Bankruptcy Newsletter
August, 2016

<u>Creditor's Unrepentant Attitude Escalates Punitive Damages from $33,700 to $250,000</u>
A lender who improperly took $297.72 was hit with $250,000 in punitive damages on top of $17,550 in actual damages for willful violation of the automatic stay under section 362 (k) of the Federal Bankruptcy Code. *In re Mocella,* 10-42287 (Bankr.N.D.Ohio June15, 2016).

Section 362 (k) allows for the following when a creditor willfully violates the automatic stay: (1) Except as provided in paragraph (2), an individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorneys' fees, and, in appropriate circumstances, may recover **punitive damages**.

The violation of the automatic stay resulted from a series of mistakes that the lender did not fully correct until 11 months after they arose. The chapter 13 debtor owed about $11,000 to an auto lender that was to be paid in full during the life of the plan. The debtor had a $77,000 home mortgage and a separate $3,000 unsecured loan also owing to the mortgage lender.

The problems began when the home mortgage lender had taken over servicing for several thousand mortgages from a lender with a similar name as the auto lender's. Mistakenly the lender believed it had taken over servicing the auto loan , and subsequently filed a notice of transfer with the bankruptcy court. As a result, the trustee was prompted to send the auto loan payment to the mortgage lender for several months. These funds were applied to the home mortgage.

Although the debtor informed the lender about the mistake, the improperly received funds were not returned until the lender was sued for a willful violation of the automatic stay. In the meantime the debtor was damaged by the mistakes made and was unable to purchase a new car. The auto lender who was behind in receipt of payments, would not release its lien.

Had the mortgage lender shown humility and acknowledged the mistakes made, the punitive damages would have most likely been set at $33,700. However, the judge in her 50 page opinion described the lender's conduct in the following manner: utter lack of adequate review; patently unreasonable; wanton; reckless indifference; and wholly unreasonable. The larger award was made in view of the mortgage lender's "self righteous attitude regarding its wrongful conduct".

<u>The Inherited IRA and Bankruptcy: Ensuring Your Beneficiaries Receive the Benefit</u>

The court of *In re Norris*, 550 B.R. 271 (Bkrtcy.D.N.J. 2016) was asked to settle the issue of "whether an inherited individual retirement account (IRA), which names a debtor as beneficiary, constitutes property of the bankruptcy estate.

The Chapter 7 debtor in *Norris* asserted both an exemption and an exclusion from her estate of the interests in pension funds including an IRA which named her as beneficiary. Before ultimately finding that the IRA was excluded from the estate, the court began it's examination of the issue by analyzing the relevant New Jersey law and it's Federal counterparts.

1. N.J statute exempts from creditors' claims, property held in a **qualifying trust** and it operates to exclude IRAs from the bankruptcy estate. N.J. Stat. Ann. Sect 25:2-1(b). The Federal equivalent is 11 U.S.C.A. Sect. 541(c)(2).

2. IRAs are said to be **"qualified"** and receive favorable federal income tax treatment when they met the requirements set forth in the Internal Revenue Code (IRC); specifically 26 U.S.C.A. sect. 408(a), (d), and (e).

3. The Third Circuit uses a the five part *In re Yuhas*, 104 F.3d (3d Cir.1997) test to determine if an IRA is excluded from the bankruptcy estate.

- Is the IRA a "trust" within the meaning of the Bankruptcy Code
- Do the funds represent the debtor's "beneficial interest"
- Is the IRA qualified under the IRC
- Is there a "restriction on the transfer" of the IRA
- Is the restriction "enforceable under nonbankrutpcy law

11 U.S.C.A. sect 541(c)(2); 26 U.S.C.A. sect 408.

The IRA at issue in this case was determined by the court to be excluded from the bankruptcy estate. Consequently, the debtor beneficiary was able to use the IRA as the deceased intended instead, of paying off creditors.

<u>Inherited IRAs in Ohio</u>

On December 20, 2012, House Bill 479, which is also known as the Ohio Asset Management Modernization Act of 2012 ("AMMA") was signed into law effective March 27, 2013. As a result, inherited IRAs are considered exempt under Ohio Revised Code 2329.66 (A)(10)(e). There, however, are no reported Ohio cases under this section.

<u>Assignment and Bankruptcy: Added Protections for Business Owners</u>

In the case of *In re Napoleon*, the insurance checks that a Chapter 13 debtor received postpetition from a health insurer were not included in the "property of the estate," even though the debtors were the only named payeees on the checks. Prior to the commencement of their Chapter 13 case, the debtors had executed an assignment in favor of the medical clinic where the debtor-wife received treatment, conferring whatever rights they had in the insurance proceeds to the clinic and promising to cooperate in paying over to the medical clinic "any and all insurance proceeds." The debtors' names were placed on the checks only as a result of the administrative protocols of their insurer. Nonetheless, this did not affect the fact that, due to the prepetition assignments, the checks belonged to the clinic rather than to the estate.

This case is important to any business person because it provides protections that can be built into any contractual agreement. By holding an assignment of money prepetition, business owner can ensure that they will be paid from an existing pot of money without having to fight for position with any other creditor. *In re Napoleon,* 2016 WL 2893764 (Bkrtcy. E.D.N.C., Judge Humrickhouse*).*

Holding an assignment of money gives business owners an additional protection should their client's file for bankruptcy. In this case, if the debtors decided to keep the insurance proceeds instead of giving them to the clinic via the assignment agreement, the clinic (creditor) would have a very good argument for the non-dischargeability for this particular debt.

<u>Transfers to Joint Owner were not Fraudulent</u>

A Chapter 7 debtor-farmer's transfer of agricultural equipment to the joint owner of the equipment did not warrant denial of the debtor's discharge based on the theory of a fraudulent transfer. The circumstances surrounding the transfers did not create an inference of fraud, because the debtor offered evidence substantiating the debts between him and the joint owner. The transfer was also promoted by the debtor's divorce and his desire to "look out for himself", *In re Borstad*, 2016 WL 2343382 (Bkrtcy. D.N.D., Judge Hastings).

Discharge Denied for Transferring Business Assets

A chapter 7 debtor's transfer of a private car service business's telephone number, customer information, and vehicle to her new business evidenced that the new business was created to hinder her creditor (and former business partner) from collecting on debts owed. As a result, these actions warranted a denial of the debtor's discharge. The court found that the customer information (which had been compiled for a decade), and the telephone number (consistently used by repeat customers and the creditor to generate business) had substantial value. Additionally, the transfer of the vehicle should have been documented in the debtor's filing became it was property of the bankruptcy estate before the debtor and creditor agreed to dissolve the business. *Cheung v. Flectcher*, 2016 WL 1060181.

Failure to Retrieve Car in City Impound did not Prevent Chapter 7 Debtor from Receiving Discharge

In the case of *In re Frazier,* 551 B.R. 410 (Bkrtcy.N.D.Ill 2016), a creditor filed a complaint seeking a determination that debt owed by a Chapter 7 debtor concerning a vehicle was nondischargeable, and objected to its discharge.

Here, the debtor's car was impounded by the city government as a result of unpaid fees for parking violations. Ultimately, the car was either sold or destroyed by the city when the debtor failed to retrieve the car. The court found that the debtor's conduct was motivated solely by her financial situation, with no understanding or consideration of how her actions would affect the creditor.

After the debtor's car was initially impounded, she was able to obtain funds to retrieve the vehicle. The car was subsequently impounded a second time, and the creditor supplied funds for its retrieval by the debtor. Unfortunately, after the car was impounded a third time, the debtor learned that it was not functioning and could not pay for repairs or to have it towed from the impound lot. As a result, the debtor opted to file an amended plan under which she provided for surrender of the vehicle with the intent of turning the car over to the creditor. However, before the car could be retrieved by the creditor, it was either sold or destroyed per the notices given by the city impound yard.

As a result, the court held that the facts did not arise to a level where the debtor committed a "willful and malicious injury, nor did the debtor act with the intent to "hinder, delay or defraud the creditor". Because the debtor neither violated 11 U.S.C.A. section 523(a)(6) or 727 (a)(2), the debt was not excepted from discharge and the debtors discharge was not denied.

Beneficial Interest at Petition Date Brought Debtor's Motorcycle into Property of the Estate

The debtor in a case converted from Chapter 13 to Chapter 7 had a beneficial interest in a motorcycle when his bankruptcy petition was filed. The beneficial interest was strong enough to bring the motorcycle into the property of estate, even though a certificate of title naming the debtor as owner was not issued until some weeks post petition.

Prior to his bankruptcy filing the debtor had paid $1,500 for the motorcycle and had taken possession thereof from the seller, together with a certificate of title endorsed by the seller. In fact, the debtor was judicially estopped, from denying that when his Chapter 13 petition was filed he was the owner of the motorcycle. The debtor, in order to obtain a certificate of title in his name postpetion had filed an application with the state claiming to have purchased the motorcycle prepetition. *In re Chesley*, 2016 WL 2616747 (Bkrtcy. M.D.Fla.).

<u>Debtor/Attoreny was "Fiduciary" of Non-Client</u>

An Illinois attorney prepared a will for his client. He failed to secure the necessary attestation by two (2) witnesses. He forged another name on the will and directed his secretary to notarize the signature of a non-existent witness. The will drafted by the attorney was denied probate and the intended beneficiary inherited nothing. The intended heir brought state court action and was awarded judgment of $590,221.87. The attorney then filed his own bankruptcy. The intended beneficiary brought an adversary proceeding and alleged that the debt was non-dischargeable . The Court found that the Debtor/Attorney stood in a "Fiduciary Capacity" as that term was used in a dischargeability exception. The Debtor argued that he had no fiduciary duties other than to this client and that any duties that he may have owed to his non-client were non-fiduciary and insufficient to support a cause of action under 11 USC 523(a)(4). His defense was rejected. *Barry v. Galloni*, 2016 WL 245912 (M.D. Ill.)

Ohio is one of the few states that requires "privity". The lead Ohio case is *Simon v. Zipperstein*, 32 Ohio St. 3d 74 (1987). *Zipperstein* was a malpractice action brought by a son of the Testator against the attorney who prepared the will. The court found the son had no standing.

In the Illinois case, the underlying facts indicated more than malpractice. The common law of Illinois also requires privity. The Court found that (1) Debtor/Attorney's conduct was intentionally deceitful, (2) there was a forgery, (3) filed the will for probate and concealed the misconduct, (4) directed his secretary to notarize the forged signature. The Court found the debt to be non-dischargeable per 11 USC 523(a)(4).

Sincerely,

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Roger E. Luring

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D. Andrew Venters