AMERICAN BANKRUPTCY INSTITUTE

2021 Virtual Annual Spring Meeting

ABI's Commission on Consumer Bankruptcy vs. the Consumer Bankruptcy Reform Act

Hosted by the Consumer Bankruptcy and Legislation Committees

Hon. Rebecca B. Connelly
U.S. Bankruptcy Court (W.D. Va.); Harrisonburg

Marcy J. Ford
Trott Law; Farmington Hills, Mich.

Christopher L. Hawkins
Bradley Arant Boult Cummings LLP; Birmingham, Ala.

Henry E. Hildebrand, III
Chapter 13 Trustee; Nashville, Tenn.

Ariane Holtschlag
FactorLaw; Chicago

Too Much of a Good Thing?

Comparing the Consumer Bankruptcy Reform Act of 2020 with the Final Report of the ABI Commission on Consumer Bankruptcy

ABI Annual Spring Meeting
April 15, 2021

THIS IS NOT INTENDED TO PROVIDE LEGAL ADVICE

PANELISTS

- **Hon. Rebecca Connelly** – Chief Judge, United States Bankruptcy Court for the Western District of Virginia
- **Henry Hildebrand** – Chapter 13 Trustee, United States Bankruptcy Court for the Middle District of Tennessee
- **Ariane Holtschlag** – Partner, The Law Office of William J. Factor, Ltd., Chicago, Illinois
- **Marcy Ford** – Managing Partner, Trott Law, P.C., Farmington Hills, Michigan
- **Chris Hawkins** – Partner, Bradley Arant Boult Cummings LLP, Birmingham, Alabama (Moderator)

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AGENDA

- Overview of the Act and the Commission Report
- Student Loans
- Attorneys' Fees and Access to Justice
- Turnover
- Modification of Mortgage and Automobile Loans
- CFPB Involvement in Bankruptcy
- Parting Thoughts

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OVERVIEW OF THE ACT AND THE COMMISSION REPORT

- ABI Commission on Consumer Bankruptcy Scope of Work
  - To recommend improvements to the consumer bankruptcy system that can be implemented within its existing structure
- Stated Purpose of the Consumer Bankruptcy Reform Act of 2020
  - Simplify and modernize the consumer bankruptcy system to make it easier for individuals and families forced into bankruptcy to get back on their feet.

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OVERVIEW OF THE ACT AND THE COMMISSION REPORT

- Limitations on the ABI Commission on Consumer Bankruptcy
  - To aid in implementation, Commission generally limited its recommendations to changes to the Bankruptcy Rules and suggested best interpretations of existing statutes.
- No Limitations on the Consumer Bankruptcy Reform Act of 2020
  - The Act proposes wholesale changes to the Bankruptcy Code intended to improve access to financial relief through the bankruptcy process.
  - The Act was introduced in a "lame duck" session and has not yet been reintroduced in the 117th Congress.

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STUDENT LOANS

- **Commission Report**
  - Discharge after 7 Years, or upon showing of undue hardship
  - Private Loans Fully Dischargeable
  - Non-dischargeable student loans treated as priority claims
  - Payment of interest under plan
  - USDOE bright line rules on challenges to hardship discharge and consideration of "maintenance and cure plans" in determining repayment plans
  - Less Draconian interpretation of Brunner

§ **Consumer BK Reform Act**
  - All student loans fully dischargeable
  - No distinction between government and private loans

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ATTORNEYS' FEES AND ACCESS TO JUSTICE

- **Commission Report**
  - Systemic changes to reduce financial and other burdens on debtors
    - Improved form software and use of video-conferencing
  - Non-dischargeable attorneys' fees
  - Bifurcated payment of fees
  - Removal of credit counseling requirement
  - Simplified means test
  - Increased chapter 13 debt limits

§ **Consumer BK Reform Act**
  - Removal of credit counseling requirement
  - Removal of means test

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TURNOVER

- **Commission Report**
  - Code revisions to explicitly recognize retention of estate property as a violation of the automatic stay
  - Code revisions to require creditor's turnover of collateral on demand of party entitled to property, subject to provision of proof of insurance or other security sufficient to protect the creditor against loss of value
  - Code revisions to permit enforcement of turnover rights by motion

§ **Consumer BK Reform Act**
  - Unconditional requirement to deliver collateral to debtor or trustee on demand, without further action

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MORTGAGE AND AUTO LOANS

- **Commission Report**
  - Antimodification provision remains intact
  - Increased debt limit in chapter 13 to address real estate market realities
  - Consensual mortgage loan modifications encouraged
  - Framework for disposing of residence subject to underwater mortgage
  - Maintain *Till* framework for interest rates
  - "Hanging paragraph" remains intact on autos acquired within 910 days

§ **Consumer BK Reform Act**
  - Antimodification provision eliminated for mortgage loans
  - Debtors may dispose of residence subject to underwater mortgage
  - Debtors may pay liquidation value to keep car (excluding cars purchased within 90 days prior to bankruptcy)

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CFPB INTERVENTION IN BANKRUPTCY

- **Commission Report**
  - ABI forum, including Consumer Data Industry Association, on credit reporting
  - No changes to the role of the United States Trustees in protection of the bankruptcy system by overseeing administration of bankruptcy cases

§ **Consumer BK Reform Act**
  - CFPB conferred standing to appear and be heard on any issue in a bankruptcy case
  - Consumer Bankruptcy Ombuds appointed by director of CFPB
  - Bankruptcy courts required to adjudicate alleged violations of consumer protection statutes (FDCPA) through claim disallowance

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PARTING THOUGHTS

- What are the costs of the Consumer Bankruptcy Reform Act?
  - Administrative costs of multiple plans under Chapter 10
  - Cost of litigating plan performance issues in venues other than bankruptcy court
  - Increased cost of borrowing resulting from removal of antimodification provisions and removal of limits on student loan dischargeability
  - Delays associated with increased consumer protection oversight placed on judges
- Does the Act remove the quid pro quo conceived in the Bankruptcy Code in order to obtain a discharge (honest disclosure of non-exempt assets, consistent performance under plan)?
- What concepts in the Act could be incorporated into the existing structure of the Bankruptcy Code without its complete dismantling?

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Student Loans: CBRA v. ABI Commission

Henry E. Hildebrand, III
Chapter 13 Trustee
United States Bankruptcy Court for the Middle District of Tennessee

Student loans present one of the most significant economic problems in the United States. The Federal Reserve has warned repeatedly of the long term and broad impact these student loan have had or will have on individuals and the economy.

Burdensome student loans have affected career choices for borrowers. While a graduate degree can often result in higher entry-level earnings, the high costs of graduate education, on top of undergraduate costs, generate significant amounts of debt that often preclude further borrowing – and further education. Substantial student loan debt impacts the career choices taken by individuals.

Individuals with substantial student loan debt are forced to make career choices based upon the need to repay student loans, steering the best and the brightest away from public service, non-profits, teaching, or working in an underserved community. While programs have been developed to assist a student loan borrower in obtaining an elimination of student loan debt following service in the public sector, compliance with the requirements has been very low.

People with substantial student loan debt find it difficult to purchase a home. The top reason given why certain millennial renters did not buy a home was that their student loan debt precluded them from saving adequate funds to purchase a home.[1]

Some renters cannot afford to purchase homes but some millennials with student loan debt cannot even afford to rent apartments, particularly in high-rent areas like New York, Chicago, Boston, Washington D.C. The average rent in the United States increased in 2020 to $1,861 for a two-bedroom apartment and $2,051 per month for a three-bedroom apartment.[2] Approximately 14 million young adults between the ages of 23 and 37 are living at home with one or both of their parents.

Student loan borrowers defer life choices due to burdensome loan balances. Borrower's decisions such as when to get married, when to have children and how large a family to have are affected by this nondischargeable debt. The burdens of student loans impacts all aspects of American life.

Both the CBRA and the ABI Commission on Consumer Bankruptcy focused not on dealing with the entire student loan problem or the high cost of education. Both responses focused on the lack of a meaningful remedy to a debt problem in bankruptcy.

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[1] Equifax "Millennials, Mortgages and Student Debt".
[2] Report, February 2021, "The State of Rental Market", Apartment Guide.com

The basic question comes down to whether there should be any sort of means testing to avoid the impact of student loans. The CBRA proposed a simple solution: simply repeal 11 U.S.C. § 523(a)(8), thereby making all student loans dischargeable in bankruptcy.

The ABI Commission Report, however, was far more nuanced. The Commission recognized that the original version of § 523(a)(8) excepted a student loan from discharge until after five years had passed. The code also then recognized that student loans could still be discharged if there were a showing of "undue hardship." The overwhelming acceptance of the principles in *Brunner v. New York State Higher Educ. Serv. Corp. (In re Brunner)*, 831 F.2nd 395 (2nd Cir. 1987) made the establishment of a hardship to justify the discharge of a student loan virtually impossible to achieve. The Commission recommended that the *Brunner* test be discarded and replaced with a more flexible and usable exception to discharge. Acknowledging that the adjustment could be effected through regulatory changes rather than statutory modification, the Commission suggested that the Department of Education acknowledge that a hardship in bankruptcy could be established, justifying the discharge of the student loan obligation, the debtor could not pay a student loan over the standard ten-year contractual schedule while maintaining a reasonable standard of living, the debtor could not pay the loan in full during its contractual repayment period (usually ten years) and the debtor had not acted in bad faith by failing to pay the student loan at all prior to the filing of the bankruptcy.

The Commission suggested that in Chapter 13 § 1322(b)(1) be interpreted to allow a separate classification and payment of the student loans that could be nondischargeable, turning the student loan not discharged as a priority debt that would be treated like assigned support in § 1322(a)(4).

The Commission recognized the financial impact of discharging all student loans owed by debtors in bankruptcy. The Commission found that there were legitimate reasons to limit the relief, not the least of which was the substantial cost, full discharge Chapter 13 repayment plan. Discharging the student loan in bankruptcy would be a nontaxable event. The Commission would require an independent analysis of the debtor's ability to pay. Abandonment of the ill-reasoned *Brunner* test and a statutory command that courts use a "reasonable" standard of living as the test would and should provide the safety mechanism, avoiding the moral hazard of discharging a debt owed to the federal government by one who had the capacity to make a payment.

The Commission recognized that the substantial cost of a bankruptcy discharge which would flow to the public fisc is not to be ignored. As the Federal Reserve had noted:

"The highest income 40% of households (those with incomes above $74,000) owe almost 60% of the outstanding education debt and make almost three-quarters of the payments. The lowest income 40% of households hold just under 20% of the outstanding debt and make only 10% of the payments. . . . During the pandemic, less-educated workers have been most likely to lose their jobs. Many are in service industries that cannot transition to remote arrangements. Zoom might work for lawyers, financial advisors, and insurance managers, but it doesn't work for restaurant and retail workers where households are less likely to have student loans. In other words, student loans are not the central factor generating hardship during the pandemic. . . ."[3]

The question really goes to whether there should be a restriction on full or partial discharge based upon ability to pay. The Commission suggests the affirmative. The CBRA suggests that the elimination of this debt should flow to all debtors.

[3] Baum, Sandy and Looney, Adam – *Who Owes the Most in Student Loans: New Data from the Fed* – Friday, October 9, 2020 – https://www.brookings.edu/blog/up-front/2020/10/09/who-owes-the-most-in-student-loans-new-data-from-the-fed/.

Attorney's Fees Covered by the Consumer Bankruptcy Reform Act of 2020

By: The Honorable Rebecca B. Connelly
Judge of the United States Bankruptcy Court for the Western District of Virginia[4]

After two years of research and discussion, the ABI Commission on Consumer Bankruptcy (hereinafter, the "Commission") in 2019 released its final report and recommendations of improvements to the consumer bankruptcy system.[5] As one improvement, it recommended restructuring the Bankruptcy Code's approach to attorney's fees in bankruptcy cases.[6]

On December 9, 2020, Senators Warren and Nadler introduced their proposed "Consumer Bankruptcy Reform Act of 2020" (the "CBRA"). The proposed CBRA makes individual debtors ineligible for chapter 7 bankruptcy and repeals chapter 13 completely. In place of chapters 7 and 13 for individual consumer debtors, the CBRA creates a new "chapter 10." Elsewhere in this presentation, you will learn about how the proposed chapter 10 bankruptcy will work. In this portion, I will cover how the CBRA addresses attorney's fees in the proposed chapter 10 bankruptcy, and how—if at all—the CBRA incorporates the Commission's suggestions.

ABI Commission's Suggestions

The Commission was charged with recommending "improvements to the consumer bankruptcy system that can be implemented within its existing structure." Therefore, the Commission operated under the framework of the existing chapters 7 and 13 (rather than the newly proposed chapter 10) when developing its suggestions with respect to attorney's fees. Among other concerns, the Commission noted the practical outcome of the wide-spread case law declaring prepetition attorney's fees are dischargeable coupled with the United States Supreme Court's decision in *Lamie v. United States Trustee*,[7] which held that chapter 7 attorney's fees may not be treated as an administrative expense and therefore cannot be paid from estate assets.

The practical outcome is the requirement that debtors pay their attorney in full before their attorney files a chapter 7 case on their behalf, which potentially breeds all sorts of problems.[8] An alternative is a fee arrangement in chapter 7 cases to bifurcate the legal services to be provided—a nominal fee for prepetition services, with a postpetition agreement for postpetition services. The Commission found this fee agreement problematic in many respects, as well.[9] Another option for debtors is simply filing a chapter 13 bankruptcy to take advantage of the automatic stay earlier while allowing the attorney to feel more secure that she will receive payment of her fees through the plan, but this is a more expensive option and may be

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[4] Judge Connelly gratefully acknowledges the assistance of her law clerks, Luke Graham and Caleb Chaplain, for the preparation of these materials.
[5] *See* Final Report of the ABI Commission on Consumer Bankruptcy (hereinafter the "Final Report").
[6] *See id.* at Part III.A.
[7] 540 U.S. 526 (2004).
[8] For a more in-depth discussion of the problems the Commission saw with this common fee arrangement, see Final Report at 90.
[9] *See id.* at 91.

inappropriate for a debtor who desires a chapter 7 bankruptcy.[10] It is rare that debtor attorneys will offer any other payment arrangement—such as payment of the fees after filing—since attorney's fees are deemed dischargeable and not payable out of the estate.[11] Debtors may avoid paying attorney's fees by representing themselves, but studies show those who do so often have inferior outcomes.[12]

To address this, the Commission presented four separate statutory amendment options: (1) automatically except chapter 7 attorney's fees from discharge, and create an exception to the automatic stay for these fees; (2) provide for the exception of chapter 7 attorney's fees, but only after the attorney moves to except those fees and the court approves such motion after judicial review of the fees; (3) make the chapter 7 discharge contingent on payment of all attorney's fees anticipated by the fee agreement with the debtor's attorney, with an exception to the automatic stay for those fees; or (4) provide for an exception to the automatic stay with respect to chapter 7 attorney's fees, and delay entry of discharge for a brief period of time to permit discussion and potential payment of a reasonable fee.[13] The Commission favored options two and four, and recommended congressional consideration of those two options.[14]

CBRA on Chapter 10 Attorney's Fees

As noted above, the proposed CBRA repeals chapter 13 and makes individuals ineligible for chapter 7. In place of those options for individual debtors, the CBRA creates "chapter 10," which allows for specific and limited repayment plan options. It appears that CBRA permits a debtor to pay attorney's fees under a repayment plan, but it is unclear how the debtor with no "minimum payment obligation" accomplishes the "attorney fee only" plan.

The CBRA as proposed amends section 329 of the Bankruptcy Code to add in a new subsection (c) detailing when compensation shall be allowed to a debtor's attorney under chapter 10.[15] Subsection (c)(1) addresses five requirements of the fee agreement. First, the agreement must be made not more than 90 days prepetition. Second, the agreement must specify the services provided or to be provided and the related fees and expenses. Third, the agreement must clarify that the debtor will only be liable for attorney's fees and expenses which are (i) provided for in the agreement, (ii) for adversary proceedings in which the debtor is a party, and (iii) for services "required by the debtor or the court that the attorney should not have reasonably anticipated at the time of the agreement." As a fourth requirement, the fee agreement cannot provide for interest or fees for delays in payment or for costs of collection. And finally, the agreement must not provide for pre-dispute arbitration agreements or joint-action waivers. The attorney is further required by subsection (c)(2) to discuss the fees and expenses under the agreement with the debtor, explaining the consequences and obtaining the debtor's consent to the filing of a certification with the court. The certification under subsection (c)(3) requires the attorney to certify that the fee agreement complies with subsection (c)(1), the attorney has held

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[10] *See id.* at 91–92.
[11] *See id.* at 91.
[12] *See id.* at 89–90 (citing Angela K. Littwin, *The Affordability Paradox: How Consumer Bankruptcy's Greatest Weakness May Account for Its Surprising Success*, 52 WM. & MARY L. REV. 1933, 1974 tbl.3b (2011)).
[13] *See id.* at 94–95.
[14] *See id.* at 96–98.
[15] *See* Consumer Bankruptcy Reform Act of 2020, S. 4911, 116th Cong. § 104(n) (2020).

the discussion with a consenting debtor in subsection (c)(2), and the attorney certifies that "the enforcement of the agreement would not impose an undue hardship on the debtor or the debtor's dependents."

New Bankruptcy Code section 1024 will address confirmation of a chapter 10 plan.[16] For the court to confirm a chapter 10 plan, section 1024(a)(6) requires that all the elements of new subsection 329(c) listed above be satisfied. In addition, the compensation must be found to be "reasonable" by the court. This amendment suggests that the debtor may pay her attorney's fees through a plan. If a repayment plan is confirmed for a debtor who would have filed a chapter 7 case under today's version of the Bankruptcy Code, this may resolve the problem of having to save up and pay attorney's fees in full prior to filing.

However, because it appears the attorney fee claim is discharged upon confirmation,[17] it is possible the discharge will deter attorneys from filing such plans for such debtors. Likewise, if the debtor has no disposable income, it is hard to see how an attorney could certify the repayment of the attorney fee obligation is not an undue hardship. Finally, it is unclear the extent to which a debtor may engage with an attorney for post-petition services when the attorney may be prohibited from doing so because services post-petition may be reasonably anticipated by any experienced debtor's attorney.[18] Still, though, the question remains how debtors who will receive an almost immediate discharge because their "minimum payment" under a repayment plan is determined to be $0 will find representation. All things considered, the chapter 10 repayment plan option does not fix the fee issue in cases in which a debtor has only exempt assets and no disposable income.

Conclusion

The Consumer Bankruptcy Reform Act in some ways addresses the Commission's primary concern regarding chapter 7 fees which generally must be paid in full prior to filing a chapter 7 petition on behalf of the debtor. But it does not appear to go far enough in addressing the Commission's concerns. While many debtors will have the ability to pay their attorney's fees through a repayment plan in chapter 10 bankruptcy, some debtors will qualify for an almost immediate discharge without payment or satisfaction of the repayment plan. Those very same debtors—with little assets and income—are the types of debtors who may find it difficult to pay their attorney in full prior to filing bankruptcy. Given the requirements of proposed section 329(c) and the immediate discharge under proposed section 1031 in some cases, many low-income debtors may have less access to bankruptcy relief under the CBRA.

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[16] *See* § 102(a) (inserting 11 U.S.C. § 1024).
[17] *See id.* (inserting 11 U.S.C. §§ 1022(a)(1)(B)(i), 1031(a)(1)). It appears for the debtor with no minimum payment obligation, the discharge occurs upon confirmation of the repayment plan or on the expiration of the deadline to file the plan.
[18] *See id.* § 104(n) (inserting 11 U.S.C. § 329(c)).

TURNOVER: THE ABI COMMISION ON CONSUMER BANKRUPTCY VS. THE CONSUMER BANKRUPTCY REFORM ACT OF 2020.[19]

By: Ariane Holstschlag
The Law Office of William J. Factor, Ltd.
Chicago, Illinois

Why is turnover reform needed?

Commencement of a bankruptcy case creates an estate; the estate is comprised of the debtor's property interests "wherever located and by whomever held". 11 U.S.C. § 541(a). In Chapter 7, the estate assets are administered by the trustee. 11 U.S.C. § 323. In Chapter 13, the estate assets are administered primarily by the debtor. 11 U.S.C. § 1303. Section 542 of the Bankruptcy Code provides that "an entity…in possession, custody, or control…of property that the trustee may use, sell, or lease under section 363 of this title…shall deliver to the trustee…such property or the value of such property, unless such property is of inconsequential value or benefit to the estate." 11. U.S.C. § 542(a).

To enforce turnover under section 542 of the Bankruptcy Code against third parties, an adversary proceeding is required. *See* Fed. R. Bankr. P. 7001 ("The following are adversary proceedings…(1) a proceeding to recover money or property, other than a proceeding to compel the debtor to deliver property to the trustee…."); *see also In re Taronji*, 174 B.R. 964, 966 (Bankr. N.D. Ill. 1994)("Ordinarily, a trustee must bring a separate adversary proceeding in order to recover disputed property of the estate, but when the property is held by the debtor, the trustee may proceed by motion.").

It is generally accepted that motion practice is quicker and cheaper than commencement of an adversary proceeding. Turnover motions can often be heard on as little as seven days' notice by mail and typically do not have an associated filing fee. Adversary proceedings, on the other hand, typically do have a filing fee and utilize the heightened service and notice requirements of the Federal Rules of Civil Procedure. A filing fee of a few hundred dollars may not seem like a substantial financial hardship. However, in the context of a debtor bringing such an action in a Chapter 13 case, that filing fee may very well be a substantial financial hardship. Additionally, the difference between notice of seven days or thirty may not seem like a substantial delay for a legal remedy. However, again, in the context of a debtor bringing such an action in a Chapter 13 case, for example seeking to recover a vehicle that was impounded pre-petition, the additional delay in obtaining relief may have a significant practical impact on the debtor's ability to maintain employment and earn the funds necessary to make her plan payments. The situation is such that for a Chapter 13 debtor, even these small procedural hurdles are likely to be dispositive of the substantive issue.

[19] Written by Ariane Holtschlag of FactorLaw in Chicago, Illinois. The views expressed herein do not necessarily reflect the views of FactorLaw or its clients.

This tension between the immediate need of an asset administrator to physical possession of estate assets, and the due process rights of third parties in possession of that property is not a new problem. In 1984, Judge John H. Allen of the United States Bankruptcy Court for the District of Utah, Central Division, described the tension well in his memorandum opinion issued in the case of *In re Riding*, 44 B.R. 846 (Bankr. D. Utah 1984). That same tension exists today as illustrated by the case of *City of Chi. v. Fulton*, 141 S. Ct. 585 (2021)[20]. There, the debtors argued that section 362 of the Bankruptcy Code creates an affirmative duty for a creditor to turnover a vehicle impounded (but not destroyed) pre-petition. This would mean that a debtor need not commence an adversary proceeding to obtain turnover in such a situation, nor even a motion. The Supreme Court rejected the debtors' argument. However, some Justices, especially Justice Sotomayor, during oral arguments and in a concurring opinion, stressed the importance for "rule drafters and policymakers" to resolve the problem.

Turnover reform recommended by the ABI Commission on Consumer Bankruptcy.

ABI's Commission on Consumer Bankruptcy performed its work in the shadow of *City of Chi. v. Fulton* while the cases wound their way to the Supreme Court. The Commission was aware of the turnover problems highlighted by those cases and it was charged with finding a pragmatic solution that could be implemented within the Bankruptcy Code's existing structure. The Commission resolved as follows[21]:

§ 2.01 Protection of Interests in Collateral Repossessed Prepetition

(a) Section 362(a)(3) should be amended to expressly require the return of estate property to the party entitled to possession of estate property under the Bankruptcy Code.

(b) A new paragraph should be added to section 362(b), providing that

> (1) any estate property held by a creditor and subject to a potential loss of value due to accident, casualty, or theft may be retained by a creditor holding the property unless the party entitled to possession under the Bankruptcy Code provides proof of insurance or other security sufficient to protect the creditor against such loss of value;
>
> (2) if the creditor's interest in estate property is a statutory lien dependent upon possession by the creditor, then, in addition to the requirement of protection of value set out above, upon transfer of the property to the appropriate party (A) the property shall be deemed to be continuously subject to a lien, equivalent in amount and priority to the creditor's statutory lien, (B) such lien shall be effective during and after the debtor's case, and (C) if the debtor retains possession of the property after the case is closed, the creditor shall have a right of replevin or other right to recover the property, and upon recovery, the creditor's statutory lien shall be restored as if there had been no break in possession; and

[20] Opinion available at https://www.supremecourt.gov/opinions/20pdf/19-357_6k47.pdf

[21] A full copy of the Commission's report including this resolution and the Commission's rationale for this resolution is available at https://consumercommission.abi.org/.

(3) these provisions are without prejudice to a creditor's right to retain the collateral while promptly seeking annulment of the automatic stay based on a lack of adequate protection, on bad faith, or on other unusual circumstances.

(c) A new subsection should be added to section 542, providing that a creditor holding property of the debtor or the estate secured by a consumer debt shall, upon demand by the party entitled to the property under this title, deliver the property to that party, except as provided in the new paragraph added to section 362(b), set out above.

(d) The new subsection to section 542 should be added to the exceptions in Federal Rule of Bankruptcy Procedure 7001(1), so that the appropriate party may enforce such right by motion. A party entitled to possession may seek only turnover rather than the imposition of sanctions for violation of the automatic stay; the new subsection would allow turnover to be pursued by motion rather than by adversary proceeding.

Turnover reform proposed under the Consumer Bankruptcy Reform Act of 2020.

The approach of the Consumer Bankruptcy Reform Act of 2020, was not as restrained as the Commission's resolution creating instead an unfettered affirmative duty to immediately turnover property by revising section 542 of the Bankruptcy Code as follows[22]:

(a) Except as provided in ~~subsection (c) or (d)~~ subsection (d), (e), or (f) of this section, an entity, other than a custodian, in possession, custody, or control, during the case, of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, ~~shall deliver to the trustee~~ shall, without any condition or further action by the trustee, the debtor, or the court, deliver promptly to the trustee, and account for, such property or the value of such property, unless such property is of inconsequential value or benefit to the estate.

(b) Except as provided in subsection ~~(c) or (d)~~ subsection (d), (e), or (f) of this section, an entity that owes a debt that is property of the estate and that is matured, payable on demand, or payable on order, shall pay such debt to, or on the order of, the trustee, except to the extent that such debt may be offset under section 553 of this title against a claim against the debtor.

(c) An entity in possession of property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, shall have, upon delivery of such property to the trustee, the same rights in the property as if the entity remained in possession.

(d) An entity that holds property that the trustee may use, sell, or lease under section 363 of this title, or that the debtor may exempt under section 522 of this title, and that is subject to a potential loss of value due to accident, casualty, or theft shall not be required to deliver such

[22] A fully copy of the Consumer Bankruptcy Reform Act of 2020 is available at https://www.abi.org/feed-item/the-consumer-bankruptcy-reform-act-of-2020.

property to the trustee unless the party entitled to possession provides proof of insurance or other security sufficient to protect the creditor against such loss of value.

~~(c)~~(e) Except as provided in section 362(a)(7) of this title, an entity that has neither actual notice nor actual knowledge of the commencement of the case concerning the debtor may transfer property of the estate, or pay a debt owing to the debtor, in good faith and other than in the manner specified in subsection (d) of this section, to an entity other than the trustee, with the same effect as to the entity making such transfer or payment as if the case under this title concerning the debtor had not been commenced.

~~(d)~~(f) A life insurance company may transfer property of the estate or property of the debtor to such company in good faith, with the same effect with respect to such company as if the case under this title concerning the debtor had not been commenced, if such transfer is to pay a premium or to carry out a nonforfeiture insurance option, and is required to be made automatically, under a life insurance contract with such company that was entered into before the date of the filing of the petition and that is property of the estate.

~~(e)~~(g) Subject to any applicable privilege, after notice and a hearing, the court may order an attorney, accountant, or other person that holds recorded information, including books, documents, records, and papers, relating to the -debtor's property or financial affairs, to turn over or disclose such recorded information to the trustee.

What's next?

Is the National Rules Committee working on a solution???

MORTGAGE PROTECTIONS CRUMBLE UNDER BOTH THE ABI COMMISSION ON CONSUMER BANKRUPTCY AND THE CONSUMER BANKRUPTCY REFORM ACT OF 2020

By: Marcy J. Ford
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As noted elsewhere in these materials, the ABI Commission on Consumer Bankruptcy (the "Commission") was charged with recommending improvements within the existing structure of the consumer bankruptcy system.[23] The authors of the Consumer Bankruptcy Reform Act of 2020 (the "Act") felt no such constraint or boundaries. While the extent and depth of the proposed modifications aimed at mortgages varied between the Commission and the Act, the drafters of both documents have sent a clear signal that the generous protections currently afforded to mortgage holders, servicers, and investors are in disfavor. This is based on the underlying belief that those protections make it materially more difficult for families to achieve true and sustainable financial relief. While the Commission took a more measured approach, it is not clear that this was due to a desire to protect mortgages, but rather was a result of their goal to remain within the current structure. When presented with the complete destruction of principal residential mortgage protections proposed in the Act, it is questionable whether a future Commission effort would be as measured. Even without further modification, if either of the proposals are ever enacted into law, previously non-modifiable mortgages will come under fire.

With a scalpel versus a hatch approach, Commission members focused on vacant and underwater property that the debtor wishes to surrender. First, the Commission proposed an amendment to 523(a)(16) allow a discharge of post-petition HOA fees if the debtor stated an intention to surrender and does not possess, occupy, or otherwise use the property (such as by renting the property to a third party). This amendment would allow the debtor to eliminate post-petition property-related liability where the mortgage obligation and the debtor's legal title is not terminated through transfer, foreclosure, or sale. Of course, this provision alone would result in a significant burden to HOAs and other members of the HOA community where the debtor continues to hold legal title to the residence.

Second, and perhaps to the joy of the HOA community and local taxing authorities, one of the Commission's more aggressive recommendations with regard to mortgages allows a unilateral transfer of the debtor's principal residence subject to an underwater mortgage. The Commission recommends an amendment of Federal Rule of Bankruptcy Procedure 6004 where the debtor seeks to satisfy a claim secured by the debtor's principal residence pursuant to section 1325(a)(5)(B):

The centerpiece of the Commission's recommendation is that courts should interpret sections 1322(b)(8) and 1325(a)(5)(B) to allow payment of a mortgage claim by transferring the property to the principal mortgage holder. To meet the good-faith confirmation requirement of section 1325(a)(3), the plan would have to give the mortgage holder the option of having the

[23] *See* Final Report of the ABI Commission on Consumer Bankruptcy (hereinafter the "Final Report") at p. VIII.

property sold free and clear of liens by consenting to a sale under section 363(f)(2). Good faith also would require the plan to give the principal mortgage holder sixty days from confirmation to choose between taking a direct transfer of the property or allowing it to be sold free and clear of liens. Finally, the plan would have to specify deadlines for either issuance of a deed to the lender or the conduct of a section 363(f) sale following the mortgage holder's decision.[24]

While the Commission used a scalpel with regard to mortgage treatment, some have suggested that the Act used a hatchet. Although aggressively addressing underwater mortgages, Commission authors maintained the anti-modification protections for the debtor's principal residence. The Act proposes similar treatment for underwater principal residential mortgages, but it also allows the modification of all mortgages under the Residence Plan. The Commission focused narrowly on addressing the situation where the mortgage holder would not foreclose. In contrast the Act broadly considered the Bankruptcy Code's non-modification provisions as the primary culprit in both the creation of so-called "zombie mortgages" and the overuse of foreclosure as a response to unfeasible plans where no modification was allowed.

In making its recommendation, the Commission seeks to address (at least) two identified problems. First, the good faith debtor who does not wish to maintain the real property as the principal residence, but due to reasons beyond his control cannot relieve himself of legal title. Admittedly this debtor will not likely achieve a complete fresh start despite complying will all plan requirements. Second, the Commission expresses concern about the prevalence of "zombie mortgages" and relies on 2008 data to support this amendment. However, shifts in underwriting, among other factors, has driven zombie mortgages down to below 4% as of the third quarter of 2020 per AAOM Data Solutions. The Act and Commission recommendations with regard to underwater mortgages are a major and fundamental shift in law and policy, which could allow virtually all homeowners to walk away and start fresh when their initial housing investment does not maintain its value and no longer meets their needs. Mortgage investors and insurers could and would be saddled with an unprecedented number of properties that become vacant as part of pre-filing planning. These lenders may become responsible for junior liens, insurance, taxes, and even liability suits. If the Act was adopted into law, the same debtors will be able to choose between modification and surrender, and creditors would face even greater losses. Such a drastic change would come at a significant cost that would in all likelihood be ultimately borne by future borrowers.

[24] *See* Final Report at 179.

Consumer Protection Aspects of the Consumer Bankruptcy Reform Act of 2020

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Charged with recommending improvements to the consumer bankruptcy system that could be implemented within its existing structure,[25] the ABI Commission on Consumer Bankruptcy (the "Commission") spent approximately two years exploring pragmatic improvements on a wide range of topics, including: treatment of student loans; attorneys' fees and trustee compensation; improving access to the bankruptcy process; and aligning debt limitations and other eligibility requirements with current economic realities. The Commission's final report touched on certain topics covered by other consumer protection statutes, most notably the Fair Credit Reporting Act.[26] However, the Commission's primary focus remained on improvements to the consumer bankruptcy process, balancing relief to the debtor with principles of fairness to creditors and other parties in interest.

The Consumer Bankruptcy Reform Act of 2020 (the "Act") proposed both sweeping changes to the structure of the Bankruptcy Code and the integration of numerous consumer protection concepts into the bankruptcy process.[27] These proposed changes reflect a different scope and purpose from that of the Commission. Whereas the Commission's goal was to make recommendations to improve the bankruptcy process as a whole, the Act seems to reflect a view that the Bankruptcy Code primarily is – or should be – a consumer protection statute. This view is evident in, without limitation, the proposed revisions to the Bankruptcy Code that: permit the unqualified discharge of student loan debt; create the absolute right to cram down residential mortgage loans; and reduce procedural limitations on the modification of auto loans.[28] The focus here, however, is on the proposed oversight of the Consumer Financial Protection Bureau (the "CFPB") on the bankruptcy process and the requirement that bankruptcy judges handle consumer protection statute violations through the claims allowance process.

Consumer Protection Proposals under the Act

The Act inserts consumer protection elements into the bankruptcy process through proposed amendments to both the Bankruptcy Code and the Consumer Financial Protection Act of 2010 (the "2010 Act"). One key proposal is the creation of a consumer bankruptcy ombuds.[29] This ombuds would be designated by the director of the CFPB in consultation with the Attorney General.[30] The ombuds would receive, review and attempt to resolve debtor complaints.[31] The Act proposes coordination between the ombuds and the Executive Office of the United States

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[25] *See* Final Report of the ABI Commission on Consumer Bankruptcy (hereinafter the "Final Report") at p. VIII.
[26] *See* Final Report at 207.
[27] *See* S. 4911, 116th Cong. (2020)(hereinafter, the "Act") at §101.
[28] *See id.*
[29] *See id.* at §201(a).
[30] *See id.*
[31] *See id.*

Trustee Program (the "EOUST").[32] The ombuds also would compile data regarding consumer bankruptcy filings and consumer complaints, as well as make recommendations to the CFPB's director and the Attorney General regarding amicus briefs and appearances in individual bankruptcy cases.[33]

Perhaps more strikingly, the Act proposes to grant the CFPB supervisory and enforcement authority with respect to bankruptcy law.[34] While the Act contemplates some coordination between the ombuds and the EOUST,[35] there is no specific mention of coordination between the CFPB and the EOUST with respect to the CFPB's proposed supervisory authority.

The Act also provides for a revision to the Fair Debt Collection Practices Act to enumerate certain actions in a bankruptcy case as unfair practices, including: a) the filing of a lawsuit or claim in a bankruptcy case that is based on a debt without an actual reasonable good-faith belief that the applicable statute of limitations for enforcement of that debt has not expired as of the time of filing; and b) any act to knowingly collect or attempt to collect a debt that has been discharged in bankruptcy except acceptance of a purely voluntary payment of the debtor without encouragement or coercion by the debt collector.[36]

Finally, the Act proposes to amend Section 502 of the Bankruptcy Code to insert the bankruptcy judge as an arbiter of consumer protection statutory disputes via the claims allowance process.[37] Under the Act, the court shall, after notice and a hearing, disallow any claim if the creditor: engaged in inequitable conduct (including a violation of federal or state law) that harmed the debtor, whether or not the conduct was connected with the claim or an obligation that gave rise to the claim; or violated a Federal consumer financial law in connection with the claim or obligation that gave rise to the claim.[38]

Logistical and Policy Concerns Associated with the Act

The Act reflects the sponsors' apparent view that the Bankruptcy Code is – above all else – a consumer protection statute. From that viewpoint, it seems logical to attempt to bring essentially all consumer bankruptcy issues under the oversight and supervision of the CFPB and its appointed ombuds. However, while the Bankruptcy Code certainly includes certain consumer protections, it is not an exclusively consumer protection statute. Rather, the Bankruptcy Code provides the framework for an orderly liquidation or reorganization for the benefit of both debtors and creditors, including provisions that promote the debtor's best efforts toward repaying debts.

The Bankruptcy Code already vests the bankruptcy system oversight function in the United States Trustees and case trustees, who monitor not only for creditor compliance but also for debtor compliance. Bankruptcy judges have jurisdiction – and in most instances the power to

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[32] *See id.*
[33] *See id.*
[34] *See id.*
[35] *See id.*
[36] *See id.* at §205.
[37] *See id.* at §104.
[38] *See id.*

enter final judgments – with respect to disputes that arise under, arise in, or are related to the Bankruptcy Code. This can include disputes regarding alleged violations of federal consumer protection statutes that are raised in adversary proceedings running in tandem with the administration of a debtor's bankruptcy case.

By injecting the CFPB and a bankruptcy ombuds, the Act creates unnecessary redundancies in bankruptcy process oversight, in some instances failing to clearly delineate each party's oversight role. The EOUST, individual United States Trustees, and case trustees have for years applied their specialized bankruptcy knowledge and expertise to preserve the integrity of the bankruptcy system, filing motions in consumer cases and bringing lawsuits as necessary to curb abuses by both creditors and debtors. While it is possible that the CFPB could develop this type of bankruptcy expertise, the CFPB's involvement in individual cases is not only unnecessary, but also counterproductive. It adds another layer of oversight that would bog down the bankruptcy process. While coordination among the CFPB and bankruptcy practitioners certainly would be welcome with respect to the CFPB's rulemaking authority under the 2010 Act, the proposed bankruptcy oversight function would only add confusion as to how the Bankruptcy Code is to be enforced.

From a logistical standpoint, the Act's proposed revisions to the claims allowance process have the potential to bring cases to a screeching halt, in some cases delaying the very benefits that the Bankruptcy Code affords consumers through the confirmation of feasible plans. Under the provisions of the Act, bankruptcy judges will be forced to adjudicate consumer protection issues that may have no bearing whatsoever on the debtor's case. Without limitation, the Act indicates that a claim can be disallowed for a creditor's inequitable conduct with respect to the debtor, even if the conduct is wholly unrelated to the underlying claim. Such matters are more properly brought in the form of a separate adversary proceeding in which the debtor or the estate may seek a separate recovery, as is contemplated under the current system. The Act's proposed punishment via claim disallowance – while perhaps well-intentioned – could lead to protracted litigation impacting the feasibility of proposed plans and could derail bankruptcy judges' dockets. Like the CFPB oversight and ombuds provisions, this provision of the Act attempts to solve consumer protection-oriented problems in a redundant and inefficient manner.

Conclusion

Bankruptcy is about more than consumer protection. It is about providing a fresh start to debtors who are acting in good faith and putting forth their best efforts to repay their debts. With its provisions regarding the consumer bankruptcy ombuds, CFPB oversight, and claims disallowance, the Act attempts to solve non-existent oversight issues, injecting new parties into a process already guarded by the EOUST, individual United States Trustees, and case trustees. The Act also stands to impede the plan confirmation process by forcing bankruptcy judges to render judgments on alleged consumer protection statute violations and other asserted creditor inequitable conduct at the claims allowance stage. This cumbersome process is unnecessary, given the ability of debtors to seek recoveries for such violations and inequitable conduct in separate proceedings. There is no doubt that consumer protection laws are necessary, and that a centralized agency can advance consumer protection goals. However, in the context of bankruptcy, the better approach might be for the CFPB to coordinate with the EOUST regarding the latter's protection of the bankruptcy system instead of creating redundant processes and roles.

Faculty

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