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RECEIVERSHIP NEWS

BANKRUPTCY DEPT.

Cutting the Gordian Knot:

The Ninth Circuit Bankruptcy Appellate Panel's In Re Pak Decision Attempts A Logical Definition of "Projected Disposable Income" Despite the Tangled Language of 11 U.S.C. Section 1325 (b).

By The Honorable Theodor C. Albert, United States Bankruptcy Court Judge, Central District of California*

[The Gordian Knot[1] was reportedly beyond any mortal's ability to unravel until Alexander the Great in 333 BCE provided the simple solution of cleaving the knot with his sword, as Judge Albert explains in footnote 1, below. In In Re Pak the 9th Circuit BAP solved a similar conundrum -- what is "projected disposable income" -- albeit in a less dramatic fashion. Ed.]

Judge Theodor C. Albert

Must a debtor who attempts reorganization under Chapter 13 pay what he reasonably can toward his debts over time? Or is he, based upon a "plain meaning" of statutory language, obligated only to pay a multiple of the average income he received in the 6 months preceding the petition, regardless of future events or his actual ability to pay more?

Or, seen from another side, is an earnest debtor prevented from confirming a "best efforts" plan merely because he had a higher income in the months immediately preceding the petition but (for example) has lost his job? One would have thought that BAPCPA stood, if anything, clearly for the proposition that debtors must pay what they reasonably can. But in attempting the close-in work of statutory construction for post BAPCPA Chapter 13's, a conundrum has emerged concerning what Congress had in mind for determining debtors' minimum requirements.

THE ISSUE

On November 7, 2007 the Bankruptcy Appellate Panel for the Ninth Circuit in *In re Pak*, 378 B.R. 257 (9th Cir. BAP 2007), finally provided at an appellate level in the Ninth Circuit a logical and workable definition of "projected disposable income," despite a confusing tangle created concerning this already existing language by a new definition of related terms as inserted into 11 U.S.C. §1325(b)(1)(B) under BAPCPA.[2]

Giving new meaning to "projected disposable income" post BAPCPA has bedeviled some fifty bankruptcy courts across the country. Courts have struggled in various ways to bring a logical and consistent meaning to this term resulting in a near even split of authority.[3] The issue is an important one in Chapter 13 practice. In the event of an objection, §1325(b)(1)(B) now requires that the court can only confirm a Chapter 13 plan if it provides that "all of the debtor's projected disposable income to be received in the applicable commitment period

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Publisher's Comments

By Robert Mosier, Publisher*

This is our special bankruptcy edition of the Receivership News coinciding with the California Bankruptcy Forum's Annual Conference May 16-18. We feature a lead article by Bankruptcy Judge Theodor C. Albert who highlights the Ninth Circuit BAP's dissection of the "projected disposable income" language of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 and other troublesome definitional issues presented by the reform legislation,

Ted Phelps

Kevin Singer

Craig Collins

We also pick up the remainder of the recap (and explication) of the most significant business bankruptcy decisions in the last year from Bankruptcy Judge Dennis Montali, Cecily A. Dumas, Esq. and Ron Mark Oliner, Esq. Beverly N. McFarland and William H. Crispin, Esq. provide the second part of their excellent article discussing banks' handling of defaulting residential real property development projects. There is also a special edition of Ask the Receiver dealing with the clash of receivership and bankruptcy from expert Peter Davidson, Esq., and a special bankruptcy tax column from Charles F. Rosen, Esq. Alan Mirman's "Heard in the Halls" column is back as well.

Loyola's sparkling main lecture hall was a perfect setting for 85 attendees at the 2004 two-day event. The proceedings were televised to an adjacent lecture hall equipped with massive video screens for the additional 62 professional persons who attended. There were 24 panels in two days.

Most exciting of all is upcoming Loyola III – "Receiverships in the New Millennium," the California Receivers Forum's quadrennial 2-day seminar on receivers and receiverships, set for January 16 and 17, 2009 at the Loyola Law School of Los Angeles campus near Downtown LA. This edition of the comprehensive program will feature even greater participation by judges from throughout California on both core and emerging receivership topics. There will be approximately 24 panel presentations on virtually all aspects of receivership law and administration plus written materials, sample pleadings and additional supporting documents.

I and my co-chair Kirk Rense are directing this effort with assistance from many members of the receivership community. LA-based receiver and consultant Ted Phelps (*Phelps Consulting Group*) is the Assistant Chair to organize and honcho the panels, and LA receiver Kevin Singer (*Receivership Specialists*) is the Assistant Chair to coordinate sponsorships for the event. CPA Craig Collins has agreed to be our budget guru. Many more receivership professionals from throughout California will be preparing materials and coordinating individual panel presentations.

Nor will the social side of life be ignored. The last seminar featured a special luncheon and hosted reception. A number of rooms at the nearby Jonathan Club will be reserved for out-of-town attendees. Registration materials will provide full information on reserving these rooms as well as accommodations at other Downtown LA hotels. There are many fine restaurants nearby for the epicures in the group. Hollywood and the Sunset Strip are only a cab ride away.

So save the dates – January 16 and 17, 2009. Our Fall edition of the Receivership News in September will have complete information and registration materials. For those wishing to get a head start (seating will be limited) watch the California Receivers Forum website – www.receivers.org – for information as it becomes available. See you there.

Loyola Law School was the ideal setting for learning and discussion at the 2004 seminar.

Robert P. Mosier

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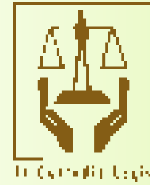

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beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan." (Emphasis added.)

Before BAPCPA, bankruptcy courts usually subtracted Schedule J expenses from Schedule I income to determine "projected disposable income" as the minimum payments due under the plan, consistent with debtor's "best efforts." However, under BAPCPA, a new formula-driven approach was inserted in various key areas in the Code, such as in determining which individual Chapter 7 cases constituted "abuse" under §707(b) for failure of the debtor to pay all that he could reasonably afford to pay to his creditors.[4]

BAPCPA seemingly evidenced an overall determination of Congress to replace the traditional discretion of bankruptcy judges with an arithmetic formula.[5] However, as explained below and as observed in *In re Pak*, to the extent that elimination of judicial discretion and maximization of debtor's best efforts was Congress' intent in determining the minimum payments required under a Chapter 13 plan as well, the language actually used in BAPCPA created thorny and even contradictory issues of statutory construction.

In re Pak is additionally noteworthy because it shows the BAP panel's struggle to harmonize the "plain meaning" doctrine of statutory construction found in cases such as *Lamie v. United States Trustee*, 540 U.S. 526, 534, 124 S. Ct. 1023 (2004) with the commands that context is important and statutory interpretation is a "holistic" endeavor. *See, e.g.*, *Hough v. Fry (In re Hough)*, 239 B.R. 412, 414 (9th Cir BAP 1999) quoting *Robinson v. Shell Oil Co.*, 519 U.S. 337, 341, 117 S. Ct. 843 (1999) and *United Sav. Ass'n of Texas v. Timbers of Inwood Forest Assocs. Ltd.*, 484 U.S. 365, 371,108 S. Ct. 626 (1988).

THE FACTS

Mr. Pak was laid off from his job as a software engineer in 2002 and was unable to find new work until August 2005. During his unemployment Mr. Pak lived on savings, unemployment benefits and his 401k. He also accumulated substantial unsecured debts. In October 2005 he filed a Chapter 7 petition and his original schedules I and J showed as of the petition net take home pay of $5,530.20 per month and expenses of $3,718, leaving net monthly income of $1,812.20. His form 22A in which Chapter 7 debtors calculate "current monthly income" showed less than one third his actual income at the time. This was because he was unemployed for four of the six months immediately preceding his petition, and "current monthly income" under §101(10A) is calculated historically as the *average* of the 6 months preceding bankruptcy.

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A Primer for Lenders: Legal Aspects of Practical Solutions for Defaulted Residential Development Projects and Loans

By Beverly N. McFarland and William H. Crispin, Esq.*

(Last issue of the RN featured a "Primer for Lenders: Practical Solutions for Defaulted Residential Development Projects." This is Part II, discussing the evolving legal developments in this national real estate crisis. Ed.)

Practical business solutions for lenders and receivers with residential construction and development projects and loans in default were the focus of Part I of this article. We identified a number of legal issues that we now address. We will refer to general principles of law, but be warned: your particular issue or set of facts may differ from those discussed, and/or the applicable law[1] may have changed by court decision or legislative action. Readers may not (and should not) rely on anything discussed herein as legal advice applicable to your situation. Our article is not meant to cover all construction and development project and loan legal issues, but rather to address issues that appear in many receiverships. We hope this will assist lenders, receivers and their attorneys in considering all reasonable alternatives.

Can a Bank[2] Incur Lender Liability if It Takes Back a Real Estate Project but Does Not Maintain It While Attempting to Sell the Asset?

If the bank takes a deed in lieu of foreclosure and, as part of that arrangement, extinguishes the debt of the borrower, maybe not. But if the obligations of the borrower (developer) under the deed of trust increase because the underlying collateral (real estate project) deteriorates through lack of care while the bank holds the property, borrower bad faith claims may arise against the bank. When banks seek to hold borrowers liable for a deficiency after a judicial foreclosure, borrowers often assert counterclaims (sometimes in amounts substantially greater than the defaulted debt) against the bank, claiming that the bank violated its implied duty to act fairly under the contractual agreement (whether the original loan agreement or a later workout agreement).

Whether a bank did or did not act fairly would depend upon the particular circumstances of the case. But a duty to act fairly seems to arise frequently when a bank exercises its discretion under a loan agreement, particularly when the loan agreement permits a lender to exercise some power exclusively in its sole discretion.

This exercise of power by the lender without restriction seems to draw the most interest from plaintiffs' lawyers alleging bad faith, i.e. that the lender acted unfairly without sufficient regard for the interests of the borrower. There is less likelihood of a successful claim for bad faith where the loan agreement requires that certain specified objective criteria must be met (conditions that first must be satisfied) before the bank can exercise such power under a loan agreement. In those situations, the factual issue presented is simpler — did the bank act reasonably in deciding whether the conditions were satisfied, rather than the more complex inquiry into whether the bank acted in bad faith toward the borrower. For an excellent discussion of these issues see, Storek & Storek, Inc. v. Citicorp Real Estate, Inc., (2002) 2002 Ca. App.1st Unpub. LEXIS 3948 and the cases cited therein, rev'd on appeal, (2002) 100 Cal. App. 4th 44.

Is a Lender Liable to Pay Mechanics' Liens if It Takes a Deed in Lieu of Foreclosure on the Deed of Trust?

Probably. Generally, where a bank takes a deed in lieu of foreclosure, it in effect merges the deed (the greater interest) with the lien (the lesser interest) extinguishing the lien except where it is necessary for the protection of the buyer's rights that the lien be maintained. Alliance Mortg. Co. v. Rothwell, (1995) 10 Cal. 4th 1226. But junior liens including mechanics' liens are not extinguished by the mere taking of the deed in lieu.

Taking a deed in lieu is a negotiated, consensual transaction, giving the bank an opportunity to work out all claims in advance or gain some indemnity from the borrower. Stewart Title Guar. Co. v. Fallgatter, (2006) 2006 Cal. App. Unpub. LEXIS 2023. One could write a volume on how to deal with mechanics' liens as receiver. Receivers appointed to protect and preserve construction and development projects should obtain a qualified industry lawyer to assist them as soon as possible. By way of contrast, a recorded deed of trust given as security for the purchase price of property or for construction has priority over subsequent mechanics' liens and a trustee's sale of the property (rather than engaging in a deed in lieu transaction) extinguishes such liens. Rheem Mfg. Co. v. United States, (1962) 57 Cal. 2d 621.

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Judicial Foreclosure Contrasted with Non-Judicial Foreclosure.

The principal difference between these two processes is that in a judicial foreclosure (or judicial sale) the lender preserves the right to pursue the borrower for any deficiency, i.e. the amount still due after the private sale of the property. Of course, the borrower has his/her statutory right of redemption after a judicial sale.

In contrast, when a lender exercises its power under the deed of trust ("a trustee's sale") in a non-judicial foreclosure, it gets the proceeds from the private sale, but is not entitled to pursue the borrower for any deficiency (unless the borrower has committed either fraud in the inducement of the loan or has committed bad faith waste). Alliance Mortg. Co. v. Rothwell, (1995) 10 Cal. 4th 1226 and Sumitomo Bank of Calif. v. Taurus Developers, Inc., (1986) 185 Ca. App. 3d 211.

The latter case, Sumitomo, provides a lender with some practical guidance when it comes to making its bid in a trustee's sale. Making the wrong bid may preclude a lender bringing breach of contract, bad faith waste or fraud claims against a developer/borrower in the event the lender later discovers defects known to the developer prior to the trustee sale.

Sumitomo holds that the lender may proceed against the developer for negligent construction in the event the lender makes a full credit bid, but only after satisfying a difficult standard of proof and possible defenses that might be difficult for a lender to overcome.

In Sumitomo the bank exercised its power of sale under the deed of trust and bid the entire amount of the outstanding debt at the sale, a so-called "full credit bid". After it took possession, the lender discovered numerous latent defects in the property, i.e. improperly designed and built structural retaining walls, improperly designed drainage, inadequate water proofing, and leaking roofs. The lender bank repaired these defects and sought to recover against the developer for breach of contract, bad faith waste and fraud. The bank claimed that the developer had a duty under the loan agreement to report known defects, that the builder intentionally constructed the condominium project in an improper manner in order to use the loan proceeds for other purposes and that the developer concealed the defects in order to induce the lender to make a full credit bid.

The Court applied the so-called "full credit bid rule," declaring that the lender had no recourse against the developer for breach of contract, bad faith waste or fraud for impairment of the collateral because the full credit bid established that there was no impairment. For good measure, the Court held that the developer had no duty to disclose the defects since the developer did not control the trustee's sale and thus the bank/lender could not reasonably rely on the developer's failure to disclose the defects or, indeed, for any representations that might have been made.

The Court did allow a claim by the lender against the developer for negligent construction, however, but ruled that the lender must satisfy a "five-factor test" in order to recover, while noting a possible defense that could be raised by the developer, i.e. that the lender always had a right to make inspections of the project.

All in all, a lender should carefully consider the likelihood of construction defects in deciding on how much to bid for property at a trustee's sale. It appears that a lender should make the same calculation when accepting a deed in lieu of foreclosure in exchange for full payment of the underlying indebtedness. Stewart Title Guar. Co. v. Fallgatter, (2006) 2006 Cal. App. Unpub. LEXIS 2023.

Where there is a dispute about the priority of liens, lenders usually opt for a judicial foreclosure because the court's rules on the priority of liens in the context of a sale wipes out those liens and the lender gets the property free and clear to the extent that proceeds are not available for junior lien holders.

The same rule applies when there is a non-judicial sale under a power granted in the deed of trust. The sale in that instance wipes out junior liens to the extent funds from the sale are not available to satisfy them after the senior lien holders are paid. This rule doesn't apply, however, where the owner/borrower or a successor in interest to the owner/borrower purchases the property in such a sale. In those instances, the junior liens are unaffected for equitable reasons, namely that the borrower cannot escape from these liens by purchasing his own property at a trustee's sale. Stewart Title.

Continued on page 6...

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Should the Receiver Make Repairs to a Property?

There is legal authority in California for a receiver to *repair* property. Hozz v. Varga, (1958) 166 Cal. App. 2d 539. Generally, however, orders appointing receivers prohibit the receiver from making capital *improvements* without prior order of the court. Further, California's rules of court prohibit the receiver and the party seeking the appointment of the receiver from entering into any contracts or understandings regarding what capital improvements will be made. Rule 3.1179(b)(4).

It appears that a lender would be better served having the repairs done within a receivership prior to a foreclosure sale, rather than undertaking the repairs itself and without the possible protection of a court order. In a receivership, the receiver presumably would seek instructions from the court regarding the repairs and costs thereof and the court would likely require that the receiver obtain sufficient insurance coverage for defective work. While the estate would be liable for any negligence by the receiver in having the repairs made, the receiver would not be personally liable save for egregious misconduct well beyond mere negligence. Chiesur v. Superior Court, (1946) 76 Cal. App. 2d 198.

In a receivership setting, the scope of the required work and its costs would be court approved and the liability of the receivership would be limited to its assets. Of course, the costs of the repairs and any liabilities beyond applicable insurance coverage would be payable out of the receivership estate. We could not find any authority for the proposition that the lender, as the party requesting the appointment of the receiver, would be liable.

In the event that no funds were available within the estate to fund the repairs, the receiver could obtain funds from a third party or the lender with court approval and issue a receiver's certificate which should be notarized and recorded. The lien document should also state that it is in a super priority position after administrative expense of the estate.

Does a Lender Have Any Recourse Under the Owners and Contractors Insurance Policy aka "OCIP" Wrap If Construction Defects are Discovered?

The answer is maybe, *if* the lender moves quickly and appoints a qualified receiver who gives a "provisionary notice" of claims to the insurance company and confirms that the premiums have been maintained by the borrower/developer.

Prior to 2000, developers, contactors and subcontractors held separate insurance for each protection desired or required by the lender. However, the insurance industry, a creative bunch, grouped such coverage into wraps. According to industry specialists, a wrap-up insurance program is a single insurance policy or group of policies issued by an insurance carrier that affords insurance coverage to all enrolled construction participants for all covered work performed on a designated construction project, subject to the limits of the policy. In California, the coverage usually does not include workers' compensation, as that coverage is available through a state program.

Wraps may be purchased either by an owner or a general contractor, and provide many benefits to the lender relating to quality control of the project. However, in the best laid plans of "mice and men (or women)", projects may still end up with construction defects. A receiver appointed to a construction and development project should investigate all insurance coverage and communicate as quickly as possible with the agents or companies in an effort to try to understand and preserve this potentially valuable coverage for the estate.

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[1]William Crispin is licensed to practice in Washington D.C., Virginia and Illinois and has represented receivers with local counsel before California courts pro hac vice, but is not licensed to practice law in California.

[2] Many lenders are now dealing with defaulted construction and development loans more aggressively as it pertains to residential projects. The FDIC is also dealing with the financial crisis a bit more aggressively by hiring more staff members and obtaining administrative enforcement actions against banks and individuals.

(see http://www.fdic.gov/bank/individual/enforcement/index.html "The FDIC processed a total of 23 orders in February. These included eight cease-and-desist orders; eight removal and prohibition orders; four civil money penalties; two terminations of cease-and-desist order; and one termination of a supervisory prompt corrective action directive").

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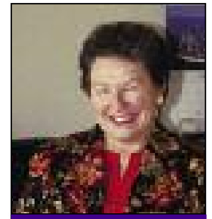

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Bay Area Bankruptcy Forum and San Francisco Bar Assn. Review 2007's Key Business Bankruptcy Case Decisions

(This is the second of a two-part article – Ed.)

"Recent Developments in Business Bankruptcy" was the subject of panel presentations by the Bay Area Bankruptcy Forum and the San Francisco Bar Association Commercial Law and Business Section for attorneys from throughout the greater Bay Area and San Jose in November 2007.

The authors, panelists and presenters at the annual evening programs – The Honorable Dennis Montali, United States Bankruptcy Judge; Cecily A. Dumas, Esq., (a partner in the firm Friedman Dumas & Springwater LLP); and Ron Mark Oliner, Esq. (a partner in the firm Duane Morris LLP) – have excerpted the facts and law from some of the most important cases reported on for readers of the Receivership News.

Cap on Claim for Lost Rent is Based on Time, Not Money.

Under Bankruptcy Code § 502(b)(6)(A), a landlord's claim for unpaid rent under a terminated lease is limited to "the rent reserved by such lease, without acceleration, for the greater of one year, *or 15 percent*, not to exceed three years, of the remaining term of such lease" (emphasis added). Some courts have concluded that "15 percent" means 15 percent of the rent still due, rather than 15 percent of the time left on the lease—a significant difference, for example, in situations where the lease provides for periodic rent increases. Based on this conflict in interpretation, the bankruptcy court deemed the statutory language to be ambiguous. The court nevertheless found, based on legislative history, that Congress meant "15 percent" to refer to time rather than money. The court also concluded that any amount a landlord is able to recover on his own—in this case, by drawing on a security-deposit letter of credit—must be applied dollar-for-dollar against the capped claim, rather than (as the landlord wished) against the total rent that would be due before the cap is applied.

In re Connectix Corp., 372 B.R. 488 (Bankr. N.D. Cal. 2007).

Creditors Have No Direct Claim for Breach of Fiduciary Duty by Directors of an Insolvent or Near-Insolvent Corporation.

Corporate directors generally owe a fiduciary duty to the corporation and its shareholders. Courts have recognized that when a corporation is insolvent (or in the less clearly defined "zone of insolvency"), the corporation's creditors also have standing to enforce the directors' fiduciary duty by way of a derivative lawsuit. See Production Resources Group v. NCT Group, Inc., 863 A.2d 772 (Del. Ch. 2004). Observing that an individual shareholder may also bring a direct lawsuit for a breach of fiduciary duty that injures her specifically, the court in *Production Resources* suggested in dicta that such a remedy may also be available to an individually-harmed creditor of an insolvent or near-insolvent corporation. The Delaware Supreme Court has now repudiated that suggestion, holding that a creditor may enforce a corporate director's fiduciary duty only derivatively and never directly, no matter how individualized the harm, whether the corporation is in the zone of insolvency or insolvent outright. (Such a creditor may, of course, bring a direct claim for any contractual or other nonfiduciary violation.) When a corporation is in bankruptcy, therefore, any claim for breach of fiduciary duty belongs to the estate, rather than to any individual creditor, even though the claim may be brought by the creditor derivatively.

North American Catholic Educational Programming Foundation, Inc. v. Gheewalla, 930 A.2d 92 (Del. 2007).

Assignee for the Benefit of Creditors Not Liable for Attorneys Fees Under Prevailing Party Clause in Lease.

Plaintiff and Appellant, Sherwood Partners, Inc. is an assignee for the benefit of creditors of a tenant under a lease. In 2002 the assignee sued to recover a security deposit, contending that the landlord violated California law by drawing upon a security deposit. The trial court ruled in favor of the assignee; the court of appeal reversed in favor of the landlord. On remand the landlord recovered attorneys' fees from the assignee and the tenant. On the second appeal the assignee contended that it was not liable for the fees.

In reversing the trial court and relieving the assignee of the requirement to pay the landlord's attorneys' fees under a "prevailing party" principle, the court relied on Credit Managers' Assn. v. Brubaker, 285 Cal. Rptr. 417 (Cal. Ct. App. 1991). In that case the court refused to impose damages on an assignee for the benefit of creditors since the assignee did not assume the liabilities of the assignor. The court characterized the assignee for the benefit of creditors as a disinterested third party who liquidates and distributes assets. It concluded that the beneficial procedure of an assignment for the benefit of creditors would be impossible to use if the assignee had to assume the liabilities of the insolvent business.

Relying on *Brubaker*, the *Sherwood* court pointed out that the assignment did not include an assumption by Sherwood of the tenant's underlying contractual liabilities, including the attorneys' fees provision in a written lease.

Sherwood Partners, Inc. v. EOP-Marina Business Center, LLP, 62 Cal. Rptr. 3d 896 (Cal. Ct. App. 2007).

The Honorable Dennis Montali, United States Bankruptcy Judge

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is pleased to announce
his appointment as

Receiver for
Seasons at Tradition
A 1,200 lot planned single family home subdivision

Circuit Court of the Twentieth Judicial Circuit
State of Florida

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is pleased to announce
his appointment as

Receiver for
Cascades at Southern Hills
A 925 lot planned residential subdivision

Circuit Court of the Nineteenth Judicial Circuit, in and for
Hernando County, Florida

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is pleased to announce
his appointment as

Receiver for
The Townhomes at San Simeon
A 219 unit planned town home subdivision

Circuit Court of the Twentieth Judicial Circuit
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are pleased to announce
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v. Creative Capital Leasing

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is pleased to announce
his appointment as

Receiver for
"Blairwood" a condominium project in Carmichael, CA
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International (A securities fraud
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City of Bellflower and Paramount vs.
Juan Ponce et al.

Superior Court
County of Los Angeles
Southeast District

Continued from page 3.

Upon motion of the United States Trustee for dismissal of the petition as abusive under §707(b)(3), the debtor converted to Chapter 13. His revised Schedules I and J showed net monthly income of $989.70; however, his plan proposed payments of only $300 per month for 36 months, which would have paid less than 7% of his $172,931 of unsecured debts, whereas 36 months at $989.70 would have yielded more than 20%. Creditors objected to confirmation but the debtor countered that $300 was more than his "disposable income" as that term is defined under §1325 and therefore he met the statutory requirements because he had devoted all "projected disposable income" as required under §1325(b)(1)(B).

The problem is created because the phrase "*projected* disposable income" existed in the statute before the BAPCPA amendments, but is not defined under the Code. However, under the BAPCPA amendments "disposable income" is defined in the immediately adjoining part of the subsection, i.e.: " (2) For purposes of this subsection, the term 'disposable income' means *current monthly* income received by the debtor…less amounts reasonably necessary to be expended [for certain enumerated expenses]." §1325(b)(2) (emphasis added).

Of course, "current monthly income" is, in turn, newly defined in §101(10A) as all of the money debtor receives from any source (whether or not it is taxable income) within the six months preceding the petition divided by six. However, wags have observed that this definition makes clear that "current monthly income" is neither current, nor monthly nor income.[6]

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THE DEBTOR'S ARGUMENT

The debtor argued that since "*disposable* income" was a defined term, "projected disposable income" as used within the same subsection merely added a multiplier, i.e. whatever "disposable income" was (as defined historically by reference to "current monthly income") times the number of months in the plan. Debtor observed, as have many other courts, that the definition of "disposable income" is by its own terms expressly limited "for purposes of this subsection," i.e. to §1325(b), and these two words together, i.e. "disposable income," appear only one other place within the subsection, as part of "*projected* disposable income."

Therefore, as many other courts have observed, unless "disposable income" is a meaningless "floating definition with no apparent purpose,"[7] then "projected disposable income" must reference "disposable income"[8] for the duration of the plan period. Since under this approach "disposable income" is a fixed number calculated historically, the debtor's argument is that the "projected" part of the language must mean merely a simple arithmetic calculation, i.e. that historical number multiplied by the number of months of the plan.

THE BAP'S ANALYSIS

Several of the courts which have reached this conclusion consistent with the debtor's argument in *In re Pak* observed that courts are bound to enforce a statute's "plain meaning" irrespective of whether it is "reality based," and had Congress intended a more forward-looking analysis, such as the historic Schedules J minus I analysis, it could have made that choice. Instead under a "plain meaning" analysis these courts found that Congress intended a new meaning of "projected disposable income" reported on the Form 22A and based solely on the historical information included within "current monthly income" even if, based on current conditions, the debtor could clearly afford more. *See, e.g., Kagenveama, supra*, 2006 Bankr. LEXIS 2759 at 5-7.

Or, as stated in slightly different contexts, the courts are not free to rescue Congress from its "drafting errors" in favor of what the courts might think is the preferred result. *Lamie*, supra, 540 U.S. 526 at 542, 124 S. Ct. 1023 at 1034, quoting *United States v. Granderson*, 511 U.S. 39, 68, 114 S. Ct. 1259 (1994)(concurring opinion) and "The fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning." *Union Bank v. Wolas*, 502 U.S. 151, 158, 112 S. Ct. 527, 531 (1991).

But the BAP in *In re Pak* was not so sure that this construction of "projected disposable income" was that easily susceptible to a "plain meaning" analysis. First, the BAP observed that "projected disposable income" existed in

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§1325(b)(1) *before* the BAPCPA amendments and that Congress had not amended the §1322(a)(1) requirement that the debtor commit "such portion of future earnings or other future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan." *In re Pak*, 378 B.R. at 262.

Then there was Congress' retention of the word "projected," a word in plain English that is essentially forward-looking "to calculate, estimate or predict (something in the future) based on present data or trends." *Id.* at 264, citing *In re Slusher*, 359 B.R. 290, 297 (Bankr. D. Nev. 2007) quoting *The American Heritage College Dictionary* 1115 (4th Ed. 2002). There is the §1325(b)(1) requirement that "projected disposable income" be applied "as of the effective date of the plan" another undefined term, but most logically associated with date of confirmation which might not occur until months after the petition date. The BAP in In re Pak observed that it made "little sense" to tie the determination of "projected" to what presumably in most cases is at least 6 months old and maybe even much older information. In re Pak, 378 B.R. at 265.

"Projected disposable income" is used in five other parts of the Code other than §1325(b)(1)(B)[9] although none of these other sections purport to define it. However, at least in the sections of Chapter 12 which reference the term, §§1225(b)(1)(B) and (C), its meaning is not constrained by cross reference to the "disposable income" definition found in §1325(b)(2) which incorporates "current monthly income," and so these sections are rather obviously forward-looking.[10] But the BAP in *In re Pak* could not determine whether this meant that Congress intended a wholly different approach in Chapter 13 while using the same language because of the explicit cross reference to "current monthly income" in §1325(b)(2), and so concluded that none of the provisions of the Code provided definitive guidance. *In re Pak*, 378 B.R. at 264-65 n.7.

Further, the BAP in *In re Pak* observed that the formulistic interpretation of "projected disposable income" would lead to arbitrary and even bizarre results whenever income changes dramatically, whether because of change in employment status or otherwise, in the six months preceding the petition.

For example, the opposite problem from *In re Pak* was also posited, i.e., where the debtor faced a *decrease* in income from the "disposable income" calculation based on historical data. A formulistic approach would prevent such an earnest debtor from proposing any confirmable Chapter 13 plan by arbitrarily fixing "the debtor's obligations during the life of the plan regardless of a change in circumstances." *See, e.g., In re Warren*, 2007 WL 2683837 at *2 (Bankr. M.D. Ala.); In re Jass, 340 B.R. 411, 415 (Bankr. D. Utah 2006).

Moreover, although BAPCPA legislative history is not helpful in shedding light on these particular terms, there can be no doubt that the overall thrust of the BAPCPA amendments was to compel debtors to pay what they can reasonably afford on their debts.[11] It would therefore be absurd and anomalous to interpret "projected disposable income" in such a way as to allow either a debtor like Mr. Pak to leave substantial money on the table in calculating "disposable income," or alternatively, to prevent an earnest debtor from proposing any plan based on current "best efforts" only because he is constrained by income enjoyed within the six months preceding bankruptcy but no longer available after a job loss or similar calamity, the BAP reasoned.

Consequently, based on the "holistic" approach to statutory interpretation, and mindful that context is important, the BAP in In re Pak determined that "projected disposable income" was not susceptible to a "plain meaning" analysis and was vague and ambiguous. In reaching this conclusion, the BAP in *In re Pak* joined with dozens of other courts who have held that Congress' retention of the term "projected" to modify "disposable income" has created an ambiguity.[12]

CONCLUSION – THERE IS STILL ROOM AND NEED FOR JUDICIAL STATUTORY INTERPRETATION

The BAP in *In re Pak* therefore decided that "disposable income" as defined in §1325(b)(2) [and the calculation of "current monthly income" as set forth on Form 22 incorporated by reference], is merely the starting point for a determination of "projected disposable income" and the court is free to receive

Continued on page 12...

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evidence of change in circumstances to "reflect reality going forward" when evaluating plans for confirmation. This is clearly the more logical and reasonable interpretation and one consistent with the overall purposes of the BAPCPA amendments, but it resurrects the dreaded judicial discretion which evidently Congress sought to eliminate in many of the BAPCPA amendments.

Moreover, it is merely one example of numerous problems with the BAPCPA language generally facing courts, who must continue to try to square what Congress may have intended with what it actually said. It also underscores the problems faced when Congress attempts to circumscribe judicial discretion with "one size fits all" formulas that will lead, as in Mr. Pak's case, to anomalies and even to the "delicious irony"[13] of a debtor evading under the formula what he surely would have been forced to pay had the basic old-fashioned discretion of the judge been trusted. The "Gordian Knot" metaphor was all too appropriate. Where the language used under BAPCPA is not susceptible to a coherent, logical and consistent interpretation, the courts must continue to use their interpretive swords in order to bring about a workable resolution.

**The Honorable Theodor C. Albert was appointed judge of the United States Bankruptcy Court for the Central District of California by the Ninth Circuit United States Court of Appeals on June 1, 2005. Judge Albert brought more than 25 years of private practice experience in bankruptcy and financial law to the bench, and formerly served as a United States Bankruptcy Trustee. He is a recipient of the Peter M. Elliot Award for highest standards of ethics and scholarship. Judge Albert sits in the Santa Ana division of the Court.*

---

[1] This was Judge Klein's allusion from his concurring opinion in *In re Pak*, 378 B.R. 257 (9th Cir. BAP 2007). "The Gordian Knot" was reportedly beyond any mortal's ability to unravel until Alexander the Great in 333 BCE provided the simple solution of cleaving the knot with his sword. The resulting metaphor describes any decisive and swift solutioin to an otherwise intractable problem.

[2] "The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005," Pub. L. 109-8, 119 Stat. 23 was a substantial amendment of the Bankruptcy Code, effective as to most of its provisions October 17, 2005. All statutory citations are to Title 11 of the U.S. Code, unless otherwise specified.

[3] See notes 8 and 12 for a catalog of the cases, respectively, finding a "plain meaning" of the statute and those finding the term ambiguous.

[4] *In re Pak*, 378 B.R. 257, 265, n.10, (quoting BAPCPA Presidential Signing Statement, available at http://www.whitehouse.gov/news/releases/2005/04/20050420-5.html. See 151 Cong. Rec. S2462-02 (Mar. 10, 2005) (Statement of Senator Sessions)("People who need a fresh start under this bill will get one. The people who can pay some of their debts back will have to do that.")

[5] "In enacting BAPCPA, 'Congress demonstrated a determination to replace judicial discretion under general standards with precise rules-based calculations. One can understand why bankruptcy judges would chafe at such restrictions, but that does not mean the Congress did not mean what it said'." *In re Rotunda*, 349 B.R. 324 (Bankr. N.D.N.Y. 2006) (*citing* Culhane & White, 13 Am. Bankr. Inst. L. Rev. at 682.)

[6] Messrs. Burd, Couchot and Garza, Orange County Bankruptcy Forum, materials for "Roundtable Discussion with Local Bankruptcy Judges on Bankruptcy Cases of the Past Year. March 25, 2008."

[7] *In re Alexander*, 344 B.R. 742, 748 (Bankr. E.D. N.C. 2006)

[8] *See also, Coop v. Frederickson (In re Frederickson)*, 375 B.R. 829 (8th Cir. BAP 2007); *In re Kolb*, 366 B.R. 802 (Bankr.S.D.Ohio 2007); *In re Hanks*, 362 B.R. 494 (Bankr. D. Utah 2007); *In re Kagenveama*, 2006 Bankr. LEXIS 2759 (Bankr. D. Ariz. 2006); *In re Tranmer*, 355 B.R. 234 (Bankr. D. Mont. 2006); *In re Rotunda*, 349 B.R. 324; *In re Guzman*, 345 B.R. 640 (Bankr. E.D. Wis. 2006); *In re Barr*, 341 B.R. 181 (Bankr. M.D. N.C. 2006) and others.

[9] *See* §§1129(a)(15)(B), 1222(a)(4), 1225(b)(1)(B), 1225(b)(1)(C) and 1322(a)(4).

[10] Indeed, although "projected disposable income" is not defined in Chapter 12, at §1225(b)(2) it is provided: "disposable income" means income which is received by the debtor and which is not reasonably necessary to be expended (A) for the maintenance or support of the debtor or for a domestic support obligation that first becomes payable after the date of the filing of the petition; or (B) for the payment of expenditures necessary for the continuation, preservation, and operation of the debtor's business."

[11] *See* Note 4, supra.

[12] *See, e.g. In re McCarty*, 376 B.R. 819 (Bankr. N.D. Ohio 2007): *In re Warren*, 2007 WL 2683837 (Bankr. M.D. Ala. 2007); *In re Mancl*, 375 B.R. 514, 516 (Bankr. W.D. Wis. 2007); *In re Meek*, 370 B.R. 294 (Bankr. D. Idaho 2007); *In re Knippers*, 2007 WL 1239297 (Bankr S.D. Tex. 2007); *In re Mullen*, 369 B.R. 25 (Bankr. D. Or. 2007); *In re LaPlana*, 363 B.R. 259 (Bankr. M.D. Fla. 2007); *Kibbe v. Sumski* (In re Kibbe), 361 B.R. 302 (1st Cir BAP 2007); *In re Gordon*, 360 B.R. 679 (Bankr. S.D. Cal. 2007); *In re Riggs*, 359 B.R. 649 (Bankr. E.D. Ky. 2007); *In re Slusher*, 359 B.R. 290 (Bankr. D. Nev. 2007); *In re Hardacre*, 338 B.R. 718 (Bankr. N.D.Tex. 2006) and many others.

[13] This is Judge Klein's phrase in his concurring opinion *In re Pak*, 378 B.R. at 273.

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ASK THE RECEIVER

By Peter A. Davidson, Esq.*

*PETER A. DAVIDSON, with Moldo Davidson Fraioli Seror & Sestanovich LLP located in Los Angeles, is a receiver and an attorney who specializes in representing receivers in state and federal court.

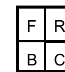
Peter A. Davidson

Q I was appointed receiver for a business. Shortly after my appointment the owners put the business into bankruptcy and I turned over possession to the debtor. I was not discharged as receiver. I just learned that the bankruptcy was dismissed. Can I retake possession of the business as receiver and once again operate it?

A Probably. It depends on what the order dismissing the bankruptcy says and what happened during the bankruptcy proceeding. Section 349(b)(1)(A) of the Bankruptcy Code provides: "Unless the court, for cause, orders otherwise, a dismissal of a case other than under section 742 of this title- (1) reinstates – (A) any proceeding or custodianship superseded under section 543 of this title". A custodianship includes a receivership or an assignee under a general assignment for the benefit of creditors. 11 U.S.C. §101 (11). Therefore, dismissal of the bankruptcy would reinstate the receivership. See, In re Parrish, 275 B.R. 424, 433 fn. 10 (Bankr. D. Dist. Co. 2002) ["Dismissal additionally reinstates any state receivership or assignment for the benefit of creditors proceeding."]. However, you need to review the dismissal order to make sure that in dismissing the bankruptcy the court did not, for some reason, order that the receivership would not be reinstated because the statute states: "unless the court, for cause, orders otherwise". Additionally, you need to determine what happened during the bankruptcy proceeding. To the extent the business or its assets were sold, transferred, liened and or foreclosed on during the bankruptcy, that activity would remain valid and would affect the reinstated receivership. For example, if a secured creditor got relief from the automatic stay and foreclosed on business assets or assets were sold during the bankruptcy, that would affect what reverts into the receivership, if anything, upon dismissal of the bankruptcy. See, In re Sports & Science, Ind., Inc., 95 B.R. 745, 747 (Bankr. C.D. Cal. 1989) where the court states that the purpose of §349 is to "undo the bankruptcy case, as far as practicable, and to restore all property rights to the position in which they were found at the commencement of the case". The court notes, however, that "transfers made in accordance with the Bankruptcy Code or orders of the court" would not be unwound. See also, In re Searles, 70 B.R. 266, 270 (D.R.I. 1987) ["the 'property of the estate' that reverts in its prior owners after dismissal includes only the property left in the estate at the time of dismissal".].

Q In a prior Ask the Receiver column you discussed having a receiver in aid of execution appointed to sell a judgment debtor's domain names or other intellectual property. Have any cases specifically addressed this practice?

A There have not been any reported cases in California on this issue as yet, which is not surprising since receivership cases, let alone enforcement of judgment receivership cases, rarely result in appeals. However, there is a slip opinion arising out of a district court case that is now on appeal that may result in a reported decision on the issue. In Office Depot, Inc. v. Zuccarini, 2007 WL 3481254 (N.D. Cal. 2007) the district court granted an ex parte application to appoint a receiver to take control of internet domain names owned by the defendant so they could be auctioned off to satisfy a judgment. The defendant appealed the order to the Ninth Circuit and sought a stay of placing the domain names in receivership and their sale. The district court stayed the sale, pending the appeal, but not the receivership. The court agreed with the defendant's contention that if the auction went forward it would be very difficult for the defendant to force the return of the domain names to him if he succeeded on his appeal, which the court found addressed an issue of first impression. The court did not stay the receivership, however, because it prevented the defendant from hiding or modifying his domain name property and the receivership would allow revenue generated from the domain names to be collected and applied to the judgment. Once the Ninth Circuit rules on the appeal, we may finally have a reported decision on this issue.



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• The bullet indicates those receivers who completed a comprehensive 16-hour course on receivership administration and procedures presented at Loyola Law School in April 2000.

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■ The square indicates those who facilitated the October 2004 Loyola Law School course.

JUNE 11, 2008 LA/OC CHAPTER PROGRAM: "FEDERAL REGULATORY RECEIVERSHIPS — MAXIMIZING RECOVERY FOR DEFRAUDED CONSUMERS AND INVESTORS"

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Many federal agencies frequently seek expedited appointment of receivers to preserve and recover assets for the benefit of consumers and investors victimized by deceptive, fraudulent and even criminal conduct. The panel will provide insights and discuss emerging issues in regulatory receiverships from the perspectives of the Federal bench, the Federal Trade Commission, an experienced federal enforcement action receiver and from experienced regulatory receivership counsel.

Administrative considerations, the receiver's relationship with the Court and parties, how to maximize value of the receivership estate, use of civil contempt proceedings and fraudulent transfer actions, and the impact of recent cases will all be discussed.

Panelists will include: The Honorable Audrey B. Collins – United States District Court Judge, sitting in the Central District of California; John D. Jacobs, Esq., Senior Staff Attorney for the Federal Trade Commission; Robb Evans and Kenton Johnson of Robb Evans & Associates LLC, a firm that has long specialized in administering regulatory receiverships; and Gary Caris, Esq. of McKenna Long & Aldridge LLP, experienced receivership counsel.

Registration, networking and dinner is scheduled from 6:00 to 7:00, when the program commences. 1.5 hours of MCLE or CPE credit have been approved. Pre-registration costs are $65 for CRF members, $75 for non-members and $30 for government employees. RSVP by email to tspangler@jbsassociates.ws.

Ignore at Your Peril: BAPCPA Tax Changes Affect all Bankruptcy Chapters

By Charles F. Rosen, Esq.*

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) contained certain changes to the Bankruptcy Code that affect tax matters. I believe I must shoulder the blame — at least in part — for many of the changes. While I was still with the IRS in the mid-1990s the IRS national office made the mistake of asking me for suggestions for changes to the Bankruptcy Code.

I obliged them with a multi-page memo setting out changes that (a) codified existing majority position case law, (b) made hard and fast certain procedural positions that had been taken by the IRS, and, (c) generally simplified the life of those at the IRS Bankruptcy Units across the country which had to work with the law and the bankruptcy courts. Imagine my surprise when virtually all of my recommendations were contained in the IRS Chief Counsel's letter of August 28, 1996 delivered to the National Bankruptcy Review Commission (attachment "A" to the Commission's Tax Report). Now I don't take all of the blame (I know many others in the IRS held similar views), but I do not know if any of the same suggestions were passed along by others to the IRS Chief Counsel. I presume they were passed along in some fashion, a presumption that allows me to sleep at night.

Chapters 7 and 13 Individual Debtor Cases

So what are the more significant changes that came from new BAPCPA traps for unwary debtors' counsel? **Three changes** especially come to mind as they concern individuals in Chapters 7 and 13 cases.

First, Bankruptcy Code section 507(a)(8)(A)(ii)(I) was amended to clarify the 240-day-plus-30-day offer in compromise measuring period (measured from the date of assessment of a tax to the date of the petition filing) and to further include any offer that was more than pending (to include an offer that had been accepted but not fully performed by the debtor — i.e. where all offer payments were not yet paid or all required future years' returns were not filed and paid timely).

Subsection 507(a)(8)(A)(ii)(II) was amended to further include a 240-day period, plus 90 days, as a measuring period for any time during a prior bankruptcy where the 240-day period had not fully run. But this subsection goes even further as it includes any tax collection action that was stayed in a prior bankruptcy case. Thus subsection (II) includes not only an offer in compromise in a prior bankruptcy but, among other scenarios, any time a Collection Due Process (CDP) hearing was requested during the period ended 240 days after the date of assessment.
When applying these sections it must be kept in mind that there may have been several offers previously filed by the same taxpayer. Also remember that a taxpayer may have requested a CDP hearing for some tax periods but not others, so that the measuring period only applies to those tax periods for which a hearing was requested.

Remember that these are actual calendar day measuring periods, not monthly measuring periods. This is especially important if a measuring period includes February 29th of a Leap Year. Many bankruptcy attorneys have been burned by miscalculating the precise day (not monthly) time periods. The short-hand practice of estimating based on average 30-day months is a dangerous no-no. In my former life as an IRS Bankruptcy Advisor, I can't remember how many times a lawyer would call and ask if I could help them out because of a malpractice claim caused by a few days' miscalculation (sorry… the answer was that I had no authority to adjust the law).

Second, an unnumbered paragraph was added at the end of section 507(a)(8) — sometimes referred to as a hanging paragraph. The IRS has statutory appeal periods that prohibit the IRS from taking enforced collection action or filing Notices of a Federal Tax Lien if a taxpayer acts timely on a request for

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an administrative Collection Due Process hearing and, possibly, a judicial appeal of the results of the hearing (See 26 U.S.C. 6320 and 6330). The added hanging paragraph suspends the dischargeability measuring periods established by Section 507(a)(8) when the IRS (or a state taxing agency, for that matter) is prohibited from enforcing tax collection. There are also other periods when enforcement of tax obligations is prohibited, but these are often difficult to identify. They do not always appear in the literal (plain English) transcripts most attorneys request from the IRS and are often omitted in the more detailed internal computerese MCC transcripts that tax professionals prefer to use.

So why are these two Section 507(a)(8) changes important? The reason is straightforward. If you do not clear the hurdles posed by these changes, the debtor's tax liabilities delineated in other portions of section 507(a)(8) remain priority taxes and are not dischargeable in bankruptcy (please see 11 U.S.C. 523(a)(1)(A) regarding exceptions to discharge).

The **third** significant change affecting individuals has to do with the death of the Chapter 13 super-discharge for all tax liabilities. Bankruptcy Code 1328(a)(2) was amended to make nondischargeable in a Chapter 13 case all those taxes that are non-dischargeable in a Chapter 7 case. This includes the priority taxes described in Section 507(a)(8), as well as taxes related to fraudulent returns, unfiled returns, unaudited deficiencies (and the like), and related to a debtor's attempt to evade or defeat the tax. These are enumerated in Sections 523(a)(1)(B) and (C).

Thus it now appears that all taxes must be paid in full in a Chapter 13 case, with the possible exception of (a) general unsecured tax claims, (b) secured tax claims that are not fully secured and that absent the lien security would revert to general unsecured taxes, and (c) all unsecured penalties related to taxes for which the tax period ended more than three years before bankruptcy filing date (see 11 U.S.C. 523(a)(7).)

Under Section 1322 there is no requirement that general unsecured claims for taxes excepted from discharge under section 523(a)(1)(B) and (C) be paid in full. But if not fully paid under the plan, they will survive the new section 1328(a) discharge. This creates the issue of whether a Chapter 13 plan can have two general unsecured claim classes, one for tax claims and one for all other claims. If not, then a Chapter 13 plan will likely have to pay a 100% dividend on all general unsecured claims – seemingly defeating the purpose of the Chapter.

Chapter 11 Reorganization Cases

Section 1125(a) of the Bankruptcy Code was amended to make it clear that "adequate information" in the plan disclosure statement must include "A. . . a discussion of the potential material Federal tax consequences of the plan to the debtor . . ." Prior to this change drafters of Chapter 11 disclosure statements typically brushed off tax issues by cavalierly assuming that the requirement to discuss tax ramifications of a plan only meant the tax ramifications that might affect creditors, but not the debtor or successor to the debtor. Such disclosure statements merely tell readers/creditors that they should consult with their own tax professionals to determine how a confirmed plan might affect their own tax situation. This was never the intention of the drafters of the Bankruptcy Code.

Section 1129(a) also was amended to eliminate the disparate treatment that was often given to tax claims, especially those that were secured by liens on assets of the debtor. The changes bring tax claim treatment in Chapter 11 cases more in line with treatment of tax claims in other bankruptcies. For example, if what at first glance appears to be a wholly-secured tax claim but is really either unsecured or under-secured, the unsecured portion now must be treated as part of whatever category of claims it would have been found if not for the apparent perfected tax lien.

The section was also amended to require that unsecured priority claims must be paid within five years of the petition filing date rather than six years from the date of assessment. In the past debtors had some tax liabilities filed and assessed well after the petition was filed, through inadvertence, a lack of funds to have returns prepared, or because of strategic Chapter 11 planning. The amendment to the Bankruptcy Code now often greatly shortens the payout period. Finally, it is now codified that a taxing agency's fluctuating rate of interest is the proper rate to be applied to payments, rather than some lesser

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FEES, FEES, FEES – WHO PAYS THE FEES?

Recent Unpublished California Court of Appeals Decisions Illustrate Receivership Fee Problems and Pitfalls

Although the following cases are not published and may not be cited as authority for any of the issues discussed and ruled upon, each nevertheless illustrates points that every careful receiver should take to heart lest he or she become the victim of a similar fact pattern. All three concern payment of a fiduciary's fees – a subject of at least passing interest to the receivership community.

Must the Party Seeking the Receiver's Appointment Pay Any Shortfall?

In Fassler v. Pacific Star, 2008 Cal. App. Unpub. Lexis 2879 (filed April 8, 2008) the party seeking appointment of a receiver told the court it would pay any shortfall – "We realize there is an expense to the [receivership] and the statute provides that if there is not enough money in the case to pay for the receiver that we'll pay and that's fine." – to overcome the court's fears that the expense of a receivership would overwhelm the small winery business in dispute. The court was persuaded, appointed a receiver, put a $10,000 cap on receivership fees, later uncapped that cap, and ultimately awarded $77,448.43 to the receiver. $20,000 of this amount was to be taken from the business accounts and the balance was to be paid by the party that sought the receivership. Complicating matters was the fact that the parties settled the corporate liquidation suit in the interim – a settlement that apparently did not address payment of the receiver's fees.

On appeal counsel for the party seeking the appointment argued that their client hadn't really agreed to pay any shortfall – they (the counsel) had just recited to the trial court what they believed the law to be. Appellant's counsel also argued that fees should be paid from potential future business revenues or by taxing the underlying real property not owned by the business (owned by a principal of the business entity). Finally they trotted out the U.S. Supreme Court decision Atlantic Trust Co. v. Chapman (1908) 208 U.S. 360 for the proposition that "no such liability [i.e. for paying a receiver fee shortfall] could arise from the simple fact that it was on plaintiff's motion that a receiver was appointed…."

The appellate court affirmed the trial court. It first cited language familiar (and comforting) to every receiver: "'Courts generally are vested with large discretion in determining who shall pay the cost and expenses of receivership.'" (Baldwin v. Baldwin (1947) 82 Cal.App.2d 851, 856.) "As a general proposition the costs of a receivership are primarily a charge upon the property in the receiver's possession and are to be paid out of said property. However, this is not an invariable rule. In many cases a direct liability is imposed upon the parties to the action, or upon some of them, for the remuneration of the receiver." (Andrade v. Andrade (1932) 216 Cal. 108, 110; [citation omitted] "'This may result from the irregularity of the appointment, or from the insufficiency of the fund, or out of the agreement between the parties.'" (Ephraim v. Pacific Bank (1900) 129 Cal. 589, 592.)"

The appellate court held that requiring fees to be paid from future business revenues "could seriously impact its ability to continue as a going concern" and distinguished Atlantic Trust Co. v. Chapman on the basis that there had been no discussion of payment of fees in the Atlantic case, unlike the case at bar, where there was an express agreement by the party seeking appointment to be responsible for any shortfall.

The lesson? Although things turned out well for this receiver, this controversy (and its attendant uncertainties) could have been avoided by a careful receiver who made sure that responsibility for paying receivership fee shortfalls was addressed and allocated in the appointing order.

Receiver, Heal Thyself

Butterwick v. Fitzpatrick, 2008 Cal. App. Unpub. LEXIS 1293 (filed February 15, 2008) was a messy case involving the unwinding of a professional medical corporation and a companion partnership (involving many of the same principals) that leased medical equipment to the medical corporation. The receiver was appointed upon stipulation of the parties.

The receiver ultimately realized that there were two distinct receiverships, began maintaining separate accountings for each, and ultimately sought (and obtained) authority to place the medical corporation in bankruptcy. The receiver ultimately asked the court, among other things, to tax payment of some receivership fees incurred in one case to the other entity in receivership, and also asked that the individuals / principals of both be made personally liable for payment of fees.

The trial court refused these requests, and the appellate court confirmed. Although the discussion is lengthy, two issues were highlighted. The first was the receiver's failure to seek clarification of apparent ambiguity in the appointing order and the second was his continuing administration of the insolvent professional corporation (taking interim fees from the other entity). The appellate court stated:

> "The Receiver argues the language of the order was ambiguous because it did not directly address the allocation issue and therefore it should be construed against each of the physician parties who stipulated to the appointment of the receiver. However, the court had a reasonable basis to conclude that to the extent there was any ambiguity, the Receiver had the affirmative obligation to seek clarification from the court. 'If the receiver's powers are in doubt, the receiver should petition the court for instructions.' (Well & Brown, Cal. Practice Guide: Civil Procedure Before Trial (The Rutter Group 2007)P9:762.)"

The second error concerned the receiver's failure to disclose operating losses. The appellate court agreed with the trial court that the receiver did not act in an appropriate manner when, rather than seek instructions, he continued to provide services to the professional corporation despite knowing the entity had insufficient assets to pay his fees without seeking instruction. The appellate court stated:

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Heard in the Halls Notes, Observations, and Gossip Relayed

by Alan M. Mirman

Alan M. Mirman

Welcome to the latest edition of Heard in the Halls. Please provide your snippets of news, questions or comments about receivership issues or the professional community by telephone, mail, fax, or email to: Alan M. Mirman, Mirman & Bubman, LLP. 21860 Burbank Blvd, Suite 360, Woodland Hills, CA 91367. Phone: (818) 451-4600; Fax: (888) 451-7624; email: alan@mirmanbubman.com

Here is what we have Heard in the Halls ...

- Have you visited the updated Forum website? The directory includes extensive search capabilities. It is open to non-members, and offers a great opportunity to identify receivers, experienced receivership lawyers, vendors, etc. for your case, and for any additional referrals. Just type in www.receivers.org!

- On the move: Your Heard in the Halls columnist Alan M. Mirman has his own announcement to make. After 16 years as a partner at Horgan, Rosen, Beckham & Coren, a new firm is born: Mirman & Bubman, LLP. Alan Mirman and Michael Bubman have started the firm, which will be in Woodland Hills (as noted above). Alan continues to represent lenders and receivers, and Michael's background is in business litigation, and representation of receivers, owners and lessors of long term care facilities.

- Insolvency Professional Jeffrey Golden Presented the Peter M. Elliott Award for Highest Standards of Ethics and Scholarship: Jeffrey I. Golden was presented the 2007 Peter M. Elliott Award at a February 26 meeting and ceremony of the Orange County Chapter of the California Bankruptcy Forum. The Chapter administers the Peter M. Elliott Award and hosted a lovely dinner with more than 200 persons in attendance. Jeff Golden, past president of the Orange County Chapter and partner with Weiland, Golden, Smiley, Wang-Ekvall & Strok, LLP, was presented the prestigious award for his many contributions to the Southern California bankruptcy community as a lawyer, trustee, receiver and scholar. The Peter M. Elliott Award is given in honor of the late Peter Elliott, one of the pioneers of the Orange County bankruptcy community. Jeff was the last clerk to Judge Elliot before his untimely retirement.

- News from the North: Fiduciary Management Technologies, Inc. (FMT), whose principals are California Receivers Forum Past President Marilyn Bessey and partner Scott Sackett, have signed an exclusive partnership agreement with U.S. Bank, the sixth largest commercial bank in the U.S., to provide a "one stop shopping" environment for receivers and other fiduciaries. U.S. Bank will provide financial services integrated with FMT's case and financial management software programs designed specifically for receivers, assignments for the benefit of creditors (ABC's), trust management, and liquidating and disbursing agents. For more information contact Marilyn at marilyn.bessey@efmt.com

- Welcome to another new Receivers Forum member: Jim Taylor, Senior Vice President of Sperry Van Ness, San Diego/National Director for Special Assets Division, has over 30 years of expertise in the evaluation and disposition of special assets and heads up Sperry Van Ness's Special Assets Division. The Special Assets Division utilizes its national reach and local expertise with over 900 commercial agents, Equities Division and Accelerated Marketing Division to work with receivers and lenders to evaluate and sell investment property and land at the highest possible price in the shortest possible time. For more information please contact Jim Taylor directly at (858) 642-2344.

Alan M. Mirman is a partner in the newly formed Woodland Hills law firm of Mirman & Bubman, LLP, and specializes in creditor's rights. His practice includes aspects of provisional remedies, representation of receivers, litigation, loan and lease documentation, and the like.

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discounted and/or fixed rate that is usually beneficial to the debtor. Remember that for about 9 months in 1982-83 the IRS's rate of interest was at 16% - 20% because of substantially increased prime interest rates. At times since then the quarterly adjusted interest rate has been as high as 10%, compounded – not inexpensive interest.

Changes Affecting Chapter 11 DIPs / Trustees and Chapter 7 Trustees

Another significant change brought about by BAPCPA was to the Judicial Code at Section 960. Until BAPCPA became law, it was common for Chapter 11 debtors and Chapter 7 trustees to defer the filing of those tax returns that were required to be filed during the bankruptcy proceeding. Chapter 11 debtors are now required to file and pay all income tax returns and all payroll tax returns as they become due, rather than at the end of the case. Failure to do so in a Chapter 11 case can be a basis for conversion or dismissal of the case, pursuant to 11 U.S.C. 1112(b)(4)(I).

Chapter 7 trustees must file all returns on time and not at the end of the case. They may defer payment of the tax until final distribution only if A (1) the tax was not incurred by a trustee duly appointed or elected under Chapter 7 of title 11; or (2) [if] before the due date of the tax, an order of the court makes a finding of probable insufficiency of funds of the estate to pay in full the administrative expenses allowed under section 503(b) of title 11 . . . A (28 U.S.C. 960(C).)

Receivership Tax Obligations Contrasted With Bankruptcy Tax Obligations

How does all of the above fit into the ambit of a receivership? In a receivership most tax claims must be paid in full over time but there are no hard and fast rules of how or when they are to be paid. The exception to this is with respect to Federal taxes which, according to 31 U.S.C. 3713, must be paid after reasonable administrative and secured claims have been paid, but before all other creditors. There is no measurable timetable provided within which this is required to be done, except as might be mandated by the court.

There is a caveat to this. Where the majority of claims that are to be dealt with by the receivership entity are tax debts, and if the receivership entity and its creditors can agree that all other unsecured debts are not likely to be paid in any event, a receiver may discuss with interested parties whether filing a bankruptcy petition is in everyone's best interests. It may be a quicker and cheaper alternative for all those involved.

Chuck Rosen and alter ego.

**Charles F. Rosen is an attorney with the Law Offices of A, Lavar Taylor and is an expert on receivership and bankruptcy tax law. Mr. Rosen served as bankruptcy advisor for the Special Procedures Branch of the Internal Revenue Service for more than twenty years.*

Continued from page 17.

"Although the receiver now contends that he acted in good faith, the court had a reasonable basis to conclude that the Receiver's conduct did not fully meet the high standards expected of a fiduciary under the circumstances. The Receiver could easily have protected himself and the parties by discontinuing his services until he had been given direction by the court."

The lesson? Clarify and disclose, clarify and disclose.

Receiver or Referee? Does it Matter?

The last case, Padilla v. Serino, 2008 Cal. App. Unpub. LEXIS 1306 (February 19, 2008) concerns a stipulated receiver who was later appointed a referee pursuant to stipulation of the parties to resolve certain issues. Unfortunately for the gentleman, the parties caused the underlying action to be dismissed with prejudice before the referee brought his motion for payment of his referee fees. The trial court granted his fee motion and the parties subsequently appealed. On appeal the referee argued that, as in a receivership case, the court retained jurisdiction to enter an order awarding his referee fees even after dismissal of the underlying action. The appellate court disagreed, found orders entered after the dismissal to be void, stating that there is a material difference between receivers and referees.

In a receivership case the receiver remains in charge of the property until discharged by the court regardless of a dismissal of the action by the parties (the appellate court reasoned); dismissal of an action does not discharge the receiver from accountability to the trial court, nor does it deprive the trial court of jurisdiction to settle the receiver's account (citing to Pacific Bank v. Madera Fruit & Land Co. (1899) 124 Cal. 525, 525-527). But there is no such rule allowing post-judgment recovery of referee fees, the court held. The referee was , not entrusted with control of property (as is a receiver). Dismissal of the case divested the trial court of all jurisdiction and any orders entered after dismissal were void.

The lesson? Pay close attention, and never assume. –Ed.

Heard in the Halls Notes, Observations, and Gossip Relayed by Alan M. Mirman

Continued

- Loyola III – the Forum's third 2-day intensive workshop on administering receiverships, on receivership law and practical use of receivers is coming January 16 and 17, 2009. This will both repeat elements of the 2004 program and add new materials about emerging receiver and receivership applications. Chair Bob Mosier's goal is to increase the participation of judges from throughout the state, update all basic course materials and add new materials on emerging areas. Watch this publication and the CRF website for more information. The program will be, as always, at the Loyola Law School of Los Angeles campus near downtown LA.
- The California Receivers Forum State Board Meeting will be held at the Hyatt Grand Champion Hotel in Indian Wells, California on May 15 immediately preceding the beginning of the Annual California Bankruptcy Forum Conference. Among the items on the agenda to be discussed are the budget for the next fiscal year, the preparations and budgeting for Loyola III, the growth of Receivers Forum membership, statewide dues structure and associated items.
- 2008 – 2009 California Receivers Forum Directories are still available. If you have not received yours contact Toni Spangler at (949) 497-3673 ext. 200. There are extra directories available for purchase at $15.00 (to cover costs of printing and postage). Send your check made payable to California Receivers Forum to JBS & Associates, Attn. Toni Spangler, 954 La Mirada Street, Laguna Beach, CA 92651.

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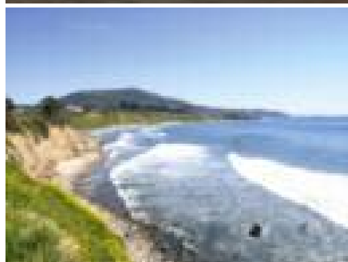

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