

Newsletter

Volume XXVII, Number 1 Debtor-Creditor Section, Oregon State Bar Winter 2008

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COMMENTS FROM THE CHAIR

By Teresa H. Pearson

Miller Nash LLP

As I write this in late January, it looks like the practice of law will become busier for debtor-creditor lawyers in 2008. The subprime lending crisis and housing bubble are hitting the markets hard. The Federal Reserve just made a surprise cut in interest rates, and Congress and the President are discussing an economic stimulus package, all in efforts to stave off a recession. In the meantime, candidates for president are all pitching their own proposals to bring back prosperity.

As we start having more to do and less time to do it in, it helps to remember one big thing that make the practice of law easier – good relationships with your fellow lawyers and opposing counsel. Those relationships sometimes develop through working on the same cases, but often they develop when we work together for common goals. Participation in section activities is a great way to make and deepen friendships with your fellow debtor-creditor lawyers. A number of events coming up this year will give you this opportunity:

- Saturday Session, February 23, 2008, at the Salem Conference Center,
- Northwest Bankruptcy Institute, April 18-19, in Seattle, and

- the Section's Annual Meeting, September 19-20, in Salishan.

The Saturday Session this year will discuss two topics of practical importance to many of us – revisions to the local bankruptcy rules, and the potential unbundling of legal services for debtor's counsel.

We also have a number of very active committees working to accomplish important goals. We've got some great volunteers working with these committees, and I encourage you to get to know them better by becoming involved in those areas that are personally interesting to you. I want to take this opportunity to bring your attention to some of these activities:

- CARE. This program educates high school kids on basic credit matters. Debtor-creditor lawyers go into high schools, and spend a couple of hours teaching kids the basics of credit cards, car loans, and student loans. The time commitment is easily manageable, you already know the material you need to know, and it's a great chance to do some good for your community. We'd especially like to expand the CARE program into some of the rural areas of Oregon, so if you are outside the Portland or Eugene metro areas, we encourage you to

Continued next page

participate. Contact: Laura Walker, 503-224-3092, lwalker@chbh.com.

■ **Consumer Bankruptcy Committee.** This committee brings together debtors' counsel, creditors' counsel, members of the US Trustee's office, the chapter 13 trustee, the judges, and others to discuss consumer bankruptcy law issues, problems and fixes. Contact: Laura Donaldson, 503-241-4869, laura@vbcattorneys.com.

■ **Legislative Committee.** Although the state legislature is not in session this year, the legislative committee has already started gathering information and preparing bills for the next legislative session. If you think there is a debtor-creditor law that needs to be changed, or are just interested in how legislation is made, this might be the committee for you! Contact: David Hercher, 503-205-2628, dave.hercher@millernash.com.

■ **Public Education.** We are moving forward to provide education to potential consumer debtors that, after BAPCPA, bankruptcy is still an option. The committee is working on radio spots and brochures to provide the public with basic, understandable information and directions to resources. Hon. Albert E. Radcliffe, 541-465-6802, albert_radcliffe@orb.uscourts.gov.

■ **Pro Bono.** This committee has long been active in providing legal services in the debtor-creditor area to low income Oregonians. Contact: Valerie Tomasi, 503-228-6044, vtomasi@farleighwitt.com.

■ **New Lawyer Committee.** Last, but not least, this committee presents three programs a year geared toward helping newer lawyers learn the ropes. It is a great way to start developing a network, and provides more experienced lawyers a chance to lend a hand. Watch for

email announcements of upcoming meetings! Contacts: Aaron Varhola (Portland), 503-546-7913, avarhola@integraonline.com; Natalie Scott (Eugene), 541-868-8005, nscott@mb-law office.com.

We have several other informational resources available to support Oregon's debtor-creditor lawyers. You already know about this Newsletter, because you are reading it. What you may not know is that the section has a terrific website, which has been recently updated to provide new and better information and links useful to Oregon lawyers. I encourage you to take a minute to check it out.

By working together to improve the practice of law in Oregon, we also get to know one another better. That makes it so much easier to talk when our clients are at loggerheads, and we need to find a way to get the daily legal work done right with minimal hassle and cost. More importantly, it makes the practice of law more enjoyable.

If you want to know more about any of these great opportunities, feel free to contact me, or check out the section's newly-remodeled website at <http://osb-dc.org>. We are looking forward to a great year in 2008!

SECTION WEBSITE

The Debtor-Creditor Section website, <http://osb-dc.org>, is now accepting postings for job vacancies.

Debtor-Creditor Newsletter

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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.

STATE TAX WITHHOLDING FOR NONRESIDENT SELLERS: ORS 314.258

By Cleve Abbe

LandAmerica Lawyers Title

and Patrick Wade

Hershner Hunter LLP

Sellers of Oregon real property interests began facing a new tax withholding law on January 1, 2008. ORS 314.258 (2007 Oregon Laws, Ch. 864; House Bill 2592) requires that closing agents withhold prescribed amounts from the real property sales proceeds of certain nonresidents and remit the withholding amounts to the Oregon Department of Revenue (DOR).

Lawyers involved in both consensual and nonconsensual transfers of real property interests may find that they are either closing agents or sellers under the definitions of this statute and its associated administrative rule. They also should expect clients to seek advice about exemptions and other aspects of the statute and the rule.

Purpose and Approach

When a person, whether a resident or a nonresident, has gain on the sale of Oregon real property, the person is subject to state tax on that gain. According to DOR testimony for HB 2592, many nonresidents do not report gains of this nature and do not pay the applicable taxes. The statute is intended to capture missing taxes by compelling closing agents to withhold funds and remit those funds to DOR as tax payments. The statute (to oversimplify) requires the closing agent to obtain a timely certification that an exempt taxpayer is exempt. (Two exemptions that may be claimed frequently are the exemptions for an Oregon resident and for a company having a place of business in Oregon.) If the taxpayer does not provide the certification, the closing agent must withhold a portion of the sales proceeds and remit the withheld funds to DOR.

Because the statute, for the most part, requires either a certification ("affirmation") of exemption or withholding, it will require something from most sellers.

Administrative Rule and Forms

DOR has generated an administrative rule for the statute at OAR 150-314.258 and the following forms and instructions:

- Form 40-WE – Affirmation of Exemption from Withholding on an Oregon Real Property Conveyance.
- Form 40-CW – Transferor's Certificate of Oregon Withholding Amount.
- Combination Form: Form OR-18 – Report of Tax Withheld on Real Property Conveyances – **and** Form TPV – Payment of Tax Withheld for Nonresidents.
- Instructions: Withholding on Real Property Conveyances (with forms).

The DOR forms use the term "transferor" for the party affected by the withholding requirement. This article usually refers to the transferor as the seller.

Transactions Affected

The statute applies to more than just deeds for fee simple title. It may cover the transfer through escrow of virtually any interest in real property: a sale by land sale contract, a grant of easement, the transfer of the beneficial interest under a trust deed, the transfer of a leasehold estate, or even the transfer of corporate stock when the corporation owns real property and falls within a complex definition contained in the Internal Revenue Code.

The statute's broad reach arises from its definitions. The statute applies to the closing of "a conveyance of a real property interest." "Conveyance" is defined as "a sale, lease, encumbrance, mortgage or creation of a secured interest in real property." "Real property interest" is defined as "a United States real property interest, as defined in section 897(c) of the Internal Revenue Code, that is located in the State of Oregon."

Withholding Agents

The withholding obligations of the statute clearly apply to Oregon escrow agents that close the sales of Oregon real estate; however, the obligations extend to others as well. In the terminology of the statute, it applies to an "authorized agent," which "means an agent who is responsible for closing and settlement services in a conveyance of a real property interest." That may seem simple enough; however, "closing and settlement services" is another defined term. It means "services that are provided for the benefit of a transferor or a transferee in connection with a conveyance of a real property interest, and the receipt or disbursement of moneys in connection with a sale, lease, encumbrance, mortgage or deed of trust in or related to real prop-

erty.” Because this definition uses the phrase “in connection with,” DOR has construed the statute to have a broad reach. The rule states:

The term “authorized agent” includes but is not limited to an escrow agent, title company, real estate agent, broker, attorney, and a qualified intermediary (QI) under IRC section 1031.

Although the QI is an agent for this purpose, a QI is not an agent for purposes of IRC section 1031. See Treasury Regulation section 1.1031(k)-1(g)(8). An “authorized agent” does not include an employee of a transferee who merely makes payments to a transferor in connection with a conveyance.

OAR 150-314.258(1)(a).

Further comments on the term “qualified intermediary” appear below in the section on exchange companies.

Exemptions Not Requiring Certification

The statute by its terms applies only to natural persons and C corporations (a federal tax status). ORS 314.258(2)(b). Therefore, the rule places the following parties outside the scope of the statute:

- An estate.
- A trust.
- An S corporation.
- A general partnership.
- A limited partnership.
- A nonprofit corporation.
- A limited liability company that for purposes of US Treas Reg §301.7701-3 has not elected to be classified as an association taxable as a corporation and is not a disregarded entity the sole member of which is a transferor within the meaning of ORS 314.258(2)(b) [subsection (2)(b) of section (4), chapter 864, Oregon Laws 2007].
- An agency or instrumentality of the United States or the State of Oregon.
- A city, county or other municipal or public corporation.

OAR 150-314.258(2)(a)(B) and (C).

The statute prescribes no particular method for a closing agent to document that a seller falls in this first group of exempt, or unaffected, sellers. Nevertheless, it will be useful for a closing agent to document in its file when a seller is in this group. A closing agent should request a seller’s confirmation when the seller has this status. Confirmation will be

on a closing agent’s form, because DOR’s exemption form does not address these exemptions.

Exemptions Requiring Certification

Certain natural persons and C corporations are also exempt. They must claim the exemption with an affirmation form, under penalty of perjury, and must furnish the affirmation form to the closing agent in a timely manner. Failure to make an affirmation or failure to submit it timely results in withholding. Of this second group of exemptions, the ones that will apply most frequently are Oregon residency (for individuals) and doing business in Oregon (for C corporations). ORS 314.258(3)(a)(C)(i) and (ii).

Another exemption requiring certification is one for a transaction for \$100,000 or less. Other exemptions in this group require the advice of a tax professional, as they are based on the transfer being a nontaxable transaction under Oregon law. A seller who fails to obtain the required advice before closing could jeopardize eligibility for an exemption. The second group of exemptions is itemized in DOR Form 40-WE, discussed in more detail in the sidebar on “Closing Agent Procedures for ORS 314.258.”

Withholding Amount

The statute specifies the withholding amount as the least of (a) 4% of the consideration paid for the seller’s interest, (b) 4% of the net proceeds received by the seller, or (c) 10% of the gain includable in the seller’s taxable income. ORS 314.258(2)(a). Because (b) will always be less than (a), a more appropriate amount for (b) might have been **all** the net proceeds (the alternative used in Colorado’s similar statute). “Net proceeds” is defined by the rule as “the amount shown on the settlement statement (before reducing for withholding) related to the conveyance that is being disbursed to the seller, or any amount related to the conveyance that is disbursed to the seller.” OAR 150-314.258(3)(b). The (c) amount will depend on the seller’s basis and closing costs. DOR Form 40-CW is the means for calculating the withholding amount; however, if the seller fails to deliver the completed form to the closing agent in a timely manner, withholding will be 4% of the consideration or all of the net proceeds, if the latter is less.

Transfers of Interests Other Than Fee Simple Estates

When a title company acts as a licensed escrow agent, the title company is likely closing a sale in which the seller executes either a deed to the buyer or

a land sale contract (contract to convey). Note, however, that the statute reaches other kinds of transfers, which are less likely to be closed through title company escrows but could be handled by lawyers. In those circumstances, lawyers will need to be alert to the requirements of the statute. A lawyer's alignment with one side does not remove the lawyer from the statute's reach. With respect to affected transactions besides those involving deeds and contracts, the statute's definition of "conveyance" specifically includes a lease and the creation of a security interest. ORS 314.258(1)(c). The rule, in contrast, construes the statute to apply to the **transfer** of a security interest, not to its creation. OAR 150-314.258(1)(d).

Procedures for Compliance

The statute and rule necessitate a multi-step approach for compliance, including (1) distribution of information about the withholding requirement to the seller before the signing appointment; (2) determination of whether the transfer or the transferor is exempt (and, if exempt, whether the exemption requires taxpayer certification); (3) determination of the amount of withholding when no exemption applies; (4) transmittal of a copy of the exemption form to DOR when a claimed exemption so requires; and (5) remittance of withholding to DOR and mailing of the necessary forms when a seller is nonexempt. The steps apply separately to each seller in a transaction, including each member of a couple entitled to file a joint state tax return.

The sidebar describes in more detail the procedures that title companies and other closing agents may be expected to follow to comply with ORS 314.258 and OAR 150-314.258.

Advice of Tax Professional

As noted above, nontaxable transactions are exempt provided that the seller has professional advice to that effect. Specifically, the statute requires that the taxpayer have "professionally competent knowledge or advice" that the transaction is nontaxable under Oregon tax law. ORS 314.258(3)(a)(C)(iii). The rule provides some guidance on this phrase. It states:

"Professionally competent knowledge or advice" includes oral or written advice from a tax professional (i.e., public accountant, certified public accountant, licensed tax consultant, licensed tax preparer, enrolled agent, or attorney) regarding the conveyance in which that professional advises there likely will be

no recognition of gain in connection with the conveyance.

OAR 314.258(4)(c)(C).

Notwithstanding the reference to oral advice, when the seller claims an exemption based on nonrecognition of gain for a reason not among eight specifically itemized in Form 40-WE, the seller must provide something in writing to the closing agent as an attachment to the signed Form 40-WE. The writing does not require prior receipt or review by DOR. This "claimed exemption," the last of the nine on the form related to professional tax advice, is that the transferor "Has received advice from a tax professional that there is no tax estimated to be due because the conveyance is: . . . Fully exempt from the recognition of gain under ORS chapter 316, 317, or 318 as explained to the department in writing at the time the transaction is completed (attach explanation to this form)."

Exchange Companies

For delayed exchanges, the rule identifies an exchange company ("qualified intermediary" in the terminology of the rule) as an "authorized agent" subject to the statute's requirements. If the taxpayer (exchanger) receives some cash at closing from the relinquishment leg of an exchange, those funds will be subject to withholding absent another exemption. If the closing agent disburses exchange funds to the exchange company and the exchange subsequently fails, the funds held by the exchange company will be subject to withholding absent an exemption. If less than all of the exchange funds are used to complete the exchange and the exchanger receives the unused funds, they will be subject to withholding absent an exemption. The rule states:

Deferred exchanges. If a transferor enters into a like-kind exchange under IRC section 1031, withholding is not necessary at the time the transferor relinquishes the property to a Qualified Intermediary (QI) unless part of the proceeds from the sale are disbursed to the transferor. If the exchange later fails or the transferor receives from the QI any part of the proceeds from the sale, the QI is required to withhold on the proceeds disbursed to the transferor.

OAR 150-314.258(3)(g).

In an example, the rule calls for the exchange company to apply the consideration, net proceeds and gain figures from the closing to determine the amount to withhold. OAR 314.258(3)(h).

Impact on Lawyers

As mentioned above, a lawyer could have withholding obligations under the statute, if the lawyer is providing services to either the transferor or the transferee in connection with a real estate transaction and in connection with the receipt or disbursement of funds for that transaction. (See ORS 314.258(1)(a) and (b)). That is, if the lawyer handles funds of the seller, the withholding obligations may come into play.

Another area of lawyer involvement is advice to a seller about exemptions and withholding amounts. Many exemptions depend on professional advice. Notwithstanding the rule's allowance for oral advice, a lawyer responding to a seller's request for advice may wish to provide the advice in writing. For withholding based on the seller's gain, Form 40-CW permits an adjustment for partial nonrecognition of gain. The adjustment could apply, for example, in an installment sale. This is an area in which the seller may require professional advice to identify the reason for and amount of the adjustment.

Particular ambiguities, such as the following, merit consideration by lawyers involved in nonconsensual transfers:

1. Nonjudicial foreclosure sale. After a nonjudicial trust deed foreclosure sale, the trustee is the person who conveys the real property, being the holder of an equitable interest (power of sale) in the real property previously granted by the borrower.

- Is the trustee the "transferor" under statute and rule?
- If so, does the trustee execute the claim of exemption (Form 40-WE)?
- If not, is the borrower the transferor?
- What if title has changed and the original trust deed grantor is no longer the property owner? Who then is the transferor?
- If the trustee can determine who is the transferor, what is the trustee's duty regarding withholding? It is the rare foreclosure in which the borrower cooperates. If the borrower is the "transferor," then the trustee is unlikely to obtain a signed exemption form (Form 40-WE). If there is no claim of exemption from the borrower but there are excess proceeds payable to the borrower, is withholding required? The statute permits a claim of exemption when "[t]he transferee is acquiring the real property interest through foreclosure," but with no signed claim of exemption, withholding is required for a covered transaction.

- If withholding is required but there is no claim of exemption, the required withholding amount is 4% of the consideration (the foreclosure sale price?) or all of the net proceeds, if the latter is less.
- The rule provides that "any amount . . . disbursed to the seller" (before withholding) is net proceeds. Is a disbursement by the trustee to the borrower a disbursement to "the seller"?
- If the trustee withholds, can the trustee remit the funds when it has no taxpayer identification number for the borrower?
- The statute's definition of "closing and settlement services" requires "the receipt or disbursement of moneys." Does a trustee handle money only when receiving "cash" at the sale, or does a credit bid count as receipt of money? If cash is what counts, must a trustee fill out Form 40-CW for all cash sales, even when the net proceeds figure is zero?
- Should "consideration" include forgiveness of debt when the debt exceeds the foreclosure sale price?
- If a trustee is completing Form 40-CW, should the trustee show the higher of the debt or the sale price as the consideration amount, even though the net proceeds is zero?
- Must a trustee retain all Forms 40-CW with zero proceeds for six years, the same as those with amounts greater than zero?

2. Judicial foreclosure sale. After a judicial foreclosure or other real property execution sale, the sheriff is the person who conveys the real property pursuant to statute.

- Under the statute, is the sheriff the transferor, and is the transfer therefore exempt from withholding under the government exemption in OAR 150-314.258(2)(a)(C) and (5)(d)?
- Is there a chance that any portion of the proceeds of the sheriff sale could pass through the client trust account of the foreclosing creditor's lawyer?
- Does the lawyer have any obligation under the statute if such funds are disbursed to the debtor, comparable to those of a trust deed trustee after a nonjudicial foreclosure sale?

3. Deed in lieu of foreclosure. What is the threshold at which a creditor's lawyer should require, or debtor's lawyer approve, a signed claim of exemption (Form 40-WE) from the debtor in connection with a deed in lieu of foreclosure? The rule requires

withholding for a nonexempt transferor when there is “additional consideration” for the deed in lieu. If that “additional consideration” passes through the client trust account of the lawyer for the creditor or the debtor, the lawyer may be an “authorized agent” required to withhold, absent a claim of exemption.

4. Other default contexts. A land sale contract forfeiture or strict foreclosure could present challenges similar to those for a nonjudicial trust deed foreclosure or a judicial mortgage foreclosure. Even an FED judgment of restitution or a voluntary surrender of leased premises could involve transfers of “a real property interest” within the scope of the law. Whenever cash

enters into the circumstances and flows through a lawyer’s client trust account, the lawyer must consider the requirements of the statute and rule.

Improving the Statute

The Oregon Land Title Association, the title company trade association, and other interested parties may seek legislation in the upcoming session to correct and improve the statute. For example, two points of interest are narrowing the statute to affect only licensed escrow agents and to affect only deeds and land sale contracts for fee simple title. If the effort is successful, nonresident withholding will become simpler.

CLOSING AGENT PROCEDURES FOR ORS 314.258

1. Distribution of forms. The DOR forms call for advice of a tax professional in some instances and identification of figures from a seller’s property records in other instances. The seller should be advised of the withholding requirement **before** the signing appointment. DOR’s publication “Withholding on Real Property Conveyances” contains all four of the relevant DOR forms. It is currently posted on DOR’s website at <http://www.oregon.gov/DOR/PERTAX/formspit.shtml>. Click on 2008 Tax Year. The forms are designed to allow on-screen preparation. **NOTE:** Sellers exempt because they will remain Oregon residents or will maintain a place of business in Oregon need not review the complexities of other exemptions and the withholding formulas.

2. Exemptions not requiring certification. Some exemptions do not require certification by the taxpayer. ORS 314.258(2)(a)(B) and (C). The closing agent may exercise discretion in choosing how to confirm that one of these exemptions applies. When a seller does not claim one of these exemptions, the seller must turn to Step 3. **NOTE:** DOR regards sellers who fall within the next category as subject to the statute but able to elect exempt status through the certification described in Step 3.

3. Exemptions requiring certification. An exemption itemized in DOR Form 40-WE requires a seller’s affirmation under penalty of perjury that it applies. When there are two or more sellers, each must review the form and elect one or more applicable exemptions. Among the Form 40-WE exemptions are those for a sale of \$100,000 or less, for an individual who resides in Oregon, for a C corporation with a permanent place of business in Oregon, and for a tax-deferred exchange under IRC §1031 or §1033. Other exemptions in this group require advice from a tax professional. See OAR 150-314.258(4)(b)(C). When the seller claims an exemption through Form 40-WE, no further action is required for that seller; except that, for some sellers, the closing agent must send a copy of the signed Form 40-WE to DOR within 20 days of closing. See Step 5. The closing agent must keep all other certifications available for inspection by DOR. When a seller does not claim an exemption of this kind and is not exempt under Step 2, the seller must identify the withholding amount, Step 4. **NOTE:** A seller claiming an exemption based on professional advice of nontaxable transfer must obtain that advice **before** signing. Further, for Form 40-WE to apply, the seller must submit the signed form to the closing agent **before** any proceeds of the sale are disbursed.

4. Identification of withholding amount. When a seller claims no exemption, DOR Form 40-CW (Certificate of

Withholding) establishes the amount of withholding. Sellers should refer to their property records for adjusted basis and costs of sale, both of which must be identified in the form. The withholding amount should be rounded to the nearest dollar. **NOTE:** If a seller fails to deliver the form to the closing agent timely (“timely” appearing to mean before recording), the closing agent must withhold and remit to DOR 4% of the consideration paid for the seller’s interest or all of the seller’s net proceeds, if the latter is less.

5. Transmittal of exemption form to DOR in certain circumstances. In the following circumstances, the closing agent must send a copy of signed Form 40-WE to DOR within 20 days of closing:

- When the seller claims exemption as an Oregon resident AND has a non-Oregon address; or
- When the seller claims exemption based on the seller’s transfer being an exchange that qualifies or will qualify for nonrecognition of gain under IRC §1031 or §1033.

6. Remittance of withholding to DOR. When the seller is nonexempt, the closing agent must remit the withholding to DOR within 20 days of closing (or, more specifically, within 20 days of disbursing the seller’s net proceeds after deduction of the withholding), accompanied by DOR Form TPV. The closing agent must send a separate remittance and separate Forms TPV for each nonexempt seller, except when two sellers are eligible for filing a joint state tax return. For them, Form TPV may identify both persons.

7. Delivery of transmittal form to seller. A closing agent remitting withholding to DOR must complete combination Form OR-18 and Form TPV. The top portion (Form OR-18 – Report of Tax Withheld on Real Property Conveyances) calls for information about the closing agent, the seller, the property sold and the amount withheld. The bottom portion (Form TPV – Payment of Tax Withheld for Nonresidents) is a payment voucher that identifies the tax year and quarter, the taxpayer’s (or joint taxpayers’) tax ID number(s) and the payment amount. The closing agent completes both portions, then sends Form TPV with the payment to DOR, sends Form OR-18 to the seller, and retains a copy of the combination form in its file.

8. Retention of signed exemption form or withholding form. The closing agent must retain any signed DOR Form 40-WE for six years from closing and as a matter of practice should retain DOR Form 40-CW and combination Form OR-18 and Form TPV, when used, for the same period.

DIGITAL POTATOES, PEARS AND PUMPKINS: THE PERISHABLE AGRICULTURAL COMMODITIES ACT TRUST IN THE ELECTRONIC AGE

By Brandy A. Sargent
Stoel Rives LLP

Since it was enacted in 1930, the Perishable Agricultural Commodities Act (“PACA” or the “Act”) has been amended in a number of ways, most recently to address the realities of conducting agricultural transactions in the electronic age. This article discusses the basics of PACA, recent “digital amendments,” and a potential pitfall of doing business electronically.

PACA History

Congress enacted PACA to protect producers of “perishable agricultural commodities” from commission merchants, dealers and brokers who wrongfully rejected shipments of such commodities during periods of declining prices. *George Steinberg & Son, Inc. v. Butz*, 491 F2d 988, 990 (2d Cir 1974). PACA originally contained two major protections. First, it prohibited certain practices by commission merchants, brokers, and dealers, including unfair counting and weighing, rejection, or dumping of perishable agricultural commodities. 7 USC §499b; *In re Magic Restaurants, Inc.*, 205 F3d 108, 110 (3rd Cir 2000). Second, it created a licensing program for commission merchants, brokers and dealers of perishable agricultural commodities, and gave the Secretary of Agriculture the power to refuse, suspend or terminate a license based on conduct in violation of §499b of the Act, among other things. 7 USC §§499c, 499d, 499h; *In re Magic Restaurants*, 205 F3d at 111.

Although PACA improved the protection of agricultural suppliers, by the early 1980s certain shortcomings in PACA had become apparent. These reflected changes in the financial structure of the agriculture industry: (a) climbing overhead costs, including the costs of debt servicing, resulting in an increase in delayed payments; (b) an increase in hidden security agreements which resulted in diversion of money away from suppliers; and (c) increased business failures and bankruptcies with no meaningful recovery to suppliers. *Regulations Under the Perishable Agricultural Commodities Act*, 49 FR 45735 (Nov. 20, 1984). Sellers of agricultural commodities were “unsecured creditors and receive little protection in any suit for recovery of damages where a buyer has failed to make payment as required by the

contract.” HR Rep 98-543 (1983), 1984 USCCAN 405, 407. To remedy these shortcomings, in 1984 Congress amended PACA to create a trust for the benefit of unpaid sellers and suppliers of perishable agricultural commodities (the “PACA Trust”). *Id.* at 408; 7 USC §499e(c).

PACA Trust Coverage

Perishable Agricultural Commodities

The PACA Trust, like the rest of the Act, applies only to transactions involving “perishable agricultural commodities” – defined as fresh fruits and fresh vegetables of every kind and character, whether or not frozen or packed in ice. 7 USC §499a(b)(4). The federal regulations implementing PACA further define “fresh fruits and fresh vegetables”:

Fresh fruits and fresh vegetables include all produce in fresh form generally considered as perishable fruits and vegetables, whether or not packed in ice or held in common or cold storage, but does not include those perishable fruits and vegetables which have been manufactured into articles of food of a different kind or character. The effects of the following operations shall not be considered as changing a commodity into a food of a different kind or character: Water, steam, or oil blanching, battering, coating, chopping, color adding, curing, cutting, dicing, drying for the removal of surface moisture; fumigating, gassing, heating for insect control, ripening and coloring; removal of seed, pits, stems, calyx, husk, pods rind, skin, peel, et cetera; polishing, precooling, refrigerating, shredding, slicing, trimming, washing with or without chemicals; waxing, adding of sugar or other sweetening agents; adding ascorbic acid or other agents to retard oxidation; mixing of several kinds of sliced, chopped, or diced fruit or vegetables for packaging in any type of containers; or comparable methods of preparation.

7 CFR §46.2(u).

One might think that this definition is expansive enough to cover any kind of agricultural product, but several decisions exclude certain agricultural products from PACA coverage. *E.g.*, *Regal Marketing, Inc. v. All American Farms, Inc.*, 58 Agric. Dec. 1133, 1135 (1999) (peanuts, pecans, coconuts and chestnuts are not covered by PACA). Others address whether agricultural products are “fresh” or have been manufac-

tured into food of a different kind or character. *E.g.*, *Endico Potatoes, Inc. v. CIT Group/Factoring, Inc.*, 67 F3d 1063, 1071 (2d Cir 1995) (products containing less than ninety percent fresh ingredients, such as cream cheese with scallions, cole slaw, and potato salad, are not entitled to PACA protection); *In re L. Natural Foods Corp.*, 199 BR 882, 888-90 (Bankr ED Pa 1996) (dried apricots and prunes not protected by PACA); *In re Fleming Companies, Inc.*, 316 BR 809, 913-14 (D Del 2004) (canned fruit not entitled to PACA protection); *cf* Deudall, Mark, "The Interaction Between the Bankruptcy Code and the Perishable Agricultural Commodities Act," 2006 *Ann Surv of Bankr Law* Part I §4 (cited herein as Deudall), n. 49 (*Fleming* decision may not conform to federal regulations on mixing and packaging). Decisions that addressed whether french fries were entitled to PACA protection were overruled in 2003 when the regulations were amended to include "battering and coating" as processes which do not change the product into food of a different kind or character. *See Fleming Companies, Inc. v. USDA*, 322 F Supp2d 744, 752 (ED Tex 2004), *aff'd*, 164 Fed Appx 528 (5th Cir 2006); Deudall at text accompanying notes 50-53 (detailing the great "french fry debate").

Commission Merchants, Dealers, and Brokers

The PACA Trust applies only to perishable agricultural commodities received by a commission merchant, dealer, or broker. A commission merchant is a person "engaged in the business of receiving in interstate or foreign commerce any perishable agricultural commodity for sale, on commission, or for or on behalf of another." 7 USC §499a(b)(5). A broker is a person "engaged in the business of negotiating sales and purchases of any perishable agricultural commodity in interstate or foreign commerce for or on behalf of the vendor or the purchaser, respectively," but the definition does not cover independent agents "negotiating sales for and on behalf of the vendor and if the only sales of such commodities negotiated by such person are sales of frozen fruits and vegetables having an invoice value not in excess of \$230,000 in any calendar year." 7 USC §499a(b)(7); 7 CFR §46.2(n).

In contrast, a dealer is a "person engaged in the business of buying or selling in wholesale or jobbing quantities . . . any perishable agricultural commodity in interstate or foreign commerce." 7 USC §499a(b)(6). Wholesale or jobbing quantities are "aggregate quantities of all types of produce totaling one ton (2,000 pounds) or more in weight in any day shipped, received, or contract to be shipped or received." 7

CFR §46.2(x). There are exceptions to the definition of "dealer." First, no producer is considered a dealer with respect to sales of perishable agricultural commodities raised by that person. 7 USC §499a(b)(6)(A); 7 CFR §46.2(m)(3). Second, no person buying perishable agricultural commodities solely for sale at retail is considered a dealer until the invoice cost of such purchases in any calendar year exceeds \$230,000. 7 USC §499a(b)(6)(B); 7 CFR §46.2(m)(2). Finally, no person buying any perishable agricultural commodity (other than potatoes) for canning and/or processing within the state where they are grown is a dealer, unless the product is frozen, packed in ice, or consists of cherries in brine. 7 USC §499a(b)(6)(C); 7 CFR §46.2(m)(4). If a person is not otherwise a "dealer" for PACA purposes, but secures a license under 7 USC §499c, the person is considered a dealer while the license is in effect. 7 USC §499a(b)(6).

In the last decade, the definition of "dealer" has expanded to cover restaurants which meet the "wholesale and jobbing quantities" and "\$230,000" per year requirements. *See e.g.*, *J. Ambrogi Food Dist. Inc. v. Top Dog America's Bar & Grille*, 2005 WL 1655891 (ED Pa July 14 2005) (and cases cited therein). Some commentators suggest that the definition of "dealer" could be expanded further to include prisons, hospitals, nursing homes and other large purchasers of PACA commodities. *See* 3 Ruda, Howard, *Asset Based Financing: A Transactional Guide*, § 30.07[2] (2006).

PACA Trust

The PACA Trust is a nonsegregated "floating" trust comprising (a) perishable agricultural commodities received in all transactions, (b) all inventories of food and other products derived therefrom; and (c) all receivables or proceeds from the sale of such commodities and food or products derived therefrom. 7 CFR §46.46(b); 7 USC §499e(c)(2). The PACA Trust is created immediately upon transfer of ownership, possession, or control of the covered goods. 7 CFR §46.46(c). However, the PACA Trust provisions do not apply to transactions between members of an agricultural cooperative and the cooperative. 7 USC §499e(c)(2); HR Rep 98-543, 1984 USCCAN at 409. Parties who comply with the PACA Trust's requirements are eligible beneficiaries of the trust until they are paid in full. 7 CFR §46.46(c). Payments made by a dishonored check are not considered paid. 7 USC §499e(c)(2). In some courts, "payment in full" may include attorneys' fees (if they are provided for by the contract between the parties), interest, and shipping fees. *Country Best v. Christopher Ranch*,

LLC, 361 F3d 629, 632 (11th Cir 2004); *Prestige Produce, Inc. v. Silver Creek, Inc.*, 2006 WL 581262, at *5 (D Idaho Mar. 9, 2006); *Lincoln Diversified, Inc. v. Mangos Plus, Inc.*, 2000 WL 890198, at *2 (SDNY July 5, 2000).

Commingling of PACA Trust assets is not prohibited. 7 CFR § 46.46(b). The party claiming the benefit of the PACA Trust must establish the details of the transaction, but detailed tracing is not required; pro-rata distribution to all claimants establishing their rights is contemplated. 49 FR at 45738. The onus is on the commission merchant, broker, or dealer to preserve the trust assets and assure that all eligible transactions are covered, even if disputed. *Id.*; Deudall at text accompanying notes 74-80. PACA Trust assets are not property of a debtor's bankruptcy estate. 49 FR 45735-01. Although one can grant a security interest in goods covered by the PACA Trust, the interest will be junior to properly preserved PACA rights. *Id.*; *Asset Based Financing* §30.07[1][b]. Failure to maintain PACA Trust assets violates the Act, 7 USC §499b(4), and can subject individuals in control of trust assets to personal liability, including, possibly, denial of a bankruptcy discharge. See Leonard, Nicole, "The Unsuspecting Fiduciary: The Curious Case of PACA and Personal Liability," 25 *Am Bankr Inst J* 32 (May 2006); Sousa, Michael D., "Are You Your Produce Vendor's Keeper? The Perishable Agricultural Commodities Act and §523(a)(4) of the Code," 15 *J Bankr L & Prac* 6 Art. 3 (Dec 2006).

The PACA Trust and Electronic Commerce

The PACA Trust is a valuable tool for agricultural suppliers to obtain payment and a potential trap for purchasers and their lenders. Since the creation of the PACA Trust in 1984, the Act has been amended to reflect changes in the way parties do business in agricultural transactions covered by the Act. The last several years, in particular, have seen two developments in PACA law related to electronic commerce.

Preserving PACA Trust Benefits Electronically

Although the PACA Trust arises automatically, potential beneficiaries will lose the benefits of the trust unless they comply with the Act's notice and timing requirements. The Act provides two methods by which a beneficiary can preserve its rights. First, the unpaid supplier, seller or agent can give a written notice of intent to preserve the PACA Trust benefits and include the following information for each shipment: (a) the names and address of the trust beneficiary, seller-supplier, commission merchant, or agent, and debtor; (b) the date of the transaction, commodity, invoice price,

and terms of payment (if different than provided by the regulations); (c) the date of receipt of notice that a payment was dishonored (if applicable); and (d) the amount past due and unpaid. 7 CFR §46.46(f). The written notice must be given within thirty calendar days (x) after the expiration of the time for payment under PACA's regulations (in most cases, ten days per 7 CFR §46.2(aa)); (y) after expiration of the time for payment agreed to by the parties in writing before entering into the transaction (which cannot be longer than thirty days and still qualify for trust protection, 7 CFR §46.46(e)(2)); or (z) after the supplier, seller or agent receives notice that a payment has been dishonored. 7 CFR §46.46(f)(2); 7 USC §499e(c)(3).

The second method of preserving PACA Trust benefits, available only to PACA licensees, was added in 1995. Licensees may include the following language in their invoice or other billing statement, along with the terms of payment if they differ from the PACA regulations and the parties have agreed to such terms in writing before the transaction:

The perishable agricultural commodities listed on this invoice are sold subject to the statutory trust authorized by section 5(c) of the Perishable Agricultural Commodities Act, 1930 (7 U.S.C. 499e(c)). The seller of these commodities retains a trust claim over these commodities, all inventories of food or other products derived from these commodities, and any receivables or proceeds from the sale of these commodities until full payment is received.

7 CFR §46.46(f)(3); 7 USC §499e(c)(4). This language will preserve trust benefits.

In 1997, eleven produce trade groups petitioned the Agricultural Marketing Service (AMS) of the United States Department of Agriculture (USDA) to clarify that the "invoice method" of trust preservation included transactions consummated through the use of Electronic Data Interchange (EDI), an increasingly popular form of electronic communication. *Proposed Revision to Regulations Under the Perishable Agricultural Commodities Act*, 62 FR 33574 (June 20, 1997). EDI is essentially a set of standards for electronically structuring information traditionally contained in documents exchanged between parties. http://en.wikipedia.org/wiki/Electronic_Data_Interchange (accessed 1/11/2008). In response, AMS proposed to change the PACA regulations by defining "invoice" and "billing statement" to include "communications customarily used between parties to a transaction in perishable agricultural com-

modities in whatever form, documentary or electronic, for billing or invoicing purposes." 7 CFR §46.46(a)(5). At least one respondent to the proposed changes requested that the rule be strengthened to eliminate the need for the recipient to receive or read the statutory language. The USDA rejected this request. "[A] seller engaged in electronic transactions must ensure in the agreement with its buyer that the buyer is receiving the trust statement as part of the electronic transmission. Otherwise, the seller is responsible for finding other means of giving notice to the buyer" *Revision to Regulations Under the Perishable Agricultural Commodities Act*, 62 FR 60998 (November 14, 1997).

In 2005, after a decade of having the responsibility of ensuring receipt of EDI transactions left up to trust beneficiaries, agricultural trade groups again requested that AMS and the USDA change the regulations applicable to EDI transactions. *Regulations Under the Perishable Agricultural Commodities Act*, 71 FR 4831 (Jan 30, 2006). This time the rule makers were receptive. In January 2006, the AMS provided notice of proposed changes in the PACA regulations to address concerns that the PACA Trust might not be preserved if: (a) the buyer or its agent failed (willfully or through oversight) to receive the entire EDI transmission; (b) the buyer or its agent failed to download the information; (c) the buyer or its agent did not opt to receive the information; (d) the buyer or its agent did not buy the data field that allows inclusion of the trust language; (e) the EDI service provider did not translate the field containing the trust language; or (f) buyer required EDI transactions but refused to accept traditionally printed notices. *Id.* AMS received more than sixty comments to the proposed changes, overwhelmingly favoring the changes. *Amendments to Regulations Under the Perishable Agricultural Commodities Act*, 71 FR 65426, 65427 (Nov 8, 2006). AMS rejected proposals by two respondents suggesting that the USDA allow for blanket trading partner agreements to preserve the PACA Trust, explaining that the Act allows for only two methods of preserving the PACA Trust, which do not include blanket agreements. *Id.* at 65428. AMS also rejected suggestions that the regulations be amended to provide for a streamlined, low-cost method for preserving trust rights. *Id.* at 65428-29 (refusing to define for the industry how costs should be managed).

The amended regulations, effective June 29, 2007, provide that the PACA licensee has met its obligations to preserve the PACA Trust if the required information (the trust language and payment terms, if different than the regulations) is sent electronically to the

buyer or a third-party vendor designated by the buyer, irrespective of whether the statement is downloaded or accepted. 7 CFR §46.46(f)(4). The regulations also provide that buyers utilizing electronic systems must allow sufficient space for the required trust language, and make it an unfair practice to fail to accept the trust statement, whether in documentary or electronic form. 7 CFR §46.46(f)(5).

Losing PACA Trust Benefits Electronically

If the advent of the digital age has made it easier for agricultural producers to preserve their PACA Trust rights, it has also arguably made it easier to lose them. One limitation to PACA Trust rights is that the seller and buyer cannot agree to payment terms longer than 30 days after receipt and acceptance of the products. 7 CFR §46.46(e)(2). The reason is that the Act's protections are intended to benefit suppliers who sell on a cash or short-term credit basis. *Greg Orchards & Produce, Inc. v. Roncone*, 180 F3d 888, 891 (7th Cir 1999); HR Rep 98-543. Most courts that have considered the issue have held that even a seller that properly preserves its PACA rights can waive those rights by a post-default agreement to extend payment terms past thirty days. *See, e.g., In re Lombardo Fruit and Produce Co.*, 12 F3d 806, 809 (8th Cir 1994); *Greg Orchards*, 180 F3d at 892; *American Banana Co., Inc., v. Republic National Bank of N.Y.*, 362 F3d 33, 44 (2d Cir 2004); *Paris Foods Corp. v. Foresite Foods, Inc.*, 2007 WL 568841, at *7 (ND Ga Feb 20, 2007); *but see In re Cafeteria Operators, LP*, 299 BR 411, 416 (Bankr ND Tex 2003) (questioning whether any post-default agreement could waive properly perfected PACA Trust rights).

The major disagreement in the cases is not over whether an agreement to extend payment terms past thirty days may disqualify a seller from PACA protection, but whether oral agreements or a course of conduct, as opposed to written agreements, may effect such a disqualification. *Compare Patterson Frozen Foods, Inc. v. Crown Foods Int'l, Inc.*, 307 F3d 666, 699 (7th Cir 2002) (only a written agreement can waive PACA Trust protections), *with American Banana*, 362 F3d at 46-47 (oral agreements can waive trust protection). In *Patterson*, the court held that an agreement to extend payment terms did not have to be a formal written contract; it simply had to satisfy the "generally applicable statute of frauds." 307 F3d at 671. In *American Banana*, the court found no substantive difference between oral and written agreements because "[t]o hold otherwise would yield the unacceptable result of preserving trust protection for a seller who reaches an agreement containing

a payment period exceeding thirty days and performs thereunder so long as the seller does not reduce the agreement to writing." 362 F3d at 47. Following these cases, courts have concluded that email messages can form the basis for a waiver of PACA Trust protection, under certain circumstances. *See, e.g., In re Dixie Produce & Packaging, LLC*, 368 BR 533, 536 (Bankr ED La 2007) ("An agreement sufficient to extend payment terms may be an informal writing, such as an email, letter, or fax, as long as it satisfies the Statute of Frauds"); *Cafeteria Operators*, 299 BR at 418 ("e-mails between the parties satisfy the writing requirement, to the extent that one is required under PACA"); *Paris Foods*, 2007 WL 568841, at * 8 (conversations, emails and letters waived PACA Trust protections).

In *Cafeteria Operators*, the court reviewed the provisions of the Electronic Signatures in Global and National Commerce Act, 15 USC §7001 *et seq.*, and held that for transactions involving interstate commerce, e-mails constitute writings. 299 BR at 418. However, the court agreed with the defendant that the emails in question did not evidence a meeting of the minds or if they did, the agreement in question was entered into by a broker or agent of the PACA Trust beneficiary who did not first obtain the required written authority to waive the PACA Trust protections on behalf of its principal. *Id.* at 418-19. *See also In re Brown & Cole Stores, LLC*, Case No 06-13950, Order Denying PACA Claim of Associated Grocers, Inc. (Bankr WD Wash Sept 14, 2007) (creditor's emails did not constitute an agreement to pay outside of statutory terms because the debtor never responded to emails from the creditor discussing extended terms).

In *Paris Foods*, two plaintiffs brought PACA Trust claims against a purchaser for failure to pay their invoices for produce. On a motion for summary judgment, the court held that both plaintiffs had waived their PACA Trust protections. Plaintiff Paris Foods, Inc. ("Paris") had entered into negotiations by telephone in which terms outside the statutory limits were discussed. Paris followed up the conversation with a letter setting forth the terms discussed on the phone. The purchaser responded by email confirming the terms discussed by the parties and stating that it had begun to operate under the new terms. Paris responded again by email that the purchaser had complied with the new terms. 2007 WL 568841 at * 2. Dennis Sales LTD ("Sales") also had telephonic discussions with the purchaser about a past due account in which Sales accepted a long-term payment plan. This agreement was followed up by a letter and subsequent emails

and telephone conversations regarding further payments under the plan. *Id.* at *2-3. The court rejected Paris's and Sales's arguments that post-default agreements cannot waive PACA Trust protections. The court disregarded *Cafeteria Operators* as not binding in the Eleventh Circuit, and held that the post-default oral agreements, letters and emails were sufficient to waive the PACA Trust benefits. *Id.* at *8.

It is important to note that at least one court has held that even if the buyer and seller agree to terms that waive PACA Trust protection, the Secretary of Agriculture still has the ability to penalize violations of the Act. *Baiardi Food Chain v. USDA*, 482 F3d 238, 243-44 (3d Cir 2007). Therefore, even if a purchaser has avoided PACA Trust liability, its failure to pay timely can still be grounds for sanctions by the USDA.

Conclusion

The PACA Trust continues to evolve as the agricultural industry evolves. PACA issues can arise not only for the buyer and seller, but also for lenders, agents and individuals involved in agricultural transactions. Because both perfecting PACA Trust protection and losing it can be as simple as sending or failing to send an electronic transmission, practitioners with clients in the industry should address compliance issues early. There is little room for repair.

OREGON STATE BAR DEBTOR-CREDITOR SECTION

ANNUAL MEETING AND CLE

at Salishan Resort on the Oregon Coast
September 19 and 20, 2008

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FINDING A HOME IN CHAPTER 11

By **Natalie C. Scott**
Muhlheim Boyd, LLP

Consider the unfortunate debtor who fails the means test for chapter 7 and is over the debt limit for chapter 13. Or one who has no regular income to fund a chapter 13 but is reluctant to file chapter 7 for fear of charges of what the cases used to call substantial abuse. Imagine hundreds, no thousands, nay tens of thousands of individuals drowning in oceans of debt that they just cannot get on top of as their creditors race to the courthouse and debt relief agencies promise a debt-free life if only you pick up the phone and call now.

Conventional wisdom was that word would get out that BAPCPA did not abolish bankruptcy as the popular press seemed to say and that filings would soon return to "normal" levels. Despite some increased bureaucratic hurdles, people would realize that bankruptcy was still available and, in many cases, the best option. However, it's not clear that word has gotten out – certainly not with respect to the potential for chapter 11 to provide a home in bankruptcy to some individuals.

Some Statistics

As expected, calendar year 2006 filings were the lowest in nearly twenty years. *See* ABI Press Release (April 17, 2007), at <http://www.abiworld.org>. Since then, the number of bankruptcy filings appears to be increasing (and is expected to increase still more if Congress enacts legislation affecting home mortgage modification in chapter 13). That may not be the case in Oregon, though. According to information from the Administrative Office of the US Courts, chapter 11 filings in Oregon for fiscal years 2001 through 2004 (September 30 to September 30) averaged around 40. Fiscal year 2005 had 29 and 2006 had only 15. This past fiscal year, 2007, Oregon had 26 chapter 11 filings. Thus, in a relatively small market for chapter 11s, Oregon is nonetheless feeling the effects of BAPCPA, perhaps attributable to a lack of awareness of how individuals can use chapter 11.

Profile of a Chapter 11 Debtor

Chapter 11 is usually associated with debtors like ENRON or Delta Airlines, or even an archdiocese of the Roman Catholic Church. It is not generally seen as an option for the average person. Indeed, even post-BAPCPA, when an individual may not have to propose

a 100% plan to stay in chapter 11, an individual considering chapter 11 typically has more assets, indebtedness, and income than the average debtor, maybe even rising to the oxymoronic status of a "rich" debtor.

For example, consider a dentist who buys a dental practice using a loan of \$350,000 to his PC. The debt is secured by a blanket lien on the purchased asset. Every lender worth its salt would also demand a personal guarantee from the dentist. While the \$350,000 is secured debt of the PC, the \$350,000 guarantee is unsecured debt of the dentist that, by itself, puts the dentist over the unsecured debt limit for a chapter 13. In places like California, where million-dollar home mortgages are not uncommon, many debtors knock up against the secured-debt limit.

These potential chapter 11 debtors are not Martha Stewart or OJ Simpson or the CEO of a big corporation. Some are people trying to start businesses. Others are professionals with high levels of personal debt. Still others are real estate investors or developers who have not weathered the recent market changes. They may not be the mass of consumer debtors, but neither are they multi-billion dollar corporations.

Why Individual Chapter 11s Are More Attractive Now

Chapter 11 has always been expensive. As of January 2008, the filing fee is \$1039. Attorney fees could run from \$20,000 to \$50,000 for an individual chapter 11 case. US Trustee fees add thousands per quarter on top of that. If the dentist in our example has gross annual receipts of \$700,000, all of which are disbursed (including the dentist's salary), the US Trustee fees effective January 1, 2008, would be \$6,500 per year.

Nonetheless, the fact is that BAPCPA has broadened the class of debtors whose choice may be chapter 11 or nothing. The new means test keeps more "rich" debtors out of chapter 7. The lack of a significant increase to debt limits keeps the same ones out of chapter 13. So a costly chapter 11 may be only option if there is to be a bankruptcy option at all. Anticipating this problem, Congress tinkered with chapter 11 so that, for some individual debtors, it may not be a bad place to be.

The biggest change is the apparent abolition of the rule of absolute priority. That rule – which is still in place for corporate chapter 11s – resides in §1129 of the Code. In general, before BAPCPA, individuals who had an objecting creditor and could not propose a 100% plan could not do chapter 11. Now §1129(b)(2)(B)(ii), together with new §1115 (which expands property of

Continued next page

the estate to include post-petition income in chapter 11) and §1129(a)(15) (which allows individuals to propose plans that pay projected disposable income for five years), may mean that individuals no longer have to propose a 100% plan if there is a dissenting creditor. Two bankruptcy courts have upheld that conclusion – one upholding a ten-year 95% distribution plan and the other approving a plan proposing a mere 3% distribution. *See In re Tegeeder*, 369 BR 477 (Bankr D Neb 2007), and *In re Roedemeier*, 374 BR 264 (Bankr D Kansas 2007).

There are many other unsettled issues, as well as practical concerns about whether to file an individual chapter 11, all of which are beyond the scope of this article. For a comprehensive discussion, *see, e.g.*, Bruce A. Markell, *The Sub Rosa Subchapter: Individual Debtors in Chapter 11 after BAPCPA*, 2007 U. Ill. L. Rev. 67.

Restructuring Small Business

One of the most interesting kinds of case is what our firm calls the “corporate collapse” case (although they usually involve limited liability entities other than corporations). The typical case involves a small, usually one-owner business with creditors knocking on the owner’s door waving personal guarantees. Before BAPCPA, that owner would have had two choices: either to file two bankruptcies (one for the business entity and one for the individual) or to walk away from the business and file individually. With the increased requirements BAPCPA places on debtor’s counsel, individual chapter 7s and chapter 13s have gotten a whole lot more expensive; dual bankruptcies seem insurmountably expensive.

However, the apparent death of the absolute priority rule in individual cases has opened up the possibility to do in chapter 11 what was often done in chapter 13s with mom-and-pop businesses. Basically, the owner “collapses” the business entity and assumes the business’s debt (which results in no greater debt if the owner already has guaranteed all of the business’s debt) and then files one individual chapter 11. This theory stands limited liability practice on its head and raises a multitude of practical, legal, and potential ethical issues (for example, ensuring that both corporate and personal creditors would not be in a worse position after collapse) that are beyond the scope of this article. However, it is one of the most intriguing new possibilities out there and a way for at least some debtors to find a home in chapter 11.

Conclusion

Until changes are made to chapter 13 debt limits, chapter 11 may be the only path available to many debtors. BAPCPA has made chapter 11 a better option for individuals, although certainly not a cheap nor a simple one. As the law becomes better settled on various potential issues, however, it may be that more individual debtors will seek refuge in chapter 11.

NINTH CIRCUIT CASE NOTES

By Matthew A. Goldberg

Kirkpatrick & Lockhart Preston Gates Ellis, LLP

ATTORNEY SANCTIONED FOR PROVIDING “UNBUNDLED” LEGAL SERVICES TO DEBTOR CLIENTS

Hale v. U.S. Trustee, 509 F3d 1139 (9th Cir 2007)

Debtors signed an agreement with their attorney providing that for a fee of \$250, the attorney would prepare debtors’ bankruptcy petition but would not sign it or represent the debtors at their §341(a) meeting. Moreover, the agreement provided that the attorney would not represent debtors in any other proceedings related to their bankruptcy case, including but not limited to adversary proceedings, conversion proceedings or dischargeability actions. The attorney described this type of representation as providing “unbundled” legal services to *pro se* debtors.

The bankruptcy court *sua sponte* raised the issue of the propriety of the attorney’s methods and the trustee sought sanctions against the attorney. At a subsequent hearing, one of the debtors testified she did not understand the term “*pro se*” and she believed that the attorney was going to represent them in the traditional sense of the word. Apparently, the attorney had not told the debtors about the existence of the §341(a) meeting, let alone that the attorney did not plan to attend.

The court ordered the attorney to disgorge his \$250 fee as a sanction for not providing competent representation and failing to obtain his clients’ informed consent as to the scope of the “unbundled” representation. Because the attorney had provided similar legal representation in over 200 cases in the previous year, the court also ordered the attorney to pay an additional \$2,000 sanction and forbade the attorney from signing fee agreements in which he did not agree to provide the

“reasonable and necessary services required to represent a debtor in a bankruptcy case,” including but not limited to appearing at the §341(a) meeting. The district court affirmed the bankruptcy court on all issues.

The Ninth Circuit affirmed the bankruptcy court’s disgorgement order, relying on §329(b), which states that a bankruptcy court may examine the reasonableness of a debtor’s attorney’s fees and may order the return of any such fees to the extent the court finds them excessive. With respect to the additional sanctions imposed by the bankruptcy court, the Ninth Circuit affirmed but based its ruling only on the bankruptcy court’s inherent power to sanction vexatious conduct. It rejected the bankruptcy court’s reliance on FRBP 9011(c) because the attorney had violated Rule 9011(a). By its own terms, 9011(c) permits a court to sanction only violations of 9011(b), which concerns bad faith filings, not violations of 9011(a). The proper sanction for a 9011(a) violation is contained within 9011(a) itself: striking the unsigned or improperly signed filing.

CREDITORS’ ATTORNEY CAN RECEIVE FEES RELATED TO APPEAL OF DECISION DENYING ATTORNEY’S FEES FOR FILING INVOLUNTARY BANKRUPTCY

In re Wind N’ Wave, 509 F3d 938 (9th Cir 2007)

When the attorney for creditors who had filed an involuntary chapter 7 petition applied for fees under §503(b)(4), the bankruptcy court denied the request. It declined to follow what appeared to be controlling BAP precedent from *In re Sedona Institute*, 220 BR 74 (9th Cir BAP 1998), which had held that an independent allowable expense claim under §503(b)(3) is not a prerequisite to an award of attorney’s fees under §503(b)(4). On appeal, the BAP reversed, relying on *Sedona*, and remanded the case to the bankruptcy court for a determination of the appropriate fees to be awarded under §503(b)(4). The BAP denied, however, the creditors’ request for the attorney fees incurred in bringing the BAP appeal itself. The creditors appealed, seeking not only their attorney fees in bringing the original BAP appeal, but also their fees for appealing the BAP’s fee denial to the Ninth Circuit.

On this issue of first impression, the Ninth Circuit reversed the BAP’s summary denial of the creditors’ request for fees arising out of the successful appeal of the bankruptcy court’s denial of the creditors’ attorney’s original fee request under §503(b)(4). Citing its

decision in *In re Smith*, 317 F3d 918 (9th Cir 2002), the court reiterated the rule (previously applied in the context of debtor’s attorney’s fees) that recovery of legal fees for litigation over a fee application is appropriate if two factors are present: 1) the services for which compensation are sought satisfy the requirements of §330(a); and 2) the case is one in which the time and expense incurred by the litigation is “necessary.” The court also discussed the important public policy behind ensuring adequate compensation for bankruptcy attorneys so that highly qualified attorneys don’t shun bankruptcy work in favor of more remunerative kinds of work.

Here, the court found that the creditors’ attorney easily satisfied the two-part *Smith* test. First, there had been no dispute over the reasonableness of the fees being sought. Second, the court found that the litigation over fees was necessary, especially in light of the fact that the bankruptcy court had declined to follow relevant Ninth Circuit precedent.

CREDITOR DOES NOT HAVE CONSTRUCTIVE NOTICE OF BANKRUPTCY WHEN DEBTOR’S NAME AND ADDRESS ARE CORRECT BUT HIS SOCIAL SECURITY NUMBER IS NOT

Ellet v. Stanislaus, 506 F3d 774 (9th Cir 2007)

Debtor’s chapter 13 petition misstated the last digit of his Social Security number. This same error appeared in the notice of the §341(a) meeting sent to creditors. Both the petition and the notice did contain debtor’s correct name and address. One creditor, the California Franchise Tax Board (“Board”), received the notice but did not file a proof of claim. The debtor’s plan was confirmed and was completed two years later. The Board received no distributions under the plan because of its failure to file a proof of claim. A year after debtor completed payments under his plan, the Board sent debtor a demand for his unpaid taxes. Debtor filed an adversary proceeding to determine the dischargeability of his tax debt. The lower courts held that the tax debt was not discharged and debtor appealed.

On this issue of first impression, the Ninth Circuit affirmed the lower courts and ruled that the debt had not been discharged. The court rejected debtor’s argument that the Board had been put on constructive or inquiry notice of the bankruptcy because debtor’s name and address had been correct and, therefore, should have researched the name and address on the notice to determine whether the named individual

owed any taxes. Essentially, the court allocated to the debtor the risk that a mistake in the notice provided to creditors might result in a creditor's failure to participate in the bankruptcy, thereby precluding the debtor from discharging his obligations to that creditor. The debtor was in the best position, the court stated, to include the correct Social Security number on his petition as required by Fed. R. Bankr. P. 1005 as it existed at the time of the filing of debtor's case. Requiring a creditor to "ferret out a debtor's correct identity," the court held, would be "overly burdensome and inappropriate," regardless of whether that creditor could have taken steps to ascertain whether it had a claim against the person identified in the notice of the §341(a) meeting.

BAP CASE NOTE

By Doug Pahl
Perkins Coie LLP

CHAPTER 13 DEBTOR'S "PROJECTED DISPOSABLE INCOME" NOT SET IN STONE BY DEBTOR'S PRE-BANKRUPTCY HISTORY

In re Pak, 378 BR 257 (9th Cir BAP 2007)

In *Pak*, the Bankruptcy Appellate Panel interpreted the phrase "projected disposable income" in §1325(b)(1)(B), one of the more complex issues of statutory interpretation to arise out of the chapter 13 provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).

While Pak was an unemployed software engineer from April 2002 until August 2005, he accumulated substantial unsecured debt. In August 2005, Pak secured work on a contract basis as a software engineer at \$8,666.67 per month, or \$104,004.04 annually. On October 31, 2005, he filed a voluntary chapter 7 petition. The court dismissed the chapter 7 case but granted Pak's motion to convert to chapter 13. Pak filed a chapter 13 plan and amended Schedules I and J showing net take-home pay of \$5,411.89 per month and expenses of \$4,421.99, for a net monthly income of \$989.70. His chapter 13 plan proposed payments of \$300 per month for 36 months, for a total of \$10,822.20 over the life of the plan.

Creditors, the Trustee and the United States Trustee all objected to the proposed plan on the grounds that it failed to dedicate all of Pak's "projected disposable income" as required by the Code: if the debtor made

plan payments based on his full net monthly income, his payments would total \$35,629.20 over the life of a 36-month plan. Pak argued that his plan met the requirements of §1325 because it dedicated more than his statutory "disposable income" to plan payments. The Bankruptcy Court sustained the objections, denied confirmation and ultimately dismissed the chapter 13 case. The BAP affirmed.

The Code does not define "projected disposable income," but at the BAP, Pak argued that the bankruptcy court should have applied the term "disposable income" as defined in §1325(b)(2). He contended that "the addition of the term 'projected' to 'disposable income' in §1325(b)(1)(B) adds a mere multiplier, based on the number of months within the applicable commitment period (in this case, 36 months), to determine the minimum amount that a debtor must pay to his unsecured creditors in chapter 13 in order to satisfy the §1325(b)(1)(B) condition to confirmation."

The BAP noted that a number of courts have followed the logic advanced by Pak – that the plain meaning of the statute requires that "projected" serve as a mere multiplier of the defined term "disposable income." The panel quoted from *In re Kagenveama*, 2006 Bankr LEXIS 2759 at *5 (Bankr D Ariz July 10, 2006):

Care was taken by Congress to modify the old definition of disposable income and to replace it with one based upon "current monthly income." This is clear; there can be no doubt about it. Section 1325(b)(2) states what the definition of "disposable income" is "for the purpose of this subsection"; nowhere else, other than in Section 1325(b)(1)(B), do the words "disposable income" appear in the referenced subsection. Unless the definition applies to "projected disposable income," it has no meaning.

The BAP chose not to follow the "plain meaning" courts, however, and instead affirmed the decision of the bankruptcy court consistent with the majority of courts that have addressed this question. The panel concluded that "Congress' retention of the term 'projected' to modify 'disposable income' in §1325(b)(1)(B) is ambiguous. It does not fit as neatly into the role of mindless multiplier as the 'plain meaning' decisions would suggest . . ." The panel reasoned that the forward-looking word "projected" would be deprived of meaning if the plain-meaning view were to prevail – a result at odds with canons of statutory construction.

With little assistance from the statute or the legislative history and with no binding precedent, the panel

seemed to be most influenced by the practical difficulties that would be encountered by the plain-meaning devotees.

[T]he “plain meaning” interpretation of “projected disposable income” takes leave of reality when faced with debtors whose incomes change dramatically, due to a change in employment status or otherwise during the six months preceding their bankruptcies. This is not a one-way ratchet problem: for every debtor whose *increased* income from the “disposable income” calculation would mean money left on the table that otherwise could be paid to creditors, there are debtors whose *decreased* income would effectively preclude their proposing a feasible chapter 13 plan. [Emphasis in original.]

The panel concluded that “‘disposable income,’ as defined in §1325(b)(2), is the starting point for determining ‘projected disposable income,’ subject to adjustment, based on evidence, to reflect reality going forward.”

Judge Klein concurred in the result but on a different theory, focusing more broadly on the purposes of the Bankruptcy Code and on the flexibility of the term “current monthly income” as defined in §101(10A).

STATE COURT CASE NOTES

By Donald H. Grim
Greene & Markley, P.C.

VALUE OF “USE AND OCCUPATION” IN FED ACTION IS FAIR MARKET RENTAL

LIG Investments LLC v. Roach 215 Or App 210,
170 P3d 561 (2007)

Plaintiff purchased a residence at a trustee’s sale following the foreclosure of a deed of trust and then brought a forcible entry and detainer (FED) action to remove defendant, the trustor. The trial court entered a judgment granting plaintiff restitution of the property.

Defendant sought to stay the judgment and retain possession of the property pending an appeal challenging the validity of the sale. Defendant filed a supersedeas undertaking, proposing to pay \$1,000 per month as the fair market rental value of the property and arguing that under ORS 19.335(2) her use and occupation of the property was that of a tenant. Plaintiff objected, arguing that the supersedeas undertaking

is intended to protect a successful party obtaining a judgment and that defendant’s offer was insufficient because plaintiff was entitled to other expenses in addition to the fair market rental value of the property. The trial court agreed with plaintiff and ordered defendant to pay \$2,706 per month.

On appeal, the order for supersedeas undertaking was reversed and remanded. “[T]he value of the use and occupation of real property in an FED action is the fair market rental value of the property.” Thus, plaintiff was not entitled to additional expenses such as the cost of interest on borrowed funds or interest on lost profits. The court declined to comment on whether an FED action is the correct mechanism to acquire possession of real property from a former owner in the absence of a landlord-tenant relationship.

IMPACT OF AUTOMATIC STAY ON GENERAL JUDGMENT OF DISSOLUTION OF MARRIAGE

In re Marriage of Cam 216 Or App 358, — P3d — (2007)

Husband, believing wife was in agreement, drafted a judgment of dissolution of marriage and presented it to the trial court. The court entered the judgment, which dissolved the marriage and addressed property division, child custody, and child and spousal support.

Before submitting the judgment, husband filed a chapter 13 petition in bankruptcy court. After the trial court entered the judgment of dissolution, husband’s bankruptcy case was dismissed. On wife’s motion, the trial court ordered the entire judgment of dissolution set aside on the grounds that the parties had not reached an agreement and husband had concealed assets. Husband appealed.

The Court of Appeals affirmed but on different grounds. Although neither party had raised the issue of the husband’s bankruptcy case, the record contained the necessary information about it. The court observed that the automatic stay rendered the property division portion of the judgment void; however, portions of the judgment dealing with the dissolution of the marriage and spousal and child support were subject to exceptions to the stay.

Nevertheless, the trial court was correct to set aside the entire judgment, because ORS 107.105(1) “contemplates the entry of a general judgment that resolves all the parties’ requests for relief,” and there was nothing in the record to indicate that the trial court intended to dissolve the marriage without resolving all ancillary issues at the same time.

CONSUMER COMMITTEE

By Aaron R. Varhola

The Consumer Bankruptcy Committee (also known as the Circle of Love) usually meets every other month on the third Thursday of the month in the 8th Floor conference room at the United States Bankruptcy Court – 1001 SW 5th Avenue, Portland, Oregon 97204. Our next meeting will be on Thursday, April 10, 2008, at 4:30 PM. The committee is chaired by Laura Donaldson, who can be reached at 503-241-4869 or laurad@vbcattorneys.com . To learn more about the Committee or to be added to the mailing list, please contact Ms. Donaldson.

November 15, 2007 Meeting

Todd Trierweiler asked about the domestic support obligation (DSO) form, and what happens if the recipient or clients move and cannot complete the form. Judge Dunn said keeping the case open for a brief time isn't a problem.

There was a general discussion of alleged misconduct by creditors and collection agencies. Brian Lynch stated there was a decision against B-Line for a lack of due diligence, and Judge Brown said she had awarded \$10,000 against a collection agency for egregious conduct. Judge Dunn awarded \$2300 in attorneys' fees against a creditor for double-charging attorneys' fees.

Aaron Varhola noted that other collectors are entering cases after filing, and collectors are being more negligent with docketing notices of bankruptcy and objections to collection activity.

Fee Waiver Objections. One trustee will always file objections to fee waivers in chapter 7 cases, because of small increases in income. Judge Dunn indicates that independent evidence can sometimes show a debtor is making under 150% of the poverty line.

Chapter 13 Trustee's Office. Brian Lynch will presume wage orders are necessary in all chapter 13 cases. In his view the only good argument against entry of a wage order is if the debtor's job would be negatively affected by entry. All petitions against entry should be sent at least a week before the §341 meeting to pre-con@portland13.com to avoid the conversation about it at the hearing.

The Chapter 13 Trustee's Office will not seek to take Oregon tax kicker checks, although a creditor might object to a debtor keeping the kicker check. A kicker

check can be used to pay off IRS tax liability.

Judge Dunn's decision in *In re Pak* holds that B22 income (CMI, or current monthly income) is a starting point for determining actual monthly income; a party who disagrees with the B22 income can object and prove otherwise. [See BAP Case Note on *In re Pak* at page 18 of this issue.]

Brian Lynch's office is approaching big lenders about what they will do to mitigate losses in a refinancing crunch.

New rules are in effect as of December 1, 2007, most significantly Rule 9037, which requires redaction of Social Security numbers, minors' names or initials, or account numbers on filings with the court.

US Trustee's Office. Pam Griffith reported that Tom Renn would like to distinguish between trustees "running late" vs. "running" behind. He says a big problem is document production deficiencies by debtors.

The US Trustee is looking at Social Security numbers more carefully for both bankruptcy or criminal violations if false Social Security numbers pop up during document requests. The office will seek to file more §727 motions, objections to confirmation, or motions to dismiss cases.

Ms. Griffith described the *Ellett* case, in which the debtor's Social Security number was wrong [see Ninth Circuit Case Note at page 15 of this issue], as well as the *Arando-Perez* case, 374 BR 800, where a §727 motion was filed when a debtor mistakenly reported two Social Security numbers. The court in that case refused to grant a stipulated motion to dismiss an adversary proceeding over the Social Security numbers.

IRS. Jeff Werstler told us attorneys can now use a 2848 form to access online tax information, and a 8821 form to get up to three years of returns filed after the request is made. He also explained the 4506 transcript form.

Mr. Werstler notes that limits to §1305 claims are put in orders confirming plans. Clients may also get a "lock-in letter," automatically setting their number of exemptions at zero, but can petition to get the number of exemptions changed. Discussion centered on §1305 claims and IRS objections.

Rich Parker has circulated an email about restricting access to drivers' licenses without proof of citizenship.

Pamela Griffith said the US Trustee's office will float the idea of a committee on unbundling legal services (petitions vs. adversaries).

Judge Dunn lets attorneys out of adversary proceedings if they are unable to contact their clients. Judge Dunn is also concerned about pro se debtors who don't know how to settle their adversary proceedings and waste court time.

Rich Parker asks everyone to read the PLF newsletter. SB 176 allows the ODR to collect debts from a successor business.

January 17, 2008 Meeting

Todd Trierweiler told the group about an opening at his law firm. Laura Donaldson said the Section's Young Lawyers Group is a way for younger lawyers involved in the Section.

Laura Donaldson brought in copies of the January 8 New York Times article discussing Countrywide's "Recreation" of letters changing escrow amounts for borrowers. Pam Griffith said the US Trustee's office wants to hear from member attorneys about examples of creditor misconduct, particularly involving larger lenders.

The Chapter 13 Trustee's office needs to see proof of charitable contributions. Most of the time, delay in discharge is caused by final audit and setting up a reserve (primarily for attorney fees). Todd Trierweiler's office said that the Chapter 13 Trustee may not allow the Earned Income Tax Credit and Additional Child Tax Credit on Schedule I as income because of problems with the final audit.

Lawyers are asked to change the initials on pleadings and other court documents to reflect current judge caseload as of the January 1 docket shift. The judge designated on the online docket is the correct one.

Pam Griffith said her office has suspended new debtor audits because of lack of funding, but audits of existing debtors will continue. Ms. Griffith also noted that creditors have been lax in filing claims.

Judge Perris stated that draft revisions of Local Rules will be out around February 14.

Jeff Werstler of the IRS stated that there will be a different IRS manager for Portland for next year at least.

The IRS is getting requests from trustees for future years' refunds; the IRS does not have the authority to direct turnover of straddling refunds to chapter 7 trustees. There is a draft local rule requiring debtors to turn over tax refund checks to the trustee; Mr. Werstler asks debtors to physically turn over checks to the trustee themselves, because the IRS can only seize tax refunds for child support and state taxes.

Mr. Werstler discussed the chance that tax liability will not be discharged because of "attempts to evade or defeat" collection of tax. He will look to *U.S. V. Merrill*, 336 BR 804 (D Or 2005), and the following factors: (1) the number of periods taxes are due, particularly with previous bankruptcies; (2) the amount of tax paid on time (whether enough is being withheld); (3) self-employed people who pay little or no tax; (4) tax debt compared to total debt; (5) collectability of the tax debt; (6) whether the bankruptcy is filed immediately after assets are transferred; (7) whether the taxpayer provides information or turns over assets to the IRS; (8) dissipation of assets before filing or purchase afterwards; (9) unusual divorces that place assets out of reach of the IRS – such as property going to one spouse and debts to another – while the ex-spouses still live together; and (10) previous relationship between the taxpayer and the IRS.

After discussion about whether a debtor can rely on the bankruptcy discharge with respect to tax debt, Mr. Werstler said the IRS will usually send a warning letter before the statute of limitations expires if it wants to challenge a discharge for an attempt to "evade or defeat" collection.

The Debtor-Creditor Newsletter will accept camera-ready display ads

Advertising will be limited to those entities which provide goods and services to section members. Cost and ad sizes are:

Quarter page	\$150
Half page	\$250
Full page	\$450

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