State Bar of Georgia

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Creditors' Rights Section Newsletter

SPRING 2005

CREDITOR'S RIGHTS SECTION LEADERSHIP 2004-2005 BAR YEAR

MESSAGE FROM THE CHAIRS:

Jan Rosser and I have been happy to pick up the ball and chair the section this year. We have held two successful seminars and are proud that our Newsletter chairs have put together this informative newsletter. HOWEVER, WE ARE LOOKING FOR NEW TALENT to run the section next year. We are both happy to help and will remain on the board to advise the new chairs. Do not be shy. If you would like to be a leader in our area of the law, can devote a small amount of time to activities, putting together seminars and gathering and disseminating information helpful to our members, you just might be the person. Several years ago, Jan and I decided that if you split the position, it is not too much of a burden on any one person. We think it is still a good idea but it is not required. If you can find good committee chairs and can motivate them to do their share, the job won't be too time-consuming. The new year starts July 1, 2005. Please consider taking an active role in The Creditors' Rights Section. We have well over 300 members who need this section. Don't let them down. Simply contact me via email at hisenberg@isenberg-hewitt.com or by telephone at 770-351-4400.

Harriet Isenberg, Co-Chair

BILLS AND NOTES - a case law and legislation update

CREDITOR AWARDED ATTORNEY FEES UNDER O.C.G.A. § 13-1-11 IN ACTION ON ACCOUNT *by Gregory M. Taube*

In *Kroger v. U.S. Food service of Atlanta, Inc*. 270 Ga. App. 525, 607 S.E.2d 177 (2004), the Georgia Court of Appeals directed the trial court to award attorney fees to a creditor under O.C.G.A. § 13-1-11. This decision is noteworthy because the creditor had sued the debtor on an account and claimed attorney fees based on a notice that appeared on the creditor's invoices. The invoices informed the debtor that the creditor would seek attorney's fees if the debtor's failure to pay the invoices resulted in collection through an attorney. In order to reach a conclusion that the creditor was entitled to attorney fees under O.C.G.A. § 13-1-11, the appellate court must have concluded that the invoices constituted "other evidence of indebtedness" as that phrase is used in the statute. As the court noted, "subsection (a) of O.C.G.A. § 13-1-11 states in part: '[o]bligations to pay attorney[] fees upon any note or *other evidence of indebtedness* … shall be valid and enforceable and collectible as part of such debt if such note or *other evidence of indebtedness* is collected by or through an attorney after maturity … ." (Emphasis added.)

Unfortunately, the court did not discuss whether an invoice constitutes "evidence of indebtedness" under O.C.G.A. § 13-1-11. Such a discussion would have been helpful because the court's treatment of invoices as "evidence of indebtedness" appears to conflict with the court's prior decision in *O'Brien's Irish Pub, Inc. v. Gerlew Holdings, Inc.*, 175 Ga. App. 162, 332 S.E.2d 920 (1985). In the earlier case, the court determined that a written contract whereby one party agreed to provide services to the other party, who in turn agreed to pay for the services, was not an "evidence of indebtedness" under O.C.G.A. § 13-1-1. In support of its conclusion, the court noted that "*Black's Law Dictionary*, Deluxe 4th Ed., 1968, defines 'evidence of debt' as '[a] term applied to written instruments or securities for the payment of money, importing on their face the existence of a debt.'" Like the contract described in the *O'Brien's Irish Pub* decision, invoices are not written instruments or securities for the payment of money importing on their face the existence of a debt.

PROPOSED LEGISLATION WOULD FACILITATE SERVICE OF PROCESS IN GATED AND SECURED COMMUNITIES *by Gregory M. Taube*

A proposed bill recently assigned to the House Judiciary Committee would facilitate service of process on defendants who reside in gated or secured communities. *See* H.B. 705. If the bill becomes law, service could be perfected upon a defendant by delivering a copy of the summons and complaint to the guard or managing agent of a gated or secured community wherein a defendant resides if the process server is denied access after producing a driver's license and evidence of a current appointment as a process server. The bill also would establish a procedure by which process servers could obtain statewide appointments. H.B. 705 has been assigned to the House Judiciary Committee (Civil). As the bill was proposed late in the current legislative session, it is likely to be held over to the next session.

INTEREST RATES IN CHAPTER 13 CASES *by William A. Rountree*

Pursuant to the "cram down" provision of 11 U.S.C. § 1325(a)(5)(B), when a Chapter 13 debtor proposes to pay a secured claim through the plan, the payments must aggregate not less than the allowed amount of the secured claim. Although § 1325 has consistently been interpreted to mandate payment of interest on secured claims, the question of how to determine the appropriate rate has persisted.

In May 2004, the Supreme Court resolved this issue in *Till v. SCS Credit Corp.*, 124 S.Ct. 1951 (2004). The Tills filed a Chapter 13 petition and scheduled a secured claim of $4,894.89 owing to SCS Credit Corporation ("SCS"), with an annual interest rate of 21%. The claim was held secured to $4,000.00 based on the value of the collateral, and the Debtors proposed to pay the secured claim over the life of the plan at an annual interest rate of 9.5 percent. The Tills arrived at this rate, known as the "prime-plus" or "formula" rate, by augmenting the national prime rate of approximately 8% to account for the risk of nonpayment posed by borrowers in their financial condition. SCS objected, contending it was entitled to the contract rate of interest, which was the "rate…it would obtain if it could foreclose on the vehicle and reinvest the proceeds in loans of equivalent duration and risk … ." *Id.* at 1957.

The bankruptcy court overruled the objection, and the district court reversed, holding that the 21% "coerced loan rate" was appropriate. The Seventh Circuit Court of Appeals agreed that the contract rate was an appropriate starting point but concluded that it should be considered a "presumptive rate" that could be challenged with evidence from either party that a higher or lower rate should apply. The Seventh Circuit dissent discussed the merits of a "cost of funds rate" that would focus on the cost to the creditor of obtaining the cash equivalent of the collateral from another source; but, because of the litigation costs inherent in determining an individual creditor's cost of borrowing, the dissent ultimately concluded that a "prime-plus" or "formula" rate would be more appropriate.

The Supreme Court identified three important considerations governing the choice of an appropriate interest rate:

> First, the Bankruptcy Code includes numerous provisions that, like the cram down provision, require a court to "discoun[t] … [a] stream of deferred payments back to the[ir] present dollar value," to ensure that a creditor receives at least the value of its claim. We think it likely that Congress intended bankruptcy judges and trustees to follow essentially the same approach when choosing an appropriate interest rate under any of these provisions. Moreover, we think Congress would favor an approach that is familiar in the financial community and that minimizes the need for expensive evidentiary proceedings.
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> . . .
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> Second, Chapter 13 expressly authorizes a bankruptcy court to modify the rights of any creditor whose claim is secured by an interest in anything other than "real property that is the debtor's principal residence." Thus, in cases like this involving secured interests in personal property, the court's authority to modify the number, timing, or amount of the installment payments from those set forth in the debtor's original contract is perfectly clear. Further, the potential need to modify the loan terms to account for intervening circumstances is also clear: On the one hand, the fact of the bankruptcy establishes that the debtor is overextended and thus poses a significant risk of default; on the other hand, the postbankruptcy obligor is no longer the individual debtor but the court-supervised estate, and the risk of default is thus somewhat reduced.[1]
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> . . .
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> Third, from the point of view of a creditor, the cram down provision mandates an objective rather than a subjective inquiry. That is, although § 1325(a)(5)(B) entitles the creditor to property whose present value objectively equals or exceeds the value of the collateral, it does not require that the terms of the cram down loan match the terms to which the debtor and creditor agreed prebankruptcy, nor does it require that the cram down terms make the creditor subjectively indifferent between present foreclosure and future payment. Indeed, the very idea of a "cram down" loan *precludes* the latter result: By definition, a creditor forced to accept such a loan would prefer instead to foreclose. Thus, a court choosing a cram down interest rate need not consider the creditor's individual circumstances, such as its prebankruptcy dealings with the debtor or the alternative loans it could make if permitted to foreclose. Rather, the court should aim to treat similarly situated creditors similarly, and to

[1] The Court identified several factors that contribute to this reduction in risk: (1) A court may only approve a cram down loan if it believes the debtor will be able to make all of the required payments (essentially having a court determine the creditworthiness of the debtor); (2) Chapter 13 plans must provide for submission to the trustee of all or such portion of the Debtor's future income as is necessary for the execution of the plan, so the possibility of nonpayment is greatly reduced; (3) The Bankruptcy Code's extensive disclosure requirements reduce the risk that the Debtor has significant undisclosed obligations; (4) The public nature of bankruptcy proceedings reduces a debtor's opportunities to take on additional debt.

> ensure that an objective economic analysis would suggest the debtor's interest payments will adequately compensate all such creditors for the time value of their money and the risk of default.

Id. at 1959-60 (citations omitted) (emphasis in original). In light of these considerations, the Court rejected the coerced loan, presumptive contract rate and cost of funds approaches. The Court reasoned that each of these approaches is complicated, imposes significant evidentiary costs and "aims to make each individual creditor whole rather than to ensure the debtor's payments have the required present value." *Id*. at 1960. Conversely, the formula approach entails a straightforward, objective inquiry and minimizes the need for evidentiary proceedings. Moreover, the "prime-plus" rate depends on the state of financial markets and the bankruptcy estate rather than the creditor's circumstances or its prior interactions with the debtor.

The Court declined to decide the proper scale for the risk adjustment but noted that other courts have generally approved adjustments of 1% to 3%. Under 11 U.S.C. § 1325(a)(6), a court may not approve a plan unless "the debtor will be able to make all payments under the plan and to comply with the plan." This provision, along with the cram down provision of § 1325(a)(5), obligates the court to select a rate high enough to compensate the creditor for its risk but not so high as to thwart the plan's success. Therefore, the Court opined that a bankruptcy court should not confirm a plan if it determines the likelihood of default is so high as to necessitate an "eye-popping" interest rate. *Id*.

Subsequent Cases

To date, the only published opinion in the Eleventh Circuit discussing *Till* is *Baxter v. Berksteiner*, 2004 WL 2201300 (Bankr. S.D. Ga. Sept. 9, 2004) (Dalis, J.). The *Berksteiner* opinion addressed four separate cases with an identical issue: the debtor filed a Chapter 13 plan that did not provide an interest rate to be paid on allowed secured claims, a secured creditor set forth an interest rate on the face of its claim, and the Chapter 13 Trustee proposed to pay the allowed secured claim at the interest rate so specified. The debtors objected, contending that the trustee was obligated to apply an interest rate of 12% per annum in compliance with Local Bankruptcy Rule for the Southern District of Georgia 3001-2 ("LBR 3001-2"), which provides:

> INTEREST ON CLAIMS IN CHAPTER 13 CASES
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> Without in any way limiting or amending any provision of the Code or Rules that govern the filing of proofs of claim, all claims filed in this Court shall be filed for the net principal balance only as of the date of the debtor's filing of his or her case.
>
> Unless otherwise ordered by the Bankruptcy Judge, the Chapter 13 Trustee is directed to pay interest at a rate of 12% per annum on all allowed secured claims and is further directed to file objections to or notify debtor's counsel with respect to any claim which is not filed in accordance with the terms of this order.
>
> The sanction provisions of Bankruptcy Rule 9011 apply to claims filed in violation of applicable provisions of the Bankruptcy Code and Rules.

The court agreed with the debtors, reasoning that the Supreme Court's decision in *Till* and LBR 3001-2 control. The Court explained as follows:

> Under *Till*, the Supreme Court placed the evidentiary burden squarely on the creditors to establish an interest rate higher than the interest rate proposed by a debtor in a Chapter 13 plan. *Till*, --- U.S. at ----, 124 S.Ct. at 1961. This evidentiary burden applies equally to the default rate of 12% provided by LBR 3001-2. Therefore, in circumstances where the debtor has

> proposed an interest rate in the plan, which plan has been distributed to all parties in interest, the creditors holding allowed secured claims must object to confirmation and present evidence to meet the burden of proof by a preponderance of the evidence that a higher rate is required to comply with 11 U.S.C. § 1325(a)(5)(B)(ii). Additionally, where the debtor's plan is silent and the creditor believes it should receive more than the 12% default rate established by LBR 3001-2, the creditor must also object to confirmation and meet this same burden of proof.

Berksteiner, 2004 WL 2201300 at *2.

The court rejected the Trustee's reliance on *In re Davis*, 314 F.3d 567 (11th Cir. 2002) (holding Chapter 13 trustee could not unilaterally act without bankruptcy court approval to modify a creditor's claim after a Chapter 13 plan had been confirmed). The *Berksteiner* court stated that the interest rate formulation prescribed by *Till* "has nothing to do with claim allowance." 2004 WL 2201300 at *2. Claim allowance under § 506 establishes the amount of the claim and the status (general unsecured, unsecured priority or secured), whereas the plan confirmation process establishes the interest rate required to provide the secured creditors with the requisite value under § 1325(a)(5)(b)(ii). *Id.*

GEORGIA HOMESTEAD EXEMPTION *by William A. Rountree*

In *Wright v. Taylor* 2005 WL 174576 (Bankr. N.D. Ga. Jan. 27, 2005) (Mullins, J.), the Chapter 7 Trustee asserted that the debtor should be entitled to a homestead exemption of only $10,000.00 under O.C.G.A. § 44-13-100(a)(1), where the debtor's residence was titled in both spouses but only one spouse filed bankruptcy. The last sentence of the statute, as amended in 2001, provides:

> In the event title to property used for the exemption provided under this paragraph is in one of two spouses who is a debtor, the amount of the exemption hereunder shall be $20,000.00[.]"

O.C.G.A. § 44-13-100(a)(1). The court noted that several bankruptcy courts have interpreted this language. In *In re Burnett*, 303 B.R. 684, 686 (Bankr. M.D. Ga. 2003) Judge Walker examined the plain language of the statute and determined:

> The sentence uses the phrase "who is a debtor," which uses a singular verb, rather than the plural form "who are debtors," so that it refers to the "one" spouse holding title. In other words, the spouse holding title must be a bankruptcy debtor in order to take advantage of the $20,000.00 exemption, but the statute imposes no requirement that the non-titled spouse also be in bankruptcy.

Id. In *In re Hartley*, Case No. 01-13332-WHD, slip op. at Doc. No. 21 (Bankr. N.D. Ga. July 18, 2002), Judge Drake ostensibly reached the same conclusion: that the last sentence of O.C.G.A. § 44-13-100(a)(1) is "a special exception for cases in which the title to the residence is in the name of only one spouse" and "where the property is titled *in both spouses*, and either one spouse files bankruptcy or both spouses file bankruptcy, the statute by its own terms, would not apply." In *In re Neary*, 2004 Bankr. LEXIS 617, Case No. 03-97808-MGD, slip op. at Doc. No. 24 (Bankr. N.D. Ga. April 21, 2004), Judge Diehl looked beyond the statutory language to the legislative history of the amendment. Judge Mullins agreed with Judge Diehl, finding that the phrase "in one of two spouses who is a debtor" is not entirely clear and therefore requires an examination of the legislative history.

Upon examining the legislative history, Judge Mullins determined that the General Assembly of Georgia intended to protect the *equitable* interest of a non-debtor spouse in a residence titled in the debtor. If the non-debtor spouse actually has title to the property, he or she does not need such protection. Because the non-debtor spouse in the instant case had joint title to the property, he did not have an equitable interest but, rather, a true equity interest that could not be reached by the debtor's creditors. Therefore, Judge Mullins concluded that the debtor's spouse did not need, and was not entitled to, a $10,000.00 exemption in addition to the debtor's $10,000.00 exemption. The court reasoned further that the alternative construction of the statute could produce an absurd result: if the Trustee sold the property, the non-debtor spouse would receive his equity interest while the debtor received a $20,000.00 homestead exemption. Such an outcome would be tantamount to "double dipping" and would constitute unjust enrichment. *Id*. at *5.

OTHER RECENT GEORGIA BANKRUPTCY COURT DECISIONS *by William A. Rountree*

In *Turner v. Jo*hnson (In re Johnson), 318 B.R. 907 (Bankr. N.D. Ga. Jan. 10, 2005) (Mullins, J.), the U.S. Trustee moved to dismiss the debtor's Chapter 7 case as a bad faith filing. The debtor owned a home valued at $367,500.00 with a $348,000.00 mortgage, which accounted for approximately three-quarters of her total debt. The monthly mortgage payment exceeded 66% of her monthly net income. The Trustee argued that the debtor exhibited bad faith in favoring excessive housing costs over repayment of creditors, thereby warranting dismissal for cause under § 707(a). The court disagreed, reasoning that the size of the mortgage alone did not constitute bad faith.

The Trustee argued in the alternative that the debtor's case should be dismissed for substantial abuse under § 707(b). The Trustee urged the court to adopt the "projected" disposable income test applied in *Walton v. Smith (In re Smith)*, 229 B.R. 895 (Bankr. S.D. Ga. 1997) (Dalis, J.), to reduce expenses determined to be unnecessary or unreasonable. The court refused to adopt the test for two reasons. First, the court opined that there is no clear standard to determine a debtor's "ability to pay" because specific factors, such as the amount of repayment, level of income, ability to fund a Chapter 13 plan, necessary expenses, and lifestyle changes cannot be fairly determined. Second, the court reasoned that there is a distinction between "currently available" disposable income as determined from the petition and "projected" disposable income. The court determined that to follow the Trustee's recommendation would go beyond merely reducing expenses and, in essence, force the debtor to make significant lifestyle changes by surrendering property. The court noted that ability to pay in a hypothetical Chapter 13 case is but one of many factors to be considered within the totality of the circumstances. As the debtor was a widow with a minor son and a reasonable budget, and had been forced into bankruptcy by the failure of her business, the court concluded that the totality of circumstances militated against dismissal.

In *Faulknor v. Amtrust Bank,* 2005 WL 102970 (Bankr. N.D. Ga. Jan. 18, 2005) (Bonapfel, J.), the debtors filed a motion to redeem a vehicle and notice of time to respond upon Amtrust Bank by certified mail addressed to "Amtrust Bank, c/o Ohio Savings Bank, Attn: President … ." Judge Bonapfel concluded that the debtor's service of the motion upon an "office," as opposed to an "officer," failed to meet the due process requirement of Bankruptcy Rule 7004(h) that service of process upon an insured depository institution in a contested matter be addressed to an officer of the institution.

In *In re Barger*, 2005 WL 174880 (Bankr. N.D. Ga. Jan. 21, 2005) (Bonapfel, J.), the Chapter 7 Trustee's special counsel was also counsel for the debtor with regard to her personal employment discrimination claims not belonging to the estate. The special counsel filed a motion to approve a compromise and settlement of the debtor's personal claims, along with an application for approval of compensation. The court held that Bankruptcy Rule 9019 was not applicable because the claims being compromised were not property of the estate and the Trustee was not a party to the settlement. Neither were attorney fees to be paid from estate property. Accordingly, disclosure and court approval were not required.

UPCOMING EVENTS

April 14-16, 2005 – Southeastern Bankruptcy Law Institute *Seminar on Bankruptcy Law and Rules*, Grand Hyatt Buckhead, Atlanta, Georgia (for more information visit www.sbli-inc.org).

May 4-6, 2005 – Columbia Law List & Strategic Research Institute *Global Debt Collection Summit*, Grand Hyatt Buckhead, Atlanta, Georgia (for more information visit www.srinstitute.com).

June 9-12, 2005 – State Bar of Georgia *Annual Meeting*, Westin Harbor Resort, Savannah, Georgia.

SEEKING SUBMISSIONS

Your newsletter committee plans to publish a newsletter at least twice a year and possibly quarterly, but we need your help. Anyone interested in submitting material for possible publication in future issues should contact Will Rountree (wrountree@maceywilensky.com; (404) 584-1200) or Greg Taube (greg.taube@nelsonmullins.com; (404) 817-6144).