CHAPTER 7 TRUSTEES' DUTIES AND DEBTORS' RESPONSIBILITIES

Presented to Southeastern Bankruptcy Law Institute, Inc.

David P. Leibowitz
Lakelaw
420 W. Clayton Street
Waukegan, IL 60085
847.249.9100
dleibowitz@lakelaw.com
www.lakelaw.com

I've been a chapter 7 trustee since 1991. And I've been a debtor's attorney since 1999. So I've had the opportunity to be on both sides of thousands of 341 meetings in both my roles as debtor's attorney and as chapter 7 trustee. So consider the following observations.

- The statutes and rules concerning debtor's obligations and trustee's responsibilities in chapter 7 are uniform throughout the United States.
- There are local rules which vary the basic rules in place in several jurisdictions.
- The practice of chapter 7 trustees varies widely from district to district.
- The practice of chapter 7 trustees frequently varies widely even within the same district.

What should you do as a debtor's attorney to be prepared?

The purpose of this presentation is to reacquaint you with the basic responsibilities of debtors and trustees under the Bankruptcy Code and Federal Rules of Bankruptcy Procedure. Our accompanying presentation shows what can happen to a debtor and his attorney when they don't pay attention to their obligations under the Code and Rules.

Close attention to the Code and Rules will almost always result in accurate bankruptcy petitions and schedules – much more likely to lead to the desired result of a no-distribution report and a discharge for the benefit of the debtor.

The chapter 7 trustee may not always be at the front line of enforcing all of the debtor's obligations. Some of these obligations may be of greater concern to the United States Trustee, a secured creditor or the court. However, the trustee typically has an interest in the debtor's performing most of his or her obligations.

Debtor's Responsibilities

The starting point, of course, is the statute. Section 521 of the Bankruptcy Code sets forth in detail the obligations of the debtor in any bankruptcy case. Consider, then the text of the Code which provides as follows:

> **§ 521. Debtor's duties**
>
> **(a)** The debtor shall—
> **(1)** file—
>
> **(A)** a list of creditors; and
>
> **(B)** unless the court orders otherwise—
>
> **(i)** a schedule of assets and liabilities;
>
> **(ii)** a schedule of current income and current expenditures;
>
> **(iii)** a statement of the debtor's financial affairs and, if section 342(b)applies, a certificate—
>
> **(I)** of an attorney whose name is indicated on the petition as the attorney for the debtor, or a bankruptcy petition preparer signing the petition under section 110(b)(1), indicating that such attorney or the bankruptcy petition preparer delivered to the debtor the notice required by section 342(b); or

(II) if no attorney is so indicated, and no bankruptcy petition preparer signed the petition, of the debtor that such notice was received and read by the debtor;

(iv) copies of all payment advices or other evidence of payment received within 60 days before the date of the filing of the petition, by the debtor from any employer of the debtor;

(v) a statement of the amount of monthly net income, itemized to show how the amount is calculated; and

(vi) a statement disclosing any reasonably anticipated increase in income or expenditures over the 12-month period following the date of the filing of the petition;

(2) if an individual debtor's schedule of assets and liabilities includes debts which are secured by property of the estate—

(A) within thirty days after the date of the filing of a petition under chapter 7 of this title or on or before the date of the meeting of creditors, whichever is earlier, or within such additional time as the court, for cause, within such period fixes, the debtor shall file with the clerk a statement of his intention with respect to the retention or surrender of such property and, if applicable, specifying that such property is claimed as exempt, that the debtor intends to redeem such property, or that the debtor intends to reaffirm debts secured by such property;

(B) within 30 days after the first date set for the meeting of creditors under section 341(a), or within such additional time as the court, for cause, within such 30-day period fixes, the debtor shall perform his intention with respect to such property, as specified by subparagraph (A) of this paragraph; and

(C) nothing in subparagraphs (A) and (B) of this paragraph shall alter the debtor's or the trustee's rights with regard to such property under this title, except as provided in section 362(h);

(3) if a trustee is serving in the case or an auditor serving under section 586 (f) of title 28, cooperate with the trustee as necessary to enable the trustee to perform the trustee's duties under this title;

(4) if a trustee is serving in the case or an auditor serving under section 586 (f) of title 28, surrender to the trustee all property of the estate and any recorded information, including books, documents, records, and papers, relating to property of the estate, whether or not immunity is granted under section 344 of this title;

(5) appear at the hearing required under section 524(d) of this title;

(6) in a case under chapter 7 of this title in which the debtor is an individual, not retain possession of personal property as to which a creditor has an allowed claim for the purchase price secured in whole or in part by an interest in such personal property unless the debtor, not later than 45 days after the first meeting of creditors under section 341(a), either—

(A) enters into an agreement with the creditor pursuant to section 524(c) with respect to the claim secured by such property; or

(B) redeems such property from the security interest pursuant to section 722; and

(7) unless a trustee is serving in the case, continue to perform the obligations required of the administrator (as defined in section 3 of the Employee Retirement Income Security Act of 1974) of an employee benefit plan if at the time of the commencement of the case the debtor (or any entity designated by the debtor) served as such administrator**(*)**.
If the debtor fails to so act within the 45-day period referred to in paragraph (6), the stay under section 362(a) is terminated with respect to the personal property of the estate or of the debtor which is affected, such property shall no longer be property of the estate, and the creditor may take whatever action as to such property as is permitted by applicable nonbankruptcy law, unless the court determines on the motion of the trustee filed before the expiration of such 45-day period, and after notice and a hearing, that such property is of consequential value or benefit to the estate, orders appropriate adequate protection of the creditor's interest, and orders the debtor to deliver any collateral in the debtor's possession to the trustee.

(b) In addition to the requirements under subsection (a), a debtor who is an individual shall file with the court—

(1) a certificate from the approved nonprofit budget and credit counseling agency that provided the debtor services under section 109(h) describing the services provided to the debtor; and

(2) a copy of the debt repayment plan, if any, developed under section 109(h)through the approved nonprofit budget and credit counseling agency referred to in paragraph (1).

(c) In addition to meeting the requirements under subsection (a), a debtor shall file with the court a record of any interest that a debtor has in an education individual retirement account (as defined in section 530(b)(1) of the Internal Revenue Code of 1986) or under a qualified State tuition program (as defined in section 529(b)(1) of such Code).

(d) If the debtor fails timely to take the action specified in subsection (a)(6) of this section, or in paragraphs (1) and (2) of section 362(h), with respect to property which a lessor or bailor owns and has leased, rented, or bailed to the debtor or as to which a creditor holds a security interest not otherwise voidable under section522(f), 544, 545, 547, 548, or 549, nothing in this title shall prevent or limit the operation of a provision in the underlying lease or agreement that has the effect of placing the debtor in default under such lease or agreement by reason of the occurrence, pendency, or existence of a proceeding under this title or the insolvency of the debtor. Nothing in this subsection shall be deemed to justify limiting such a provision in any other circumstance.

(e)

(1) If the debtor in a case under chapter 7 or 13 is an individual and if a creditor files with the court at any time a request to receive a copy of the petition, schedules, and statement of financial affairs filed by the debtor, then the court shall make such petition, such schedules, and such statement available to such creditor.

(2)

(A) The debtor shall provide—

(i) not later than 7 days before the date first set for the first meeting of creditors, to the trustee a copy of the Federal income tax return required under applicable law (or at the election of the debtor, a transcript of such return) for the most recent tax year ending immediately before the commencement of the case and for which a Federal income tax return was filed; and

(ii) at the same time the debtor complies with clause (i), a copy of such return (or if elected under clause (i), such transcript) to any creditor that timely requests such copy.

(B) If the debtor fails to comply with clause (i) or (ii) of subparagraph (A), the court shall dismiss the case unless the debtor demonstrates that the failure to so comply is due to circumstances beyond the control of the debtor.

(C) If a creditor requests a copy of such tax return or such transcript and if the debtor fails to provide a copy of such tax return or such transcript to such creditor at the time the debtor provides such tax return or such transcript to the trustee, then the court shall dismiss the case unless the debtor demonstrates that the failure to provide a copy of such tax return or such transcript is due to circumstances beyond the control of the debtor.

(3) If a creditor in a case under chapter 13 files with the court at any time a request to receive a copy of the plan filed by the debtor, then the court shall make available to such creditor a copy of the plan—

(A) at a reasonable cost; and

(B) not later than 7 days after such request is filed.

(f) At the request of the court, the United States trustee, or any party in interest in a case under chapter 7, 11, or 13, a debtor who is an individual shall file with the court—

(1) at the same time filed with the taxing authority, a copy of each Federal income tax return required under applicable law (or at the election of the debtor, a transcript of such tax return) with respect to each tax year of the debtor ending while the case is pending under such chapter;

(2) at the same time filed with the taxing authority, each Federal income tax return required under applicable law (or at the election of the debtor, a transcript of such tax return) that had not been filed with such authority as of the date of the commencement of the case and that was subsequently filed for any tax year of the debtor ending in the 3-year period ending on the date of the commencement of the case;

(3) a copy of each amendment to any Federal income tax return or transcript filed with the court under paragraph (1) or (2); and

(4) in a case under chapter 13—

(A) on the date that is either 90 days after the end of such tax year or 1 year after the date of the commencement of the case, whichever is later, if a plan is not confirmed before such later date; and

(B) annually after the plan is confirmed and until the case is closed, not later than the date that is 45 days before the anniversary of the confirmation of the plan;
a statement, under penalty of perjury, of the income and expenditures of the debtor during the tax year of the debtor most recently concluded before such statement is filed under this paragraph, and of the monthly income of the debtor, that shows how income, expenditures, and monthly income are calculated.

(g)

(1) A statement referred to in subsection (f)(4) shall disclose—

(A) the amount and sources of the income of the debtor;

(B) the identity of any person responsible with the debtor for the support of any dependent of the debtor; and

(C) the identity of any person who contributed, and the amount contributed, to the household in which the debtor resides.

(2) The tax returns, amendments, and statement of income and expenditures described in subsections (e)(2)(A) and (f) shall be available to the United States trustee (or the bankruptcy administrator, if any), the trustee, and any party in interest for inspection and copying, subject to the requirements of section 315(c) of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

(h) If requested by the United States trustee or by the trustee, the debtor shall provide—

(1) a document that establishes the identity of the debtor, including a driver's license, passport, or other document that contains a photograph of the debtor; or

(2) such other personal identifying information relating to the debtor that establishes the identity of the debtor.

(i)

(1) Subject to paragraphs (2) and (4) and notwithstanding section 707(a), if an individual debtor in a voluntary case under chapter 7 or 13 fails to file all of the information required under subsection (a)(1) within 45 days after the date of the filing of the petition, the case shall be automatically dismissed effective on the 46th day after the date of the filing of the petition.

(2) Subject to paragraph (4) and with respect to a case described in paragraph (1), any party in interest may request the court to enter an order dismissing the case. If requested, the court shall enter an order of dismissal not later than 7 days after such request.

(3) Subject to paragraph (4) and upon request of the debtor made within 45 days after the date of the filing of the petition described in paragraph (1), the court may allow the debtor an additional period of not to exceed 45 days to file the information required under subsection (a)(1) if the court finds justification for extending the period for the filing.

(4) Notwithstanding any other provision of this subsection, on the motion of the trustee filed before the expiration of the applicable period of time specified in paragraph (1), (2), or (3), and after notice and a hearing, the court may decline to dismiss the case if the court finds that the debtor attempted in good faith to file all the information required by subsection

(a)(1)(B)(iv) and that the best interests of creditors would be served by administration of the case.

(j)

(1) Notwithstanding any other provision of this title, if the debtor fails to file a tax return that becomes due after the commencement of the case or to properly obtain an extension of the due date for filing such return, the taxing authority may request that the court enter an order converting or dismissing the case.

(2) If the debtor does not file the required return or obtain the extension referred to in paragraph (1) within 90 days after a request is filed by the taxing authority under that paragraph, the court shall convert or dismiss the case, whichever is in the best interests of creditors and the estate

Section 521 of the Bankruptcy Code certainly imposes a great deal of duties upon the debtor, not to mention the debtor's attorney. Let's parse out the statute to see how the debtor's duties interplay with the chapter 7 trustee's responsibilities.

Section 521(a)(1) – What must the Debtor file

The debtor is required to file schedules of assets and liabilities. That's pretty simple. Schedules A through H takes care of this. Moreover, the debtor is required to file a statement of current income and expenditures. Also simple, that's Schedule I and J. Of course a debtor is required to file a Statement of Financial Affairs. That's Official Form 7. So far so good. What else?

The Code requires debtors to provide a certificate of an attorney or petition preparer concerning compliance with section 342(b). Have you done that in all cases? Have you really taken the time to discuss with your client the alternatives to chapter 7? Have you really

explained chapter 13? Have you really explained whether chapter 11 or even chapter 12 might apply to your client? You are required to sign a papers saying you did so. Did you?

Now the fun begins. Since BAPCPA, you've been required to file copies of pay advices, a statement of the amount of monthly net income, itemized to show how calculated, and a statement disclosing any reasonably anticipated increase in income or expenditures in the next 12 months. 11 USC § 521(a)(1)(B)(iv)-(vi). Of course, your obligation to file these can be varied if your court orders otherwise. So check carefully with your local court. Many courts have varied the Bankruptcy Code's requirements for filing papers so as to avoid dismissal of bankruptcy cases pursuant to Bankruptcy Code section 707(a)(3) or automatic dismissal pursuant to Bankruptcy Code section 521(i).

Automatic dismissal pursuant to Bankruptcy Code section 521(i) has sometimes been used as a device by debtor's attorneys to seek dismissal of a case where trustees have located assets for administration. Bankruptcy Code 521(i)(4) does not address this circumstance adequately. However, courts have held that Bankruptcy Code 521(i) does not allow for dismissal over the objection of the chapter 7 trustee where to do so would prevent the trustee from administering an asset case for the benefit of creditors. See *In re Jackson*, 348 BR 487, (Bankr. SD IA 2006). Contra *Rivera v. Miranda* 2007 WL 2993611 (D. PR. 2007)

Section 521(a)(2) – Statement of Intention

If the debtor has property which secures a debt, the Bankruptcy Code requires the debtor to file a statement of intent with respect to surrender, retain, claim as exempt or redeem such property or in the alternative to reaffirm. Moreover the debtor must perform his intention with respect to this property within 30 days after the first meeting of creditors. If the debtor fails to do

so, then Bankruptcy Code section 362(h) provides, with respect to personal property, that the automatic stay terminates and the property is no longer property of the estate, unless the trustee makes a timely motion asserting that the personal property has consequential value to the estate, provides adequate protection to the secured creditor and obtains an order requiring the debtor to deliver the collateral to the trustee. Otherwise, the stay terminates with respect to such property.

Interestingly, while the debtor is required to express an intention with respect to real estate, and requires the debtor to perform his intention on a timely basis, there is no apparent consequence in the Bankruptcy Code in the event that the debtor fails to do so. Thus, it is common practice for debtors not to reaffirm their obligation with respect to real estate and simply "ride through" even if they intend to maintain payments under their mortgages post-petition.

If the debtor has not either expressed an intention with respect to personal property or has not acted upon that intention as expressed within 30 days after the conclusion of the 341 meeting, prudent trustees will move to extend the automatic stay so as to prevent loss of property from the is bankruptcy estate.

Section 521(a)(3) – Cooperation with the Trustee

Section 521(a)(4) – Surrender to Trustee property and recorded information relating to property

The debtor has a duty to provide the Trustee with the specific documents requested.[1] It is not enough to simply give the Trustee access to piles of documents and force him to sort through the information. "It is well settled that a [trustee] should not be required to drag information from a reluctant and uncooperative debtor. Because of the extraordinary relief offered under the Bankruptcy Code delay and avoidance tactics are inconsistent with, and offensive to, its purpose

and spirit." *Anderson v. Wiess (In re Wiess)*, 132 B.R. 588, 593 (Bankr. E.D. Ark. 1991) (citing *In re Tully*, 818 F.2d 106 (1st Cir. 1987)); see also *In re Cochener*, 36,0 B.R. 542 (Bankr. S.D. Tex. 2007), aff'd in part, rev'd in part, 382 B.R. 311 (S.D. Tex. 2007), rev'd, 297 Fed. Appx. 382 (5th Cir. 2008).

A debtor, even a consumer debtor, may be sanctioned for failing to cooperate with the Trustee. If the debtor fails to cooperate with the trustee, or fails to turn over property or records to property, the debtor can be subject to sanctions. *In re Cochener,* 360 B.R. 542 (Bankr. S.D. Tex 2007); *In re Stinson,* 269 B.R. 172 (Bankr. SD OH 2001). Sanctions can be serious to run nature case. In *In re Paige,* 365 B.R. 632 (Bankr. N.D. Tex 2007), the court imposed a sanction the amount of $80,000 against the debtor, a medical doctor who drew a substantial annual income, due to his intentional deceitful conduct and bad faith in concealing various businesses as well as several luxury classic cars and motorcycles from the bankruptcy trustee.

Dismissal is also available as a sanction against the debtor for failure to cooperate. On the other hand, if the debtor does cooperate with the trustee, goes above and beyond what can reasonably have been expected, resulting in tangible and measurable benefit to the trustee and the estate, that debtor might be allowed an administrative expense pursuant to section 503(a) of the Bankruptcy Code. *In re Blurton,* 334 B.R. 601 (Bankr. W.D. Tenn. 2005).

Of course, Debtor's failure to turn over books and records, as well as property, could result consequences far worse than mere dismissal. Such failure can easily result in denial of discharge. *In re Kickel,* 357 B.R. 490 (Bankr. N.D. IL 2006).

Section 521(a)(5) – Appear at the 524(d) hearing

Hopefully, your debtor-client will never have to appear at a 524(d) hearing. That's because this hearing is scheduled to inform a debtor that after the court has made a determination as to whether to grant or deny discharge. If such a hearing is scheduled, the debtor must appear. Although the sanction for not appearing is not explicit, it probably would be a bad idea for debtor to fail to appear.

Section 521(a)(6) – Duty to not retain possession of personal property subject to a secured claim absent reaffirmation or redemption

The Bankruptcy Code sought to put teeth into the obligation of a debtor to state an intention with respect to personal property subject to a security interest.

Section 521(b) Credit Counseling Certificate to be filed

Debtor must file a certificate of credit counseling. The trustee rarely is concerned about this. The United States Trustee typically enforces this obligation. Section 521(b)(2) requires that any debt repayment plan developed be filed too. Debt repayment plans seem to be as rare as hen's teeth. I've yet to see one filed in the past five years. Perhaps more of these are filed in other parts of the country. The theory that credit counseling agencies would develop debt repayment plans which would dissuade people from filing bankruptcy cases seems to have been a fantasy.

Section 521(c) Educational IRA or 529 plan to be filed.

Debtor is supposed to file with the court any interest he has in an education IRA or qualified State Tuition Program. I have seen very few, if any, debtors comply with this provision of the Code. I have not seen any effort from anyone to enforce it either.

Section 521(e) – Provide trustee with tax returns or transcripts

The trustee is to receive – not later than 7 days before the first day set for the 341 meeting – a copy or transcript of the federal income tax return for the most recent tax year ending before the commencement of the case and for which the tax return was filed.

The Bankruptcy Code provides that failure to provide this requires dismissal of the case unless debtor demonstrates that the failure to comply is due to circumstances beyond the control of the debtor. Enforcement of this requirement appears to be highly non-uniform. Many trustees don't require the tax return prior to the meeting. Many trustees don't rigorously seek dismissal of a case for failure to produce the tax return, but rather will continue the meeting until another date.

Section 521(h) – Identification documents for the 341 meeting.

Debtor is required to provide a document establishing identity with a photo-identification card or other identification establishing debtor's identity. Sometimes, even a traffic ticket might suffice.

Additional Duties of Debtor Pursuant to the Federal Rules of Bankruptcy Procedure

Having reviewed the duties of the Debtor pursuant to the Bankruptcy Code, it is worthwhile to consider additional duties of the Debtor under the Federal Rules of Bankruptcy Procedure. Here is the text of Federal Rule of Bankruptcy Procedure 4002.

Rule 4002. Duties of Debtor

(a) In general.

In addition to performing other duties prescribed by the Code and rules, the debtor shall:

(1) attend and submit to an examination at the times ordered by the court;

(2) attend the hearing on a complaint objecting to discharge and testify, if called as a witness;

(3) inform the trustee immediately in writing as to the location of real property in which the debtor has an interest and the name and address of every person holding money or property subject to the debtor's withdrawal or order if a schedule of property has not yet been filed pursuant to Rule 1007;

(4) cooperate with the trustee in the preparation of an inventory, the examination of proofs of claim, and the administration of the estate; and

(5) file a statement of any change of the debtor's address.

(b) Individual debtor's duty to provide documentation.

(1) Personal identification.

Every individual debtor shall bring to the meeting of creditors under § 341:

(A) a picture identification issued by a governmental unit, or other personal identifying information that establishes the debtor's identity; and

(B) evidence of social-security number(s), or a written statement that such documentation does not exist.

(2) Financial information.

Every individual debtor shall bring to the meeting of creditors under § 341, and make available to the trustee, the following documents or copies of them, or provide a written statement that the documentation does not exist or is not in the debtor's possession:

(A) evidence of current income such as the most recent payment advice;

(B) unless the trustee or the United States trustee instructs otherwise, statements for each of the debtor's depository and investment accounts, including checking, savings, and money market accounts, mutual funds and brokerage accounts for the time period that includes the date of the filing of the petition; and

(C) documentation of monthly expenses claimed by the debtor if required by § 707(b)(2)(A) or (B).

(3) Tax return.

At least 7 days before the first date set for the meeting of creditors under § 341, the debtor shall provide to the trustee a copy of the debtor's federal income tax return for the most recent tax year ending immediately before the commencement of the case and for which a return was filed, including any attachments, or a transcript of the tax return, or provide a written statement that the documentation does not exist.

(4) Tax returns provided to creditors.

If a creditor, at least 14 days before the first date set for the meeting of creditors under § 341, requests a copy of the debtor's tax return that is to be provided to the trustee under subdivision (b)(3), the debtor, at least 7 days before the first date set for the meeting of creditors under § 341, shall provide to the requesting creditor a copy of the return, including any attachments, or a transcript of the tax return, or provide a written statement that the documentation does not exist.

(5) Confidentiality of tax information.

The debtor's obligation to provide tax returns under Rule 4002(b)(3) and (b)(4) is subject to procedures for safeguarding the confidentiality of tax information established by the Director of the Administrative Office
of the United States Courts.

The purpose of Rule 4002 is to flesh out the debtor's obligations under Section 521 of the Bankruptcy Code. In my experience as a trustee, it is has been my observation that debtors attorneys frequently are unaware of the full extent of debtor's obligations under Rule 4002. Too many members of the consumer debtor's bar are not fully conversant with all obligations imposed upon the debtor under the rule.

Bankruptcy Rule 4002(a) Debtors' Obligations in General

Debtor has an obligation to attend and submit to an examination at times ordered by the Court. This includes the debtor's obligation to attend the 341 meeting, to submit to a Rule 2004 examination. The debtor's appearance can be compelled to attend an examination under Rule 2005 and even taken into custody if necessary pursuant to that rule.

Identification

Debtor is required to provide a photo identification issued by a governmental unit or other personal information establishing identity. This is arguably beyond the requirements in the

Bankruptcy Code. Further, debtor is required to present evidence of a social security number or a statement that such documentation does not exist. Nothing in the Bankruptcy Code requires the debtor to have a social security number. Individual tax identification numbers may well suffice. Or a statement that debtor has no social security number may well be sufficient. I have rarely encountered much difficulty with this requirement.

Other divisions of Rule 4002(a) are less known and worthy of special consideration.

Informing the Trustee

Debtor has the affirmative obligation to inform the trustee immediately, and in writing, as to the location of real estate in which the debtor has an interest. This includes leasehold interests, remainder interests after life estates, equitable interests under trusts and any other cognizable interest in real estate. This includes real estate anyplace in the world. This is necessary so that the trustee can then file a document with the recorder of deeds of the appropriate county as to the estate's interest in real estate pursuant to Bankruptcy Code section 549.

Further, debtor must inform the trustee as to the name and address of every person holding money or property subject to the debtor's withdrawal or order. This includes, for example, and not by way of any limitation.

- Self storage units
- Safety deposit boxes
- Bailees
- Pay Pal
- eBay

- Gambling websites
- Sports books, whether legal or not legal

Finally, debtors must provide the trustee with timely notice of any change of address.

Cooperation with the Trustee

Section 521 of the Bankruptcy Code requires debtors to cooperate. Rule 4002(a)(4) fleshes out this duty by imposing the following specific obligations upon debtors:

- Assist trustee in preparation of an inventory
- Assist trustee in examination of claims
- Assist trustee in administration of the estate.

This duty is broad enough to cover assisting trustee in pursuit of claims of debtor in litigation, even if the debtor doesn't stand to gain any economic benefit from these claims. Failure to cooperate may result in an order of the court to compel debtor's cooperation. And failure to comply with such a court order might result in denial or revocation of discharge.

Financial Information

Debtors must provide the trustee at the 341 meeting with evidence of current income such as the most recent pay advice pursuant to Rule 4002(b)(2)(A). The debtor's bar has seemed to have adopted well to this requirement. However, Debtors must also provide the trustee, unless instructed otherwise by the trustee or the United States Trustee, statements for each of the debtors' depository and investment accounts including:

- Checking

- Saving
- Money Market
- Mutual funds
- Brokerage Accounts

The statements must cover the date of the filing of the petition. This rule is not enforced uniformly throughout the nation. Trustees' practices vary widely not only among the districts but even within the districts. Moreover, local rules and practices frequently require additional documentation to be provided. It seems to me that a debtor's attorney would have some difficulty filing accurate bankruptcy petitions without having this information in his or her possession at the time of filing. Obviously best practices would suggest that debtor's counsel require debtors to obtain verification as to the balances in the debtor's account as of the date of the filing of the petition, particularly if there is even the slightest question as to whether a portion of the funds in these accounts might not be exempt.

Finally, Bankruptcy Rule 4002(b)(3) and 4002(b)(4) implement the requirement in Section 521 of the Bankruptcy Code that debtor provide the most recent tax return or transcript within 7 days prior to the 341 meeting.

The Trustee's Duties

We've discussed, in depth, the debtor's duties. Of course, the trustee has many duties as well. The debtor has the obligation to cooperate with the trustee in the fulfillment of his or her duties.

The source of the chapter 7 trustee's duties is found in Bankruptcy Code section 704. Among the trustee's duties in chapter 7 include:

- Collection of all property of the estate and reducing it to cash, while closing the estate as quickly as possible consistent with the best interests of all parties in interest
- Maintain accountability for all property
- Make sure that debtors carry out their intention with respect to personal property which secures debt
- Investigate the financial affairs of debtor
- Examine proofs of claim and object if necessary
- Oppose discharge of debtor if appropriate
- Provide information to others related to the estate
- Operate the business of debtor if authorized and make appropriate reports on the operation
- Make a final report and final account
- Give notices to creditors holding claims arising from domestic support obligations regarding the commencement of the case and entry of the order of discharge
- Comply with the duties of an administrator under any ERISA employee benefit plan
- Use all reasonable efforts to transfer patients of a health care business to another similar business in the vicinity

In cases in which no assets are administered, the trustee receives a fee of $60 for all such services. Clearly, the trustee has an incentive to locate assets. The debtor, just as clearly, would like to keep as many assets as possible. The tension between trustee's duties and debtor's obligations frequently leads to friction and difficulty in the relationship between trustee and debtor as well as their respective attorneys. However, all parties are better served by a cooperative and respectful relationship.

The presentation accompanying this paper is not intended to reflect a typical bankruptcy case but rather the consequences which might arise when debtors and their attorneys fail to be sufficiently aware of and focused on their obligations under the Bankruptcy Code. It is our hope that all participants in the bankruptcy system make every effort to comply with their respective duties and obligations.

The Trustee's Duties and Function

Hon. Laura K. Grandy
Chief Judge
United States Bankruptcy Court
Southern District of Illinois

I. Introduction

II. Trustee's Duties

A. Collecting and Liquidating Assets Expeditiously and in the Best Interests of the Estate — Bankruptcy Code §704(a)(1)
   1. Investigation of Assets
   2. Turnover of Assets
   3. Sale of Assets
   4. Abandonment of Assets
   5. Lifting the Automatic Stay

B. Being Accountable for All Property Received — Bankruptcy Code §704(a)(2)

C. Ensuring the Debtor Performs His or Her Intentions as Specified in Bankruptcy Code §521(a)(2)(B) — Bankruptcy Code §704(a)(3)

D. Investigating the Financial Affairs of the Debtor — Bankruptcy Code §704(a)(4)

E. Examining Proofs of Claim — Bankruptcy Code §704(a)(5)

F. Opposing Discharge of the Debtor — Bankruptcy Code §704(a)(6)

G. Furnishing Information Concerning the Estate and the Estate's Administration to Parties in Interest upon Request — Bankruptcy Code §704(a)(7)

H. Filing Final Reports — Bankruptcy Code §704(a)(9)

I. Providing Notice to Domestic Support Obligation Claimants and State Child Support Enforcement Agencies — Bankruptcy Code §704(a)(10)

III. Avoiding Powers

A. General Power — Bankruptcy Code §544

B. Statutory Liens — Bankruptcy Code §545

C. Avoidance Limitations — Bankruptcy Code §546

D. Preferences — Bankruptcy Code §547
   1. Elements of a Preference Action
   2. Defenses to a Preference Action
      a. Contemporaneous Exchange for New Value
      b. Transaction in the Ordinary Course of Business
      c. Purchase Money New Value/Relation Back
      d. Domestic Support Obligations
      e. Thirty-Day Relation-Back Period for Perfection of Any Transfer
      f. Non-profit Credit Counseling Payments
      g. $600 Limit on Consumer Transfers
      h. Other Defenses

E. Fraudulent Transfers — Bankruptcy Code §548
   1. Actual Fraud
   2. Constructive Fraud
   3. Self-Settled Trust

F. Post-Petition Transfers

I. INTRODUCTION

The Chapter 7 trustee is the engine that drives a Chapter 7 case. The trustee sets in motion the duties required by the Bankruptcy Code of the trustee, debtor, creditors, and attorneys. In fulfilling the most basic function of a trustee — to liquidate and distribute the assets of the estate — the trustee serves as the watchdog and enforcer of the Code.

The filing of a Chapter 7 petition generates the appointment of an interim trustee. 11 U.S.C. §701. The United States Trustee's Office is charged with appointing as interim trustee one disinterested person who is a member of the panel of private trustees established under 28 U.S.C. §586(a)(1). 11 U.S.C. §701(a)(1). In Chapter 7 cases, the United States Trustee either appoints panel trustees regionally or employs a random model for appointment of panel trustees in populated areas to avoid "trustee shopping." The interim trustee serves unless a trustee is elected under 11 U.S.C. §702. 11 U.S.C. §701(b). If no trustee is elected at the §341 meeting of creditors, then the interim trustee becomes the permanent trustee. 11 U.S.C. §702(d).

The role of the interim trustee is to take possession of and protect the assets of the estate. To qualify as trustee, the individual must file a bond in favor of the United States with the court. 11 U.S.C. §322. The bankruptcy trustee is a fiduciary who impartially administers the estate for the benefit of creditors.

The Chapter 7 trustee also serves as the "eyes and ears" of the United States Trustee's Office and is charged with referring cases of debtor fraud and creditor abuse to that office. The Chapter 7 trustee will refer to the United States Trustee's Office cases of identity fraud and other criminal activity that may be related to a bankruptcy.

This chapter focuses on the Chapter 7 trustee's duties in consumer cases, many of which are also required of Chapter 12 and 13 trustees.

II. TRUSTEE'S DUTIES

Section 704 of the Bankruptcy Code sets forth the duties of a Chapter 7 trustee. 11 U.S.C. §704. Sections A-I below discuss the above-referenced duties as they relate to a consumer bankruptcy case.

A. Collecting and Liquidating Assets Expeditiously and in the Best Interests of the Estate — Bankruptcy Code §704(a)(1)

1. Investigation of Assets

When a debtor files bankruptcy, every property right the debtor has becomes property of the estate. 11 U.S.C. §541. Property of the estate could include something as obvious as real estate, furniture, or a car or something less tangible such as a tax refund, or the cash value in a life insurance policy. A debtor's interest in a cause of action will also become property of the bankruptcy estate upon the filing of the bankruptcy petition and the trustee then becomes the property owner of the claim and the real party in interest. *See Kleven v. Walgreen Company (In re Christian),* 373 Fed. Appx. 608 (7th Cir. 2010).

In each instance, the trustee must balance the benefit of recovering an asset against the costs of recovery to the estate. The trustee will begin by examining the schedules filed by the debtor to determine

the "equity" in the assets. To arrive at the equity, the trustee will value each asset and deduct the liens and exemptions claimed against the asset. The trustee will also consider the costs of the liquidation, which includes the trustee's fees and may include appraisers, auctioneers, realtors, attorneys, accountants, and other recovery costs.

Property of the estate is determined as of the date the debtor files the Chapter 7 petition. Therefore, a prorated portion of the debtor's next tax refund may be recovered by the trustee. For example, if the debtor files a Chapter 7 bankruptcy on September 30, 2010, the trustee may choose to keep the case open until the debtor files his 2010 tax returns. In that case, the trustee could recover ¾ of any refunds less any exempt portion of the refunds. *See In re Andrea Meyers*, 616 F.3d 626 (7th Cir. 2010).

The trustee will next conduct a §341 meeting. 11 U.S.C. §341. The §341 meeting is set by the United States Trustee. Fed.R.Bankr.P. 2003. From the schedules, the trustee will formulate questions to ask about the assets, liabilities, income, and expenses of the debtor. The trustee will also confirm certain information at the §341 meeting such as the debtor's identity and social security number. The trustee presides over the hearing. Each debtor is sworn in, and the proceeding is recorded. Fed.R.Bankr.P. 2003(c). Creditors are given an opportunity by the trustee to ask questions regarding the debtor's petition and schedules at the §341 meeting. The trustee serves as the moderator of the §341 meeting and may limit the questioning of creditors or continue the meeting to allow all §341 meetings to remain on time since several §341 meetings are usually set at one time. Thus, it is important for the trustee to be prepared for each §341 meeting.

Each district will vary as to the documents required to be produced to the trustee by the debtors and creditors prior to the meeting. Debtors are generally required to provide the trustee with copies of their schedules, most recent tax returns, and payment advices. 11 U.S.C. §521. Failure to provide the trustee with a copy of the most recent tax return at least seven days prior to the first date set for the §341 meeting will result in dismissal of the case. 11 U.S.C. §521(e)(2). Secured creditors should provide the trustee with a copy of the documents verifying their lien. For instance, mortgage holders should provide the trustee with a recorded copy of the mortgage. Debtors and creditors should review the local rules and contact the trustee to verify the documents required prior to the §341 meeting.

At the §341 meeting, the trustee may question the debtor regarding exemptions claimed. The trustee must file an objection to the claimed exemptions within 30 days of the completion of the §341 meeting or the exemptions will be allowed. The trustee may request an extension of the time for filing objections before the time to object expires. Fed.R.Bankr.P. 4003(b). If an item of property is later found by the trustee to have a value in excess of the value schedules and exempted by the debtor, the debtor's interest in the property will be limited to that amount exempted. For example, if a debtor values a piano at $3,000 and applies $3,000 of her exemptions to the piano, the debtor will only be entitled to a $3,000 exemption payment from the trustee should the trustee sell the piano for more than $3,000. *See Schwab v. Reilly*, _ U.S. _, 130 S.Ct. 2652, 177 L.Ed.2n 234 (2010).

In order to obtain more information from the debtor or an entity, the trustee may conduct a Rule 2004 exam. Fed.R.Bankr.P. 2004. At the Rule 2004 exam, the trustee may require the production of documents to verify information on the schedules or to pursue a cause of action. Fed.R.Bankr.P. 2004(c).

2. Turnover of Assets

The trustee must collect, preserve, and protect any assets with equity. 11 U.S.C. §704(a)(1). The trustee may file a motion for turnover to require a debtor to turn over property of the estate that the trustee may use, sell, or lease. 11 U.S.C. §542(a). The trustee may also file a complaint for turnover against any entity in possession or control of an asset of the estate or that owes a debt to the estate. 11 U.S.C. §542(b). The trustee will administer all assets having equity for the estate. These assets include (among others) the equity in the debtor's vehicles, residence, rental property, time-shares, insurance policies, investments, and personal injury lawsuits. With respect to personal injury suits, the trustee will file an application to employ an attorney to represent the estate's interest in the suit. If the debtor has already employed an attorney, the trustee will usually employ the same attorney as a matter of efficiency. The trustee will need to have any settlement approved by the bankruptcy court as well as any payment of attorney's fees.

The trustee must keep all funds received in interest-bearing accounts and provide periodic reports for each account to the United States Trustee's Office.

3. Sale of Assets

Trustees are allowed to sell assets of the estate after a 21-day notice is given to all creditors of the debtor. 11 U.S.C. §363. Generally, the trustee is not required to give notice to the general public. Professionals, such as auctioneers and real estate agents may be retained by the trustee to assist with the sale. Employment of professionals requires approval by the bankruptcy court. 11 U.S.C. §327; Fed.R.Bankr.P. 2014.

The trustee may sell the assets free and clear of an interest of an entity if (a) applicable non-bankruptcy law would permit the sale free of the interest, (b) the entity consents, (c) the interest is a lien and the sale price is greater than all aggregate liens on the property, (d) the interest is in *bona fide* dispute, or (e) the entity could be compelled in a legal or equitable proceeding to accept a money satisfaction of its interest. 11 U.S.C. §363(f). The bankruptcy court may approve the trustee's sale over the objection of a lienholder, with the lien attaching to the proceeds. If a competitive bid is received by the trustee in response to the notice of sale, a hearing will be held, at which time the bankruptcy court will sell the property to the highest and best bidder. Upon completion of the sale and receipt of funds, the trustee will file a report of sale with the bankruptcy court, setting forth the asset sold, sales price, and buyer's name.

4. Abandonment of Assets

Most of the assets of an estate tend to be encumbered by one or more liens and/or be exempt. In such cases, the trustee will abandon the estate's interest in the asset after notice and a hearing and ownership of the asset then reverts to the debtor. 11 U.S.C. §554(a). Abandonment results in the asset no longer being part of the estate. The trustee will also abandon property that is inconsequential in value. *Id.* A party in interest, after notice and hearing, may also request abandonment of property. 11 U.S.C. §554(b). The trustee will need to object to the creditor's motion for abandonment if there is equity in the asset, or the property will be deemed abandoned. In certain circumstances, property of the estate may be abandoned for the debtor's failure to surrender or carry out the debtor's statement of intentions. 11 U.S.C. §521(a)(6). The trustee will need to file a motion that the property is of consequential value or of benefit to the estate to prevent the abandonment of the property in those circumstances. 11 U.S.C. §362(h)(2).

5. Lifting the Automatic Stay

The trustee will need to object to a motion to lift the automatic stay when there is equity in the asset or when a creditor requesting relief has failed to provide proof that it has a lien on the asset. When necessary to protect assets, the trustee will also need to file a motion with the court to prevent the stay from lifting automatically for the debtor's failure to file certain documents. 11 U.S.C. §521(i)(4).

B. Being Accountable for All Property Received — Bankruptcy Code §704(a)(2)

Section 704(a)(2) of the Bankruptcy Code requires the trustee to be accountable for all property received. 11 U.S.C. §704(a)(2). This requires the trustee to identify, insure, and protect the assets of the estate. If the assets are of a type that require an inventory, the trustee will request an inventory from the debtor, verify an existing inventory, or create a new inventory. The trustee is required to keep records of the assets/inventory of the estate. Fed.R.Bankr.P. 2015(a). The inventory should be detailed enough to verify later sales. The trustee will obtain insurance on assets to protect the value for the estate and require immediate turnover of uninsured unencumbered assets. Often, the trustee will photograph or videotape the assets. The trustee will be responsible for preserving and protecting the assets. For example, the trustee will take actual possession of nonexempt furs and jewelry as well as place locks on other estate property. The trustee will also give notice of the bankruptcy to every entity known to be holding money or property subject to withdrawal by the debtor. *Id.*

C. Ensuring the Debtor Performs His or Her Intentions as Specified in Bankruptcy Code §521(a)(2)(B) — Bankruptcy Code §704(a)(3)

Section 521(a)(2)(A) of the Bankruptcy Code requires the debtor who has debts secured by property of the estate to file a statement of intention with respect to retaining or surrendering such property. 11 U.S.C. §521(a)(2)(A). The statement of intention must be filed within 30 days after the filing of the petition or on or before the first meeting of creditors. *Id.* Section 521(a)(2)(B) requires the debtor to perform his or her intention within 30 days after the first meeting of creditors. The trustee must ensure that the debtor complies with §521(a)(2)(B) to prevent the property from being automatically abandoned. The trustee will need to file a motion, not later than 45 days after the first meeting of creditors, stating that the property is of benefit to the estate to prevent the automatic abandonment of the property. 11 U.S.C. §521(a)(6). The court, after notice and a hearing, may then enter an order determining that the asset is of benefit to the estate, require adequate protection of the secured creditor's interest, and order the debtor to turn the asset over to the trustee. *Id.*

D. Investigating the Financial Affairs of the Debtor — Bankruptcy Code §704(a)(4)

The trustee will begin investigation of the debtor's financial affairs under Bankruptcy Code §704(a)(4) by reviewing the schedules and statement of financial affairs. 11 U.S.C. §704(a)(4). The trustee will also review the debtor's tax returns, pay advices, bank records, and financial statements. The debtor is required to disclose financial institutions to whom the debtor provided financial statements. The trustee will review the old financial statements and insurance policies to determine undervalued or missing assets. A substantial amount of credit card debt may lead the trustee to undisclosed assets purchased on credit. Credit card statements will be reviewed for cash withdrawals prior to bankruptcy that could lead to additional assets.

The trustee will use this information to prepare for the §341 meeting. If more information is needed, the trustee will set a Bankruptcy Rule 2004 exam of the debtor.

E. Examining Proofs of Claim — Bankruptcy Code §704(a)(5)

When a purpose would be served, the trustee will examine proofs of claim and object under Bankruptcy Code §704(a)(5). 11 U.S.C. §704(a)(5). For instance, the trustee will review proofs of claim to verify perfection of security interests. Objections to unsecured claims will be filed only in asset cases.

If there are assets in a case for distribution, the trustee will request that the court set a claims bar date. The clerk's office will send notice to all creditors setting the time period in which to file claims. The trustee will review the claims register to determine the timeliness of claims filed and make appropriate objections. A proof of claim is prima facie evidence of the amount owed by the debtor to a creditor. Thus, the trustee must file an objection to claims when necessary. The trustee will object to secured claims because secured creditors are required to look to their collateral for payment and do not receive a distribution in a Chapter 7 bankruptcy.

F. Opposing Discharge of the Debtor — Bankruptcy Code §704(a)(6)

The Bankruptcy Code imposes a duty on the trustee to object to discharge "if advisable." 11 U.S.C. §704(a)(6). The trustee will examine the conduct of the debtor to determine whether grounds exist for denial of discharge. 11 U.S.C. §727(c). Specifically, the trustee will investigate acts of fraud such as asset concealment, false records, or destruction of records to verify information. The grounds on which a discharge may be denied are set forth more fully in 11 U.S.C. §727. Complaints objecting to discharge must be filed within 60 days of the first date set for the §341 meeting unless a timely request for extension of time is made. Fed.R.Bankr.P. 4004(a).

If fraud was discovered after a discharge was granted, the trustee may seek to revoke a discharge. 11 U.S.C. §727(d). The trustee must file such a request to revoke discharge within one year after the discharge was granted. 11 U.S.C. §727(e). In certain circumstances, such as when a debtor acquires property of the estate and fails to report the acquisition or entitlement to acquire the property, or if the debtor refuses to obey any lawful order of the court (other than an order to respond to a material question or to testify on the ground of privilege against self-incrimination), the trustee may request a revocation of discharge before the later of one year after the granting of the discharge or the date the case is closed. *Id.*

The trustee may file an objection to discharge in no-asset cases as well as asset cases. The trustee has a duty to prevent fraud on the estate and may proceed to object to discharge. Even though an estate may be a no-asset case, the debtor may have future earning potential to pay back the debt.

G. Furnishing Information Concerning the Estate and the Estate's Administration to Parties in Interest Upon Request — Bankruptcy Code §704(a)(7)

The trustee has a duty to provide information regarding the estate to parties in interest when requested. 11 U.S.C. §704(a)(7). In certain circumstances, the trustee may request an order of the court protecting information so as to avoid disclosure. An example of this is a protective order to not disclose health information about the debtor or a family member.

H. Filing Final Reports — Bankruptcy Code §704(a)(9)

The Bankruptcy Code requires a Chapter 7 trustee to make a final report and file a final account of the administration of the case. 11 U.S.C. §704(a)(9). This is done when the trustee is ready to close the case. The trustee must certify in the final report that all assets have been liquidated or properly accounted for and that funds of the estate are available for distribution. The trustee will first submit this report to the United States Trustee and then file it with the court upon approval by the United States Trustee. No distribution can be made until the final report is approved by the court. Fed.R.Bankr.P. 5009. See also HANDBOOK FOR CHAPTER 7 TRUSTEES, pp. 8-37, 8-41 (available online at www.usdoj.gov/ust/eo/private_trustee/library/
chapter07). The trustee must prepare the final report in the format prescribed by the United States Trustee. Prior to filing the final report, the trustee will file a final tax return, if necessary. Along with the final report, the trustee will submit any outstanding applications for professional compensation and expenses. The final report will set forth the proposed distribution so that the creditors may determine the priority of their claims and how much they will receive. 11 U.S.C. §726.

After approval of the final report and distribution of the funds, the trustee must submit a final account to the United States Trustee certifying that the estate has been fully administered in accordance with the report. Fed.R.Bankr.P. 5009. The original bank statement and canceled checks are attached to the final account. Once the final account has been filed with the bankruptcy court, the case is closed and the trustee is discharged.

I. Providing Notice to Domestic Support Obligation Claimants and State Child Support Enforcement Agencies — Bankruptcy Code §704(a)(10)

Section 704(a)(10) of the Bankruptcy Code requires a Chapter 7 trustee to provide specific information to domestic support obligation claimants and the state agencies responsible for collecting support in the state where the claimant resides. 11 U.S.C. §704(a)(10). Section 704(c)(1) requires that the trustee

> **(A)(i) provide written notice to the holder of the claim . . . of such claim and of the right of such holder to use the services of the State child support enforcement agency established under sections 464 and 466 of the Social Security Act for the State in which such holder resides, for assistance in collecting child support during and after the case under this title;**
>
> **(ii) include in the notice . . . the address and telephone number of such State child support enforcement agency; and**
>
> **(iii) include in the notice . . . an explanation of the rights of such holder to payment of such claim under this chapter;**
>
> **(B)(i) provide written notice to such State child support enforcement agency of such claim; and**
>
> **(ii) include in the notice . . . the name, address, and telephone number of such holder; and**

(C) at such time as the debtor is granted a discharge under section 727, provide written notice to such holder and to such State child support enforcement agency of —

(i) the granting of the discharge;

(ii) the last recent known address of the debtor;

(iii) the last recent known name and address of the debtor's employer; and

(iv) the name of each creditor that holds a claim that —

(I) is not discharged under paragraph (2), (4) or (14A) of section 523(a); or

(II) was reaffirmed by the debtor under section 524(c).

The above-referenced sections of the Code require the trustee to send four different notices. The trustee will need to obtain and verify the information needed. This requires the trustee to ask questions at the §341 meeting to determine if there are any such obligations and obtain the necessary addresses for the first two notices. Some trustees will prepare forms to use at the §341 meeting for this purpose. After the discharge is entered, the trustee will need to review the docket to determine whether any debts were reaffirmed or determined nondischargeable. This information will need to be included in the second set of notices.

Although no time frame is provided by statute to send the initial notice, the United States Trustee's Office suggests that the notice be sent no later than three business days after the §341 meeting is held. See HANDBOOK FOR CHAPTER 7 TRUSTEES, p. 6-14 (available at www.usdoj.gov/ust/eo/private_trustee/library/chapter07/docs/7handbook1008/Ch7_Handbook.pdf (case sensitive)). The United States Trustee's Office requires that notices to state child support enforcement agencies include the debtor's full social security number, except where prohibited by state law or regulation. *Id.* The debtor's full social security number should not be included on notices filed with the court or sent to the claim holder. *Id.*

III. AVOIDING POWERS

One of the most significant powers granted in the Bankruptcy Code is the ability of a trustee to avoid certain transactions and recover property of the estate. The primary avoidance powers are set forth in §§544 – 549 of the Code. 11 U.S.C. §§544 – 549. The basic goal of the avoidance powers is to promote equality among creditors. For instance, the avoidance powers set forth in §547 allow a trustee to recover funds collected by an overzealous creditor within 90 days before the filing of the bankruptcy while a more patient creditor waited to be paid. Avoidance powers also allow a trustee to undo certain transfers by a debtor to benefit a particular creditor or insider. The avoidance powers allow a trustee to set aside transfers made both before and after filing of a bankruptcy petition. The trustee will begin by making a demand for recovery of the transfer. If unsuccessful in recovering the transfer, the trustee will file an adversary complaint pursuant to Fed.R.Bankr.P. 7001.

"Transfer," as defined under the Bankruptcy Code, is extremely broad. 11 U.S.C. §101(54). Transfers that may be avoided extend from unperfected liens to fraudulent conveyances. The trustee may recover

transfers under §§544 – 549 for the benefit of the estate. Thus, if a debtor's house is secured by a first and second mortgage and the trustee avoids the first mortgage, the estate would stand in the position of the first mortgage — ahead of both the secured mortgage and the debtor's exemption.

A. General Power — Bankruptcy Code §544

Section 544(a) of the Bankruptcy Code cloaks the trustee with the powers of a hypothetical judicial lien creditor or bona fide purchaser of real property. 11 U.S.C. §544(a). The effect is to allow the trustee to avoid unperfected and undisclosed liens, even if the debtor or the trustee had knowledge of the liens. This section allows a trustee to use state law remedies such as fraudulent conveyance laws and equitable remedies to set aside and marshal transfers.

B. Statutory Liens — Bankruptcy Code §545

Bankruptcy Code §545 authorizes the trustee to avoid certain statutory liens against the debtor's property, such as landlord liens. 11 U.S.C. §545. The term "statutory lien" is defined in 11 U.S.C. §101(53). Mechanics liens, although a form of statutory lien, are not avoidable by the trustee if properly perfected under state law at the time the bankruptcy was commenced or within the statutory time post-petition. See generally, Mechanics Lien Law in Illinois, Chapter 12 Mechanics Liens in Bankruptcy, IICLE (2010).

C. Avoidance Limitations — Bankruptcy Code §546

Section 546 of the Bankruptcy Code places limitations on the trustee's avoidance powers. 11 U.S.C. §546. Section 546(a) provides that an action or proceeding brought under §544, §545, §547, or §548 may not be commenced after the earlier of

(1) the later of —

(A) 2 years after the entry of the order for relief; or

(B) 1 year after the appointment or election of the first trustee under section 702, 1104, 1163, 1202, or 1302 of this title if such appointment or such election occurs before the expiration of the period specified in subparagraph (A); or

(2) the time the case is closed or dismissed.

This section gives a trustee who is appointed or elected at least one year (or the balance of the two-year period, if it is greater) in which to bring an avoidance action.

D. Preferences — Bankruptcy Code §547

1. Elements of a Preference Action

The preferential transfer is probably the most frequently used avoiding power of the trustee. The term "transfer" includes not only voluntary payments of money and tangible property by the debtor, but also involuntary payments such as setoffs, garnishments, and repossessions. The creation or perfection of a lien on the debtor's property is also a transfer. 11 U.S.C. §101(54). Bankruptcy Code §547(b) sets forth

five elements that the trustee must prove to establish a preferential transfer. 11 U.S.C. §547(b). They are as follows:

The transfer must be to or for the benefit of a creditor. The term "creditor" is defined in 11 U.S.C. §101(10) very broadly. Subsection 101(10)(A) defines a creditor as an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor." A claim can include a right to payment whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured. 11 U.C.S. §101(5)(A). The debtor is required to disclose the names of creditors who received such transfers in the statement of financial affairs filed with the court. The trustee will often review check records or credit card statements to look for such transfers.

The transfer must be for an antecedent debt. "Antecedent debt" has been defined as a debt existing as of the petition date even if the claim is unliquidated, unfixed, or contingent. *Warsco v. Preferred Technical Group*, 258 F.3d 557 (7th Cir. 2001); *In re Wey*, 854 F.2d 196 (7th Cir. 1988). An antecedent debt includes the unpaid balances on loans even if the debtor is current with installment payments.

The debtor must be insolvent at the time of the transfer. The transfer must have been made while the debtor was insolvent. The Code presumes the debtor was insolvent on or during the 90 days immediately preceding the date of the filing of the petition. 11 U.S.C. §547(f). This is a rebuttable presumption, and the burden of proof may shift to the trustee. An individual is defined as insolvent if that individual's debt is greater than the fair market value of all of that individual's property, exclusive of fraudulently conveyed or concealed property. 11 U.S.C. §101(32). While litigation over insolvency in business cases can be complicated, consumer cases are more straightforward.

The transfer must be made within 90 days of the petition date for non-insiders or one year of the petition date for insiders. Section 547(b)(4) focuses on two separate time frames. Transfers are avoidable as to non-insiders only if made on or within 90 days of the petition date. Transfers are avoidable as to insiders if made within one year of the petition date. The Bankruptcy Code defines "insiders" as including relatives, a partnership in which the debtor is general partner, a general partner of the debtor, and a corporation in which the debtor is a director, officer, or person in control. 11 U.S.C. §101(31). In a consumer case, an insider will most likely be a relative of the debtor. "Relative" means an individual related by affinity or consanguinity within the third degree as determined by the common law, or an individual in a step or adoptive relationship within such degree. 11 U.S.C. §101(45). Persons who have a close relationship with the debtor such as a common-law wife or live-in boyfriend may also be considered insiders of the debtor. *Walsh v. Dutil (In re Demko)*, 264 B.R. 404 (Bankr. W.D.Pa. 2001); *McHugh v. Anderson (In re McHugh)*, No. 02 B 10425, 2003 Bankr. LEXIS 414 (Bankr. N.D.Ill. May 1, 2003) (published electronically only). The former *Deprizio* doctrine of preference avoidance (announced by the Seventh Circuit in *Levit v. Ingersoll Rand Financial Corp.*, 874 F.2d 1186 (7th Cir. 1989)) that permitted a trustee to recover an insider preference from a third-party payee has been abolished under 11 U.S.C. §547(i). A trustee may now recover an insider preference made outside 90 days but within one year only directly from an insider. 11 U.S.C. §547(i). The 90-day period is determined by counting backward starting with the day before the petition was filed. With respect to transfers by check, the date on which a check is honored is considered the date on which the transfer occurred. *Barnhill v. Johnson*, 503 U.S. 393, 118 L.Ed.2d 39, 112 S.Ct. 1386 (1992).

The creditor must have received more from the transfer than in a Chapter 7. The purpose of the preference statute is to recover payments within certain time frames and redistribute those payments *pro*

rata to all creditors. Section 547(b)(5) provides that a transfer may be avoided only if the transfer enables the creditor to receive more than the creditor would receive if

> **(A) the case were a case under Chapter 7 of this title;**
>
> **(B) the transfer had not been made; and**
>
> **(C) such creditor received payment of such debt to the extent provided by the provisions of this title.**

This subsection is usually easy for the trustee to prove because few bankruptcies result in the creditors being paid in full. Payments to secured creditors during the 90 day preference period, however, do not ordinarily meet the final criteria because the payment does not enable the creditor to receive more than it would receive in a hypothetical Chapter 7 liquidation. For example, if a debtor pays off a car loan within 90 days prior to the bankruptcy by paying $4,000 to the bank which has a perfected lien on the car title, the trustee cannot recover the payment from the bank so long as the car was worth at least $4,000. The bank would have received payment in full in a hypothetical liquidation so it did not improve its position when it received the $4,000 payment from the debtor and released its lien prior to the bankruptcy filing.

2. Defenses to a Preference Action

The Bankruptcy Code provides a number of affirmative defenses that a preference defendant may assert. These defenses are discussed in detail in below. Defenses are usually fact intensive and may involve the use of accountants and experts.

a. Contemporaneous Exchange for New Value

One affirmative defense a preference defendant may assert is contemporaneous exchange for new value. 11 U.S.C. §547(c)(1). "New value" is defined at 11 U.S.C. §547(a)(2) and in consumer cases is commonly an extension of new credit simultaneously back to the debtor or the release of a lien. *Richardson v. Fleet Credit Card Services, L.P. (In re Duncan),* 312 B.R. 184 (Bankr. C.D.Ill. 2004). The Seventh Circuit requires that new value remain unpaid so that, for instance, if credit is extended, it remains unpaid as of the petition date. *In re Prescott,* 805 F.2d 719, 731-732 (7th Cir. 1986); *McKloskey v. Schabel (In re Schabel),* 338 B.R. 376 (Bankr. E.D.Wis. 2005). Other circuits have ruled differently. *See In re JKJ Chevrolet, Inc.,* 412 F.3d 545 (4th Cir. 2005); *In re IRFM, Inc.,* 52 F.3d 228 (9th Cir. 1995).

With respect to the proposition that the "new value" defense is available in the Seventh Circuit only when the new value extended remains unpaid, *See also Begler v. Maxwell,* No. 07 C 4757, 2008 U.S.Dist. LEXIS 8760 (N.D.Ill. Feb. 5, 2008). This defense is not established when a third party pays the new value and seeks reimbursement from the bankruptcy estate. *See Maxwell v. Begler (In re marchFIRST, Inc.),* No. 01 B 24742, 2008 Bankr. LEXIS 2466 (Bankr. N.D.Ill. July 20, 2007).

b. Transaction in the Ordinary Course of Business

A second affirmative defense a preference defendant may assert is the ordinary course of business defense. 11 U.S.C. §547(c)(2). In the past, the ordinary course of business defense was often asserted but difficult to prove because it required the defendant to prove three separate elements:

1. The transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee.

2. The transfer was made in the ordinary course of business or financial affairs of the debtor and the transferee.

3. The transfer was made according to ordinary business terms.

The first element is fairly easy to establish. The second element requires the defendant to prove the time frame that normally elapsed between invoice and payment between the debtor and the defendant during the 90-day period and between the debtor and the defendant prior to the 90-day period. Payments according to the parties' terms are presumptively ordinary and should stand unless the trustee can prove that the debtor and the defendant modified their payment terms. *Kleven v. Household Bank F.S.B.,* 334 F.3d 638 (7th Cir. 2003). The final element was more difficult and expensive to prove because it required the defendant to show that the transfers were consistent with industry practices, taking into account "the range of terms that encompasses the practices in which firms similar in some general way to the creditor in question engage." *In re Tolona Pizza Products Corp.,* 3 F.3d 1029, 1033 (7th Cir. 1993).

Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Pub.L. No. 109-8, 119 Stat. 23, in cases filed after October 17, 2005, defendants no longer have to prove all three elements of the ordinary course of business defense. Under the amendment, in cases filed after October 17, 2005, a creditor must prove only that the debt was incurred in the ordinary course of dealings between the parties and that the payment was made in the ordinary course between the parties or according to ordinary terms within the industry. 11 U.S.C. §547(c)(2). Therefore, a debtor's regular monthly payment on a loan or credit card would be considered a payment in the ordinary course of business.

c. Purchase Money New Value/Relation Back

The 20-day "relation-back" period for the perfection of purchase money security interests is now increased to 30 days from possession under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Pub.L. No. 109-8, 119 Stat. 23. 11 U.S.C. §547(c)(3). In the past, trustees have routinely avoided liens of creditors that were secured by vehicles when the liens were perfected outside the 20-day grace period. *Fidelity Financial Services, Inc. v. Fink*, 522 U.S. 211, 139 L.Ed.2d 571, 118 S.Ct. 651 (1998). Trustees will now be able to avoid only transfers made within 90 days of the filing of bankruptcy that were perfected more than 30 days after the debtor received possession of the vehicle. 11 U.S.C. §547(c)(3).

For example, if a debtor purchases a vehicle on credit on September 20, 2010, and then files a Chapter 7 bankruptcy on December 15, 2010, the creditor would need to have perfected its lien on the vehicle on or before October 20, 2010, to fall within the 30-day grace period. Otherwise, the lien could be avoided by the trustee because the "transfer", i.e. lien perfection, occurred within 90 days prior to the bankruptcy filing, but did not occur within 30 days of the vehicle purchase.

d. Domestic Support Obligations

Under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Pub.L. No. 109-8, 119 Stat. 23, trustees cannot recover payments made for domestic support obligations. 11

U.S.C. §547(c)(7). Considering that support claimants are first in priority to all other creditors, a trustee would not prevail under 11 U.S.C. §547(b)(5).

e. Thirty-Day Relation-Back Period for Perfection of Any Transfer

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Pub.L. No. 109-8, 119 Stat. 23, amended §547(e)(2) of the Bankruptcy Code to extend the relation-back period on perfection of liens to 30 days. 11 U.S.C. §547(e)(2). This change was intended to mirror most state laws, which allow 30 days for filing necessary documentation to perfect a security interest. Trustees have argued that when perfection occurs after the relation-back period, the transfer cannot be substantially contemporaneous with the time the transfer took effect between the parties. There is a split among the circuits on this issue. *Pine Top Insurance Co. v. Bank of American National Trust & Savings Ass'n,* 969 F.2d 321 (7th Cir. 1992); *In re Arnett,* 731 F.2d 358 (6th Cir. 1984). It may now be more difficult for a court to find perfection made more than 30 days after the transfer to be "substantially contemporaneous" with the transfer itself.

The distinction between this exception and the exception in 11 U.S.C. §547(c)(3), discussed above, rests in the purchase money nature of the security interest addressed in 11 U.S.C. §547 (c)(3). Section 547(e)(2) provides the same exception to a creditor who perfects a security interest in property that the debtor already owns.

f. Nonprofit Credit Counseling Payments

Section 547(h) of the Bankruptcy Code states that a trustee cannot avoid a transfer "if such transfer was made as part of an alternative repayment schedule between the debtor and any creditor of the debtor created by an approved nonprofit budgeting and credit counseling agency." 11 U.S.C. §547(h).

g. $600 Limit on Consumer Transfers

The trustee may not avoid a transfer in a consumer case if the aggregate value of a property that constitutes or is affected by such transfer is less than $600. 11 U.S.C. §547(c)(8).

h. Other Defenses

Preference defendants are directed to review other defenses set forth in 11 U.S.C. §§547(c)(1) – 547(c)(9), as the discussion above focuses primarily on consumer cases.

E. Fraudulent Transfers — Bankruptcy Code §548

A trustee may avoid a transfer or obligation made or incurred within two years before the date of filing when:

1. the transfer or obligation involved an actual intent to hinder, delay, or defraud creditors, without regard to the solvency or insolvency of the debtor; or

2. the debtor received "less than a reasonable equivalent value" in exchange for the transfer when:

    a. the debtor was or became insolvent as a result of the transfer;

b. the debtor was left with unreasonably small capital;

c. the debtor intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

d. the debtor made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract or not in the ordinary course of business. 11 U.S.C. §548.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Pub.L. No. 109-8, 119 Stat. 23, extended the fraudulent transfer reach-back period on cases filed after April 20, 2006, to two years. For cases filed before April 20, 2006, the reach-back period for fraudulent transfers is one year. The standard for avoidance under §548(a)(1)(A) is commonly referred to as "actual fraud," while the standard under §548(a)(B) is called "constructive fraud."

Section 544(b) provides that the trustee can also use otherwise applicable state law to avoid transfers. Therefore, in Illinois the Chapter 7 trustee can use the provisions of the Illinois Uniform Fraudulent Transfer Act to reach back as far as four years to avoid fraudulent transfers. The trustee would file such an action in the bankruptcy court which would then apply the state law to the case.

1. Actual Fraud

In order to avoid a transfer or obligation for actual fraud under §548(a)(1)(A) of the Bankruptcy Code, the trustee will need to prove that the transfer or obligation was made with "actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted." 11 U.S.C. §548(a)(1)(A). A trustee will have a difficult time getting a debtor or defendant to admit actual intent. Thus, a trustee will have to prove "badges of fraud." *See In re Frierdich*, 294 F.3d 864, 870 (7th Cir. 2002); *Brown v. Szabo (In re Szabo)*, No. 03 B 14242, 2006 Bankr. LEXIS 24 (Bankr. N.D.Ill. Jan. 9, 2006) (unpublished).

Common badges of actual fraud are:

a. absconding with the proceeds of the transfer immediately after receipt;

b. absence of consideration when the transferor and the transferee know that outstanding creditors will not be paid;

c. a huge disparity in value between the property transferred and the consideration received;

d. the fact that the transferee is or was an officer of a corporate transferor;

e. insolvency of the debtor; and

f. the existence of a special relationship between the debtor and the transferee. *Carmel v. River Bank America (In re FBN Food Services, Inc.)*, 185 B.R. 265 (N.D.Ill. 1995), *aff'd*, 82 F.3d 1387 (7th Cir. 1996).

Other badges of fraud include factors such as (a) whether the debtor retained possession or control of the property after the transfer, (b) whether the transfer was disclosed or concealed, (c) whether the debtor made the transfer after being threatened with suit by a creditor, and (d) whether the transfer involved substantially all of the debtor's assets. *Frierdich, supra.*

The most common fraudulent conveyances in consumer cases are transfers to family members and relatives in anticipation of filing bankruptcy or to avoid a judgment.

For a more recent case outlining the badges of fraud identified in *Carmel, supra, see Grochocinski v. Schlossberg (In re Eckert),* 388 B.R. 813 (Bankr. N.D.Ill. 2008).

2. Constructive Fraud

In order to prove constructive fraud, the trustee will need to show that the debtor received less than a "reasonably equivalent value" in exchange for making a transfer or incurring an obligation. 11 U.S.C. §548(a)(1)(B). In addition, the plaintiff must prove that at the time the debtor made the transfer or incurred the obligation, the debtor either:

a. was insolvent or became insolvent as a result of the transfer or obligation;

b. was engaged in or about to engage in business or a transaction for which any property remaining with the debtor was an unreasonably small capital;

c. intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

d. made the transfer or incurred the obligation to or for the benefit of an insider under an employment contract and not in the ordinary course of business. *Id.*

Proof of constructive fraud will center around a valuation of the asset transferred. Appraisers will usually be called on to verify the value of the asset.

3. Self-Settled Trust

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Pub.L. No. 109-8, 119 Stat. 23, created a new avoidance action under Bankruptcy Code §548(e)(1) to allow a trustee to avoid a transfer to a self-settled trust any time within ten years prior to the filing of the petition if the transfer was made with the intent to hinder, delay, or defraud creditors existing at that time. 11 U.S.C. §548(e)(1).

F. Post-Petition Transfers

Section 549 of the Bankruptcy Code allows a trustee to avoid most post-petition transfers. 11 U.S.C. §549. This section provides that a trustee may avoid a transfer of property of the estate that occurs after the commencement of the case and that is not authorized by the Bankruptcy Code or the bankruptcy court. A typical post-petition transfer occurs when a bank seeks to perfect a lien on a vehicle title more than 30 days after the debtor received possession of the vehicle and after the debtor filed bankruptcy. Avoidance actions under §549 are limited under §§549(b) and 549(c).