

PREPETITION MISTAKES THAT CAN KILL CASES

(A brief study in what NOT to do)

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I. Credit Counseling Issues

A. Timeliness - credit counseling must be received during the 180-day period preceding the date of filing of the petition

1. Is credit counseling received on the day the petition is filed timely under § 109(h)? The bankruptcy courts are split on this issue, and to date, no appellate court has addressed the issue. In the most recent case, *In re Francisco*, 2008 WL 244172 (Bankr. D.N.M. Jan. 25, 2008), the bankruptcy court (Judge Starzynski) raised the timeliness question on its own motion and determined that “a debtor must obtain the budget and credit counseling prior to the date—day—of the filing of the petition.” Therefore, it dismissed the case. In its conclusion, the court stated it “would welcome a review of this decision by the Tenth Circuit Bankruptcy Appellate Panel.” It appears that the court’s wish will be granted as the debtor filed her notice of appeal on February 4, 2008 (and did not elect to have it reviewed by the district court).

2. Is close to 180 days good enough? The majority of courts that have faced this issue have reluctantly determined that Congress gave them no authority to waive a debtor’s failure to obtain credit counseling within 180 days of filing unless the debtor qualified for a statutory exception. For example, in *In re Giles*, 361 B.R. 212 (Bankr. D. Utah 2007), debtors obtained credit counseling 182 days prior to commencement of their Chapter 13 case. The trustee moved to dismiss for failure to comply with § 109(h). The bankruptcy court (Judge Thurman) rejected the debtor’s argument that they had complied with the “spirit” of § 109(h), and dismissed the case because they did not comply with the technical requirements of § 109(h). Additionally, the court encouraged the trustee to continue bringing noncompliance with § 109(h) to its attention.

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Though acknowledging the result was harsh and that the GAO had called into question the efficacy of the credit counseling requirement, the bankruptcy court (Judge Karlin) followed the *Giles* decision in *In re Gaddis*, 2007 WL 1610783 (Bankr. D. Kan. June 4, 2007). In *Gaddis*, the court on its own motion, dismissed the case because the debtor had received credit counseling 186 days before filing her petition. The court was not persuaded by the debtor's argument that the delay was essentially "no harm no foul."

In stark contrast to these two decisions, in *In re Enloe*, 373 B.R. 123 (Bankr. D. Colo. 2007), the bankruptcy court (Judge Brooks) followed the minority view and denied a trustee's motion to dismiss on the basis that the debtor's obtained their credit counseling 189 days prior to filing their bankruptcy case. The court found that it had discretion not to dismiss because the Bankruptcy Code contains no provision setting forth the remedy for failure to comply with the credit counseling requirements, while the remedy of dismissal is specifically provided for in other situations. The court emphasized there were equitable factors that tipped the balance in favor of not dismissing the case, stating it is an unfair result when it was largely the fault of counsel. Though the court's decision was favorable for the debtors, their attorney did not fare so well. Because debtors' counsel failed to properly tend to and properly schedule the case, the court sanctioned the attorney by requiring the forfeiture of attorney fees earned in the case and entering a sanction in the amount of \$200.

B. Approved agency – debtor must obtain credit counseling from an agency that is approved by the United States Trustee for the district in which the debtor files bankruptcy. In *In re Robison*, Case No. 06-10212-M (Bankr. N.D. Okla. March 16, 2006), the debtors obtained credit counseling from an agency that was approved to provide services in the Eastern District of Oklahoma, but filed their bankruptcy case in the Northern District of Oklahoma. The bankruptcy court (Judge Michael) dismissed the case for failure to comply with § 521(b)(1), stating that the fact that an agency is approved to provide services to debtors who file in one district does not affect the status of that agency to provide services in other districts.

II. Failures to Disclose Can Result in Denials of Discharge – and the “Blame It On My Lawyer” defense doesn't work

In a recent Chapter 7 case, *Wieland v. Harvey (In re Harvey)*, 2007 WL 3046507 (Bankr. N.D. Okla. Oct. 16, 2007), the debtor admitted his bankruptcy schedules were replete with error and omissions, ranging from failure to disclose assets to the omission of creditors. Among the assets the debtor failed to disclose was a potential federal income tax refund in the amount of \$6,948. The refund was generated by a substantial business loss from an antique business that debtor neglected to provide any information about in his bankruptcy schedules. When asked why he did not disclose the various omitted assets and liabilities, the

debtor stated that he did not do so because he not remember them at the time the Bankruptcy Pleadings were prepared, or that he did not provide the information because no one asked him the right questions (the “Blame It On My Lawyer” defense). The bankruptcy court (Judge Michael) was not convinced, and concluded that the debtor possessed an intent to defraud as he failed to fully disclose his assets and liabilities. As a result, the court denied the debtor a discharge pursuant to § 727(a)(4)(A).

In *United States Trustee v. Eppers (In re Eppers)*, 311 B.R. 826 (Bankr. D.N.M. 2004), the trustee sought to revoke debtor’s discharge based on an inaccurate description and value of debtor’s interest in certain real property listed in her statements and schedules. Debtor argued that she had relied on the advice of her counsel in preparing her statements and schedules. Though the bankruptcy court (Judge McFeeley) made a factual finding that debtor had in fact relied on counsel, it nevertheless revoked debtor’s discharge. The court stated that “reliance on counsel in completing statements and schedules is no defense to material misstatements contained therein, unless such reliance was reasonable.”

In an unpublished opinion, *Garrett v. Vaughan (In re Vaughan)*, 342 B.R. 385 (table, unpublished opinion)(10th Cir. BAP 2006), the 10th Circuit BAP confirmed that “reliance on counsel in completing statements and schedules does not inoculate a debtor from material misstatements they make, unless such reliance was reasonable.” The BAP stressed that debtors cannot omit required information simply because they believe the property omitted has no value or the information is not necessary.

III. Failures to Disclose Can Result in Denied Exemptions

In *In re Ford*, 492 F.3d 1148 (10th Cir. 2007) the bankruptcy court denied a Chapter 7 debtor’s exemption in a belatedly disclosed personal injury action resulting from a car action in which she was seriously injured. The Tenth Circuit BAP reversed, concluding that the bankruptcy court’s findings of bad faith were clearly erroneous and that its denial of the exemption was an abuse of discretion. The Tenth Circuit, determining that the trustee had met its preponderance of the evidence burden of proof with respect to bad faith, reversed the BAP’s decision. The Tenth Circuit stated that when findings are based on the credibility of witnesses, it must give great deference to the trial court’s findings, and it was satisfied that the bankruptcy court’s finding of bad faith was supported by some credible evidence.

Relying on the *Ford* decision, the bankruptcy court in *In re Napier*, Case No. 05-18209-M (Bankr. N.D. Okla. Feb. 4, 2008) (Judge Michael) denied a debtor an exemption for settlement funds to be received from her participation in Phen-Fen litigation. Debtor disclosed her interest in the litigation for the first time when she reopened her Chapter 7 case and sought to claim the funds as exempt. Debtor also admitted she would not have filed the

motion to reopen or disclosed the existence of the Phen-Fen litigation had she not been advised by her attorney that it was necessary to do so in order to receive her settlement funds. The court found that at the time the debtor filed her initial bankruptcy schedules and statement of affairs, she knew of the existence of the Phen-Fen litigation and her duty to disclose it.

Homestead exemptions may also be denied on the basis of failure to disclose. For example, in *In re Weaver*, 2007 WL 4241806 (Bankr. D. Kan. Nov. 30, 2007), the debtor did not list her homestead property or double-wide mobile home that had been installed there on her original Schedule B, and claimed no exemptions on Schedule C. Debtor sought to amend her schedules to claim exemptions and the trustee objected because she failed to disclose assets and continued to make false statements to the court and the trustee. The bankruptcy court (Judge Somers) sustained the trustee's objection and denied the debtor the homestead exemption.

In *In re Grant*, 2000 WL 33800187 (Bankr. N.D. Okla. Oct. 17, 2000), the bankruptcy court (Judge Michael) also sustained a trustee's objection to deny the debtors a homestead exemption for failure to disclose. The court concluded that the attempt by the debtors to amend their exemptions to claim the property as their homestead was not made in good faith. The court further stated that "to rule otherwise would render the duty of every debtor to fully and completely list all of their assets and all of their liabilities a nullity. It would also reward these Debtors for misleading the Trustee and the Court."

IV. Payment advices required by §521(a)(1)(B)(iv) – substitutions or exceptions?

In *In re Kruitbosch*, 2007 WL 2916191 (Bankr. D. Utah Aug. 29, 2007), the bankruptcy court (Judge Boulden) determined that the debtors' Chapter 13 case was automatically dismissed effective on the 46th day after the date of the filing of the petition under § 521(i)(1). The 60-day prepetition period ran from March 16, 2007, to May 17, 2007. Debtor wife submitted payment advices covering the pay dates of March 30, 2007, April 13, 2007, April 27, 2007, and May 11, 2007, but neglected to file a payment advice for pay date March 16, 2007. Seventy-seven days after filing the petition debtor wife filed a "Declaration of Missing Pay Stub" with the missing March 16, 2007, payment advice attached. The debtors cited an unpublished Tenth Circuit BAP opinion, *In re Svigel*, 378 B.R. 418 (table, unpublished opinion)(10th Cir. BAP 2007) for the proposition that year-to-date information on other filed payment advices constitutes sufficient other evidence of payment. The court rejected that argument because the BAP did not address the merits of the case, but had only remanded to the bankruptcy court for consideration of the debtor's year-to-date argument. Further, the court relied on its earlier decision *In re Miller*, 371 B.R. 509 (Bankr. Utah 2007), in which the court interpreted the statute very strictly and concluded that either all payment

advices received by the debtors were timely filed with the court or they were not. In this case, they were not.

In comparison, in *In re Reynolds*, 370 B.R. 393 (Bankr. N.D. Okla. 2007), the bankruptcy court (Judge Michael) concluded that a debtor who filed a pay stub containing year-to-date information had complied with § 521(a)(1)(B)(iv). The debtor filed his Chapter 13 bankruptcy case on February 18, 2007. With the petition, debtor filed two payment advices, one for the period December 4, 2006, through December 17, 2006, and one for the period January 29, 2007, through February 11, 2007, both of which contained year-to-date information. Debtor also filed his W-2 for 2006, which contained the same amount as the year-to-date total on his December 17, 2006, payment advice. The trustee requested a hearing regarding automatic dismissal for failure to file the required payment advices for January. The court stated that it believed there are situations where the year-to-date information on a pay stub can be sufficient “other evidence of payment received within 60 days before the date of the filing of the petition,” and such determination must be made on a case-by-case basis. In this case, the court concluded that the payment advice dated February 11, 2007, containing information for the period January 1, 2007, to February 11, 2007, created a very clear picture as to the amount of income debtor received for January 2007, which was the only period at issue.

At least one court has held that it can modify debtors’ duties to file the required payment advices to assure the administration of non-exempt assets for the benefit of creditors. In *In re Ackerman*, 374 B.R. 65 (Bankr. W.D. N.Y. 2007), the trustee filed a motion requesting that the case not be automatically dismissed even though debtors failed to file payment advices or other evidence of wages received during the 60-day prepetition period. The bankruptcy court (Judge Bucki) held that because § 521(a)(1)(B) states “unless the court orders otherwise,” and because the trustee brought the motion to defer dismissal prior to the end of the 45 day filing period, it could modify the duty to file the information required under § 521(a)(1). However, the court ordered that the trustee may still demand such documentation as he may reasonably need to complete his administration. Further, the court stated that “by waiving this submission for purposes of section 521(a)(1), I fashion an outcome that allows the trustee to collect the same information, but without the austere consequences of an automatic dismissal of the case.”