

Newsletter

Volume XXIII, Number 3 Debtor-Creditor Section, Oregon State Bar

Fall 2004

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COMMENTS FROM THE CHAIR

By Carolyn G. Wade
Hershner, Hunter, Andrews, Neill & Smith LLP

Summer is over and the year is winding to a close. Time flies when you're having fun, and also when you are engaged in a successful and rewarding year for the Debtor-Creditor Section. Let's take inventory of advances in our practice area and the contributions the section has made this year.

The Northwest Bankruptcy Institute took place on April 17 and 18 in Portland. The Institute covers all aspects of bankruptcy, and participants this year were presented with one of the strongest programs ever. The Institute is co-hosted annually with Washington's Creditor-Debtor Section. Next spring the program will take place in Seattle. I encourage anyone who did not attend this year to make the trip to Seattle next year.

Late last year, the bankruptcy court began electronic filing. Documents can now be viewed online at ECF.orb.uscourts.gov. There are still bugs to work out, but the day when all documents can be filed and retrieved electronically is finally in sight.

The formation of the Young Lawyers Committee has been exciting. So far, they've had an organizational meeting, a backstage tour of the clerks' area of the bankruptcy

courts, and a social. They have sponsored a one-hour, video-linked presentation by three trustees in Eugene and Portland, and are planning more events for the fall.

The Legislation Committee of the Debtor-Creditor Section was busy during the summer working on proposed new legislation. Their work was forwarded to the Legislative Counsel, which has drafted bills that we believe will improve our practices. One would allow recording a notice of bankruptcy without obtaining a certified copy of the petition, and would allow recording other bankruptcy court documents affecting the estate's interest in real property (updating the current statute's reference to the Bankruptcy Act of 1898!); another would allow junior lienholders to be paid from the proceeds of a foreclosure sale of property subject to a possessory lien if the foreclosing creditor is paid in full; a third would allow sheriffs to accept cashier's checks as an alternative to cash at judicial sales. Remember this exciting work when signing up for committees at the annual meeting.

At the State Bar Convention on October 14-16 the Debtor-Creditor Section sponsored a CLE program entitled "Bankruptcy Intro for

Non-Bankruptcy Lawyers-This Means You!" The course is described as Bankruptcy 101, a big-picture view designed to inform lawyers who don't want to participate in bankruptcy proceedings.

Finally, we've planned a really wonderful CLE on all aspects of trial practice to coincide with the annual meeting. We hope to see you all at the University of Oregon School of Law on November 5 and 6. If you haven't seen the "new" building yet, you'll be surprised at the interesting and very functional design. (Has anyone else noticed how, as we age, we call something "new" much longer than a few years ago? It's really a little scary!)

I've enjoyed the opportunity to help with the work of the section this year and participate with members who have a real enthusiasm for their practice. It has been a pleasure reconnecting with folks who have taken a reprieve from active participation and welcoming new members. Shaping a dynamic practice area while maintaining healthy relationships among fellow practitioners continues to be a significant goal of the section. This past year has given me a renewed appreciation for the power of active participation to move us forward together.

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MORE EXCEPTIONS AND IDIOSYNCRACIES OF THE AUTOMATIC STAY

By Sally Leisure

In the Winter 2004 issue of the Debtor Creditor Newsletter I wrote an article discussing two exceptions to the automatic stay: 11 USC §362(b)(1), which excepts criminal actions, and §362(b)(4), which excepts certain other governmental functions. Of the other exceptions, several apply only to specific types of debtors: those involved in sophisticated securities markets (§362(b)(6), (7), and (17)); merchant marines or owners of commercial ships (§362(b)(12) and (13)); and accredited educational institutions (§362(b)(14), (15), and (16)). This article will discuss the remaining exceptions that have a more general application.

EXCEPTIONS TO THE STAY

Paternity and Support Obligations

Actions to determine paternity and support are excepted from the stay by §362(b)(2)(A). This exception makes sense because paternity and support obligations are nondischargeable under §523(a)(5). However, note that the stay still applies to **enforcement** of such obligations, except against property that does not belong to the estate. §362(b)(2)(B). Nonstate property includes, for example, postpetition earnings (except in a chapter 13), exempt property and abandoned property.

This exception is not always easy to identify because property divisions in a divorce may be merged with an action to determine paternity or support. A property division is not excepted from the stay. Section 362(a)(3) stays "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate."

A Qualified Domestic Relations Order (QDRO) pursuant to 26 USC §414(p)(1) and 29 USC §1056(d)(3)(B) and (G) can be entered postpetition because it creates a property interest independent of a claim against the debtor.

Perfection of Security Interests

Certain acts to perfect security interests are excepted from the stay. §362(b)(3). This section must be read in conjunction with §546(b), which allows perfection to the extent it is allowed under applicable law to an entity with rights in the property prior to perfection, and

§547(e)(2)(A), which provides that a transfer is made at the time it takes effect as long as perfection is accomplished within ten days. Oregon law grants priority if perfection is completed within 20 days after the debtor takes delivery of the collateral. ORS 79.0317(5). Thus, a financing statement or certificate of title can be filed postpetition as long as it occurs within 20 days after delivery. Section 547(c)(3)(B) protects prepetition perfection of a security interest that occurs within 20 days of delivery. Trustees carefully examine prepetition car purchases to assure that the recording occurred within 20 days after delivery; if not the trustee will seek to avoid the security interest, leaving the woebegone creditor unsecured. Secured creditors can file continuation statements under the exception of §362(b)(3).

A construction lien can be recorded postpetition but foreclosure requires relief from stay. Contractors must adhere to specific time limits set out in the Oregon Lien Statutes.

In *In re 229 Main Street Ltd Partnership*, 262 F3d 1 (1st Cir 2001), the court was asked to rule on a dispute between a shopping center with pollution problems and the Commonwealth of Massachusetts Department of Environmental Protection. The Department had cleaned up pollutants on the property prepetition. The property owner requested a hearing because it disputed liability and the cost of clean-up. During the hearing the owner filed bankruptcy to stay the matter. The Commonwealth argued it didn't need to stop because §362(b)(3) excepted its actions from the stay. Debtor argued the Commonwealth had no lien that could be perfected postpetition and further that the state statute did not give priority to the Department over intervening creditors during a specific relation back period as is true with UCC and construction lien perfection and as required by §546(b)(1)(A). The First Circuit held that because the environmental lien trumped all other liens and encumbrances regardless of time of recording, the requirements of §546(b)(1)(A) were satisfied and the Commonwealth could continue its hearing and perfect its interest in the property. The Commonwealth could have proceeded under the exception for enforcement of regulatory powers in §362(b)(4) but it would not have been rewarded with a lien on property of the estate.

Other Common Exceptions

Certain foreclosures of HUD-insured loans on property consisting of five or more living units are excepted from the stay. §362(b)(8).

Tax entities can proceed with specified actions despite the bankruptcy stay under the 1994 amendments. §362(b)(9). Tax entities can audit, issue notices of deficiency, demand tax returns, and make certain assessments. Collection is stayed, however, as is the imposition of any liens other than statutory ad valorem property tax liens. §362(b)(18).

Lessors of nonresidential real property can evict the debtor if the lease terminates by its own terms either before or after the bankruptcy filing. §362(b)(10). Arguably the lessee's interest is not property of the estate under §541(a); a terminated lease would not be assumable by the trustee under §365.

Presentment of negotiable instruments is excepted from the automatic stay, but enforcement of the instrument against the debtor or property of the estate is stayed. §362(b)(11). In *Morgan Guaranty Trust Co. v. American Sav. &*

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The purpose of this publication is to provide information on current developments in the law. Attorneys using information in this publication for dealing with legal matters should also research original sources and other authorities.

Loan Assoc., 804 F2d 1487 (9th Cir 1986), the court held that presentment did not violate the automatic stay but that payments made by mistake could not be retained by the presenting creditor. In part because of the dispute that gave rise to this case, Congress then amended the law to clarify that presentment, notice and protest of dishonor are excepted from the stay. In *Morgan Guaranty*, the bank had paid on Manville notes just after the Manville bankruptcy filing, then sued to recover the money from the presenter.

LIABILITY FOR VIOLATING THE STAY

It is important to avoid violating the stay because courts have the authority to impose sanctions. The court can find that the violation is in contempt of court, or can simply rely on §362(h), which provides: “An individual injured by any willful violation of a stay provided by this section shall recover actual damages, including costs and attorney’s fees, and, **in appropriate circumstances, may recover punitive damages.**” (Emphasis added.) A willful violation of the stay does not require that the creditor intended to violate the stay, but can be found if the creditor knew of the bankruptcy and acted intentionally. *In re Bloom*, 875 F2d 224 (9th Cir 1989).

In *In re Schwartzenberger Vineyards*, Bankruptcy Case No. 697-64653-fra7, Adv Pro No. 98-6305fra (Bank D Or 1999) (unpublished), the court denied defendants’ motion for judgment on the pleadings but found on its way to that decision that agents can be liable for violations of the stay committed for the benefit of the principal, *citing Ramirez v. Fuselier*, 183 BR 583 (9th Cir BAP 1995), and other cases.

PROPERTY OF THE ESTATE

Only actions against property of the estate (as defined in §541) are subject to the automatic stay. Given the broad definition of estate property, courts in stay disputes must frequently analyze the property interests first. Estate property includes both legal and equitable interests. In *In re Chesnut*, 311 BR 446 (ND Tex 2004), debtor alleged that a foreclosure constituted a willful stay violation; the bankruptcy court initially agreed with the debtor and ordered the foreclosing creditor to pay the debtor \$10,000 in punitive damages. On appeal, however, the district court reversed, relying on Texas community property law. Texas law allows couples to designate property as separate or community by the way in which they take title.

The interesting facts that gave rise to this case follow: debtor married an older, wealthier woman. Thereafter, he filed his first chapter 13 case, during which Mrs. Chesnut acquired 2.52 acres of land. Her debt secured by the land went into default and three months after Mr. Chesnut received his first discharge he filed a second chapter 13 to stay foreclosure on the 2.52 acres. Notice was given to the foreclosing creditor, whose attorney advised him to go forward with the foreclosure. Two years and a trial and an appeal later, the attorney was proven right. Knowing what we all know about the costs of litigation and the time value of money, however, the foreclosing creditor would have done better to file of a simple motion for relief from stay to obtain a summary determination authorizing the sale to go forward. Of course, in that case we would not have this story to read.

The Bankruptcy Court in *Chesnut* based its decision on debtor’s assertion of an interest in the property and the notice given to the creditor. The court did not decide whether the property was property of the estate but was apparently disturbed that the creditor did not seek relief before proceeding. The appellate court reviewed Texas law, which relies on clear title records and which holds that the status of property is determined at the time the property is acquired based on the parties’ intentions; therefore, taking title in one’s name “unmistakably evidences an intention that the same shall belong to her separate estate.” 311 BR at 449 (citations omitted).

Oregon is not a community property state. Absent a prenuptial agreement courts analyze the property allocations equitably without regard to title or the parties’ intent. ORS 107.105(1)(f). Thus, each spouse has an equitable interest in the other’s property. Mr. Chesnut’s creditors could have been liable for stay violations in Oregon.

A bankruptcy filing by the holder of a second position trust deed can stay foreclosure by the first.

Property of the estate includes property that comes to the debtor up to 180 days after the bankruptcy filing if it results from a property settlement agreement with the debtor’s spouse or an interlocutory or final divorce decree. §541(a)(5)(B). The divorce action is not excepted from the automatic stay and thus cannot proceed without relief; the trustee will assert an interest in any disposition of property.

CO-DEBTOR STAY

The stay applies to the debtor and to property of the estate. Under §1301 the stay also extends to third parties who are liable with the debtor for consumer debts. The creditor is not allowed to collect from a spouse, a guarantor, or other co maker during the course of the chapter 13 case. However, if the debt is not paid in full the co-debtor is not protected post-discharge, and creditors may get earlier relief from the co-debtor stay if the plan does not provide for full payment of the claim. The co-debtor stay would not have changed the outcome in *Chesnut* because the property didn't secure a consumer debt of Mr. Chesnut.

DURATION OF THE STAY

A creditor can also run afoul of the automatic stay by proceeding before the stay has been terminated. Section 362(c) provides that the stay is effective against property of the estate "until such property is no longer property of the estate." It stays other acts until the court grants specific relief, or the case is closed or dismissed, or, with respect to an individual, until a discharge is granted or denied.

But don't be misled. A creditor cannot simply wait until the stay is terminated and then proceed to recover any prepetition claim. The injunction of §524 bars such recovery. This section applies to a creditor collecting a nondischargeable claim, a secured claim, or a claim against a debtor whose discharge has been denied.

Property of the estate remains property of the estate until the trustee abandons the property or the case is closed. §554. After abandonment of scheduled property it reverts in the debtor. §554(d) and (c). Don't assume anything about what a trustee might do until it is done.

And remember that acts in violation of the stay are void. *In re Sambo's Restaurants, Inc.*, 754 F2d 811, 816 (9th Cir 1985). In *In re Cueva*, 371 F3d 232 (5th Cir 2004), a creditor allowed a foreclosure to proceed after the petition was filed. The buyer at the foreclosure sale argued that he was protected by §549(c) as a bona fide purchaser in a postpetition transaction. The court disagreed and held the sale was void. The Fifth Circuit, like the Ninth Circuit, holds the stay voids any acts to enforce liens. Section 549(c) "is not an exception to the automatic stay." *Id.* at 238.

In *In re Smith*, Bankruptcy Case No. 694-60379fra7, Adv Pro No. 98-6207fra (unpublished), the debtor claimed damages for violation of the stay for improper postpetition foreclosure. The Oregon bankruptcy court

dismissed the claims because the property had not yet been abandoned. It remained property of the estate and thus it was the estate, not the debtor, that had been damaged.

CONCLUSION

The bankruptcy stay is crucial to the orderly administration of cases. The stay gives the trustee time to preserve assets and liquidate them to the best advantage of the creditors. The stay gives the debtor the breathing room needed to regroup for the fresh start. The exceptions exist to balance public policy issues. The exceptions are narrow and will be so interpreted by the courts.

My advice is to avoid ad hoc conclusions and quick maneuvers. Rather, talk to the trustee, talk to debtor's attorney, and ask the court for relief. The time and expense of exercising caution is preferable to the risk to your client of violating the stay, which include sanctions, foiled business transactions, monetary costs and exasperation.

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SUPREME COURT ADOPTS “FORMULA APPROACH” TO CRAM DOWN RATE FOR UNDER-SECURED CREDITORS

By Hal Scoggins
Farleigh, Wada & Witt PC

Undersecured creditors have always been subject to cram down on their interest rate (*i.e.*, they are not guaranteed to receive their contract rate) in a chapter 13 plan. However, different courts across the country have applied different rules to determine the rate they must receive. On May 17, 2004, the U.S. Supreme Court issued a decision, *Till v. SCS Credit Corp.*, 124 SCt 1951 (2004), that dictates how courts determine what interest rate under-secured creditors will be paid in chapter 13 (and probably also chapter 11 and 12) bankruptcy cases.

The Bankruptcy Code says that a chapter 13 plan must pay an under-secured creditor the value of the property securing the claim, as of the effective date of the plan. 11 USC §1325(a)(5)(B). In other words, if a creditor has a \$15,000 loan secured by a \$10,000 car, the plan must provide the creditor payments with a net present value of \$10,000 as of the effective date of the plan. Since most plans specify monthly payments over a period of time, the plan must provide for interest on the allowed claim to compensate the creditor for the time value of money. The Code does not specify how the court should determine the appropriate interest rate.

In *Till*, the Supreme Court considered four alternatives: (1) a “formula rate” which begins with the prime rate and adds some amount to account for the higher risk associated with consumer debtors in bankruptcy; (2) a “forced loan” rate based on what the creditor would obtain if it sold the collateral and reinvested the proceeds in a loan of equivalent duration and risk to the debtor’s loan; (3) a rate based on the original contract rate as the presumptive market rate, with the opportunity for debtor, trustee, or creditor to rebut the presumption that the contract rate is correct; and (4) a “cost of funds” approach, asking how much it would cost the creditor to borrow the funds.

The Court settled on the first alternative. It held that courts should use the prime rate as the base rate and make appropriate adjustments for the risk associated with the loan in question. The Court expressly did not decide the scope of proper risk adjustments. However, the Court noted that the bankruptcy court below had approved an adjustment of 1.5%, and that other courts had generally approved adjustments of 1% to 3%. This is significantly lower than what creditors in many parts of the country expect. For example, the creditor in *Till* was seeking its 21% contract rate, and the Seventh Circuit had remanded to give the debtors an opportunity to rebut this presumptive 21% rate. *See* 124 SCt at 1957-58. The Ninth Circuit has long employed the formula approach, however. *See, e.g., In re Fowler*, 903 F2d 694 (9th Cir 1990); *In re Camino Real Landscape Maintenance Contractors Inc.*, 818 F2d 1503 (9th Cir 1987). The specific rate of adjustment has been left to individual bankruptcy courts to determine.

Here in Oregon, the presumptive rate for chapter 13 plans (if the plan does not specify otherwise) is currently 9% - which is prime plus 5 points. Using the adjustment factors cited in *Till* would make our current presumptive rate between 5% and 7%. Given the frequency of adjustments in the prime rate, one may question whether the presumptive rate in Oregon will change more frequently than it has in the past. On the other hand, if the debtor proposes a different rate in the plan, or creditors negotiate different rates for their claims, the presumptive rate is not particularly relevant.

There is some question whether *Till* will affect chapter 11 cases. The plurality opinion states that one of the major considerations in selecting the “formula” approach was that Congress intended for courts to follow essentially the same approach in all of the various provisions under the Bankruptcy Code requiring a stream of deferred payments to be discounted back to present value. 124 SCt 1958-59 & n.10. On the other hand, footnote 14 of the opinion indicates that because there is a contingent of lenders who will willingly provide financing for chapter 11 debtors, it might make sense to determine what rate “an efficient market would produce.” Nevertheless, given other language in the opinion about uniformity of interpretation and application, it is likely that the formula approach will now become the nationwide standard in chapter 11 and 12 cases as well as chapter 13 cases.

YOUNG LAWYERS TRUSTEE PRESENTATION

By Ronald R. Sticka, John H. Mitchell and
Thomas M. Renn

The Debtor-Creditor Section Young Lawyers Group asked us to speak to them about issues we see as trustees. We compiled a list of the top three tips for attorneys and the top ten issues to watch. We created these lists for the presentation and they should not be interpreted as any sort of trustee policy.

TIPS FOR ATTORNEYS:

1. Disclosure. Answer all questions; amend schedules if necessary. Be thorough with your client; don't assume facts or testify for the debtor.
2. Preparation. Anticipate issues; bring issues to 341 meeting. Prepare clients; make sure client reads and understands the petition and schedules.
3. Document. Confirm information; provide in advance, at meeting.

TOP TEN ISSUES TO WATCH:

1. Accurate and quality information in schedules is the biggest issue.
2. Obvious omissions may indicate the petition was not read before it was signed. Answer all questions asked in schedules and statement of financial affairs; read, don't assume.
3. Avoid using "unknown" rather than listing actual value or amount; do not intentionally omit any creditors or assets.
4. Avoid incorrect or overstated exemptions (now found in ORS ch. 18).
5. Be sure to provide requested documents or other information.
6. Use fair market value, not some deceptive value, for assets.
7. Actions at §341 meeting of creditors: advise client to dress appropriately and keep children under control. The meeting is recorded: note attorney appearance, have debtors speak clearly, watch for errors with name or SSN, bring photo ID and SSN verification.
8. List all income from every source for all three years. Don't forget contracts - leases, rental property, details of terms.
9. Notify the trustee immediately after filing of any assets needing immediate attention.
10. Advise debtors of adverse consequences of spending tax refunds or inheritance, or selling property without authorization.

NINTH CIRCUIT CASE NOTES

By Ashley S. Hohimer
Miller Nash LLP

363 SALE NOT AUTHORIZED UNTIL PROPERTY OWNERSHIP DETERMINED

In re Rodeo Canon Development Corporation,
362 F3d 603 (9th Cir 2004)

The debtor held legal title to real property located in Beverly Hills, California. After acquiring the property, the debtor entered into various loan agreements, securing the indebtedness with deeds of trust on the property. When the debtor defaulted on the loans, the lenders sought to foreclose and the debtor filed for bankruptcy.

Once in bankruptcy, the ownership of the property came into dispute. Although the debtor unquestionably held legal title, its partner claimed that the property was purchased with partnership funds, thus making the partnership the equitable owner. Because loan obligations were incurred without partnership consent, the partner argued that the liens against the property were invalid.

An adversary proceeding was brought to resolve the ownership issue, but before a decision was rendered, the trustee moved to sell the property free and clear of all liens pursuant to 11 USC §363. The trustee proposed that any interest found to be held by the partner would attach to the sale proceeds pending resolution of the adversary proceeding over ownership. The bankruptcy court authorized the §363 sale, the sale was conducted, and 50 percent of the proceeds were held in trust pending conclusion of the adversary proceeding.

The partner appealed and the BAP reversed, basing its holding on the fact that the sale did not provide the partner with adequate protection under §363(e). The Ninth Circuit affirmed on a different basis, finding that §363 required the court to determine whether the debtor in fact owned the property **before** authorizing its sale. Finding that the bankruptcy court prematurely concluded that the property was "property of the estate," the Ninth Circuit held that the sale was not authorized by law. The case was remanded with an order to disgorge funds the debtor received from the sale.

EMOTIONAL-DISTRESS DAMAGES NOT RECOVERABLE FOR VIOLATIONS OF STAY
In re Dawson, 367 F3d 1174 (9th Cir 2004)

The Ninth Circuit has held that the Bankruptcy Code does not allow recovery of emotional-distress damages caused by a creditor's willful violation of the automatic stay. In rejecting the chapter 13 debtors' argument that emotional distress damages are a type of "actual damages" available under §362(h), the court first noted that the statutory language suggests that "actual damages" were meant to redress financial injury. The court was further persuaded by the fact that various other federal statutes used the term "actual damages" to mean some form of economic loss. Adopting the reasoning of the Seventh Circuit, the court noted that the automatic stay is in place primarily for the financial protection of the unsecured creditors - not as protection for a debtor's "peace of mind." Although the court recognized that severe emotional distress could result from a stay violation, it held that §362(h) was not intended to duplicate tort remedies already existing under state law.

REASONABLY EQUIVALENT VALUE AND THE INDIRECT BENEFIT RULE
In re Northern Merchandise, Inc.,
371 F3d 1056 (9th Cir 2004)

Before filing chapter 7, the corporate debtor tried to get its lender to provide additional financing. Because of the debtor's poor financial performance, the lender refused to directly supply the debtor with working capital. The lender agreed, however, to loan funds to the debtor's shareholders. Although the loan transaction was evidenced by a note from the shareholders, the proceeds of the loan were deposited directly into the debtor's checking account. The same day the loan was executed, the debtor granted the lender a security interest. Once the debtor was in bankruptcy, the trustee brought a fraudulent transfer action against the lender, arguing that the debtor did not receive "reasonably equivalent value" in exchange for the security interest. Both the bankruptcy court and the BAP agreed with the trustee.

The Ninth Circuit reversed, refusing to accept that the funds received by the debtor were simply capital contributions made by the shareholders. The court held that "reasonably equivalent value" under §548(a)(1) can come from a party other than the recipient of the allegedly fraudulent transfer. Because the debtor benefited from the loan, and because all parties acted in good faith, the court found that the lender was protected under §548(c).

DON'T LET GO UNTIL THE CHECK CLEARS
In re JWJ Contracting Co., Inc.,
371 F3d 1079 (9th Cir 2004)

The debtor was hired by the city to improve an airport runway, and the debtor subcontracted with the creditor to supply and install steel reinforcing bars for the job. As required by state law, the debtor posted a bond to guarantee completion of the project and payment of all subcontractors. The debtor paid the creditor for its work with a single check, at which time the creditor immediately issued an unconditional release of its interest in the debtor's bond. The check was ultimately dishonored due to insufficient funds, and the creditor demanded that the debtor remit a cashier's check for the amount due. When the debtor filed for bankruptcy, the trustee initiated a preference action to recover the payment made to the creditor with the cashier's check.

The bankruptcy court rejected the trustee's claim and held that the cashier's check (which replaced the NSF check) was a contemporaneous exchange for new value in the form of the creditor's earlier release of its bond claim. The BAP reversed, and the Ninth Circuit affirmed the BAP's holding. Because the creditor gave an unconditional release of the bond claim in exchange for what turned out to be an NSF check, the replacement cashier's check was given in exchange for what was actually an unsecured debt.

CREDITOR DOESN'T NEED TO
CONTRIBUTE MONEY TO MAKE A
SUBSTANTIAL CONTRIBUTION

In re Cellular 101, Inc., 377 F3d 1092 (9th Cir 2004)

The chapter 11 administrative claimant was an authorized dealer of AT&T services. The debtor operated as a subdealer and was an agent of the claimant. Unhappy with the business practices of both the claimant and the debtor, AT&T threatened to terminate the dealership contract. The claimant's principal avoided the unfavorable outcome by agreeing to sell to AT&T all his stock in claimant. The principal entered into the sale despite the fact that the debtor had a right of first refusal. To prevent the sale from closing without its consent, the debtor filed for chapter 11.

Once in bankruptcy, the debtor made no effort to reorganize. Ultimately, over the debtor's objection, the court confirmed the plan of reorganization proposed by the claimant and AT&T, whereby the claimant's principal would sell the majority of his stock to AT&T and part of the proceeds would go to the debtor. Over the debtor's objection, the bankruptcy court also approved both the claimant's and the principal's request for an administrative expense for attorney fees and costs. The debtor appealed, and both the district court and the Ninth Circuit affirmed.

To recover on a §503(b) administrative claim, a claimant must be a creditor of the estate and have made a "substantial contribution" to the bankruptcy plan. The debtor disputed that the principal was a creditor, but the court found that because the principal had filed a joint proof of claim with the claimant, he was a creditor (albeit a creditor with a disputed right to payment) under §101(5). The debtor also argued that the claimant did not make a substantial contribution to the reorganization because only the principal contributed funds to the plan. But the court disagreed, holding that a creditor can substantially contribute to a bankruptcy plan without providing the funds used in the reorganization. Here both the claimant and its principal had contributed substantially to the reorganization.

NO DEPOSIT, NO LEASE, NO POSSESSION

In re Casserino, 379 F3d 1069 (9th Cir 2004)

When the debtor filed chapter 7, he was living in an apartment complex with a month-to-month lease. Before the debtor took occupancy, the landlord had required prepayment of the last month's rent (\$750) and a refundable security deposit (\$400). After the bankruptcy was commenced, the trustee demanded that the landlord remit the debtor's deposit and prepaid rent to the estate. The debtor claimed that the prepaid rent and security deposit were exempt pursuant to Oregon law.

The bankruptcy court held that the prepaid rent and deposit were exempt, because Oregon law provides that "a homestead may be claimed in any interest in property that carries with it the right to possession." And as rights attendant to the leasehold, the deposit and prepaid rent were subject to the exemption. On appeal, the trustee argued that the debtor, as a lessee, was not an "owner" under the Oregon statute and thus was not entitled to the exemption. Both the BAP and Ninth Circuit rejected the argument.

In its opinion, the Ninth Circuit noted that while Oregon courts had never specifically ruled on whether a residential leasehold qualifies as a homestead, Oregon courts had consistently held that the homestead exemption should be liberally construed. Because the security deposit and the prepaid rent were required for the debtor to be entitled to take possession of the property, they could not be detached from the rest of the exemptible leasehold interest.

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BAP CASE NOTES

By Douglas Pahl
Perkins Coie LLP

CLAIMS TRADERS NOT REQUIRED TO
DISCLOSE AMOUNT PAID
In re Burnett, 306 BR 313 (9th Cir BAP 2004)

In their chapter 13 case, the debtors included in their schedules debts owed to Home Depot, JC Penney and Ethan Allan. Resurgent Capital Services (“Resurgent”) acquired these accounts and filed proofs of claim. The debtors objected, requesting that the claims be disallowed unless Resurgent provided proof of the transfer and disclosed the amounts it paid for the accounts. Resurgent provided proof of the transfer but failed to disclose the consideration it had paid for the accounts. The Bankruptcy Court sustained the debtors’ objections to the claims.

The BAP reversed. It reviewed Bankruptcy Rule 3001(e), which addresses transferred claims, and contrasted those portions of the Rule that require disclosure of the terms of a transfer and those that do not. Rules 3001(e)(1) and (e)(2) relate to transfers of claims other than for security and do not require that the terms of the transfer be disclosed. Rules 3001(e)(3) and (e)(4), by contrast, relate to transfers for security and expressly require a transferee to disclose the terms of its transfer. The BAP delved into the history behind these provisions, examining the claims trading evils sought to be exposed by requiring disclosure. The BAP pointed out that Rules 3001(e)(1) and (e)(2) were amended in 1991 to remove the requirement that consideration be disclosed.

The BAP concluded that, pursuant to Rules 3001(e)(1), the amount paid to purchase claims is not relevant to the question of whether the claims should be allowed.

In dissent, Judge Ryan focused on the procedural aspects of the Bankruptcy Court’s decision. Judge Ryan concluded that Resurgent’s failure to timely provide proof of the assignments, information legitimately requested by the debtors, provided sufficient grounds for the Bankruptcy Court to sustain the objection. The Bankruptcy Court’s subsequent refusal to allow Resurgent to remedy these failures was not, Judge Ryan argued, an abuse of discretion.

NONDISCHARGEABILITY – ONCE IS ENOUGH
In re Garcia, 313 BR 307 (9th Cir BAP 2004)

The debtors sought chapter 7 relief twice, once in 1993 in California and again in 2002 in Nevada. In the 1993 case, a creditor, the Bankruptcy Recovery Network (“BNR”), filed a complaint seeking a determination that its claim was nondischargeable under 11 USC §523(a)(2). The Bankruptcy Court for the Southern District of California entered a money judgment against the debtor by default. The judgment did not expressly state that the amount was nondischargeable.

In 2002, the debtors again sought chapter 7 relief, this time before the Bankruptcy Court for the District of Nevada. Again, BNR filed a complaint seeking a nondischargeability determination pursuant to §523(a)(2), as well as §523(a)(10), which prohibits discharge of obligations that were or could have been scheduled in a prior bankruptcy case in which the debtor waived or was denied discharge. BNR also argued that relitigation of the dischargeability question was precluded by *res judicata*.

The Nevada court rejected each of BNR’s arguments. The court concluded that, because the question of dischargeability was not actually litigated in the California court, and because the question of dischargeability was not specified in the final judgment rendered by the California court, claim preclusion was not an impediment to reviewing the merits under §523. After a trial on the merits, the court concluded the debt was dischargeable.

The BAP reversed. Claim preclusion will bar relitigation when: (1) the parties are identical or are in privity, (2) a court of competent jurisdiction rendered the earlier judgment, (3) the judgment was final and on the merits, and (4) both suits involved the same claim or cause of action.

The question on appeal was whether the Nevada court should have found that the third element of claim preclusion had been satisfied. The BAP ruled that the court should have concluded that the judgment was final and on the merits of the question of dischargeability because default judgments are “final judgments on the merits” under Ninth Circuit precedent. Thus all the elements of claim preclusion were satisfied.

The BAP also noted that the doctrines of merger and bar, which form parts of claim preclusion, prevented the debtors from revisiting the question of dischargeability. Under the merger doctrine, all claims pled by BNR were merged into the California judgment and the debtors were barred from asserting defenses that should have been raised in the earlier proceeding.

The BAP held that even if the default judgment had been issued in error, the Nevada bankruptcy court should have honored it.

LOCAL BANKRUPTCY COURT CASE NOTE

By Ashley S. Hohimer
Miller Nash LLP

ARBITRATION AWARD GIVEN
PRECLUSIVE EFFECT
In re Rosendahl, 307 BR 199
(Bankr D Or 2004)

The debtor, a footwear company employee, was sued by his employer in California state court for fraud, conversion, and breach of fiduciary duty. The case went to arbitration, and after the arbitrator issued an interim award in favor of the employer, the debtor filed chapter 7. The bankruptcy court granted the employer relief from stay to continue with the arbitration, and a final award was issued against the debtor.

The employer moved to except its claim from discharge pursuant to §523(a) of the Code, maintaining that the claim arose from the debtor's willful and malicious conduct. The employer argued that the findings of the arbitrator in the final award supported the exception claim, and that the findings should be treated as final and given full faith and credit for issue preclusion purposes. The bankruptcy court acknowledged that issue preclusion principles apply in exception-to-discharge proceedings. Because the arbitration was conducted as an adversarial proceeding, all parties were represented by counsel, all witnesses testified under oath and were subject to cross examination, and each party had an opportunity to submit evidence. The bankruptcy court held that the §523(a) issues were already litigated. Thus, the arbitrator's decision had preclusive effect.

STATE COURT CASE NOTES

By Heather E. Harriman and Aaron M. Wigod
Greene & Markley PC

SUPREME COURT

NO ATTORNEY FEES FOR SUCCESSFULLY
DEFENDING A BAR COMPLAINT
*Kovac v. Crooked River Ranch Club and
Maintenance Assoc.*, 337 Or 162, 93 P3d 69 (2004)

Kovac sued Crooked River Ranch and Crooked River Ranch prevailed at summary judgment. Kovac appealed and, while the appeal was pending, filed two complaints with the Oregon State Bar against Crooked River Ranch's counsel. Crooked River Ranch ultimately prevailed on the appeal and the OSB took no action on the bar complaints. Crooked River Ranch petitioned for its attorney fees. Of the fees the trial court awarded, over \$1,000 was incurred by Crooked River Ranch's counsel in responding to the bar complaints. The court of appeals modified the award, holding that ORS 9.537, which provides immunity to persons who file bar complaints, prohibits even the award of attorney fees in responding to a bar complaint.

COURT OF APPEALS

FILL IN THE BLANK OR IT'S AMBIGUOUS
Western Surety Co. v. FDS Diving Constr. and Salvage
193 Or App 1, 88 P3d 293 (2004)

In the release provision of a contract, the parties released all claims arising out of the parties' relationship "other than any such claims specifically expected [sic] If 'none' so state:" - with several blank lines provided. The parties did not insert "none" into the blank lines and did not specifically identify any exceptions to the broad release. The matter came before the court on summary judgment, which the trial court granted. The court of appeals concluded that the release provision was ambiguous because it was unclear whether the parties meant that there were no exceptions and simply forgot to fill in the word "none," or the parties understood that there were exceptions to the release language but failed to identify what exceptions were intended. Because of the ambiguity, the issue could not be decided on summary judgment.

DECISION ADHERED TO
Burden v. Copco Refrigeration, Inc.
 193 Or App 476, 89 P3d 1286 (2004).

This case, summarized in the last issue (decision at 192 Or App 378, 86 P3d 59 (2004)), recently came up for reconsideration. On reconsideration, the court adhered to its previous ruling but added, in response to the plaintiff's argument that ORCP 7 provides a presumption of adequate service regardless of evidentiary preclusions: "There can be no presumption of adequate service if there is not first competent evidence that service occurred in accordance with ORCP 7."

INSURER'S ABILITY TO SEEK
 DAMAGES FROM TENANT
Koch v. Spann, 193 Or App 608, 92 P3d 146 (2004).

Landlord's insurer, by way of subrogation, sued tenant for negligently causing the fire damage that the insurer was covering. Tenant relied on two Oregon cases which recognized a complete defense to either a direct action or a subrogation claim based on a landlord's contractual obligation to maintain fire insurance. The trial court granted summary judgment against the insurer on its subrogation reversed claim.

The court of appeals reversed. It noted that the cases supporting defendant's position involved lease agreements specifically obligating the landlord to maintain fire insurance. Thus, if the landlord (or insurer by way of subrogation) were allowed to pursue the tenant for damage to the premises caused by fire, it would deprive the tenant of that which the tenant had bargained for: insurance against liability for its own negligence. In this case, however, the tenant and landlord had not even addressed which party would maintain fire insurance. Therefore, the insurer's pursuit of damages from the tenant based upon the tenant's negligence did not deprive tenant of anything for which he had bargained.

PREJUDGMENT INTEREST
Jones v. Dorsey, 193 Or App 688, 91 P3d 762 (2004)

Defendant appealed a judgment for partnership accounting and related claims arising out of the breakup of a partnership. The trial court had held that defendant terminated the partnership and owed plaintiff an accounting; the court also awarded prejudgment interest to plaintiff. On appeal, defendant argued that a prejudgment interest award was impermissible because the value of the business was neither "ascertained nor ascertainable by simple computation" - a standard supported by Oregon case law.

The court of appeals disagreed. It held that although the amount owed may not be ascertainable without resolving complex issues of fact, it is not a bar to a determination that the defendant owed sums certain at a date certain. In this case, the plaintiff proved that defendant had breached his fiduciary duties owed to his business partner, kept inadequate records of business activity, and excluded plaintiff from the business. The court ruled that a prejudgment interest award is particularly appropriate where, as in this case, the difficulty in ascertaining the amount owed is attributable to the defendant's misconduct.

EXPERT WITNESS FEES ARE NOT
 "COSTS [OR] DISBURSEMENTS"
In re Marriage of Taylor,
 193 Or App 694, 92 P3d 124 (2004)

A premarital agreement prohibited an award of "attorney fees" or "costs and disbursements." The court of appeals considered whether expert witness fees are considered "costs and disbursements." Relying on ORCP 68A(2), which defines "costs and disbursements" as "reasonable and necessary expenses incurred in the prosecution or defense of an action other than for legal services, the fees of officers and witnesses," the court ruled that a fee for the services of an expert witness is not a cost or disbursement within the meaning of ORCP 68.

JUROR MISCONDUCT: WHAT WARRANTS A MISTRIAL?

Hill v. LaGrand Indus. Supply Co.,
193 Or App 730, 91 P3d 768 (2004).

In Oregon, jury misconduct warrants a mistrial only if the misconduct amounts to a criminal obstruction of justice such as fraud, bribery, or forcible coercion. Here the acts alleged to be “forcible coercion,” *i.e.*, verbal assaults, intimidation, verbal harassment, and threats, did not constitute intentional obstruction, impairment, or hindering of “the jury’s function by means of placing a juror in fear by threatening to commit a crime that affected the juror in some fashion.”

In reaching its conclusion, the court found instructive the definition of “obstructing governmental or judicial administration” in ORS 162.235, which provides that obstruction occurs “if the person intentionally obstructs, impairs or hinders the administration of law or other governmental or judicial function by means of intimidation, force, physical or economic interference or obstacle.” The court also relied upon the definition of “intimidation” found in Oregon case law: “intentionally placing another in fear by threats to commit a crime.”

BREACH OF CONTRACT OR TORT?

Archambault v. Ogier,
194 Or App 361, 95 P3d 257 (2004)

Plaintiffs purchased property from defendants and sued defendants for breach of contract nearly six years later when plaintiffs discovered defects in the property. Defendants argued that plaintiffs’ action was really for misrepresentation, which is subject to a two-year statute of limitations. Plaintiffs claimed that they purchased the property under a contract consisting of the earnest money agreement and the disclosure statement and that defendants breached that contract by delivering property that did not conform to the descriptions and representations contained in the contract. On summary judgment, the trial court concluded that plaintiffs’ action was actually one in tort and dismissed it as barred by the two-year limitations period.

The court of appeals reversed, concluding that plaintiffs’ claim was a contract action and thus not time barred. First, the court discounted plaintiffs’ claims based upon the disclosure statement because, according to the terms of the earnest money agreement, plaintiffs had waived the right to rely upon the disclosure statement. Then the court considered whether the claims

based upon the earnest money agreement alone were contractual in nature. The earnest money agreement specifically stated that defendants would deliver the property that was connected to a septic tank and a working well and that the appliances, heating and plumbing systems were in “good working order.” Because plaintiffs’ claim was based upon defendants’ failure to deliver the property in the condition represented in the earnest money agreement, plaintiffs’ claim sounded in contract, not tort. The court also held that the specific promises made in the earnest money agreement were not “merged” into (and extinguished by) the deed.

BUT THE TRUSTEE KNEW ABOUT IT! WHY ISN'T IT MINE?!

Vucak v. City of Portland,
194 Or App 564, 96 P3d 362 (2004).

As we all know, assets that are not properly “scheduled” in a chapter 7 debtor’s bankruptcy schedules are not abandoned to the debtor when the debtor receives his or her chapter 7 discharge. 11 USC §521(1); *Hamilton v. State Farm Fire & Cas. Co.*, 270 F3d 778, 784 (9th Cir 2001). Here, the question was whether the trustee’s actual knowledge of an unscheduled asset, and his admitted intent to abandon the asset, are sufficient to cause the property to be abandoned to the debtor upon discharge.

Plaintiff sustained injury in an automobile collision in 2000. In 2001, plaintiff filed for protection under chapter 7. Plaintiff did not list her claim for personal injury damages as an asset on Schedule B of her Schedules. Plaintiff did disclose, on Schedule I, that she was receiving disability benefits relating to personal injury. The chapter 7 trustee submitted an affidavit stating that he believed “that the petition and schedules filed by [plaintiff] adequately disclosed the existence of her personal injury claim,” and that he concluded the claim would be burdensome to administer and of little value to the estate. The trustee informed the court of his intent to abandon the personal injury claim to plaintiff without notice to creditors (by “operation of law”). Citing the “overwhelming majority of federal courts that have addressed the issue,” the court of appeals held that the trustee’s knowledge of plaintiff’s personal injury claim was irrelevant. If the asset is not properly scheduled, it does not become the debtor’s property upon discharge, regardless of the trustee’s actual intent to abandon the property.

“OOPS, I FORGOT HOW TO RECOVER MY
ATTORNEY FEES”

Forsi v. Hildahl, 194 Or App 648, 96 P3d 852 (2004).

On the day of trial, plaintiff sought to amend her complaint to reduce her prayer for damages from over \$27,000 to \$5,500 in order to enable her to claim attorney fees under ORS 20.080. The trial court permitted the amendment, the jury returned a verdict in plaintiff's favor for \$5,500, and the court awarded plaintiff her attorney fees.

The court of appeals affirmed. Courts have “ample discretionary authority to allow amendments, provided the proffered amendment does not substantially change the cause of action or interject an entire new element of damage.” In this case, plaintiff's amendment did not interject a new claim in the litigation, did not alter an element of any existing claim, and defendant's “sudden exposure to attorney fees” did not amount to prejudice. The court additionally noted that prejudice does not exist if the defendant's potential exposure is greatly reduced, as it was here.

You Too Can Be An Author

If you would like to write an article, or would like to read an article on a particular topic, please contact:

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CONSUMER BANKRUPTCY COMMITTEE

By Amanda Bailey
VandenBos & Chapman, LLP

MAY 20, 2004 MEETING

Wayne Godare, chapter 13 trustee's attorney, introduced Brian Lynch, the new chapter 13 trustee. Mr. Godare passed out checklists for requesting a payoff and an escrow payoff, and requested that these forms be used.

Brian Lynch, chapter 13 trustee, announced that his office no longer is requesting quarterly exhibit D-2s be sent to his office, unless the Order Confirming Plan says otherwise. Mr. Lynch emphasized that all wage orders submitted should have his name as the payee, instead of Mr. Yarnall.

All chapter 13 plan payments should be sent to a post office box; they are no longer accepted at the trustee's office or by hand-delivery at confirmation hearings. Proof of the payment can be brought to the confirmation hearing by the attorney.

Jeffrey Werstler of the IRS suggested practitioners contact the practitioners' hotline to expedite transcript requests. Attorneys should have a Power of Attorney (POA) on file with the IRS; if you do not, the agent will hold while you fax the POA at the time of your phone call. If you make the request via fax and a POA is not on file, the request will be kicked over to a default system and it will take approximately 30 days.

The IRS now receives electronic notices from courts using electronic noticing systems. Chapter 7 cases will be handled in Philadelphia. Chapter 13 cases with simple proofs of claim will be farmed out at some point. Proofs of claim that are complicated or have sticky issues will be handled locally by Mr. Werstler. Chapter 11 cases will stay local.

The IRS still wants to receive quarterly exhibit D-2s if the Order Confirming Plan provides for them. Mr. Werstler's office hours are 6:00 am to 2:45 pm and his phone number is 503-326-3292. If any of the local numbers sends you to voicemail and states the person is gone, you can call the general line at 503-326-3214.

Susan Egnor, attorney for the State of Oregon, announced the court has added a provision to the wage order which authorizes continued payment for support obligations. This can be used in lieu of a stipulated order for relief which the State sends to debtors' attorneys. Any questions on child support should be directed to Randy Burkell at 503-986-6140.

The court will be doing a BETA test on motions for relief with Jason Wilson-Aguilar and Tom Hooper. The creditor will serve the documents on debtors and debtors' attorneys, but will not file them with the court. Debtors will respond on the same document and file the response with the court.

Judge Brown stated that she will no longer add to the Order for Relief an exhibit stating there is no evidence of assignment. Debtors' attorneys must check for evidence of assignment from one secured creditor to another.

AUGUST 19, 2004 MEETING

Judge Perris announced that Raema Manning has retired and Juliette Kasner is a new law clerk in Judge Perris's chambers.

Judge Brown asked that when drafting a default order for relief from stay, you start fresh on a blank form each time. She has seen attorneys copy from a previously used order and include terms not applicable to the new order.

Wayne Godare announced the much-anticipated DANCE (a periodic training session for Chapter 13 debtors' counsel) has been scheduled and flyers have been sent out. Mr. Godare recommends contacting his office immediately to sign up as only 40 people are allowed per session. Mr. Godare advised as a practice tip to bring a new feasibility analysis to the confirmation hearing when modifying plan provisions.

Mr. Godare also advised that the new wage order has the lock box address in Tennessee and asked attorneys to start using this new form immediately. There is a four to five day turnaround before plan payments show up on the trustee's website. If an attorney appears at the confirmation hearing with a copy of a payment sent by the attorney, Mr. Godare will treat the payment as having been made. If a debtor shows up with a copy of the payment, Mr. Godare will require proof that the payment has been received.

Mr. Godare reminded practitioners to use chapter 18 of the ORS for exemptions. The trustee will start objecting to the use of the old exemptions in chapter 23.

Due to the increase in chapter 13 filings, 341s will now be held on Mondays in addition to Tuesdays. Any 341s that do not fit on the Tuesday calendar will be placed on the afternoon calendar for the preceding Monday.

The trustee's office asks practitioners to submit materials for confirmation hearings earlier than the day before the hearing. Cases will be set over if the materials are not received in time to be reviewed and processed by the trustee's office.

Dan Rosenhouse, attorney for the State of Oregon, encourages practitioners to submit wage orders and stipulations regarding child support as soon as possible after a case is filed.

Todd Trierweiler reported that electronic filing of chapter 7s and chapter 13s has been successful. When cases are electronically filed, the case number and trustee are provided immediately. For an emergency case, the short form gets filed electronically but the deficiency is filed in paper form. Original signatures on the petition and schedules must be kept for 10 years. Mr. Trierweiler's firm uses the "Best Case" program for petition preparation. Best Case has a function for ordering a credit report; creditors appearing on the report are automatically added to the schedules and matrix. The cost is \$40 per credit report. EZ-Filing has a similar option.

November 1 is the deadline for mandatory electronic filing in Washington.

There has been a large number of emergency filings. The clerk's office is trying to accommodate them but there is no guarantee the filings will be completed before the date requested. Judge Perris reminded practitioners to state the deadline and why the emergency filing is needed.

The Consumer Bankruptcy Subcommittee usually meets every other month on the third Thursday of the month at 4:30pm in the 8th floor conference room at the United States Bankruptcy Court in Portland. However, the next meeting will be on the second Thursday in December (the 9th) at 4:30 pm. All bankruptcy practitioners are encouraged to attend. Please contact Ian Wallace at 503-253-7777 to add topics to the agenda or for further information.

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