DEBTOR MATH VS. TRUSTEE ACCOUNTING: PRACTICAL INTAKE, PRE-PETITION PLANNING, AND RED FLAGS

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CONSIDERATIONS BEFORE YOU FILE

- Initial Interview
- Business Bankruptcy
- Pre-Bankruptcy Planning
- Red Flags
- Practice Tips

INITIAL CLIENT INTERVIEW

INITIAL CLIENT INTERVIEW

Where everything begins

- The initial interview sets the tone for the entire case
- Bad facts discovered late do not improve with time
- Intake is about fact-gathering, not reassurance
- The goal is to surface risk before filing, not defend it later
  - Attorney’s fees can also better be determined
  - Not every case is a fixed fee case

COLD INTAKE FORMS

Debtor insights

Have clients complete forms **before** you ask questions. Cold forms reveal:

- Omissions and optimism
- What Debtor knows/thinks is important
- How much time you need to spend deep diving into their financials

Ask detailed questions

Yes/No questions don’t tell the whole story. Be specific:

- Ask for dates, amounts, sources
- Use time frames based on code (90 days, last year, 910 days)
- Separate ownership, use, and control
- Management and control matter for estate inclusion in Texas

INTAKE FORM: INFORMATION COLLECTED & NEXT STEPS

Client Information Collected

- Contact and reference information
- Identity, household size, prior filings, pending foreclosure
- Household income and all income sources
- Accounts: checking, savings, retirement, domestic support, other funds

Assets & Debts

- Real property: value, mortgage status, arrears
- Vehicles: purchase date, mileage, liens, arrears
- Other secured debts (same data points)
- Unsecured debts
- Student loans (amounts, status, and dischargeability acknowledgment)

Additional Disclosures

- Tax filings and amounts owed (prior 4 years)
- Pending or past legal proceedings, including prior bankruptcies
- Other claims, significant assets, or potential liabilities not otherwise disclosed

Attorney Review & Discussion

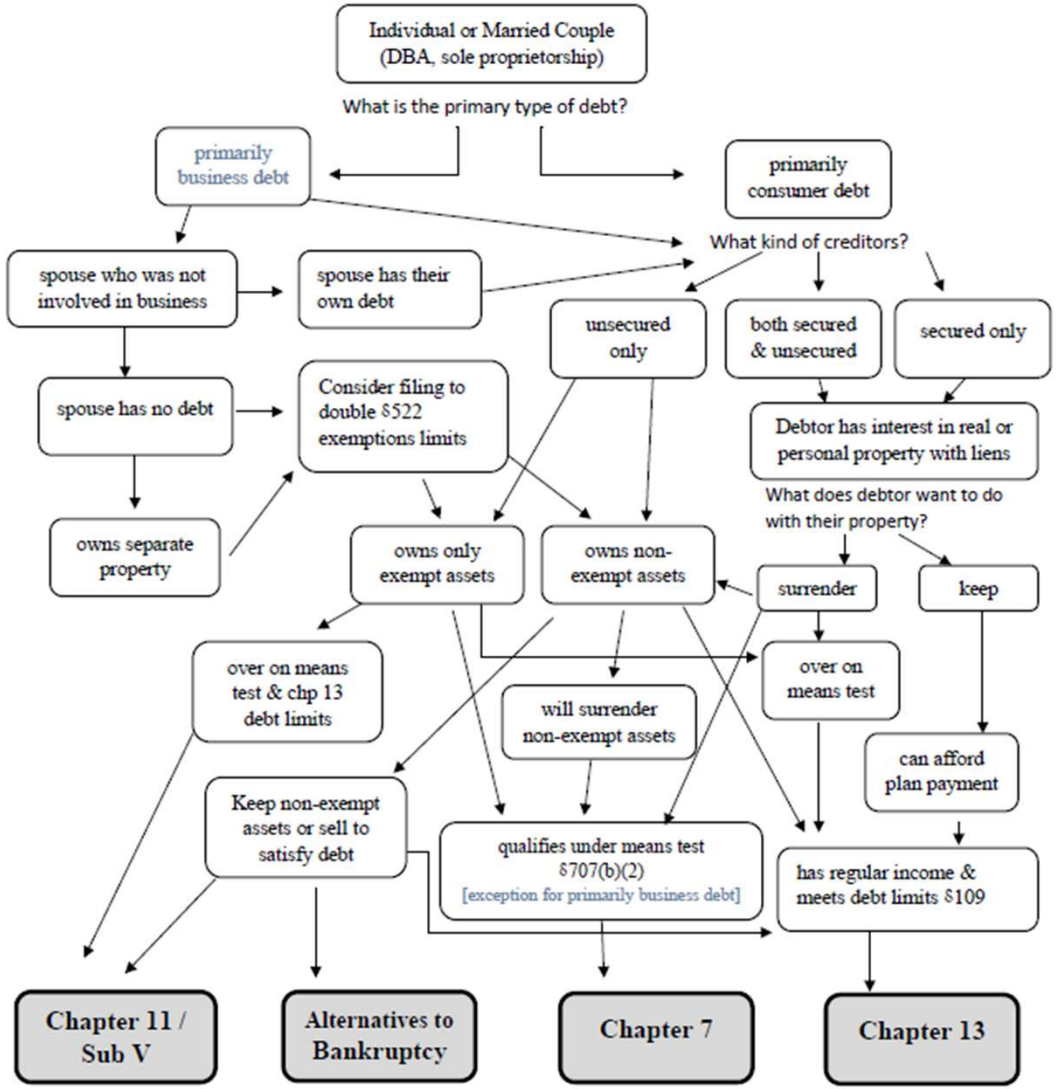
- Review responses with the client
- Discuss bankruptcy alternatives and reorganization feasibility
- Address likely fees and costs based on disclosed facts
- Answer client questions and concerns
- Determine whether representation is appropriate for the firm

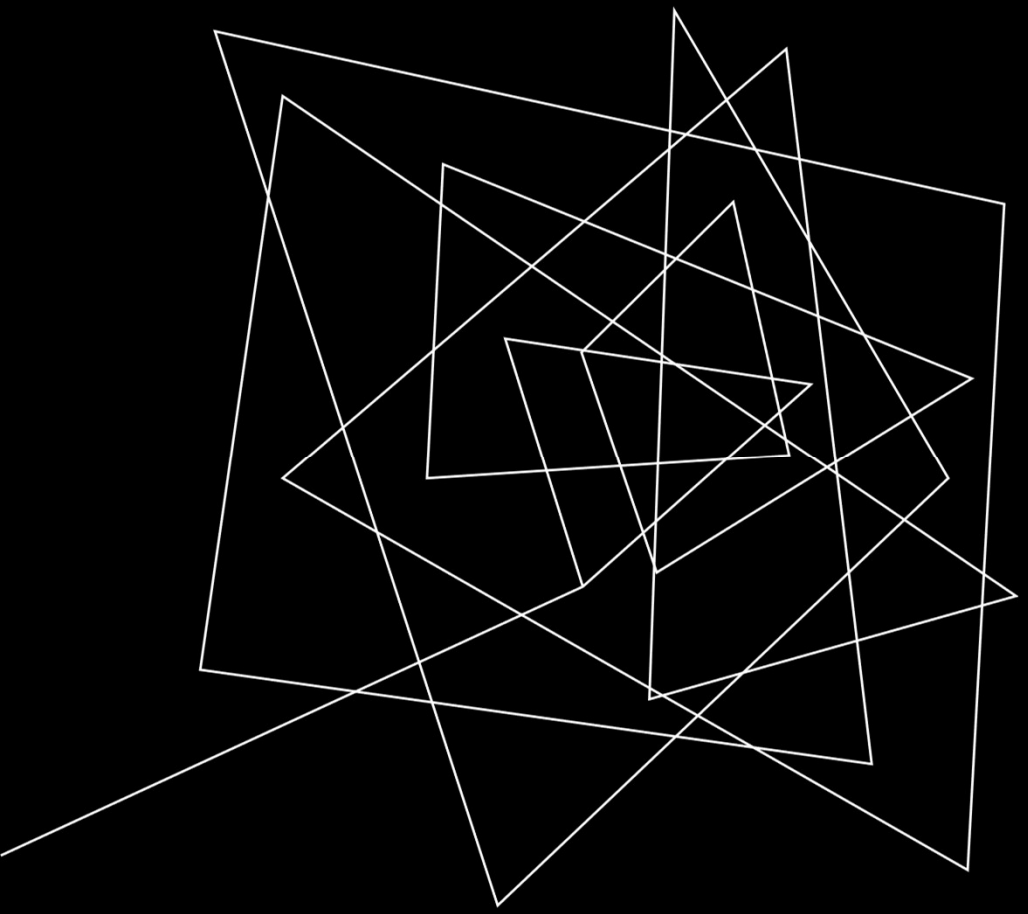
INTERNAL CLIENT FORMS

Contract and Disclosure Form	• Includes contract and all required bankruptcy disclosures • Includes identification of parties and anticipated events • Includes disclosures required under 11 USC § 527(a) and (b), 342(b) and 521(a).
Detailed debtor information forms and checklist of documents needed	• Includes detailed information required to complete schedules • Identifies documents that Trustee requires and internally requested information
Payment Calendar and Trustee Payment Instructions	• Detailed instructions so debtor can stay current on payments
Notice of Pending Dismissal of Case	• If all documents are not filed with the Petition (Chapter 13), a notice that the case will be subject to dismissal if documents are not provided by the identified deadline.
Summary of Ch 13 obligations and concerns	• Includes a bullet point summary of obligations e.g., payment obligations, warning that client must pay post-petition HOA fees, requirements to maintain insurance on collateral, and like issues
Notice to Disclose Claims/Assets Arising During Ch 13	• Ensure client understands they need to disclose claims, inheritances, and recoveries during the Ch 13 proceeding

QUESTIONS THAT DECIDE THE CASE

- Who actually needs bankruptcy protection?
- Is the debt primarily consumer or business?
- Is there a business that should file, dissolve, or do nothing?
- What does the debtor own? And who controls it?
- Does the debtor want to keep or surrender property?
- Is any property claimed as “separate”?
- What are debtor’s active disputes/litigation that could lead to a discharge objection?
- Is Chapter 7, 13, or 11 realistically available?


Individual or Married Couple (DBA, sole proprietorship)
What is the primary type of debt?
primarily business debt
primarily consumer debt
What kind of creditors?
spouse who was not involved in business
spouse has their own debt
unsecured only
both secured & unsecured
secured only
spouse has no debt
Consider filing to double §522 exemptions limits
Debtor has interest in real or personal property with liens
What does debtor want to do with their property?
owns separate property
owns only exempt assets
owns non-exempt assets
surrender
keep
over on means test & chp 13 debt limits
over on means test
will surrender non-exempt assets
can afford plan payment
Keep non-exempt assets or sell to satisfy debt
qualifies under means test §707(b)(2) [exception for primarily business debt]
has regular income & meets debt limits §109
Chapter 11 / Sub V
Alternatives to Bankruptcy
Chapter 7
Chapter 13



BUSINESS OWNERS IN BANKRUPTCY

DEBTOR'S BUSINESS IS NOW YOUR BUSINESS

Does the business still exist?

Is the spouse involved in the business?

Are there assets or receivables?

Should the business file, dissolve, or do nothing?

Is the business winding down?

BUSINESS OWNERS IN BANKRUPTCY

Not everyone can afford Chapter 11 / Subchapter V

- Decide whether the business should file at all
- Sole proprietors may continue working post-petition
- Single member LLCs with co-mingled accounts
- Can the business continue?
- Review and verify who owns business assets – the member or the business? (applies to titled and untitled assets)
- Review the business income and receivables (consider what exemptions will apply)
- Business assets vs debtor's interest (clearly schedule what comes into the estate)
- Explain what the automatic stay will protect, review the co-debtor stay before filing

BUSINESS DISSOLUTION CONSIDERATIONS

- Dissolution and notice to creditors still matter
- Poor wind-downs invite preference and transfer scrutiny
- Should business dissolve first, then file personally on guarantees

PRE-BANKRUPTCY PLANNING

WHAT COMES INTO THE ESTATE

11 USC §541 – Property of the Estate

- Legal interest
- Equitable interest
- Causes of action
- Business interests

Considerations

How much planning can you do to limit non-exempt assets:

- Pre-petition IRA/Retirement contributions
- Social Security only bank accounts
- Title loans prior to filing
- Repaying creditors/friend/family
- Diminishing bank balances
- Tax refunds
- Non-filing spouse's separate or sole managed community property

JUST BECAUSE YOU CAN DOESN'T MEAN YOU SHOULD

- Discovery is easy in bankruptcy
- Rule 2004 is broad
- Bad planning can:
  - Delay or deny discharge
  - Trigger adversaries
  - Complicate the case

Pre-bankruptcy planning is allowed

Pre-bankruptcy manipulation is not

Timing matters more than labels

Intent matters more than creativity

You inherit the client's choices

SHADES OF GRAY: TURNING NON-EXEMPT INTO EXEMPT

Pigs get fat, hogs get slaughtered

- Small, ordinary planning often survives
- Big, last-minute moves attract attention
- The closer to filing, the louder it looks
- Subtle beats sophisticated every time

Sometimes allowed, always scrutinized

Red flags

- Large amounts
- Proximity to filing
- No historical pattern
- One change may be explainable
- A pattern may be bad faith

POST-PETITION RETIREMENT CONTRIBUTIONS

Allowed, not automatic: Lawful retirement contributions are permitted, but good faith and feasibility control.

Chapter matters:

- **Chapter 7:** Focus is on **pre-petition conduct**; post-petition contributions rarely matter.
- **Chapter 13:** Contributions are scrutinized under **good faith and disposable income**.

Red flags: New or increased contributions, maxing out limits with low payout, or timing that looks strategic rather than consistent.

***In re Perkins*, No. 22-20025 (Bankr. S.D. Tex. Apr. 6, 2023)**
Post-petition 401(k) contributions excluded from estate and disposable income under § 541(b)(7) when made in good faith within IRS limits.

PRE-BANKRUPTCY CONSIDERATIONS

Transfers	Preferences	Insiders	Luxury Purchases
Was it transferred or retitled?	Who Got Paid and Why?	Repaying insiders invites extra scrutiny	Credit used close to filing is examined
Can include liens (voluntary, involuntary, statutory)	When were they paid?	Expect follow up, know the details before filing	Review the statements before they file
Was cash "reorganized"?	Why were they paid?	"They helped me out" is not reasonably equivalent value	Trustees look at: • timing • purpose • intent
Did ownership suddenly make sense?	Was it ordinary course?	Be prepared for claw back discussions	Is it likely to cause an adversary?
Does the timing look convenient?	Does it look like a preference?	Make the Debtor aware in writing before they file	Purchases within 90 days create a presumption of fraud, outside that the burden stays with the creditor

TRUSTEE POWERS

11 U.S.C. § 548 — Fraudulent Transfers

- Look-back: Transfers made **within 2 years before filing**
- Covers:
  - **Actual fraud** (intent to hinder, delay, or defraud)
  - **Constructive fraud** (less than reasonably equivalent value + insolvency)
- **Chapter 7:** Used to **recover assets for liquidation**
- **Chapter 13:** Used to **increase plan value or address good-faith issues**

11 U.S.C. § 547 — Preferences

- Look-back:
  - **Within 90 days** before filing (non-insiders)
  - **Within 1 year** before filing (insiders)
- Elements include:
  - Transfer to creditor
  - On account of antecedent debt
  - While debtor insolvent
  - Creditor received more than in Chapter 7
- **Chapter 7:** Recovery leads to **asset redistribution**
- **Chapter 13:** Recovery usually affects **plan payments**

Other Trustee Actions

Chapter 7 Trustee

- Liquidates non-exempt assets
- Brings avoidance actions to **take assets**
- Objects to exemptions
- Objects to discharge (§727(a))
- Case ends after liquidation

Chapter 13 Trustee

- Oversees **repayment plan**
- Uses avoidance powers to increase plan payments, not liquidation
- Objects to exemptions
- Objects to confirmation and good faith
- Oversees plan performance for 3–5 years

A Chapter 7 trustee looks backward to liquidate assets and can deny discharge, while a Chapter 13 trustee looks forward to manage payments and enforce a repayment plan.

ADVERSARIES

Luxury Purchases

- **11 U.S.C. § 523(a)(2)(C) — Presumed Nondischargeability**
- Creates a **presumption of fraud** for:
- **Luxury goods/services** over the statutory threshold
- Incurred **within 90 days** before filing
- Also applies to **cash advances**
- Shifts burden to debtor to rebut presumption

Accurate Disclosures

- **11 U.S.C. § 523(a)(2)(A) — False Pretenses / False Representation**
- Used to challenge discharge of debt based on fraud
- Often paired with §523(a)(2)(C)
- Creditors love this section for adversary proceedings

Issue	Code Section	Look-Back Period	What It Covers	Why It Matters
Fraudulent Transfers	**11 U.S.C. § 548**	2 years (§548 period) 4 years (Texas law)	Transfers made with intent to hinder, delay, or defraud, or for less than reasonably equivalent value while insolvent	Core pre-bankruptcy planning trap
State Law Transfers	**11 U.S.C. § 544(b)**	Varies (state law)	Lets trustee use state fraudulent transfer law (often longer reach-back)	Reaches older "planning"
Preferences	**11 U.S.C. § 547** (Texas B&C Code §24.005 & 24.006)	90 days (non-insiders) / 1 year (insiders)	Payments on old debt that let one creditor jump the line	Insider preference may be actionable as fraudulent conveyance under TX law (1 yr extinguishment or 2 yrs for others)
Recovery	**11 U.S.C. § 550**	N/A	Allows trustee to claw back property or value	This is where the money comes back
Luxury Purchases	**11 U.S.C. § 523(a)(2)(C)**	90 days	Presumed fraud for luxury goods or services over threshold	Burden shifts to debtor
Cash Advances	**11 U.S.C. § 523(a)(2)(C)**	70 days	Presumed fraud for cash advances over threshold	Credit card landmines
Fraud-Based Debt	**11 U.S.C. § 523(a)(2)(A)**	N/A	False pretenses, false representations, actual fraud	Creditor adversary favorite
Transfer = No Discharge	**11 U.S.C. § 727(a)(2)**	1 year	Transfer or concealment with intent to hinder, delay, or defraud	Nuclear option
Lying on Paper	**11 U.S.C. § 727(a)(4)**	N/A	False oath or account (schedules, SOFA, testimony)	"I forgot" defense fails

RED FLAGS

REVIEW DEBTOR'S DOCUMENTS **BEFORE** FILING

The Trustee Will Ask (So Should You)

- Do the schedules match the bank statements?
- What does the bank statement activity show?
- Does the SOFA match the schedules?
- Does the means test match reality?
- Do tax returns tell a different story?
- Would a trustee flag this file on first read?

BANK STATEMENTS

- Unexplained deposits or withdrawals
- Cash withdrawals with no explanation
- Transfers between accounts right before filing
- Payments to insiders shown on statements but missing from the SOFA
- Providing trustee bank statements for accounts that aren't scheduled
- Business income or receivables appearing in statements but not scheduled
- Means test income inconsistent with bank deposits
- Tax returns tell a different story than the bank activity
- Sudden drops in balances right before filing
- Accounts opened or closed shortly before filing
- "That's not my account" (but the name is on it)
- "I don't use that account anymore" (but it's active)

No common assets listed (cell phone, furniture, kitchen items)

Date of filing balances that are wildly different from schedules

Listing assets clearly not owned by individual debtor

100% exemptions of cash or bank balances

SOFA omits transfers, payments, or business activity

Means test income doesn't line up with reality

Tax returns tell a different story than the schedules

Sudden asset transfers or retitling before filing

Large or unusual payments to insiders

Luxury purchases or credit use close to filing

Retirement contributions that spike right before bankruptcy

Non-filing spouse property with unclear management or control

Business assets or receivables missing from schedules

"Bare legal title" claims without documentation

Inconsistent explanations between intake, schedules, and testimony

PRACTICE TIPS

PRACTICE TIPS THAT SAVE CASES

- Make clients complete intake forms **before** the interview
- Review bank statements **before** drafting schedules
- Ask the same question **twice** (paper and live)
- Tie every number in the schedules to a document
- Flag and explain unusual transactions in advance
- Document explanations in your file (not just your head)
- Decline cases when the risk outweighs the benefit
- Assume a trustee will read everything & prepare the debtor for the §341 meeting
- Slow down filing when facts need time to age

What the Trustee Does	What Debtor's Counsel Should Do
Reads the petition, schedules, and SOFA first	Review every schedule **before** filing
Looks for inconsistencies and amendments	Ask why numbers changed and document the answer
Pulls bank statements early	Review bank statements **before** drafting schedules
Uses bank statements as the timeline	Tie every number in the schedules to a document
Cross-checks schedules, SOFA, means test, and tax returns	Make sure all documents tell the same story
Follows the money	Ask where non-exempt funds went
Flags insider payments and transfers	Identify and explain insider payments **in advance**
Looks for asset movement before filing	Delay filing if facts need time to age
Evaluates badges of fraud	Ask uncomfortable questions early
Uses Rule 2004 when facts don't add up	Assume Rule 2004 is coming and prepare accordingly
Relies on documents, not explanations	File like you'll have to defend every line
Decides whether to object, investigate, or litigate	Decide whether the case should be filed at all

CASE LAW

Case	Court	What Triggered Trustee Scrutiny	Key Holding	Practice Takeaway
In re Sissom, 366 B.R. 677	Bankr. S.D. Tex. (Houston)	Bank statements, schedules, and testimony didn't match; insider transfers; unexplained funds	Trustee proved intent to hinder, delay, or defraud; exemptions limited; court relied on documents over debtor explanations	**Bank statements control the narrative**; inconsistent disclosures destroy credibility
In re Soza, 542 F.3d 1060	5th Cir.	Eve-of-bankruptcy annuity purchase using non-exempt funds	Even without actual intent, exemption denied under Texas law; "something less than intent" can still be fraud	**Last-minute exemption planning still gets unwound**; timing + effect matter
Matter of Reed, 700 F.2d 986	5th Cir.	Converting non-exempt assets into homestead; secret accounts; missing cash	Discharge denied for actual intent and failure to explain loss of assets	**Conversion alone isn't fatal — bad facts are**; unaccounted cash kills discharge
Matter of Swift, 3 F.3d 929	5th Cir.	Insider transactions; "cute" pre-filing deals; schedule manipulation	Discharge denied under §727(a)(2); court coined "pigs vs. hogs"	**Too clever is still fraud**; relatives + timing = trouble
In re Myers, 486 B.R. 365	Bankr. S.D. Miss.	Bad-faith conversion; undisclosed accounts, vehicles, income; new entity formed with estate assets	Post-petition assets swept into estate; LLC deemed estate property	**Bad-faith conversion expands the estate**; disclose everything or lose control
In re Carroll, 520 B.R. 491	Bankr. M.D. La.	LLC used as asset shield; commingling; no records	Substantive consolidation ordered	**Entity games + no records = consolidation**; form won't save substance

THANK YOU

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Fifth Circuit Bench Bar

"To Liquidate or Not to Liquidate: What's Best for the Client?"

Friday, March 8, 2024, from 10:05-11:20 a.m. (75 minutes)

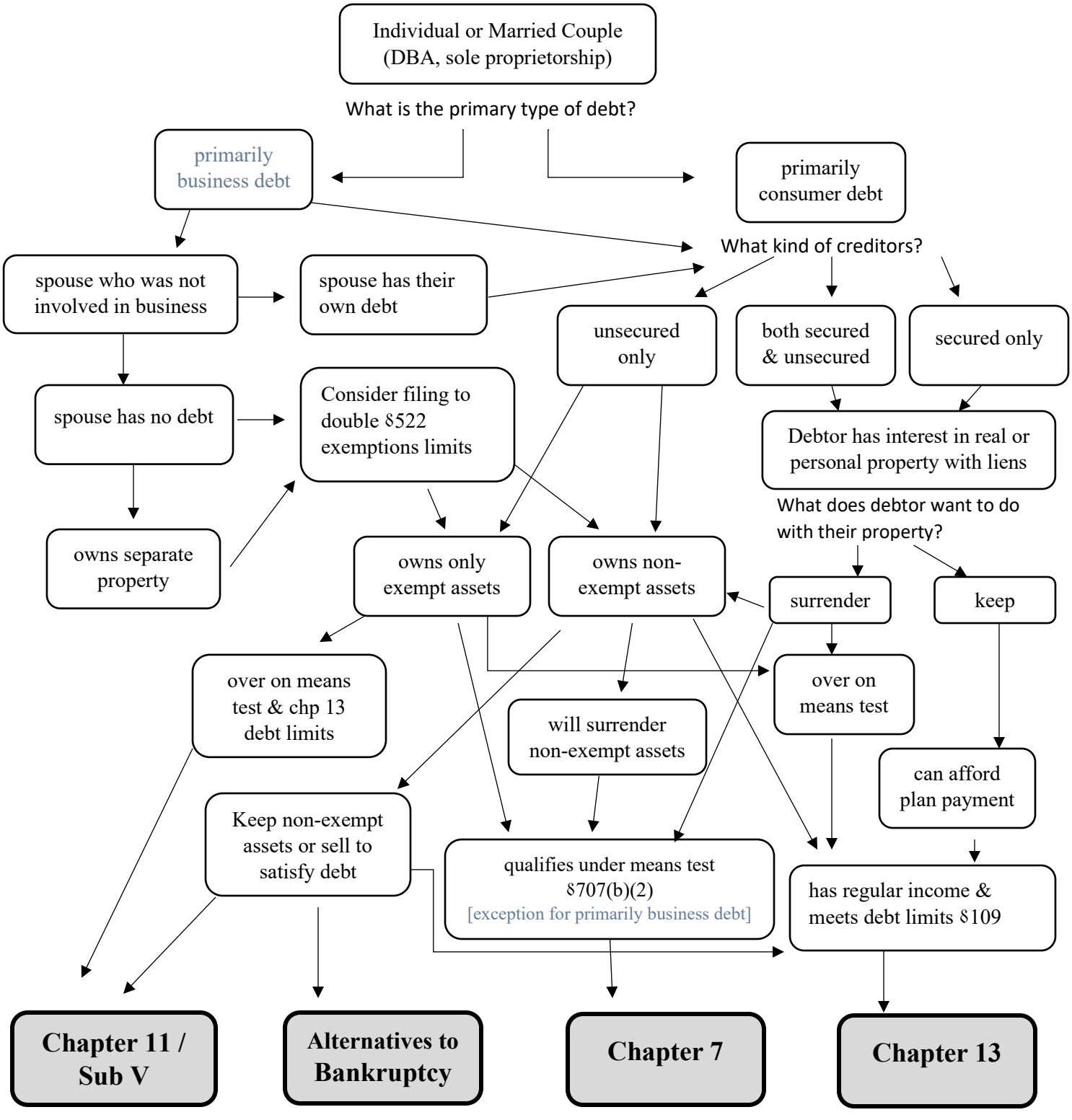
Panelists:

Cristina Rodriguez

Bill Cherbonnier

Ferdie Laudmuniey

Chief Judge Craig Gargotta



- Can provide more flexibility in plan options than a 13
- Spouse must engage in business to qualify for sub V
- Typically, more expensive than a 13 or 7

- Federal Bankruptcy law does not apply
- Less disclosures and oversight
- Certain debtors should stay out of bankruptcy court

- No debt limit
- Liquidation of non-exempt assets to pay creditors
- Little to none debtor control over distribution to creditors
- No plan payments

- Most helpful in stopping repossessions or foreclosures
- Has a debt limit that disqualifies several debtors
- Absolute right to convert or dismiss absent fraud

I. FILING DECISIONS

A. *What is the reason for seeking bankruptcy protection?*

Determine what is the catalyst for the Debtor seeking bankruptcy protection. Is there a particular creditor suing? Is there a pending foreclosure? Does the debtor want to save or shut down their business? What kind of fresh start is best? Like most people, debtors have been struggling with not having enough income to cover all their debts and expenses for a long time, but there is generally a specific catalyst that has driven them to seek help. Often identifying that issue can help determine which chapter of bankruptcy to file and the timing of that filing.

B. *Who needs bankruptcy protection? Are they eligible to be a Debtor?*

Once you determine the catalyst then identify who needs bankruptcy protection. Is it the individual debtor, their spouse, the business they own, or all the above? Is that person or entity eligible to file? Refer to 11 U.S.C. §109 - Who may debtor.

1. **Chapter 7 - Liquidation.** Both individuals and business entities may file chapter 7s. An individual whose debt is not primarily business debt must qualify under a means test. 11 U.S.C. §707(b)(2). Only individuals may claim exemptions. 11 U.S.C. §522(b)(1). If an individual's sole source of income is from their business, such as a closely held corporation or 100% owned business entity, that is generally non-exempt, and the debtor cannot continue to spend funds without Trustee approval. A sole proprietor or 1099 employee can generally continue to work after filing. Be careful of funds in escrow or accounts receivables owed to debtor or their business on the date of filing. Debtor cannot use those funds until exemptions are allowed, or Trustee abandons the asset.

2. **Chapter 13 –** Only individuals with regular income may file chapter 13. The definition of regular income is vague and can include things like family contributions, seasonal jobs, or government assistance. The debt limit for Chapter 13 was temporarily increased to $2,750,000.00 allowing more individuals access to the protections under this chapter. Chapter 13 allows a debtor to keep non-exempt assets and pay their value to creditors over the length of the plan. Generally preferred over chapter 7 for business owners who wish to keep operating their business.

3. **Spouses –** Evaluate each debtor individually. Do they own separate or community property? Is there a common law marriage? Is more property exempt if both file? Does more property come into the bankruptcy estate if spouse files? Not every couple needs to file together. Some spouses need a different chapter of bankruptcy than their partner. Timing matters, and the order of filing matters when doing two separate bankruptcies. First to file brings property into the estate and often determines exemptions. Unless the first case is closed prior to spouse's case being filed.

4. **Prior bankruptcy cases –** Check for prior cases in all districts, use national pacer search to look for cases in all districts. Look for cases voluntarily dismissed after a 362 motion was filed. That debtor will be barred from refiling for the 180 days from dismissal. 11 U.S.C. §109(g) Discharge eligibility will depend on prior discharges received. See 11 U.S.C. §727 (8-9) and §1328 (f)(1-2). Always look back over the last 8 years. Check at least the most recent dismissal order. Look for dismissals with prejudice.

C. ***Considerations for finding the best chapter.***

1. **Chapter 7**. There is no debt limit in Chapter 7. This chapter will appoint a trustee to liquidate assets. Only individuals may claim exemptions. 11 U.S.C. §522(b)(1). Only individuals can receive a discharge in a chapter 7, business entities do not 11 U.S.C. §727(a)(1). While a chapter 7 will impose the automatic stay it brings with it the scrutiny of a chapter 7 trustee with a duty to liquidate and seek assets for the estate. There is no absolute right to convert out of a chapter 7. This is a helpful chapter when a debtor cannot afford to prosecute a claim. The 5th Circuit recently ruled that preference claims under 11 U.S.C. §547 may be sold. *South Coast Supply Co. v. Robert W. Remmert*, No. 22-20536, (5th Cir. Jan. 22, 2024). This may cause more trustees to pursue preference claims to family members or insiders. Review those consequences carefully with the debtors. Most debtors choose not to file if their friend or family members may be sued. Consider filing a chapter 7 for the business before an individual debtor with the personal guarantees for that business. Personal guarantees may be partially satisfied after the chapter 7 is administered. Creditors may stop after receiving news of the business bankruptcy. Individuals who owe significant child support arrears or priority IRS tax debts, can file and still receive a discharge for their general unsecured claims. File chapter 7s carefully, and only after extensive review. Sometimes it may be better to file a different chapter on an emergency basis and consider converting if not able to reorganize under the other chapter. Property of the estate extends 180 days after filing. If debtor has a cause of action existing on date of filing, if not exempted, it belongs to the bankruptcy estate, the case can remain open for years until resolved. Debtor's attorney fees need to be paid before filing. It can be difficult to estimate how much to charge in attorney fees for cases likely to draw adversary proceeds. Debtors can not always afford to pay ongoing attorney fees after the case is filed.

2. **Chapter 13**. This chapter offers the most flexibility for an individual. It requires payment in full of priority claims such as child support arrears. Plans can be structed creatively to give debtors time to sell property or wait for influxes of income to pay creditors. A chapter 13 trustee administers the case and charges a fee. Debtors can keep non-exempt property by proposing a plan that meets the Best Interest of Creditors Test. Creditors are less likely to file adversaries because they are receiving distributions under the plan. Property of the estate extends until the case is closed. If debtor can afford a 100% to unsecured creditors the court is often

generous with repayment options. Allows debtor flexibility to structure repayment terms within confines of the code. Can protect property where debtor only has a partial or legal interest. The automatic stay generally continues until discharge. Most effective plan for stopping foreclosure. It can be voluntarily dismissed at any time, without a finding of fraud. If the debtor receives an inheritance of after acquired asset that they do not wish to turn over to the trustee, they can generally dismiss the case and exchange their non-exempt asset for their discharge. Chapter 13 is a good option when an emergency filing is needed but there is not enough time to complete all due diligence prior to filing. Student loans are stayed from collecting during the plan.

D. ***Not everyone should be in bankruptcy. Reasons not to file.***

Remember that a Federal Bankruptcy Judge will oversee the case with powers often more expansive than remedies available to individual creditors in state court. If the debtor has committed fraud, or even if they have just converted assets to benefit themselves or an insider consider the potential adversaries that may arise in a case before filing. Discovery is not difficult in bankruptcy. Creditors can request a Rule 2004 exam and debtors must proactively disclose information or risk their discharge or perjury charges. If a debtor cannot provide supporting documentation for use of large sums of money spent prior to filing, consider not filing. Debtors without proper supporting documentation can lose their discharge for failure to cooperate with the trustee. If debtors used SBA funds for the purchase of luxury items or their personal use instead of what the loan was intended, strongly consider if bankruptcy is the best option for the debtor. Some businesses would be better served by formally dissolving with the state then having a debtor with personal guarantees file a personal bankruptcy later.

E. ***No-money-down filings.***

Some debtors cannot afford to pay the chapter 7 attorney fees and filing fees. A debtor can instead file a chapter 13 plan paying only attorney fees and little to no distribution to unsecured creditors. This option is helpful for debtors who have a bank levy and need to file immediately but do not have access to funds to pay attorney fees upfront. Debtors whose vehicles have been repossessed or who are facing foreclosure also benefit from such cases. For debtor's counsel consider debtor's ability to pay. A debtor is more likely to complete cases where debtor has significant equity in assets. Debtors will generally continue in such a case at least until attorney fees have been repaid. Debtors on wage order deductions often tend to stay in their case longer than those who can send in money voluntarily.

F. ***Conversions.***

1. **Property of the estate upon conversion.** 11 U.S.C. §348 (f)*(1) Except as provided in paragraph (2), when a case under chapter 13 of this title is converted to a case under another chapter under this title– (A) property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion.*

2. **Considerations when converting from Chapter 13 to Chapter 7.** What changed that the Debtor can no longer continue in a Chapter 13? If converting after confirmation, the means test is no longer a requirement to qualification. Debtor need only show a change in circumstance that does not allow them to complete plan payments in the 13 to overcome the means test qualification. Property acquired after the 180 days from the date of filing is not considered property of the estate unless there is a finding of bad faith. If a debtor receives a life insurance pay out, inheritance or large lump sum after 180 days but still needs a discharge of their unsecured debts, conversion is an option. If the debtor incurred debt post-petition from a divorce or medical issues, those debts can generally be included upon conversion. Be careful of debts incurred post-petition without court approval, if abusive, debtor can be denied a discharge. Once converted, it is very difficult to convert back or dismiss. Money paid to the chapter 13 trustee is returned to the debtor upon conversion. Attorney's fees to debtor's counsel are no longer paid by the chapter 13 trustee upon conversion. Make sure debtor's counsel is paid prior to conversion and disclosure of all fees received for the chapter 13 and the conversion is proper to avoid disgorgement.

II. PROPERTY OF THE ESTATE

A. *Introduction.*

The filing of a bankruptcy petition creates a bankruptcy estate. Section 541 of the Bankruptcy Code defines what is property of a debtor's bankruptcy estate. The definition of property of the estate contained in §541 is extremely broad, generally consisting of "all legal or equitable interests of the debtor in property" at the time of filing "wherever located and by whomever held." 11 U.S.C. 541(a); ***In re Burgess***, 438 F.3d 493, 496 (5th Cir. 2006).

Section 541 is divided into several subparts. Section 541(a) defines the various categories of interests that are included in property of the estate, §541(b) defines what is excluded from property of the estate, 11 U.S.C. §541(c) addresses the validity of certain contractual provisions that could otherwise prevent property from being transferred to the estate, and 11 U.S.C. §541(d) limits the estate's legal and equitable interests in property to that which is held by the debtor as of the commencement of the case.

What constitutes property of a bankruptcy estate is a federal question governed by federal bankruptcy law. ***United States v. Whiting Pools, Inc.***, 462 U.S. 198, 204–05 (1983); *see also* ***In re Segerstrom***, 247 F.3d 218, 224 (5th Cir.2001). However, whether and to what extent a debtor has a legal or equitable interest in certain property as of the commencement of the bankruptcy case is generally determined by state law. *See* ***Butner v. United States***, 440 U.S. 48, 55 (1979) (explaining that "[p]roperty interests are created and defined by state law" and, "[u]nless some federal interest requires a different result," should not be analyzed differently "simply because an interested party is involved in a bankruptcy proceeding."); *see also* ***In re Royal St. Bistro***, 26 F.4th 326, 328 (5th Cir. 2022).

Knowing what is and what is not going to be considered property of the bankruptcy estate is a gatekeeping issue of the utmost importance when considering the consequences of a potential bankruptcy filing on the rights of the parties involved.

The focus below will be concentrated on the concept of community property under the Code, and the interests in property that the debtor receives after the commencement of the case that will become part of the bankruptcy estate.

B. *Section 541(a)(2) - Community Property.*

Section 541(a)(2) provides that property of the estate includes "[a]ll interests of the debtor and the debtor's spouse in community property as of the commencement of the case that is—

> (A) under the sole, equal, or joint management and control of the debtor; or
> (B) liable for an allowable claim against the debtor, or for both an allowable claim against the debtor and an allowable claim against the debtor's spouse, to the extent that such interest is so liable.

1. General Considerations

"The term 'community property' is not defined in the [Bankruptcy] Code but has been interpreted as a term of art referring only to the means of holding marital property in those states that have adopted a community property system." 5 Collier on Bankruptcy ¶ 541.11[1], at 541-61 n. 2 (Alan N. Resnick & Henry J. Sommer, ed., 16th ed. Rev. 2011) (citing cases); ***In re Robertson***, 203 F.3d 855, 859 (5th Cir. 2000).

For purposes of §541(a)(2), "[t]he ultimate characterization of property as either community or separate is determined by applicable state law, and that determination establishes what interest, if any, the bankruptcy estate has in the property." ***In re Robertson***, 203 F.3d 855, 859 (5th Cir. 2000); ***In re Provenza***, 82 Fed. Appx. 101, 102 (5th Cir. 2003).

It is well settled in the Fifth Circuit that the term "community property" as used to define property of the estate in §541(a)(2) "includes community property and former community property that has not been partitioned as of the [bankruptcy] petition date but does not include former community property which has been divided and reclassified as separate property by state law before that date." ***In re Robertson***, 203 F.3d 855, 861 (5th Cir. 2000); ***In re Kaye***, 11-1674, 2013 WL 5428618, at *2 (E.D. La. Sept. 24, 2013). As a result, a bankruptcy filing by a party prior to a community property partition (oftentimes during pending divorce proceedings) can have a significant impact on the rights of the non-filing former spouse.

Married couples may file a joint bankruptcy case or elect to file separately. ***In re Moreno***, 622 B.R. 903, 907 (Bankr. C.D. Cal. 2020). When a married couple files separate bankruptcy cases, separate bankruptcy estates arise in both cases, but the bankruptcy estate in the case filed second does not include any §541(a)(2) community property because all of it passed into the first bankruptcy estate. The second estate is made up of only the separate property of the spouse that filed for it. ***Id***.

2. Defining Community Property, Management, and the Satisfaction of Obligations (Louisiana and Texas) [1]

LOUISIANA

La Civ. Code. Ann. art. 2338 – Community property. The community property comprises: property acquired during the existence of the legal regime through the effort, skill, or industry of either spouse; property acquired with community things or with community and separate things, unless classified as separate property under Article 2341; property donated to the spouses jointly; natural and civil fruits of community property; damages awarded for loss or injury to a thing belonging to the community; and all other property not classified by law as separate property.

La Civ. Code. Ann. art. 2340 – Presumption of community. Things in the possession of a spouse during the existence of a regime of community of acquets and gains are presumed to be community, but either spouse may prove that they are separate property.

La Civ. Code. Ann. art. 2345 – Satisfaction of obligation during community. A separate or community obligation may be satisfied during the community property regime from community property and from the separate property of the spouse who incurred the obligation . . .

La Civ. Code. Ann. art. 2357 – Satisfaction of obligation after termination of regime. An obligation incurred by a spouse before or during the community property regime may be satisfied after termination of the regime from the property of the former community and from the separate property of the spouse who incurred the obligation.

La Civ. Code. Ann. art. 2346 – Management of community property. Each spouse acting alone may manage, control, or dispose of community property unless otherwise provided by law.

TEXAS

Tex. Fam. Code Ann. § 3.002 - Community property. Community property consists of the property, other than separate property, acquired by either spouse during marriage.

Tex. Fam. Code Ann. § 3.003 – Presumption of community property.

(a) Property possessed by either spouse during or on dissolution of marriage is presumed to be community property.
(b) The degree of proof necessary to establish that property is separate property is clear and convincing evidence.

Tex. Fam. Code Ann. § 3.202 - Rules of marital property liability.

(a) A spouse's separate property is not subject to liabilities of the other spouse unless both spouses are liable by other rules of law;

[1] Louisiana and Texas are both community property states, but Mississippi is not.

(b) Unless both spouses are personally liable as provided by this subchapter, the community property subject to a spouse's sole management, control, and disposition is not subject to:
    (1) any liabilities that the other spouse incurred before marriage; or
    (2) any nontortious liabilities that the other spouse incurs during marriage;
(c) The community property subject to a spouse's sole or joint management, control, and disposition is subject to the liabilities incurred by the spouse before or during marriage;
(d) All community property is subject to tortious liability of either spouse incurred during marriage...

Tex. Fam. Code Ann. § 3.102 - Managing community property.[2]

(a) During marriage, each spouse has the sole management, control, and disposition of the community property that the spouse would have owned if single, including:
    (1) personal earnings;
    (2) revenue from separate property;
    (3) recoveries for personal injuries; and
    (4) the increase and mutations of, and the revenue from, all property subject to the spouse's sole management, control, and disposition.
(b) If community property subject to the sole management, control, and disposition of one spouse is mixed or combined with community property subject to the sole management, control, and disposition of the other spouse, then the mixed or combined community property is subject to the joint management, control, and disposition of the spouses, unless the spouses provide otherwise by power of attorney in writing or other agreement.
(c) Except as provided by Subsection (a), community property is subject to the joint management, control, and disposition of the spouses unless the spouses provide otherwise by power of attorney in writing or other agreement.

3. Cases Interpreting §541(a)(2)

In re Robertson, 203 F.3d 855, 859–861 (5th Cir. 2000) (Under Louisiana law, consent judgment that was recited into record of divorce proceeding partitioned family home (former community property) between debtor and his former spouse, such that family home awarded to former spouse was reclassified, became her separate property, and was not included in bankruptcy estate under §541(a)(2) upon debtor's chapter 7 filing).

In re Ton, 2023 WL 2706829, at *2–3 (5th Cir. Mar. 29, 2023) (Under Louisiana law, because loan representing creditor claim was "merely refinanced community obligation", loan was incurred by debtor spouse during the community property regime and could be satisfied after

[2] Community property under Texas law (unlike Louisiana) is further subdivided into jointly and solely managed community property. ***United States v. Elashi***, 789 F.3d 547, 549 (5th Cir. 2015); ***In re Ozcelebi***, 639 B.R. 365, 384 (Bankr. S.D. Tex 2022).

termination of the regime from the property of the former community under §541(a)(2) and La. C.C. art 2357).

In re Provenza, 82 Fed. Appx. 101, 102 (5th Cir. 2003) (Under Louisiana law, former spouses rights to real property located in other states that was acquired by parties jointly during their marriage were governed by laws of those states, rather than Louisiana law. As a result, to the extent that Louisiana residents purchase property, during their marriage, in a non-community property state, that property will not be considered community property for purposes of § 541(a)(2)).

In re Lee, 2021 WL 5893991, at *9 (E.D. Tex. Dec. 13, 2021) (holding under Texas law that only jointly managed community property becomes property of the bankruptcy estate under § 541(a)(2), and because personal earnings of non-filing spouse were under "the sole management and control of the spouse who earned them" under Tex. Fam. Code §3.102(a), the tax refund generated from excess withholding of those earnings was also not property of the estate under §541(a)(2)).

In re Trammell, 399 B.R. 177, 187–187 (Bankr. N.D. Tex. 2007) (Under Texas law, motor vehicle titled under non-filing husband's name was his "sole management community property" under §3.102(c) and was not included in property of Chapter 13 estate as community property that that was liable for allowable claim against debtor or against debtor and her husband under §541(a)(2)(B)).

4. Cases on Avoidance of Community Partition Agreements

In re Hinsley, 201 F.3d 638, 643–44 (5th Cir.2000) (Prepetition partition of the community estate of a Texas debtor and his non-debtor wife was void under the Texas UFTA as fraudulent; although wife's affidavit stated that she "believed" the value of the community at the time of partition to be approximately $8 million, credible and undisputed evidence indicated that actual value of the assets was much higher; with respect to one asset, the wife's valuation of $200-250,000 was flatly contradicted by her financial balance sheet which valued the asset at $1.125 million; the wife did not exchange equivalent value for the property she received in partition, and the net effect of partition was to remove valuable assets from the ownership of debtor and make them unavailable to judgment creditors.

U.S. v. Loftis, 607 F.3d 173, 177–178 (5th Cir. 2010) (Community property partition agreement between husband and wife, under which wife received assets valued at $2,337,777 and husband received property valued at $2,000,000, was voidable under the Federal Debt Collection Procedures Act (FDCPA) because husband received less than reasonably equivalent value at a time when he reasonably believed he would incur a debt beyond his ability to pay; the government was investigating the husband when the partition was completed, he faced a lengthy prison term and sizable criminal restitution, his future income questionable, and two months after the partition the husband transferred his interest in the $1,000,000 home to wife).

In re Erlewine, 349 F.3d 205, 212–213 (5th Cir. 2003) (Debtor received reasonably equivalent value in divorce judgment as a matter of law even though division of property admittedly favored non-filing former spouse; Fifth Circuit was hesitant to impute a Congressional intent to upset the

finality of judgments in an area as central to state law as divorce decrees and emphasized that case was fully litigated without any suggestion collusion, sandbagging, or irregularity).

C. *Section 541(a)(5) – Interests Acquired Within 180 Days After Filing Petition.*

Section 541(a)(5) expands the definition of "property of the estate" to include certain property interests that are acquired within 180 days after the commencement of the case. It provides that property of the estate includes "[a]ny interest in property that would have been property of the estate if such interest had been an interest of the debtor on the date of the filing of the petition, and that the debtor acquires or becomes entitled to acquire within 180 days after such date—

> (A) by bequest, devise, or inheritance;
> (B) as a result of a property settlement agreement with the debtor's spouse, or of an interlocutory or final divorce decree; or
> (C) as a beneficiary of a life insurance policy or of a death benefit plan."

Fed. R. Bank. Proc. 1007(h) provides part that "[i]f, as provided by § 541(a)(5) of the Code, the debtor acquires or becomes entitled to acquire any interest in property, the debtor shall within 14 days after the information comes to the debtor's knowledge or within such further time the court may allow, file a supplemental schedule in the chapter 7 liquidation case, chapter 11 reorganization case, chapter 12 family farmer's debt adjustment case, or chapter 13 individual debt adjustment case... This duty to file a supplemental schedule continues even after the case is closed, except for property acquired after an order is entered: (1) confirming a chapter 11 plan (other than one confirmed under § 1191(b)); or (2) discharging the debtor in a chapter 12 case, a chapter 13 case, or a case under subchapter V of chapter 11 in which the plan is confirmed under § 1191(b).

Section 1306(a)(1), however, provides that "(a) property of the estate includes, in addition to the property specified in section 541 of this title . . . (1) all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first."

The majority of courts[3] that have examined the issue have held that §1306(a)(1) captures property of the estate and broadens the definition beyond what §541 provides without regard to whether such property was acquired, devised, or inherited within 180 days of the petition. *See* ***In re Carroll***, 735 F.3d 147, 150 –52 (4th Cir.2013) ("the overwhelming majority of courts . . . agree that §1306 modifies the §541 time period in Chapter 13 cases"); *see also* ***In re Dale***, 505 B.R. 8, 12 (9th Cir. BAP 2014) (same); ***In re Castillo***, 508 B.R. 1, 6 (Bankr. W.D. Tex. 2014) (same).

Chapter 13 debtors have a duty to disclose post-confirmation assets notwithstanding uncertainty as to whether the asset may be ultimately adjudged to be property of the bankruptcy estate or vested in the debtor. ***United States ex rel. Bias v. Tangipahoa Parish School Bd.,*** 766 Fed. Appx. 38, 42 (5th Cir. 2019); see also ***In re Flugence***, 738 F.3d 126, 129–30 (5th Cir. 2013).

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[3] *But see* ***In re Key***, 465 B.R. 709 (Bankr. S.D. Ga. 2012); ***Le v. Walsh (In re Walsh)***, 2011 WL 2621018 (Bankr. S.D. Ga. June 15, 2011).

1. Cases Interpreting §541(a)(5)

In re Blount, 438 B.R. 98 (Bankr. E.D. Tex. 2010) (concluding that distributions received from an inter vivos trust by Chapter 7 debtor within 180 days after his petition filing were not acquired through "bequest, devise, or inheritance" and not estate property under §541(a)(5)).

In re Ozcelebi, 639 B.R. 365, 385 (Bankr. S.D. Tex. 2022) (While property of a spendthrift trust is not property of the estate if state law protects those assets from a beneficiary's creditors, income payments from a spendthrift trust which the beneficiary debtor is entitled to receive or does receive within the 180 day period after the filing of the bankruptcy petition are brought into the bankruptcy estate under § 541(a)(5)(A)); *see also* ***In re Moody***, 837 F.2d 719, 723 (5th Cir. 1988) (same).

In re Schmidt, 362 B.R. 318, 321 (Bankr. W.D. Tex. 2007) (Under Texas law, holding that Chapter 7 debtor's postpetition disclaimer and waiver of her testamentary interest in deceased mother's probate estate did not operate to remove testamentary interest from bankruptcy estate).

In re Chenoweth, 3 F.3d 1111, 1113 (7th Cir.1993) (Debtor "becomes entitled to acquire" inheritance or bequest, within meaning of §541(a)(5) on date of testator's death and not when will is admitted to probate).

III. EXEMPTIONS

A. *General Considerations – Opt-In or Opt-Out State?*

Congress, in the Bankruptcy Code, left to the States the choice of allowing debtors to elect the federal exemption scheme under 11 U.S.C. §522(d) or to substitute the States' exemptions. *See* 11 U.S.C. §522(b).

The State of Louisiana has elected to "opt-out" of the federal exemption scheme. *La. R.S. §13:3881(B)(1).*

The State of Mississippi has also elected to "opt-out" of the federal exemption scheme. *Miss. Code Ann. § 85–3–2.*

The State of Texas is an "opt in" state, allowing debtors to choose either the federal or the state exemptions. ***In re Perry***, 345 F.3d 303, 308 n.5 (5th Cir.2003); *see also* ***In re Bounds***, 491 B.R. 440, 444 (Bankr. W.D. Tex. 2013).

B. *Claiming and Objecting to Exemptions.*

Fed. R. Bank. Proc. 4003 sets forth the procedure for claiming and objecting to exemptions and provides in relevant part:

(a) Claim of exemptions

> A debtor shall list the property claimed as exempt under § 522 of the Code on the schedule of assets required to be filed by Rule 1007. If the debtor fails to claim

exemptions or file the schedule within the time specified in Rule 1007, a dependent of the debtor may file the list within 30 days thereafter.

(b) Objecting to a claim of exemptions

(1) Except as provided in paragraphs (2) and (3), a party in interest may file an objection to the list of property claimed as exempt within 30 days after the meeting of creditors held under § 341(a) is concluded or within 30 days after any amendment to the list or supplemental schedules is filed, whichever is later. The court may, for cause, extend the time for filing objections if, before the time to object expires, a party in interest files a request for an extension.

(2) The trustee may file an objection to a claim of exemption at any time prior to one year after the closing of the case if the debtor fraudulently asserted the claim of exemption. The trustee shall deliver or mail the objection to the debtor and the debtor's attorney, and to any person filing the list of exempt property and that person's attorney.

(3) An objection to a claim of exemption based on § 522(q) shall be filed before the closing of the case. If an exemption is first claimed after a case is reopened, an objection shall be filed before the reopened case is closed.

(4) A copy of any objection shall be delivered or mailed to the trustee, the debtor and the debtor's attorney, and the person filing the list and that person's attorney.

(c) Burden of proof

In any hearing under this rule, the objecting party has the burden of proving that the exemptions are not properly claimed. After hearing on notice, the court shall determine the issues presented by the objections.

The burden shifting framework created by Rule 4003(c) has been described as follows:

A claimed exemption is presumptively valid . . . . Once an exemption has been claimed, it is the objecting party's burden . . . to prove that the exemption is not properly claimed. Initially, this means that the objecting party has the burden of production and the burden of persuasion. The objecting party must produce evidence to rebut the presumptively valid exemption. If the objecting party can produce evidence to rebut the exemption, the burden of production then shifts to the debtor to come forward with unequivocal evidence to demonstrate that the exemption is proper. The burden of persuasion, however, always remains with the objecting party. ***In re Fehmel***, 372 F. App'x 507, 511 (5th Cir. 2010) (*quoting* ***In re Carter***, 182 F.3d 1027, 1029 n.3 (9th Cir. 1999)); *see also* ***In re Painter***, 595 B.R. 226 (Bankr. S.D. Tex. 2018).

Under both federal and state law, exemptions are to be liberally construed in favor of the debtor who claims the exemption. *See* ***In re Soza***, 542 F.3d 1060, 1068 (5th Cir. 2008).

The Fifth Circuit follows the "snapshot rule" which provides that all exemptions are determined as of the petition date. ***In re Frost***, 744 F.3d 384, 386 (5th Cir. 2014) *(citing* ***In re Zibman*****,** 268 F.3d 298, 301 (5th Cir. 2001)).

An "exemption is an interest withdrawn from the estate (and hence from the creditors) for the benefit of the debtor." ***In re Hawk***, 871 F.3d 287, 290 (5th Cir. 2017) (*quoting* ***Owen v. Owen***, 500 U.S. 305, 308 (1991)). The Supreme Court has held that a party in interest case cannot "contest the validity of an exemption after the 30-day period," even if "the debtor had no colorable basis for claiming the exemption." ***Taylor v. Freeland & Kronz***, 503 U.S. 638, 639, 643–44, 112 S.Ct. 1644, 118 L.Ed.2d 280 (1992); *see also* ***In re Hawk***, 871 F.3d at 294. Thus, if a party in interest fails to object, the property is no longer property of the estate.

C. *Comparison of Exemption Statutes.*

Although by no means exhaustive, below is a summary chart comparing the material exemption statutes, the property included, and the monetary caps on such exemptions:

HOMESTEAD EXEMPTION

Texas	Louisiana	Mississippi	Federal
-Unlimited equity not to exceed 10 acres in a city, town, or village, or 100 acres (200 for family) for rural area -Tex. Prop. Code Ann § 41.001, et seq.	-$35,000 in equity not to exceed 5 acres in a municipality, or 200 acres if not in a municipality - La. Rev. Stat. Ann. §20:1	-$75,000 in equity not to exceed 160 acres - Miss. Code Ann. §85-3-21	-$27,900 -11 USC § 522(d)(1)

MOTOR VEHICLE EXEMPTION

Texas	Louisiana	Mississippi	Federal
-One motor vehicle per licensed household member -Unlicensed debtor who relies on someone to operate a vehicle can exempt one vehicle -Motor vehicles must be included in personal property exemption cap below -Tex. Prop. Code Ann. §42.002(a)(9)	-$7,500 of equity in one motor vehicle used by debtor and family. -$7,500 of equity in one motor vehicle modified, equipped or fitted to assist debtor or a family member with a physical disability -La. Rev. Stat. Ann. §13:3881(A)(7) – (A)(8)	-None, but can include within personal property exemption below	-$4,450 -11 USC § 522(d)(2)

TOOLS OF THE TRADE

Texas	Louisiana	Mississippi	Federal
-None, but can include within personal property exemption below	-Tools, instruments, books, and one utility trailer. - La. Rev. Stat. Ann. §13:3881(A)(2)	-None, but can include within personal property exemption below	-$2,800 -11 USC § 522(d)(6)

PERSONAL PROPERTY

Texas	Louisiana	Mississippi	Federal
- $50,000 of personal property for a single person -$100,000 of personal property for a family -Includes: -home furnishings and family heirlooms -athletic/sporting equipment -clothing and food -jewelry (25% of limit) -household pets -two horses, mules or donkeys and tack for each -12 head of cattle -60 head of other livestock -120 fowl -two firearms -motor vehicles -Tex. Prop. Code Ann. §42.001(a); 42.002(a)(1)-(11)	-Unlimited (other than engagement rings) Includes: -household goods and furnishings -appliances -clothing -family portraits -military accouterments -musical instruments -poultry, fowl, one cow -dogs, cats, other household pets -wedding/engagement rings up to $5,000 -firearms up to $2,500 - La. Rev. Stat. Ann. §13:3881(A)(4)-(A)(5)	-$10,000 of personal property Includes: -household goods -1 firearm -1 radio -1 television -1 lawnmower -wearing apparel -books -pets -crops -motor vehicles -tools of the trade -health aids -cash on hand	-$14,875 total (max of $700 per item) Includes: - household goods -furnishings -wearing apparel -appliances -books -animals -crops -musical instruments - jewelry up to $1,875 (not included in cap above) -11 USC § 522(d)(3)-(d)(4)

IV. CONVERSION

A. Rule 1019. Conversion of a Chapter 11 Reorganization Case, Chapter 12 Family Farmer's Debt Adjustment Case, or Chapter 13 Individual's Debt Adjustment Case to a Chapter 7 Liquidation Case

When a chapter 11, chapter 12, or chapter 13 case has been converted or reconverted to a chapter 7 case:

(1) Filing of lists, inventories, schedules, statements

(A) Lists, inventories, schedules, and statements of financial affairs theretofore filed shall be deemed to be filed in the chapter 7 case, unless the court directs otherwise. If they have not been previously filed, the debtor shall comply with Rule 1007 as if an order for relief had been entered on an involuntary petition on the date of the entry of the order directing that the case continue under chapter 7.

(B) A new time period for filing an objection to a claim of exemptions shall commence under Rule 4003(b) after conversion of a case to chapter 7 unless:

(i) the case was converted to chapter 7 more than one year after the entry of the first order confirming a plan under chapter 11, 12, or 13; or

(ii) the case was previously pending in chapter 7 and the time to object to a claimed exemption had expired in the original chapter 7 case.

B. Cases analyzing whether a new time period to object to a claim of exemptions is triggered when a case is converted to chapter 7:

SUPREME COURT

Taylor v. Freeland & Kronz, 503 U.S. 638, 643 (1992) (creditors may not object after thirty days from the date of the meeting of creditors unless the time period is extended by the court).

CIRCUIT & BAP CASES (that allow for a new opportunity to object):

In re Alexander, 236 F.3d 413, 432 (8th Cir. 2001) (per curiam) (noting that both the chapter 7 and 13 trustees filed timely objections within thirty days of the meeting of creditors).

In re Campbell, 313 B.R. 313, 319 (10th Cir. B.A.P. 2004) (finding no binding authority in its circuit and electing to adopt the minority view that Rule 4003(b) recommences upon conversion from chapter 13 to 7).

CIRCUIT CASES (that do not allow for a new time period in which to object):

In re Bell, 225 F.3d 203, 218 (2d Cir. 2000) (conversion does not change the date for the order for relief, therefore conversion does not reset the limitations period for filing objections to exemptions).

In re Sandoval, 103 F.3d 20, 23–24 (5th Cir. 1997) (bankruptcy court improperly determined the date of conversion rather than the date of filing of the original petition for calculating the limitations period – not a Rule 4003 case because debtors changed their homestead designation from one property to another when the case was converted).

In re Smith, 235 F.3d 472, 477 (9th Cir. 2000) (conversion does not reset the date of the order for relief because the purpose of § 348 is to preserve actions already taken in the case before conversion. The dates for commencement of the case and order for relief remain the same unchanged by conversion). The Ninth Circuit previously held in Wilson v. Rigby No. 17-35716 Nov. 27, 2018 that a chapter 7 debtor could not amend his schedules to reflect an increase in vlue subject to the homestead provision under Washington state law. The court held that the date for fixing an exemption is the petition date.

In re Ferretti, 230 B.R. 883, 890 (Bankr. S.D. Fla. 1999), *aff'd without opinion*, 268 F.3d 1065 (11th Cir. 2001) (finding that because property of the estate is determined as of the original filing date, so should the date for filing thirty days from the original exemption period).

FIFTH CIRCUIT BANKRUPTCY CASES:

In re Fonke, 321 B.R. 199, 203–04 (Bankr. S.D. Tex. 2005) (Judge Isgur) (internal footnotes omitted):

> Unlike the majority and minority courts, this Court finds both Rule 1019(2) and Rule 4003(b) inherently ambiguous regarding this issue. First, the Court finds Rule 4003(b)—the basis for the minority position—ambiguous due to a lack of precision in the language regarding the creditors' meeting(s). Specifically, when the Court reads Rule 4003(b) in conjunction with §§ 348 and 341, the Court is unable to determine whether, in Rule 4003(b), "*the*" meeting of creditors refers to the *initial* meeting of creditors or *every* meeting of creditors held pursuant to § 341(a). In fact, Rule 2003—which implements § 314(a)—uses the articles "the" and "a" interchangeably.[7] As it is undisputed that both creditors' meetings are held pursuant to § 341(a), Rule 4003(b) may or may not refer to both of them. Further, this Court is not compelled by Rule 4003(b)'s failure to explicitly limit itself to the initial meeting of creditors. The Court finds it plausible that the drafters either did not consider this issue, or considered Rule 1019(2) as governing, thus making explicit mention of the 4003(b) deadline needlessly superfluous. Accordingly, this Court concludes that Rule 4003(b) is ambiguous as to whether the deadline recommences.
>
> The Court likewise finds the majority position analysis of Rule 1019(2) unpersuasive. As discussed above, the majority position courts rely on the exclusion of the Rule 4003(b) deadline from Rule 1019 as their basis for not

recommencing the deadline to object. The Court declines to adopt the majority analysis of this issue for the same reasons the Court declines to follow the minority analysis. Specifically, Rule 1019(2) may not need to mention Rule 4003(b), because Rule 4003(b) arguably states that the deadline recommences. As such, this Court finds both rules facially ambiguous as to the present issue.

***

Thus, in absence of the ability to harmonize the conflicting statutes, the Court must determine whether § 522 or § 348 controls. When interpreting conflicting statutes, the more specific statute prevails over a more general statute. *Edmond v. United States.*, 520 U.S. 651, 658, 117 S.Ct. 1573, 137 L.Ed.2d 917 (1997) (stating "[o]rdinarily, where a specific provision conflicts with a general one, the specific governs"); *Bulova Watch Co. v. United States*, 365 U.S. 753, 758, 81 S.Ct. 864, 6 L.Ed.2d 72 (1961) (stating that "a specific statute controls over a general one without regard to priority of enactment"); *In re Luongo*, 259 F.3d 323 (5th Cir.2001).

Section 348(f) addresses what is considered property of the estate upon conversion. As such, it appears to address the present issue. Section 522(c), however, specifically deals with the liability of property exempted under § 522. Accordingly, in determining the issue of liability of exempt property for prepetition debts, § 522(c) is the more specific statute. Therefore, § 522(c) trumps § 348 as to whether previously exempted property may be liable for prepetition debts by being recaptured by the estate. ***Fonke***, at 207

Judge Houser agreed with Judge Isgur in ***In re Shults***, 2007 WL 2034296, *1 (Bankr. N.D. Tex. July 11, 2007) finding that:

The Court notes that there is a clear division among courts regarding the question of whether the Rule 4003(b) objection deadline restarts after conversion from Chapter 13 to Chapter 7. *See In re Fonke*, 321 B.R. 199, 201 (Bankr. S.D. Tex. 2005) (describing split in authority). There is no controlling authority in this Circuit. *Id.* at 202. However, in *In re Fonke*, Judge Marvin Isgur held, in a thoughtful opinion, that the claim objection deadline does not recommence upon conversion of a case from Chapter 13 to Chapter 7. *Id.* at 208–09. The Court finds the *Fonke* analysis persuasive and will follow it here. Accordingly, for the reasons stated in *Fonke*, the Court concludes that the conversion of this case from Chapter 13 to Chapter 7, and the consequent convening of a second Section 341 meeting, does not extend the F.R.B.P. 4003(b) deadline for objecting to the Debtor's claimed exemptions.

But see ***In re Mullican***, 417 B.R. 389, 401 (Bankr. E.D. Tex. 2008), *aff'd* 417 B.R. 408 (E.D. Tex. 2009) (internal footnotes omitted) holding that:

Accordingly, if the case is converted in bad faith, "any property in the hands of the Chapter 13 trustee and, potentially, any property acquired by debtor during the pendency of the Chapter 13 case, will become property of the Chapter 7 estate." ***In re Siegfried***, 219 B.R. at 584. *See also* ***In re Campbell***, 313 B.R. 313, 320–21 (10th Cir. B.A.P. 2004) (reasoning that property revested in the debtor under § 1327(b) or § 522(*l*) must be recaptured by 348(f) in order for 348(f) to have meaning).

Cf. ***In re Castillo***, 508 B.R. 1 (Bankr. W.D. Tex. 2014) (finding insufficient evidence under the totality of the circumstances test from ***Mullican*** to find that conversion to chapter 7 was in bad faith).

Given the cases cited herein, the majority (slightly) hold that a claim of exemptions is fixed on the original petition filing date, not the date of conversion. This is significant because if state law (Louisiana and Mississippi) allows for only a partial exemption of homestead property, then a homestead exemption will be fixed on the original filing date. Further, any homestead appreciation will be subject to the chapter the case is pending at the time of sale.[4]

V. APPRECIATION

A. *Appreciation of Assets.*

Home appreciation – who gets it? It depends-

How did the home appreciate – pay down on debt or increase in market value? Most cases focus on appreciation, and not reduction of mortgage debt.

B. *The Issue.*

Debtor(s) file for chapter 13 bankruptcy to preserve their homestead. During the pendency of the case the home (almost always the debtor's homestead) appreciates in value due to market appreciation (generally) and/or debt service. While in the chapter 13 case, debtor is unable to make the plan and/or mortgage payments. Debtor reluctantly converts the case to chapter 7. Upon conversion to chapter 7, the trustee seeks to sell debtor's homestead because the homestead exemption may not cover the entire value of the home. Chapter 7 trustee sells the home. Excess sale proceeds are realized, and the issue is who gets the appreciation on the home – the debtor or creditors.

At the time of the chapter 13 petition being filed, a debtor retains property by paying on its debt though future earnings or income. Upon conversion from chapter 13 to chapter 7, a debtor loses the ability to control the disposition of assets that are not exempt. Further, given that a home

[4] If the case remained in chapter 13 upon sale of homestead property, then a debtor could potentially use the proceeds to pay off the debt balance of the chapter 13 plan. Further, only a debtor could sell a homestead in chapter 13 because a chapter 13 trustee does not have the right to sell property. A chapter 13 trustee's duties do not include the authority to liquidate property. *Cf.* 11 U.S.C. § 1302(b) with § 704(a)(1).

is generally the most significant asset in any consumer case, a trustee must and should consider whether there is any value. A chapter 7 trustee has a duty to "collect and reduce to money the property of the estate for which the trustee serves" for the benefit of creditors. § 704(a)(1).

Circuit courts and Bankruptcy Appeals panel have considered the issue of who gets the appreciation from the sale of homesteads with varying results.[5]

Currently, there are three circuit or bankruptcy appellate decisions that have examined the question of who gets the appreciation. *See, e.g.*, ***Castleman v. Burman (In re Castleman)***, 75 F.4th 1052, 1055 n.3, 1058 (9th Cir. 2023) (collecting cases) (Tallman, J., dissenting)(chapter 7 trustee gets the appreciation)[6], *petition for certiorari filed,* Castleman v. Burman (Dec. 7, 2023); ***Goetz v. Weber (In re Goetz)***, 651 B.R. 292, 302 (B.A.P. 8th Cir. 2023)(chapter 7 trustee gets the appreciation); *cf.* ***Rodriguez v. Barrera (In re Barrera)***, 22 F.4th 1217, 1222, 1226 (10th Cir. 2022) and ***Coslow v. Reisz***, 811 Fed. App'x 980, 984 (6th Cir. 2020) (noting that because the post-petition equity increase in debtor's home was not compensation from post-petition services, the equity did not become property of the estate).

C. *Chapter 7 Trustee Gets the Appreciation.*

Courts holding that a chapter 7 trustee on behalf of the estate focus on the language of § 348(f)(1)(A):

> **(f)(1)** Except as provided in paragraph (2), when a case under chapter 13 of this title is converted to a case under another chapter under this title--
>
> **(A)** property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession of or is under the control of the debtor on the date of conversion.

Courts following the plain meaning of § 348(f)(1)(A) adhere to the Supreme Court's guidance that "when the statute's language is plain, the sole function of the courts … is to enforce it according to its terms." ***Lamie v. United States Tr.***, 540 U.S. 526, 534 (2004). Moreover, it is only appropriate to look to legislative history for guidance where a particular statute is ambiguous. ***Ratzlaf v. United States***, 510 U.S. 135, 147–48 (1994) (Courts "do not resort to legislative history to cloud a statutory text that is clear."). These courts hold that under the paradigm of the plain meaning of the statute, § 348(f)(1)(A) is unambiguous on its face.

In doing so, courts holding that the trustee obtains the increase in appreciation for the benefit of creditors focus on the plain language of § 348(f)(1) which states in relevant part that "*property of the estate, as of the date of filing of the petition, that remains in the possession of or*

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[5] The author of this section (Judge Gargotta) notes that the 2024 Duberstein problem (in part) deals with retention of the appreciation of homestead property. Further, Bill Rochelle's ABI blog has posts about the ongoing judicial debate about who keeps the appreciation in home value. See e.g., "Circuits Are Now Split On Who Gets Appreciation In A Home When a "13" Converts to "7" (August 2, 2023) and guest columnist Paul Hage "Rising Home Values and Chapter 13: A Deepening Split" (September 13, 2023).

[6] Judge Richard Tallman's dissent examines point by point the error of the majority's ruling and the reasoning why appreciation remaining in the bankruptcy estate is erroneous.

is under the control of the debtor on the date of conversion . . . ." Courts additionally focus on the definition of § 541(a)(1) which says that property of the estate is defined as property of the state on the petition date and nothing in § 541(a) suggests or requires that an appreciation in an asset is a separate property interest. ***Goetz v. Weber (In re Goetz)***, 651 B.R. 292, 298 (B.A.P. 8th Cir. 2023) (quoting ***Potter v. Drewes (In re Potter)***, 228 B.R. 422, 424 (B.A.P. 8th Cir. 1999) ("Nothing in Section 541 suggests that the estate's interest is anything less than the entire asset, including any changes in its value which might occur after the date of filing."")). Rather, the value of the home is a characteristic or attribute of the home that is "inseparable" from the home itself. *See* ***In re Goins***, 539 B.R. 510, 516 (Bankr. E.D. Va. 2015).

Notably, the Ninth Circuit has found that under the plain language of § 348(f)(1) that the appreciation in a home belongs to the chapter 7 estate, concluding that that the plain language of section 348(f)(1) dictates that any property of the estate at the time of the original filing that is still in debtor's possession at the time of conversion becomes property of the chapter 7 estate. ***Castleman v. Burman (In re Castleman)***, 75 F.4th at 1058. The Ninth Circuit noted that although values in homes today may increase, there are instances in the past where they have declined. ***Id***. Castleman also doubted that under § 1327 Congress intended a valuation process in which "equity increases from the time of the initial filing up until plan confirmation would inure to the estate, then from time of confirmation until conversion would vest in the debtor, and finally upon conversion, any additional post-conversion changes would benefit the estate." ***Id***. at 1057 (citing ***Barrera***, 22 F.4th at 1223–24).[7]

D. *The Debtor Keeps the Appreciation in a Chapter 7 Case.*

Courts find under § 348(f)(1)(A) a facial reading of the statute indicates any increase in equity of a debtor's home is property of the estate. As noted in this paper, § 348(f)(2) provides that a case converted to chapter 7 involving "bad faith" includes property of the date as of the date of conversion. Courts have reasoned that Congress would not have had to enact § 348(f)(2) if Congress did not intend a debtor to keep appreciation in the debtor's home under § 348(f)(1)(A). *See* ***In re Harmon***, 2022 WL 20451952, at *6 (Bankr. E.D. La. June 9, 2022) (denying debtors' motion to reconvert their case back to chapter 13 after previously converting the case to chapter 7 but concluding that any increase in equity in debtors' home inures to the benefit of the debtor, following ***Barrera***).

Additionally, courts favoring that appreciation remains with the debtor analyze the statutory language of § 522 and § 348(a)(1)(A), which are almost identical. Section 522 establishes value on the date of petition, but under a chapter 7 trustee's construction of § 348(f)(1)(A) valuation would be on the date of conversion. Those cases conclude that the statutes should not be read differently.

[7] Courts have developed four ways in which to measure post-petition appreciation when property vests in the debtor: estate termination, estate preservation/conditional vesting, estate transformation, and estate replenishment. These approaches were discussed in successive columns of the American Bankruptcy Institute Journal. *See* Gunn and Kostolni, "*Post-Petition Appreciation: Whose Line (Item) Is It, Anyway*?", 42 NOV. Am. Bankr. Inst. J. 18 and Potts and Carroll, "*Consumer Point/Consumer Counterpoint*", 42 DEC. Am. Bankr. Inst. J. 32.

Finally, cases supporting the debtor's argument focus on the legislative history of § 348 and find Congress evidenced an intent to have a debtor keep post-conversion appreciation of a debtor's home.

> This amendment would clarify the Code to resolve a split in the case law about what property is in the bankruptcy estate when a debtor converts from chapter 13 to chapter 7. The problem arises because in chapter 13 …, any property acquired after the petition becomes property of the estate, at least until confirmation of a plan. Some courts have held that if the case is converted, all of this after-acquired property becomes part of the estate in the converted chapter 7 case, even though the statutory provisions making it property of the estate do not apply to chapter 7. Other courts have held that the property of the estate in a converted case is the property the debtor had when the original chapter 13 petition was filed.

H.R. REP. NO. 103-835, at 57 (1994), *as reprinted in* 1994 U.S.C.C.A.N. 3340, 3366.

Further, the legislative history found not allowing a debtor to keep the appreciation in the debtor's home a disincentive to filing chapter 13. Id. ("These later courts have noted that to hold otherwise would create a serious disincentive to chapter 13 filings."). *See e.g*, ***Barrera***, 22 F.4th at 1222; ***Harmon***, 2022 WL 20451952, at *9.

E. *Recent Bankruptcy Cases.*

In re Elassal, 654 B.R. 434, 446 (Bankr. E.D. Mich. 2023) (finding that sale proceeds from the sale of debtor's home in a chapter 13 case were not property of the estate under § 1306).

In re Adams, 641 B.R. 147 (Bankr. W.D. Mich. 2022) ("Among the interests included within the estate is the right to sell the property and enjoy the proceeds of sale, including any post-petition appreciation in value, so long as the appreciation is not allocable to a debtor's post-petition earnings").

In re Harmon, 2022 WL 20451952, at *6 (Bankr. E.D. La. June 9, 2022) (denying debtors' motion to reconvert their case back to chapter 13 after previously converting the case to chapter 7 but concluding that any increase in equity in debtors' home inures to the benefit of the debtor, following ***Barrera***).

VI. THE CLIENT

A. *The Client with a Cause of Action.*

Generally, the attorney will encounter prospective clients with one of three general classes of personal injury cases.

1. **The prospective client with a substantial case**. A substantial personal injury case requires substantial injuries combined with long-term economic loss. It's unusual for consumer bankruptcy attorneys to see this type of prospective client because a good personal injury attorney will generally not let his client get within a mile of a

bankruptcy attorney's office. If the case is truly meritorious, the chances are very high that the plaintiff attorney has no idea of the client's financial situation or that he is considering bankruptcy.

2. **The prospective client with a decent run-of-the-mill to good case.** These are good cases, but the amount of the recovery will not allow the plaintiff to retire in luxury and lead a life of ease. The plaintiff attorney is not willing to front the money to pay the clients' monthly payments on credit cards and other debt.

3. **The prospective client with a dubious or insignificant (relative to unsecured debt) case.** These are cases where the client is having a difficult time finding an attorney who will represent him. The injuries may be questionable, or the liability may be uncertain. An attorney handling the case on a contingency fee is not going to accept a case that is more work than it is worth.

B. ***Rule out Chapter 7.***

A client with a substantial or even a decent case should probably not file a Chapter 7 case under most circumstances. First, he will completely lose control of his case because the Chapter 7 trustee acquires the cause of action and becomes the real party in interest in the personal injury lawsuit. Second, the trustee may decide to settle the case with the defendant for just the amount of the unsecured debt, leaving substantial money on the table that would otherwise have gone to the debtor. Third, even if the trustee hires an attorney to prosecute the case, the debtor will be paying an unnecessary trustee's commission on the recovery.

If the prospective client's case is dubious or if the recovery is liable to be insignificant, there is a good chance that the Chapter 7 trustee would disclaim and abandon the cause of action. Make sure the client understands the risk before filing the bankruptcy case.

C. ***CYA.***

If the prospective bankruptcy client has already retained an attorney, call the attorney and let them know that their client is in your office. If the case is genuinely a good case, the personal injury attorney may advance the funds or arrange for a personal loan to the client that would allow the client to avoid filing a bankruptcy case.

If the prospective client has not retained counsel, and if neither you nor a member of your firm handles personal injury, make sure your engagement agreement specifically excludes responsibility for prosecuting or even reviewing the personal injury claim, and that you advise the client in writing to consult with competent trial counsel. It is usually a good idea to advise the client that there is a statute of limitations or bar date for filing a personal injury claim, and that he can lose his rights if he fails to take prompt action.

Even better yet, establish a working relationship with a good personal injury attorney so that you can work on the case jointly and here in the personal injury fee as allowed by your state's Rules of Professional Conduct.

If the prospective client has waited until the last minute, and has not been able to find an attorney who will take his case (usually not a very good sign), and the statute of limitations is about to expire, Chapter 7 may be the only way to extend the statute of limitations to preserve the claim (but not necessarily for the debtor).

D. ***Remember and be aware of the automatic extensions of time provided in 11 USC 108.***

11 U.S.C.A. § 108. Extension of time

> **(a)** If applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period within which the **debtor** may commence an action, and such period has not expired before the date of the filing of the petition, the **trustee** may commence such action only before the later of--
>
> > **(1)** the end of such period, including any suspension of such period occurring on or after the commencement of the case; or
> >
> > **(2)** two years after the order for relief.

Note the wording of this provision which extends the statute of limitations for the "trustee" to bring the action as opposed to the "debtor." Presumably this is to inure to the benefit of the unsecured creditors and not to a careless or negligent debtor who waits too long to bring his cause of action.

> **(b)** Except as provided in subsection (a) of this section, if applicable **nonbankruptcy law**, an order entered in a **nonbankruptcy proceeding**, or an agreement fixes a period within which the **debtor or an individual protected under section 1201 or 1301** of this title may file any pleading, demand, notice, or proof of claim or loss, cure a default, or perform any other similar act, and such period has not expired before the date of the filing of the petition, the **trustee** may only file, cure, or perform, as the case may be, before the later of--
>
> > **(1)** the end of such period, including any suspension of such period occurring on or after the commencement of the case; or
> >
> > **(2)** 60 days after the order for relief.

This provision is important bankruptcy cases in which the debtor or a codebtor covered by the automatic stay may have obligations to act within a certain timeframe pursuant to a state court order.

> **(c)** Except as provided in section 524 [Effect of discharge] of this title, if applicable nonbankruptcy law, an order entered in a nonbankruptcy proceeding, or an agreement fixes a period for commencing or continuing a civil action in a court other than a bankruptcy court on a claim **against the debtor, or against an individual with respect to which such individual is protected under section 1201 or 1301** of this title, and such period has

not expired before the date of the filing of the petition, then such period does not expire until the later of--

(1) the end of such period, including any suspension of such period occurring on or after the commencement of the case; or

(2) 30 days after notice of the termination or expiration of the stay under section 362, 922, 1201, or 1301 of this title, as the case may be, with respect to such claim.

This provision extends the time in which a debtor or codebtor in Chapter 12 or 13 may be sued. Of course, this is a moot point if the debt is discharged in the bankruptcy proceeding.

E. ***Hiring and Paying the Client's Nonbankruptcy Attorney.***

If your client retains one of the more experienced personal injury law firms or attorneys, that attorney will probably be familiar with the additional obligations incurred in representing a client who is a debtor in an active bankruptcy case. That makes your job a lot easier because you just have to review the papers and sign off if you find everything in order.

Many personal injury attorneys, however, are unaware of the additional requirements and it falls upon the debtor's bankruptcy attorney to make sure that the hiring process is done correctly to preserve the client's cause of action.

The statutory authority for hiring and compensating an attorney for the estate is found in 11 USC 327, 328, 330, which should be read in their entirety by the bankruptcy attorney. The following sections are relevant when hiring a personal injury attorney for client in an open bankruptcy case:

11 U.S.C.A. § 327 Employment of professional persons

(a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more **attorneys, accountants, appraisers, auctioneers, or other professional persons**, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

This provision clearly establishes the supervisory role of the bankruptcy judge in hiring any professional who may be involved in prosecuting a nonbankruptcy cause of action against a third-party for the benefit of the estate. Supervision extends to any kind of professional person, and presumably would also include medical and other expert witnesses in a personal injury case.

Special attention should be paid to whether the estate has any risk of financial responsibility in the event the case is lost. In most cases the plaintiff's attorney assumes these financial responsibilities, but not always.

Counsel should also remember that the trustee (or the debtor-in-possession in a Chapter 11, 12, or 13) may be able to fire and replace a personal injury attorney retained prebankruptcy.

The prebankruptcy attorney's employment is an executory contract which may be rejected under 11 USC 365, subject to a claim for rejection damages.

11 U.S.C.A. § 327 Employment of professional persons

> **(e)** The trustee, with the court's approval, may employ, for a specified special purpose, other than to represent the trustee in conducting the case, **an attorney that has represented the debtor**, if in the best interest of the estate, and if such attorney does not represent or hold any interest adverse to the debtor or to the estate with respect to the matter on which such attorney is to be employed.

This is an important section for both the bankruptcy attorney and the personal injury attorney. The Chapter 7 trustee will frequently retain the attorney who has represented the debtor in an existing, open personal injury case. This can create an unwaivable conflict of interest because the original personal injury attorney, whose obligation is to maximize recovery for his client, now represents a Chapter 7 trustee was only obligation is to the unsecured creditors. Chapter 7 trustees may settle quickly to get the case over with and get their commission, even though it might be in the best interest of the individual debtor to push the case to trial in the hope of being awarded a substantial sum above the amount of the unsecured debt. In some cases, the bankruptcy attorney might have a duty to object to the trustee's proposed employment of existing personal injury counsel.

11 U.S.C.A. § 328 § Limitation on compensation of professional persons

> **(a)** The trustee . . . with the court's approval, may employ or authorize the employment of a professional person . . . On any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, on a fixed or percentage fee basis, or on a contingent fee basis. Notwithstanding such terms and conditions, the court may allow compensation different from the compensation provided under such terms and conditions after the conclusion of such employment, if such terms and conditions prove to have been improvident in light of developments not capable of being anticipated at the time of the fixing of such terms and conditions.

In any serious personal injury case, the personal injury attorney should get his fee contract approved in advance. This section provides an extra layer of protection to an unwarranted reduction in the agreed upon fee when the case settles quickly. It also provides the debtor with a cap on the fee in the event it becomes overly complicated by reason of facts or law that were not known at the time of the employment contract. *See* ***Matter of National Gypsum Co.,*** C.A.5 (Tex.) 1997, 123 F.3d 861; ***In re Barron,*** C.A.5 (Miss.) 2003, 325 F.3d 690, rehearing denied.

11 U.S.C.A. § 330 Compensation of officers

> **(a)(1) After notice to the parties in interest and the United States Trustee and a hearing**, and subject to sections 326, 328, and 329, the court may award to . . . a professional person employed under section 327 or 1103--
>
> > **(A)** reasonable compensation for actual, necessary services rendered by the trustee, examiner, ombudsman, professional person, or attorney and by any

paraprofessional person employed by any such person; and

(B) reimbursement for actual, necessary expenses.

(2) The court may, on its own motion or on the motion of the United States Trustee, the United States Trustee for the District or Region, the trustee for the estate, or any other party in interest, award compensation that is less than the amount of compensation that is requested.

Be sure to tell the plaintiff's attorney that is compensation is not automatic and that he may not disperse fees until approval by the bankruptcy court.

11 U.S.C.A. § 330 Compensation of officers

(3) In determining the amount of reasonable compensation to be awarded to an examiner, trustee under chapter 11, or professional person, the court **shall consider** the nature, the extent, and the value of such services, taking into account all relevant factors, including--

(A) the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed;

(E) with respect to a professional person, **whether the person is board certified** or otherwise has demonstrated skill and experience in the bankruptcy field; and

(F) whether the **compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title**.

(4)(A) Except as provided in subparagraph (B), the court shall not allow compensation for--

(i) unnecessary duplication of services; or

(ii) services that were not--

(I) reasonably likely to benefit the debtor's estate; or

(II) necessary to the administration of the case.

Personal injury attorneys almost never keep track of their time, and bankruptcy judges (fortunately) almost never require timesheets from them.

11 U.S.C.A. § 330 Compensation of officers

> **(B)** In a chapter 12 or chapter 13 case in which the debtor is an individual, the court may allow reasonable compensation to the debtor's attorney for representing the interests of the debtor in connection with the bankruptcy case based on a consideration of the benefit and necessity of such services to the debtor and the other factors set forth in this section.

This is an important section and is used almost always in most Chapter 13 cases when the debtor has a personal injury case against the third-party. Debtor's attorney lists the cause of action on his schedules and statements, and makes the Chapter 13 trustee aware of the litigation. The trustee generally requires six-month status reports. A motion to settle the case and pay attorney's fees is usually filed as one motion and set for hearing. Debtor's counsel is the opportunity to ask for the use of all or part of the proceeds, and the bankruptcy court decides the distribution of the proceeds of the lawsuit between the debtor, the trustee, in the personal injury attorney.

F. ***The Client with a Looming Home Foreclosure.***

1. For lower income homeowners, calling the bankruptcy lawyer is an act of desperation, the last resort, because these prospective clients have no money to spend or spare. Some were not really qualified in the first place, others have had personal difficulties or even tragedies—unemployment, serious illness, disability, divorce, or death of a family member.

2. For middle income homeowners, bankruptcy lawyers are like dentists: nobody really wants to call them until the pain becomes unbearable.

3. For higher income homeowners, pride, embarrassment, disbelief, and denial keep them from seeking help through a public court proceeding.

In almost all cases, by the time the prospective client calls, saving the house will be more difficult if not actually impossible.

G. ***Can Bankruptcy be Avoided through State Court Proceedings?***

In judicial foreclosure states such as Louisiana, a foreclosure may sometimes the avoided by defending in state court. Practically and realistically, all that is really accomplished most of these cases is to cause a delay the inevitable and incur substantial attorney's fees which would better be spent in getting caught up on the mortgage. Additionally, a substantial bond may be required to enjoin the foreclosure, and very few individuals behind on mortgage can afford the cost. If the client is suffering a temporary setback, the extra time might be sufficient to enable them to refinance or borrow enough from relatives to set aside the foreclosure. Depending on the mortgage servicer, it might open our re-open possibilities of a loan modification.

The bigger question is: why go into state court when Chapter 13 offers a stay of the foreclosure proceeding without the necessity of posting a bond? Plus, there is the opportunity to take up to five years to get caught up on the back to payments, plus an opportunity to reorganize the homeowner's finances to make the timely payment of future monthly installments possible.

H. ***Can Bankruptcy be Avoided by a Loan Modification?***

By the time the prospective client calls the bankruptcy attorney, if a Fannie, Freddie, VA, FHA, USDA, or other government-involved loan is involved, he should have been contacted by the mortgage servicer with a list of his options and the necessary paperwork and applications to get the procedure started. If the client has not begun the loan modification process, he should be instructed to do so immediately because may cause a stay of the proceedings under nonbankruptcy federal law.

This is a summary of current available loan modification programs that appears on the Bankrate website at: https://www.bankrate.com/mortgages/loan-modification-strategy/#how-to-apply.

1. **Conventional loan modification** – For conventional mortgages owned by Fannie or Freddie, a debtor can pursue the Flex Modification program, which can reduce monthly payments by up to 20 percent, extend the loan term up to 40 years and potentially lower the interest rate.

2. **FHA loan modification** – There are a few options for an FHA loan modification, including an interest-free loan for up to 30 percent of your balance. As of May 2023, a debtor can also opt for a 40-year loan extension, a rule made effective by the U.S. Department of Housing and Urban Development.

3. **VA loan modification** – If a debtor has a VA loan, he can roll the missed payments back into the loan balance and work with his lender to come up with a new, more manageable repayment schedule. Another option might be extending the loan term.

4. **USDA loan modification** – With a USDA loan, a debtor can modify his mortgage with an extended term of up to 40 years, reduce the interest rate and receive a "mortgage recovery advance," a one-time payment to bring the loan current.

I. ***Consumer bankruptcy attorneys should also be aware of what are touted on the Bankrate website as "alternatives to foreclosure," but which are not necessarily in the client's best interest.***

1. **Forbearance:** This is a short-term solution in which the lender agrees to suspend or reduce your monthly mortgage payments for up to one year. Keep in mind that interest will continue to accrue during the forbearance period. Once the forbearance ends, the debtor will be put on a repayment plan.

2. **Refinance:** A debtor might consider refinancing if interest rates have fallen since he got his loan, he has strong enough credit and income to qualify for a new mortgage and he can afford the closing costs. Refinancing can help lower the monthly payment permanently either by reducing the loan's rate or extending its

repayment term. (However, if a debtor is at the point of considering a modification, he likely doesn't have the income to qualify for a refinance.)

3. **Short sale:** Short sales involve selling a debtor's home when the balance of his mortgage is more than the home's value (an underwater mortgage). Your lender will need to approve this type of sale, and it can have tax implications.

4. **Deed in lieu of foreclosure:** This is a last-resort option where a debtor gives up the deed to his home in exchange for the lender releasing him from the loan payments. This allows a debtor to avoid the severe credit damage of having a foreclosure on your record, but means you lose the home.

J. ***Special Problems for the Desperate Client.***

In some situations, especially cases handled *pro bono*, saving the home by curing the default or by a loan modification is not desirable (as when home is in major disrepair or when the mortgage greatly exceeds the value) but the client has no place to go and no money to get there.

In such a case, and being sure to act within the ethical bounds of the Code of Professional Responsibility, Chapter 7 bankruptcy may be used to keep the client in the house for as long as possible.

Filing a Chapter 13 with the intent of running the clock and converting to a Chapter 7 when the attorney knows there is no possibility of reorganization would most likely be a bad faith filing that could and should subject the attorney to sanctions; however, it may be appropriate to delay filing a Chapter 7 until the eve of foreclosure, or, if the property is community property or jointly owned, to file sequential chapter 7 bankruptcy by each of the spouses/owners.

K. ***The Client with Tax Problems.***

Although Chapter 13 is frequently the best vehicle for resolving nondischargeable taxes, there are sometimes other alternatives.

"Tax Resolution" Companies. Probably everyone has heard the "Optima Tax Relief" radio commercials (What? You're under 40 and don't listen to radio???) around this time of the year. This company and other companies like it use readily available software and non-attorney employees to take advantage of IRS programs that are available to the public to resolve income tax issues without the need for bankruptcy. Like internet debt settlement companies, these outfits wield some sort of mystical, unexplained attraction to prospective clients who are delinquent in paying their federal income tax.

Tax resolution companies are incredibly costly to the taxpayer, and are no substitute for the advice of a competent attorney or CPA.

However, consumer bankruptcy attorneys should be aware of nonbankruptcy options available to their prospective clients. In some cases, these programs provide relief that cannot be accomplished through either Chapter 7 or Chapter 13.

L. ***Common Nonbankruptcy Tax Relief Programs.***

1. **Currently Not Collectible.** While a taxpayer account is in CNC status, the IRS generally won't try to collect. It will not levy assets or income but will still assess interest and penalties and may keep refunds.

The IRS reviews the status annually and may begin collection if the taxpayer's financial condition improves. Importantly, the Collection Statute Expiration Date (CSED in IRS lingo), which is 10 years from the date the taxes were assessed, continues to run.

To see if a potential client qualifies, the attorney should contact the IRS with the client present to answer questions at the following numbers:

Individual taxpayers: 800-829-1040 (or TTY/TDD 800-829-4059)

Business taxpayers: 800-829-4933

The IRS will generally require a completed Form 433-A, Form 433-F, or Form 433-B before making any collection decision.

2. **Installment Agreement.** An Installment Agreement allows an individual to pay their tax balance during a time frame if they are eligible. If the individual owes $50,000 or less in combined taxes, penalties, and interest, an installment agreement may be created and the unpaid assessment will be fully paid within 72 months or by the Collection Statute Expiration Date, whichever comes first. Form 9465 will need to be completed, which is an Installment Agreement Request.

3. **Offer in Compromise (OIC).** An offer in compromise is a means for a client to settle a tax debt for less than the amount owed. An OIC is usually used when a client either cannot pay the taxes due to an economic hardship or paying the taxes would cause an economic hardship. A client who is currently in bankruptcy is not eligible to apply for an OIC.

The first step is to review Form 656 Booklet: Offer in Compromise. This booklet includes eligibility requirements, Form 433-A, and Form 656. Form 433-A will generate your client's offer amount, and Form 656 details the specifics of the offer, including scheduling payment, and allows you, as the attorney, to advocate for your client and explain why they need the offer.

Remember that the goal of the IRS is to collect as much tax as possible, and not to advise the taxpayer that he might be able to discharge years of ancient that in a Chapter 7 or Chapter 13 bankruptcy case.

4. **All nonbankruptcy tax resolution begins with filed returns.** Tax returns are of course also required to be filed in order for the client to obtain bankruptcy relief. Often Debtors provide incomplete information when asked by staff to provide copies of their tax returns.

The quickest and most efficient way to obtain tax records for debtor in bankruptcy is to prompt the client to login to their personal IRS account to provide relevant transcripts.

This should be done pre-petition, so those documents are ready and available at filing time so the information can be listed in the Statement of Financial Affairs and to be certain that a Debtor has filed their last four years of taxes as required by Section 521 the code.

IRS online accounts go back a minimum of four years for most reports and longer in other cases. The reports obtainable from a personal IRS account are as follows:

- **Return Transcript.** Return transcripts show most line items from your Form 1040-series tax return as it was originally filed, including any accompanying forms and schedules. In many cases, a return transcript will meet the requirements of lending institutions offering mortgages.

- **Account Transcript.** Account transcripts show changes you or the IRS made after you filed your original return, such as making estimated tax payments or filing an amended return.

- **Record of Account Transcript.** Record of account transcripts combine the information from return and account transcripts.

- **Wage & Income Transcript.** Wage and income transcripts show data from information returns, such as W-2s, 1098s, and 1099s reported to the IRS. The transcript may not be complete until all the earnings are reported.

- **Verification of Non-filing Letter.** Verification of non-filing letters state that IRS does not have a record of a processed tax return as of the date of the letter.

The benefit of this approach is that the attorney can be sure the data being pulled is true and accurate because it is coming straight from IRS. The only real pitfall is that ID.me is now required to access personal IRS accounts and that set up process is often arduous because it requires a video selfie and two step verification.