harm the estate or the interests of other creditors because the bankruptcy court retains jurisdiction to determine the amount the former spouse is to be paid on the claim. *In re Robbins,* 964 F.2d 342 (4th Cir. 1992); *In re Dole*, 96-77677-W (Bkrtcy.D.S.C. 2/21/97) (Court modified automatic stay to allow the state family court to decide issues related to support, equitable division of marital property, and to allow the debtor to obtain a divorce decree).

As it relates to a creditor's rights in marital disputes, in the case of *In re Koenig*, C/A No. 00-11188-W (Bankr. D. S.C. Dec. 7, 2001), a Creditor had a claim against Debtor's estranged husband which was secured by a note on which Debtor was not liable. Creditor sought relief from stay to pursue foreclosure of the collateral in Debtor's possession. In Debtor's Chapter 13 plan, she treated the debt by providing that it was to be paid outside of the plan by her estranged husband. The estranged husband failed to make payments for several months. When Creditor sought relief from the stay, Debtor objected because Creditor failed to file an objection to its treatment in the plan. The Court rejected the argument, finding that a line of cases Debtor cited were inapposite to the circumstances of this case, and there was no res judicata effect of the plan because its language was insufficient to extinguish Creditor's lien. Furthermore, it did not clearly prohibit Creditor from foreclosing its lien. The Court also determined that Creditor was

not adequately protected, no payments were being made to Creditor, and there was no equity cushion.

4.3. Pre-Petition Agreements Waving Automatic Stay

In South Carolina, the bankruptcy courts generally will enforce a knowing and voluntary waiver of the automatic stay. *See In re Darrell Creek Associates, L.P.*, 187 B.R. 908 (Bkrtcy. D.S.C. 1995) (Waiver-of-stay agreement executed pre-petition by a Chapter 11 debtor provided cause for lifting the automatic stay to allow the mortgagee to foreclose). However, in circumstances where the debtor performs under the terms of the agreement, the bankruptcy court will retain jurisdiction to determine the extent to which the automatic stay has been waived. In the case of *In re Drawdy*, No. 01-04844-W (Bankr. D.S.C. 09/20/01), the creditor sought to enforce a pre-petition waiver agreement included in a state court order, whereby Debtors waived their right to object in the event Creditor sought relief from the automatic stay. Nevertheless, the Court reasoned it was not barred because (1) the waiver provision was operative only in the event of Debtors' default of the agreement and the Court found that Debtors complied with the agreement; (2) the state court did not determine the issue of the automatic stay's applicability; and (3) the waiver agreement is not self-executing but is only one factor a court considers when determining whether relief from stay is appropriate. The Court ruled that the agreement was not enforceable because Debtors had performed according to its modified terms. The Court denied Creditor's motion for relief from stay. *See Also, In re Riley*, 188 B.R. 191 (Bkrtcy. D.S.C. 1995) (A pre-petition forbearance agreement that was executed by a Chapter 13 debtor-mortgagor and

a mortgagee and which contained a waiver of stay provision did not continue beyond the cure of default that existed when the agreement was entered).

4.4. Creditor's Rights Upon Foreclosure Sale

In the case of *In re Holmes*, 99-08796-B (Bankr. D.S.C. 11/23/1999), the mortgage creditor filed a motion for relief from the automatic stay. Prior to the filing of the Chapter 13 petition, a foreclosure action had terminated, with the mortgage creditor as the successful bidder at the foreclosure sale. Even though the Master's Deed was signed, it had yet to be recorded. The Court relied on precedent to conclude that upon foreclosure on the property, the debtor is divested of any interest, including the equity of redemption; thus, the property in question was no longer property of the bankruptcy estate. As a result, the Court concluded that such facts constituted sufficient "cause" to grant relief from the stay pursuant to Section 362(d)(1). However, the Court recognized that the debtor had raised a significant question regarding whether the service of the Summons and Complaint in the foreclosure action was effective. In applying the Rooker-Feldman doctrine, the Court concluded that the determination of proper service was left to the state courts; however, to provide an opportunity for the debtor to address the issue of proper service with the state court, the Court granted the Motion but made it effective at a later date.

Similarly, in the case of *In re Watts*, C/A No. 00-06791-W (Bankr. D.S.C. 10/27/2000), the United States of America, on behalf of the Rural Development, filed a Motion to Terminate Automatic Stay. In this case, a judgment of foreclosure and sale had been entered in the United

States District Court and the property had been sold at the foreclosure sale. Debtor objected to the Motion arguing that the sale was not fully completed. Debtor further asserted that, pursuant to Section 1322(c)(1), she had the right to cure the mortgage arrears owed to the Creditor because the sale was yet to be completed under applicable non-bankruptcy law. First, the Court followed precedent in this district to hold that the property no longer constituted property of the estate and Debtor possessed neither a legal nor an equitable interest in the property once the auctioneer's hammer fell. Furthermore, as it related to Section 1322(c)(1), the Court recognized that courts interpreting this Section were split in their decisions. The Court ultimately adopted the reasoning of the courts that have held that the language of Section 1322(c)(1) is clear and unambiguous in establishing the date of the actual foreclosure sale as the cut-off date for curing mortgage defaults. The Court once again emphasized that upon the falling of the gavel, the debtor was left with bare legal title and "‘‘[t]he additional steps of obtaining court approval, awaiting the expiration of any cure period . . . , paying the purchase price, and recording the deed may be necessary to consummate the sale, but that does not alter the fact that the purchaser's right to acquire the property has intervened." The Court ultimately found that relief from the automatic stay pursuant to Section 362(d) was warranted.

4.5. Creditor's Rights Upon Repossession

Generally, repossessed property remains property of the estate. Property in the hands of a creditor is subject to a turnover action by the debtor or trustee. If the creditor fails to voluntarily turnover the property, he may be subject to sanctions, such as attorney fees. However, the

creditor could force the issue by bringing a motion for relief from the stay because of lack of adequate protection.

In the case of *Jennings v. R & R Cars and Trucks (In re Jennings)*, No. 01-02330-W, Adv. No. 01-80044-W (Bankr. D.S.C. 9/17/01), the court found that the creditor failed to voluntarily turn over the property and entered an Order that determined damages for failing to turnover and violation of the automatic stay. Previously, in an adversary proceeding, the Court ordered the Creditor to return the vehicle, lawfully repossessed pre-petition. By the time the Order was entered, Debtors's case had been dismissed. The Court later vacated the dismissal order. Afterward, Debtors brought a contempt action against Creditor claiming it failed to comply with the turnover order. The Court found Creditor in contempt and again ordered it to return the vehicle immediately to Debtors. In determining damages, the Court considered the effect of the dismissal of the case and held that the vacation of the dismissal did not retroactively reinstate the automatic stay during the period when the case was dismissed; however, by reinstating the case, the automatic stay was simultaneously reimposed from the date of reinstatement. Therefore, the Creditor was liable for damages for violating the automatic stay after the case was reinstated as well as during the time before the dismissal when the evidence proved that Creditor knew about the turnover action. The Court also considered whether damages may be negated because Creditor orally notified Debtors that the vehicle was available for Debtors to take possession. After examining prior cases in this District and in rejecting this argument, the Court held that Section 542(a) placed an affirmative duty on creditors in

possession of estate property to deliver it to the estate. Regarding the issue of when turnover is required, the Court held that the duty to turn over is triggered upon a debtor's notification to the creditor of the bankruptcy filing, written demand for turnover, and proof of insurance.

4.6. The Automatic Stay and Third Parties

Generally, the filing of a bankruptcy petition protects the debtor. However, under some limited number of circumstances, the automatic stay is extended to protect partners of a general partnership, the general partner of a limited partnership, and officers, directors and principals of corporations, where the judgment against these would be a judgment against the corporation itself. Unless one of these exceptional circumstances exists, the automatic stay will not generally be extended to include third parties.

In the case of *In Re Litchfield Co. of S.C. Ltd. Partnership*, 135 B.R. 797 (W.D.N.C. 1992), the Debtor, a limited partnership, filed an adversary proceeding to enjoin Creditor's violation of the automatic stay provision, Section 362(a)(3), and to enjoin Creditor's state court collection efforts against Debtor's partners and a guarantor pursuant to Section 105(a) since such action endangered Debtor's ability to reorganize. The Court determined that Creditor was in violation of the automatic stay provision because Section 362(a)(3) prohibits a creditor from asserting a claim on its own behalf that a debtor may assert for the benefit of all of its creditors. Therefore, Creditor's claim against Debtor's partners and guarantor interfered with Debtor's right under law to pursue the same action. The Court further decided that it was not an abuse of discretion to grant Debtor injunctive relief because Creditor's complaint would have impaired

Debtor’s ability to reorganize.

In the case of *In re Kinard*, C/A No. 01-03621-W (Bankr. D. S.C. Nov. 21, 2001), the Creditor motioned for relief from the automatic stay with respect to Debtor's collateral, a 5.7 acre vacant parcel of land generating no income, as well as collateral pledged by a third party who had not filed for bankruptcy protection. Debtor objected to the motion and sought an injunction protecting the third party. The Court first decided that Debtor's automatic stay did not extend to the third party or its collateral; consequently, the foreclosure process could continue against the third party's collateral. In addition, the Court declined to grant the extraordinary relief of issuing an injunction to protect the third party because Debtor failed to demonstrate irreparable injury to the Debtor, lack of substantial harm to others if the injunction was granted, the promotion of public interest by issuing the injunction, and a reasonable likelihood of successful reorganization.

In the case of *In re Ragin*, C/A No. 99-11323-D (Bankr. D.S.C. 3/3/2000), the Court granted the Motion for Relief from the Automatic Stay and the Motion for Relief from Co-Debtor Stay filed by the Bank. The Bank was the holder of a second mortgage lien on a parcel of real property. The Note was signed by both Debtor and a third party, but the property that secured the Note was solely owned by the third party. The Court held that, in addition to the relief granted under Section 1301(c), the Bank was also entitled to a modification of the automatic stay for purposes of completing its Foreclosure Action.

In the case of *In re Trapp*, C/A No. 00-09987-W (Bankr. D.S.C. 1/5/2001), the mortgagee had entered into a Mortgage and Note with the Brewers, who subsequently sold the

mortgaged property to Debtor, without the Mortgagee's consent or knowledge. Debtor then filed for relief under Chapter 13 and proposed to cure the arrears on the debt and recommence monthly payments to the Mortgagee.

The Mortgagee filed a Motion to Modify Stay and Objection to Plan of Reorganization asserting that it was entitled to relief from the automatic stay pursuant to Sections 362(d)(1) and (2) to permit it to proceed in State Court with foreclosure and eviction proceedings. The Mortgagee further objected to any treatment in Debtor's Chapter 13 Plan on the grounds that there was no debtor-creditor relationship between Debtor and Mortgagee and that therefore the mortgage debt was not a "claim". Furthermore, the Mortgagee argued that the Plan may not cure and reinstate Mortgagee's claim, which was accelerated upon the expiration of the right to cure.

The Court first concluded that a Chapter 13 debtor who is not in contractual privity with the mortgagee can repay a mortgage lien through the plan because the mortgagee holds a "claim" against the debtor's estate, even though there is no privity between the mortgagee and the debtor. Furthermore, the Court concluded that the fact that the debt to the Mortgagee was accelerated due to debtors' default did not prohibit the curing of such default through the Chapter 13 Plan.

4.7. Creditor’s Rights in Single Asset Real Estate Cases

In the case of *In re Kinard*, C/A No. 01-03621-W (Bankr. D. S.C. Nov. 21, 2001), the Court granted relief from the automatic stay pursuant to Section 362(d)(2). Debtor argued that the real property collateral will appreciate in the future and that its later sale will be the only way for him to reorganize. The Court ruled that, in order for property to be necessary for

reorganization, a debtor must show a reasonable possibility of a successful reorganization and this possibility must be based on more than speculation. The Court found that the potential sale of the real property was too speculative. In addition, the court ruled that Creditor was entitled to relief from the stay pursuant to Section 362(d)(3) because the real property collateral was single asset real estate and Debtor failed to file a plan of reorganization or to make monthly payments to secured creditors within the ninety day period prescribed by the code Section. Debtor argued the real property was not single asset real estate because it was vacant land that did not presently generate income. The Court disagreed, ruling that raw land generating no income falls within the definition of single asset real estate. Finally, the Court ruled that relief from the stay was appropriate pursuant to Section 362(d)(1) because Debtor's reorganization was objectively futile and because the case was filed in subjective bad faith, evidenced by repeat filings intended to stave off foreclosure sales.

Prior to BAPCPA, the cap on SARE bankruptcies was Four Million Dollars ($4,000,000). The BAPCPA eliminated this cap. The definition of a SARE bankruptcy "means real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor who is not a family farmer on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental ..." BAPCPA §1201. Thus, larger real estate projects will be included in this definition.

Prior to BAPCPA, there was an issue as to when the debtor was required to begin the monthly payments to prevent relief from the automatic stay under Section 362(d)(3) in situations where the debtor was challenging whether they fit the definition of a SARE. Section 444 of the BAPCPA clarifies this by including in Section 362(d)(3) that the debtor may begin payments to avoid relief from the automatic stay "30 days after the court determines that the debtor is" a SARE.

Prior to the BAPCPA, there was a split of authority as to whether the debtor in a SARE could use rents from the property to make adequate protection payments in those situations where the creditor also had a security interest in those rents. The BAPCPA clarifies this issue by allowing debtors to make the adequate protection payments from the rents. BAPCPA §444.

Prior to the BAPCPA, the interest rate charged in calculating the monthly payments was the "current fair market value rate." 11 U.S.C. §363d(3)(B)(ii). This provision lead to possible disputes concerning the definition and appropriate rate to calculate the payments. Under BAPCPA, the applicable rate is now the "nondefault contract rate." BAPCPA §444. Hopefully, this change will avoid the necessity of having the court determine the appropriate interest rate.

4.8. Creditor's Rights and Purchases Just Prior to Bankruptcy

In the case of *In re Madden*, 99-08282-W (Bankr. D.S.C. 12/21/1999), the Court denied Creditor's Motion for Relief from the Automatic Stay even though the Debtor filed a Chapter 13 bankruptcy proceeding approximately two months after purchasing a truck and Debtors made no payments pre-petition on the vehicle. The Court found that the truck was necessary for an

effective reorganization because Debtors needed the vehicle in order to remain employed; although Debtors were employed with the same company, the worked separate shifts and the company was located over 10 miles from their home. The Court determined this necessity precluded relief from the stay pursuant to Section 362(d)(2). Furthermore, the Court found that even though the time between the purchase of the truck and the filing of the bankruptcy case was short, there were no indications that the bankruptcy was filed in bad faith, thus precluding relief from the stay pursuant to Section 362(d)(1). See *Little Creek Dev. Co. v. Commonwealth Mortgage Corp.*, 779 F.2d 1068 (5th Cir. 1986) (The Court held that bad faith filing may establish sufficient cause for relief from the stay pursuant to Section 362(d)(1)).

The BAPCPA addressed some of the concerns of creditors in Section 1325(a)(9) commonly referred to as the "flush" provision. The South Carolina Bankruptcy Court addressed this provision in the case of *In re Turner*, C/A No. 05-45355-jw, slip op. (Bankr. D.S.C. Mar. 31, 2006) (determining the meaning and application of the flush language found after 11 U.S.C. § 1325(a)(9)). In *Turner*, the debtor was seeking to bifurcate a secured creditor's claim into secured and unsecured portions based upon the value of the car. The creditor objected to this treatment because the car was purchased within 910 days of the filing of the bankruptcy. In referring to the "flush provision," the court held that because the car was purchased with 910 days of the filing of the bankruptcy, the debtor was prohibited from using the value of the car to bifurcate the claim and the creditor was entitled to full payment on its secured claim.

4.9. Annulling the Automatic Stay to Correct Mistakes

Generally, the bankruptcy court is a court of equity. If a creditor makes a mistake, such as mistakenly satisfying a mortgage, the court will grant the relief necessary to allow the creditor to correct his mistake, so long as it does not harm another creditor. In the case of *In re Scott*, C/A No. 00-07468-W (Bankr. D.S.C. 1/1/2001), the court went so far as to annul the automatic stay so as to allow the creditor to properly file its mortgage. The Creditor filed a Motion seeking the annulment of the automatic stay to validate the post-petition perfection of a mortgage on Debtor's home. Debtor had mortgaged his property, and the creditor forwarded the mortgage for filing in the proper office subsequent to the execution of the mortgage. Creditor, however, failed to include necessary information; therefore, the mortgage was never properly recorded pre-petition. Debtor argued that if the automatic stay was annulled in this case, the creditor would be permitted to better its position post-petition in that its lien would be perfected against third parties. Debtor also argued that the post-petition validation of the recording would prevent Debtor of his ability to file an avoidance action under Section 544. The Court found that in Chapter 7 cases a debtor does not ordinarily have standing under the strong-arm provision of Section 544(a). Having decided that Debtor could not have brought a Section 544 action in this case, the Court next addressed the issue of whether the stay could have been retroactively annulled. The Court found that "cause" existed as required by Section 361(d)(1) to annul the stay retroactively to allow the perfection of the creditors' mortgage. The Court further found that there was no equity in the property and it was not necessary for reorganization, thus warranting retroactive relief from the automatic stay also pursuant to Section 362(d)(2).

4.10 Post petition interest from Guarantors.

In bankruptcy, a creditor is entitled to post petition interest only when they are over secured. The creditor is over secured when the value of the collateral is in excess of the amount of the claim. Nevertheless, several cases have held that a guarantor is still responsible for post petition interest. *See In re Stoller's, Inc.*, 93 B.R. 628 (Bankr. N.D. Ind. 1988); *Household Finance Corp. v. Hansberry*, 20 B.R. 870 (Bankr. S.D. Ohio 1982).

5. Reaffirmation

Reaffirmation is an agreement provided for under Section 524(c) where the debtor and the creditor consensually agree that the debtor is going to reaffirm the debt. So even though the debtor receives a discharge, the debtor is still bound to pay the total debt. A Reaffirmation agreement should involve a renegotiation of the debt and the terms and/or total debt may be different from the original debt. Reaffirmations should contain an attorney affidavit whereby the attorney states that he examined and investigated the reaffirmation to his client. Reaffirmations are not supposed to pose an undue hardship on the debtor. If the reaffirmation is not evidenced by the proper paperwork, the reaffirmation can be annulled. Reaffirmations are related to Redemptions and the concept of "Ride Through". Section 722 allows a debtor to "redeem tangible personal property intended primarily for personal, household, or family use." Redemption permits the debtor to "pay off" the loan or the collateral. The amount needed for a redemption may be reduced if a debtor can use some of his state or Section 506 exemptions. A reaffirmation or a redemption agreement will not be approved if the agreement will cause "undue

hardship" on the debtor pursuant to Section 524(a)(6)(A)(i).

Prior to the 2005 amendments, including the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"), Section 521(2)(A) provided that a creditor and debtor may agree to "ride through" the bankruptcy for a particular debt. The "ride through" was not very advantageous to the creditor and was also not permitted in all circuits. So, the BAPCPA did away with the "ride through" and now, if a debtor wants to continue to keep an asset and continue to pay a debt, that debtor must reaffirm that debt.

If the code requirements of Sections 524(c) and (d), including the requirement that it be entered into prior to discharge are not met, even if it is signed by the parties, a reaffirmation agreement is unenforceable. *In re Kinion,* 207 F.3d 751 (5th Cir. 2000).

A reaffirmation agreement should involve a renegotiation of the debt and the terms may be different than the original contract terms. *In re Strong,* 232 B.R. 921 (Bankr. E.D. Tenn. 1999).

6. Chapter 11 Plans

6.1 Treatment of Secured Claims in Chapter 11 Plans

In Chapter 11 Bankruptcy, the debtor usually files the plan pursuant to Section 1121. The plan must place creditors into substantially similar classes pursuant to Section 1122. Secured creditors usually have their own class. Section 1123 provides that the plan may impair or leave unimpaired any class of secured or unsecured claims pursuant to Section 1123(b)(1); however, if the plan leaves a class unimpaired, then the plan must specifically state it pursuant to

Section 1123(a)(2). Section 1124 defines an unimpaired class as a class that is completely protected under the plan. Unimpaired classes are deemed to have protected the plan, as those creditors will receive the full amount of their security interest. Section 1129(a)(8).

For a plan to be confirmed each class must have accepted the plan under Section 1129(a)(7), or the class must be crammed down under Section 1129(b). A class has accepted the plan if at least two-thirds in amount and more than one-half in number of the creditors in the class have accepted the plan. Section 1126(c). The court may also “knock out” creditors whose acceptance or rejection of the plan was not in good faith. Section 1126(e). As a class of secured creditors, therefore, the plan can leave them unimpaired so that the secured creditors get the total amount of their lien and are deemed to have accepted the plan. The secured creditors can accept or reject the plan, and the debtor can try to “cram” the plan down on them, forcing them to accept the plan. Section 1129(b)(2) provides the mechanism to “cram down” around a secured creditor. The plan must be fair and equitable, and it must provide the following: (1) the holders retain the liens securing the claims; (2) the holders receive deferred cash payments totaling at least the allowed amount of such claim (or for the sale and proceeds of the liened items); or (3) the realization by the holders of the indubitable equivalent of such claims. Thus, it is very hard to “cram down” on a secured creditor unless the creditor is getting what they would have gotten outside of bankruptcy. Thus, it is smart for most Chapter 11 plans to go ahead and set the secured creditors up as an unimpaired class, deemed to have accepted the plan.

Claims may be classified separately if the claims are not substantially similar, if there are

good business reasons for doing so, or if the claimants have sufficiently different interests under the plan. Claims may not be classified separately solely in order to gerrymander an affirmative vote on reorganization. *Matter of Wabash Valley Power Assoc*., 72 F.3d 1035 (7th Cir. 1995) *cert denied,* 519 U.S. 965 (1996).

In determining whether a classification is reasonable, the court should look to purposes that classification serves: (1) voting to determine whether a plan can be confirmed; and (2) treatment of claims under the plan. Each class must represent a voting interest that is sufficiently distinct to merit and separate voice. *John Hancock Mutual Life Ins. Co. v. Route 37 Bus. Park. Assocs*., 987 F.2d 154 (3d Cir. 1993).

Any alteration of rights constitutes an impairment, even if the value of the rights is enhanced. *Matter of Wabash Valley Power Assoc*., 72 F.3d 1035 (7th Cir. 1995) *cert denied,* 519 U.S. 965 (1996). A claim is impaired unless the plan does not alter the legal, equitable, and contractual rights to which a claim or interest entitles the holder. *In re Windsor on the River Assoc. Ltd.*, 7 F.3d 127 (8th Cir. 1993).

The purchase of claims for the purpose of securing the approval or rejection of a plan is not per se bad faith. *In re 255 Park Plaza Assocs. L.P.,* 100 F.3d 1214 (6th Cir. 1996).

A post-petition secured lender is not entitled to vote on a plan of reorganization. *In re Kliegl Bros. Univ. Elec. Lighting Co.*, 149 B.R. 306 (E.D.N.Y. 1992).

When all requirements for a confirmation of a reorganization plan are met except for Section 1129(a)(8), the bankruptcy court must confirm the plan despite the objection of an

impaired class or classes. The court must confirm the plan so long as it does not discriminate unfairly and is fair and equitable with respect to the impaired classes. *In re Bonner Mall Partnership*, 2 F.3d 889 (9th Cir. 1993).

6.2 Chapter 11 and Individuals

With the adoption of the BAPCPA amendments, it is more difficult for an individual to file a Chapter 11 claim. For instance, a debtor filing under Chapter 11 must meet the pre-petition credit briefing requirement for eligibility set forth in Section 109(h), as well as follow the extensive disclosure requirements in Section 521. There are also new limitations on the automatic stay in Section 362. The debtor must also pay priority claims in full upon the effective date of the plan. Section 1129(a)(9).

With the creation of new difficulties under the BAPCPA for an individual to file a Chapter 11 claim, it may be in the debtor's best interest to file a Chapter 13 claim. A debtor may defer payments on priority claims without interest, pursuant to Section 1322(a)(2). Generally, creditors with impaired claims do not accept or reject a plan as is required in a Chapter 11 filing under Section 1126(b).

There are circumstances where Chapter 11 may be a better option. A debtor may choose to file a Chapter 11 claim where he is trying to liquidate a debt and pay in full. See *In re Sherman*, 2007 WL 128959 (Bkrtcy.E.D.Va. 2007) (Debtor filed under Chapter 11 to liquidate obligation to the IRS and pay in full). Also, a debtor may wish to file a Chapter 11 claim where he is not eligible to file a Chapter 13 because his unsecured debts are above the $336,900 cap

and secured debts are above the $1,010,650 cap. Section 109(e).

6.3. Chapter 11 Plans v. 363 Sales

If the debtor has filed a Chapter 11 bankruptcy, sometimes the secured creditor allows, or even requires, the sale of property prior to the confirmation of a plan of reorganization. In the past, it was the usual practice for these 363 Sales to be done without transactional costs. In the Supreme Court decision of Florida Department of Revenue v. Piccadilly Cafeterias, Inc., Number 07-312, (June 16, 2008), the Supreme Court held that such sales could not avoid the transaction costs, like deed stamps, that can be avoided under a confirmed plan of reorganization. So, when dealing with a Chapter 11, the secured creditor needs to be cautious in allowing a 363 sale prior to the confirmation of a plan.