

# Bankruptcy Law



**Boston Bar**  
ASSOCIATION

SECTION NEWSLETTER

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## 2 CLEs on Bankruptcy Code Amendments

The Bankruptcy Section is offering two comprehensive BBA CLE programs with full participation from the Bankruptcy Bench!

### September 22, 2005 from 1-5 p.m. *Reception to Follow*

Business Amendments to the Bankruptcy Code: Explanation & Outlook at Moakley U.S. Courthouse, 1 Courthouse Way, Boston

This program will focus on the sweeping changes in the Bankruptcy Code that will profoundly effect business transactions and strategies, including Chapter 11 reorganizations.

The panel will review the changes made by Congress and offer an analysis of how they will impact decisions in the court and the day-to-day practice of business bankruptcy matters.

The expert panel: the Honorable Henry J. Boroff, the Honorable Robert Somma, Joseph S.U. Bodoff, Esq., Jeanne P. Darcey, Esq., Steven T. Hoot, Esq., Michael J. Pappone, Esq., Douglas B. Rosner, Esq., James M. Wilton, Esq. and Lynne B. Xerras, Esq.

Moderator: Peter N. Baylor, Esq.

### September 28, 2005 from 1-5 p.m. *Reception to follow*

Consumer Amendments to the Bankruptcy Code: Explanation & Outlook at Moakley U.S. Courthouse, 1 Courthouse Way, Boston

This program will discuss the new provisions of the Bankruptcy Code affecting consumer cases, together with the effect of the provisions on your law practice. This comprehensive program will provide you with a practical and step by step guide to the new provisions, and how they may be implemented by practitioners and interpreted by the courts.

The expert panel: the Honorable Joan N. Feeney, the Honorable William C. Hillman, the Honorable Joel B. Rosenthal, Nina M. Parker, Esq., Melvin S. Hoffman, Esq., Phoebe Morse, Esq., James M. Lynch, Esq., Stephen E. Shamban, Esq., Doreen B. Soloman, Esq., Anne J. White, Esq., Sanjit S. Korde, Esq. and Victor Bass, Esq.

Moderator: Donald R. Lassman, Esq.

For more information and to register, please visit:

<http://www.bostonbar.org/cle/index.htm>

## SAVE THE DATE

The **Bankruptcy Law Section Steering Committee** will hold its first meeting of the 2005-2006 program year at 8:30 a.m. on September 9.

The **Bankruptcy Law Section** will hold luncheon meetings from 12:15 to 1:45 p.m. on the following dates, subject to change:

**September 14, 2005** – Consumer Issues: Pre-filing Considerations hosted by Nina M. Parker and Walter Oney

**September 19, 2005 at 12:00 p.m.** – Joint meeting with the Bankruptcy Law Public Policy Committee and the Leasing Committee of the Real Estate Section with a discussion led by Douglas Rosner.

Other programs are scheduled for:

**October 8, 2005**  
**November 15, 2005**  
**December 20, 2005**  
**January 17, 2006**  
**February 21, 2006**  
**March 21, 2006**  
**April 18, 2006**  
**May 16, 2006**  
**June 20, 2006**

All meetings are held at the BBA, 16 Beacon Street, Boston, unless otherwise noted. All interested Section members are invited to attend.

Please RSVP by calling the BBA Reservation Line at (617) 778-2030 or via e-mail at [sections@bostonbar.org](mailto:sections@bostonbar.org).

## ARTICLES WANTED

As you know, the newsletter has received numerous quality articles in the past. While there is no specific limit, most have run approximately 1,000 words. You are all invited and encouraged to contribute an article on any subject of interest, particularly if you find yourselves dealing with an unusual or undecided issue in this district. Please contact the co-editors, Guy Moss or Colleen Murphy, to pursue this further. Thanks.

## CONTRIBUTORS TO THIS ISSUE

Daniel F. Dooley  
Guy B. Moss  
Nina M. Parker  
Adam Ruttenberg  
Anne J. White

## EDITORS

Guy B. Moss  
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## LEGISLATIVE NEWS

At its August 3 - 5, 2005 meeting, the Advisory Committee on Bankruptcy Rules, in the form of proposed amendments to the Federal Rules of Bankruptcy Procedure, approved "Interim Rules and Official Forms," subject to Judicial Conference Approval. The Committee on Rules of Practice and Procedure of the Judicial Conference of the United States has also approved these Rules and recommends their adoption through standing or general orders by each of the local bankruptcy courts with respect to bankruptcy cases only from October 17, 2005 until final rules and forms are promulgated and become effective. Time otherwise did not exist to devise final rules and forms under the regular Rules Enabling Act process. For more information on the Interim Rules and Forms, see <http://www.uscourts.gov/rules>.

## Consumer Bankruptcy Committee Notice

The Consumer Bankruptcy Committee is gearing up for a busy year with new projects, including a regular column regarding consumer issues in this Newsletter and exploring new pro bono projects.

Anyone interested in serving on the Consumer Committee should contact the co-chair, Ann Brennan, at (781) 849-1136 or by email at [abrennan@shambanlaw.com](mailto:abrennan@shambanlaw.com).

## Bankruptcy Law Public Policy Committee Notice

The Bankruptcy Law Public Policy Committee and the Leasing Committee of the Real Estate Section will host a presentation led by Douglas Rosner, of Goulston & Storrs. Mr. Rosner will discuss how recent changes in the bankruptcy laws will affect commercial leasing practice, and will also address resulting issues of which landlord and tenant counsel should be aware.

This program will be held at the Boston Bar Association on September 19, 2005 at 12:00 p.m. Please RSVP by calling the BBA Reservation Line at (617) 778-2030.

## FEE CHANGES

Your editors understand that the following filing fee changes, among others, will soon take effect: 1. Adversary Proceeding filing fee to increase to \$250 effective September 20, 2005. 2. Chapter 7 filing fee to increase to \$274 effective October 17, 2005. 3. Chapter 11 filing fee to increase to \$1,039 effective October 17, 2005. 4. Chapter 13 filing fee to decrease to \$189 effective October 17, 2005. Watch out for further announcements on the website of the bankruptcy court, [www.mab.uscourts.gov](http://www.mab.uscourts.gov).

## BAPCPA – THE FIRST PUBLISHED CASES

By: Guy B. Moss

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), signed by the President on April 20, takes effect October 17, 2005, subject to limited exceptions relating to specific provisions. On August 12<sup>th</sup>, I ran a search to see if BAPCPA has been examined, let alone even mentioned, in any published cases to date. What follows are summaries of four decisions where BAPCPA was more than a mere footnote identifying change in the offing:

(1) *In re McNabb*, 2005 WL 1525101 (Bankr. D. Ariz. 2005) (homestead).

A chapter 7 debtor purchased a home in Arizona on April 15, 2004 and prior thereto had lived in California since late 2001. He filed his chapter 7 case on April 28, 2005 and moved for the abandonment of his residence, asserting that the equity was less than the Arizona homestead exemption of up to \$150,000. The abandonment was challenged on various grounds. The bankruptcy court determined:

- (a) BAPCPA's amendment of section 522(b)(3), which would have mandated application of California's exemption scheme because the debtor had moved within 730 days pre-petition, was inapplicable because it took effect October 17<sup>th</sup>. Accordingly, the exemption laws of Arizona applied under current law because the debtor's move to Arizona was more than 180 days pre-petition.
- (b) BAPCPA's addition of section 522(p), applying a \$125,000 cap on a homestead if acquired within 1,215 days pre-petition, is applicable to

the case, as among the exceptions to the general effective date; BUT, it applies only in non-opt out states. The court noted that the new cap specifically applied only "as a result of [the debtor] electing under subsection (b)(3)(A)" to take the non-Code state exemption scheme, and that where there is no election to be made, i.e. in an opt out state like Arizona, there can be no process of "electing" anything and the cap is inapplicable. The judge observed that more than two-thirds of the states have opted out of the Code's federal exemption scheme and that of those which have not, the homestead exemption is usually less than \$125,000 anyway. (Massachusetts, in contrast, is not an opt out state and does have a homestead exemption exceeding \$125,000!)

(2) *In re Hill*, 2005 WL 1870789 (Bankr. S.D. Tex. 2005) (substantial abuse).

The U.S. Trustee moved to dismiss two chapter 7 cases as a "substantial abuse" of the provisions of that chapter. Although noting that BAPCPA's introduction of "means testing" as presumed abuse in new section 707(b)(2) was not yet effective, the court analyzed the section to see if a different result would have arisen and, in doing so, commented on the new act, as follows:

- (a) BAPCPA's means test does not displace current section 707(b) jurisprudence, and only expands the basis for dismissal through a detailed means test by which abuse is presumed. Specifically, a court's discretion under current section 707(b) is maintained in BAPCPA through incorporation of the "bad faith" and "the totality of the circumstances" language developed under current law. See amended section 707(b)(3)(A), (B).

- (b) The true effect of BAPCPA's changes may not be so clear, one reason being that while current section 707(b) uses the term "*substantial abuse*", revised section 707(b) uses the term "*would be an abuse*" and then at length adds significant statutory analysis to the determination of "an abuse".
- (c) The court reviews at some length how to appreciate the contours of the new means test in section 707(b)(2)(A), and applies its review to the facts in the actual chapter 7 cases.

(3) *In re Reeves*, 2005 WL 1682564 (Bankr. W.D. Mo. 2005) (substantial abuse).

The U.S. Trustee, as in the foregoing case, moved to dismiss a chapter 7 case as a "substantial abuse", contending that in calculating a debtor's disposable income and ability to fund a chapter 13 plan, as an alternative, the court must consider the income of the non-debtor spouse. The court agreed that must be done, noting it is the majority rule, but pointed out that two distinct approaches were possible: (i) pool all income and expenses of the couple; or (ii) look to the non-debtor spouse's income only for the limited purpose of allocating to the non-debtor a fair share of a portion of the household expenses. The court didn't decide that question, having concluded the same result would be reached either way, but noted that this issue "may be rendered moot" under BAPCPA in that in means testing the term "current monthly income" is defined to include the income that the debtor's spouse receives only in a "joint case". See amended 11 U.S.C. § 101 (10A)(A). The judge then cited recent commentary suggesting that a question has to exist whether a debtor's spouse's income may be considered at all in an abuse analysis unless it is a joint case. (One might note here, however, the admonition in *Hill*, above, that current section 707(b) jurisprudence still survives apart from the means test.)

(4) *In re Weilein*, 2005 WL 1845600 (Bankr. N.D. Iowa 2005) (dischargeability).

In December, 2004 the bankruptcy court held that section 523(a)(19) (violations of federal securities laws) did not apply to a pending fraud action against a chapter 7 debtor because a judgment must have arisen prior to the bankruptcy filing. After BAPCPA was enacted, the creditor moved for reconsideration of that order. The court noted BAPCPA's insertion of "before, in, or after the date on which the petition was filed" into section 523(a)(19)(B) and observed that Congress clearly intended, by the amendment's becoming effective retroactive to July 30, 2002 (see § 1404(b) of BAPCPA), to make the section applicable to all securities fraud judgments, orders or settlement agreements arising after the enactment of the Sarbanes-Oxley Act, whether *before or after* a bankruptcy filing. Therefore, the court reconsidered its order and found the securities fraud claims non-dischargeable.

[Editor's Note: Mr. Moss is a Partner at Bingham McCutchen LLP, 150 Federal Street, Boston, Massachusetts 02110 in its Financial Restructuring Group. He may be reached at tele: (617) 951-8916; email: [guy.moss@bingham.com](mailto:guy.moss@bingham.com).]

## THE SOPHISTICATED DEBTOR'S VOCABULARY

"*Macrology*": long and tiresome talk.

"*Manqu *": having not achieved a condition pretended to, desired, or deemed suited for.

"*Miasma*": noxious atmosphere or emanations.

"*Moliminous*": momentous; laborious in the execution and of great consequence in the finished form.

"*Mountebank*": spectacular charlatan.

"*Mussitation*": murmuring, grumbling.

## CONSUMER DEBTORS – SELECT PROVISIONS OF THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005

By: Anne J. White  
Nina M. Parker  
Adam J. Ruttenberg

### I. INTRODUCTION

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (Pub. L. No. 109-8) (the "2005 Reform Act"), which amends the U.S. Bankruptcy Code (11 U.S.C. § 101 *et seq.*), imposes substantial changes for consumer debtors. Among other substantial changes, the 2005 Reform Act establishes a "means testing" procedure for consumer debtors in order to ascertain whether a bankruptcy filing constitutes abuse. This so-called "means test" is to be utilized in connection with both Chapter 7 and Chapter 13 cases. Under the 2005 Reform Act, both Chapter 7 and Chapter 13 debtors will have significantly increased filing and reporting requirements at the outset and during the pendency of their cases. There are new limitations on exemptions and new restrictions against multiple filings. Many Chapter 13 plans will be required to span five years, as opposed to three. In addition, the discharge provisions under the 2005 Reform Act effectively eliminate the "super discharge" formerly available to Chapter 13 debtors. Furthermore, there are new certification requirements imposed on debtor's counsel. In sum, the changes imposed under the 2005 Reform Act are dramatic and comprehensive. There are few aspects of the filing, administration, review and discharge of a consumer bankruptcy case that have not been substantially altered by the 2005 Reform Act.

The general effective date for the 2005 Reform Act is October 17, 2005. In large part, the amendments under the 2005 Reform Act are effective and will apply to bankruptcy cases filed on or after October 17, 2005. It should be noted, however, that many provisions of the 2005 Reform Act have effective dates other than October 17, 2005. For example, significant changes to the exemption provisions of section 522 became effective upon the enactment of the 2005 Reform Act on April 20, 2005.

### II. MEANS TESTING IN MASSACHUSETTS

The 2005 Reform Act revises and substantially replaces section 707 of the former Bankruptcy Code governing dismissal of abusive filings. Previously, only the Court or the United States Trustee could move to dismiss a case under Code section 707. The standard was "substantial abuse." Under the new language, the word "substantial" is stricken and not only the court and United States Trustee, but also the Chapter 7 trustee and any interested party (including, of course, any creditor) may move to dismiss a case using a new calculation of the debtor's monthly income and expenses prescribed by an elaborate means testing mechanism. Given the emphasis on a debtor's excess monthly income as defined in means testing, it may be anticipated that more consumer debtors will file Chapter 13 cases or convert their cases to Chapter 13 proceedings. The amended section 707(b)(1) provides that, with the consent of the debtor, any party may move to convert a Chapter 7 case to a Chapter 13 or Chapter 11 proceeding if the consumer debtor does not meet the means test.

While most focus is placed on the new means testing requirements, it should be noted that the dismissal of filings for bad faith is preserved under the new section 707. In particular, under new section 707(b)(3), a dismissal may be sought for cases filed in bad faith or in which abuse is demonstrable given the totality of circumstances<sup>1</sup>. If the debtor's income does not exceed certain threshold amounts described below, however,

only the Court and the United States Trustee may seek dismissal of the asserted bad faith filing.

**A. When is the Means Test Applicable?**

Under the provisions of amended section 707(b)(2)(C), it appears that every consumer debtor will be required to include, as part of his schedules, a statement of current monthly income and calculations employing means testing to determine whether the presumption of abuse arises<sup>2</sup>. However, new section 707(b)(7) makes means testing inapplicable to debtors who earn below a certain income. For the typical consumer debtor, it will be important to ascertain at the outset, well before the commencement of any bankruptcy case, whether the debtor is above or below the threshold earning amounts that trigger means testing.

**B. How Much Income Will Trigger The Means Test?**

Pursuant to new section 707(b)(7), dismissal may not be imposed for failure to satisfy the means test if the debtor's income is below a sum calculated using the definition of the term "median family income" as defined in new section 101(39A). Section 101(39A) defines "median family income" as that reported most recently by the U.S. Bureau of Census adjusted by an annual percentage factor tied to the Consumer Price Index. At this time, the latest available data for income by state and family size is the 2000 Census which reflects data from 1999. The table that appears below is based on search results from the U.S. Census web site and incorporates the assumption that the correct consumer price index adjustment is approximately 8.9% in total for the last four years. The table is intended for illustration purposes only, inasmuch as it can be presumed that the United States

Trustees will likely soon publish precise threshold earning amounts applicable for Massachusetts and each of the other states.

**Median Family Income In Massachusetts**

	2000 Census	Adjusted for 2005
1 - Person Household	\$41,217	\$44,885
2 - Person Household	\$51,370	\$55,942
3 - Person Household	\$63,999	\$69,694
4 - Person Household	\$72,451	\$78,899

For purposes of establishing whether or not a debtor must satisfy the means test, new section 707(b)(7)(A) compares the debtor's family income, given his particular household size, to the applicable median family income in his state. In particular, section 707(b)(7)(A) prohibits any party from asserting that a debtor has committed abuse for failure to satisfy the means test, if "the current monthly income of the debtor ... and the debtor's spouse combined" is equal or less than the applicable median family income. New section 707(b)(7)(A) requires that the debtor and the debtor's spouse's income be utilized for this income calculation without regard to whether the debtor filed individually or jointly except where the non-debtor spouse is truly living separate and apart. Under new section 707(b)(7)(B), the debtor must file a sworn statement that his non-debtor spouse is truly living separate and apart in order to avoid the inclusion of the non-debtor spouse's income in the threshold determination of the applicability of the means test. As discussed in more detail below, the 2005 Reform Act contains a new definition of the term "current monthly income" under new section 101(10A) that includes monies from third parties (including spouses) that are paid

on a regular basis toward the household expenses. It should be noted that for certain individual debtors, the income figure utilized for the threshold determination of whether a debtor must satisfy the means test may be different than the income figure utilized for the actual determination of abuse under the means test. The difference will depend on the extent a non-debtor's spouse actually contributes to the household expenses<sup>3</sup>.

**C. Applying the Means Test under Section 707 (b)(2)**

Under section 707(b)(2) of the 2005 Reform Act, there is a presumption of abuse by a debtor if his "current monthly income" as defined by new section 101(10A) exceeds by a prescribed margin his "monthly expenses" as defined by the monthly living expense standards utilized by the Internal Revenue Service ("IRS") in the context of negotiations for offers-in-compromise of tax debts.

With respect to income, the definition under section 101(10A) defines income to constitute the average monthly income from all sources during the six (6) month period prior to the filing. This sum includes child support payments received by the debtor for dependents in his household but excludes, *inter alia*, Social Security benefits. As noted above, this sum includes any amounts contributed by another, including a non-debtor spouse, on a regular basis for household expenses. If the debtor's work is seasonal, there will be obvious advantages to properly timing the filing of a bankruptcy petition to avoid a skewed 6 month average income.

With respect to expenses, the allowed monthly expenses are prescribed by standards established by the IRS in connection with their collection process. The IRS has an established mechanism for ascertaining allowable monthly expenses in connection with its

collection and compromise procedures. Further details regarding the IRS definition of allowable monthly expenses are available in the Internal Revenue Manual, Part 5, Collecting Process, Chapter 15, Section 1, Financial Analysis Handbook (IRM 5.15.1).

The IRS defines three categories of expenses, namely, National Standards, Local Standards and Other Necessary Expenses. In particular, the IRS National Standards are the permissible monthly expenses for five expense categories: (1) food costs, (2) housekeeping supplies, (3) apparel and laundry, (4) personal care products and services, and (5) a modest expense for miscellaneous<sup>4</sup>. Further, the IRS Local Standards establish permissible expenses for (1) housing and utility costs and (2) transportation. The maximum monthly allowance for housing and utilities is delineated for each county within the state of Massachusetts<sup>5</sup>. Transportation costs include vehicle insurance, vehicle payments, maintenance, fuel, parking and public transportation. For Massachusetts' residents, there are two sets of allowable transportation costs, one for debtors residing in the six counties in and around the Boston metropolitan area<sup>6</sup> and a second for those living outside the Boston Metropolitan area but in the Northeast Region in general<sup>7</sup>.

Finally, the IRS recognizes a third category of expenses specified as Other Necessary Expenses. These necessary expenses include accounting and legal costs, charitable contributions if a condition of employment, child care, court-ordered payments, dependent care, education, health care, certain involuntary deductions such as union dues, life insurance, secured debt payments if necessary, unsecured payments such as to suppliers if necessary, taxes, telephone costs, and student loans. These expenses must be necessary for the health and

welfare of the debtor or his family or for the production of income as determined by the facts and circumstances of each case. However, new section 707(b)(2)(A)(ii)(I) specifically precludes from the category of "Other Necessary Expenses" the debtor's payment of debts<sup>8</sup>. The new section also permits additional expenses for the maintenance of safety in connection with family violence. Further, if the debtor can demonstrate reasonable necessity, the debtor's food and clothing allowance may be increased by an additional 5%. In addition, a debtor may demonstrate allowable additional actual monthly costs for (1) elder or disabled care for dependents, (2) education costs not to exceed \$1,500 per year per child less than eighteen years of age, and (3) higher home energy costs. The monthly allowable expense calculation may also include an additional amount for the administrative cost of a theoretical Chapter 13 proceeding; i.e. approximately 10% of the projected plan payments. (The exact formula calculation will soon be established by the Executive Office for United States Trustee.) Finally, allowed monthly expenses may also include all payments for priority claims and the actual contractual monthly amounts due secured creditors, including those holding security interests on the debtor's primary residence, vehicle and other necessary property<sup>9</sup>.

Once the full allowed monthly expenses are determined and subtracted from the defined monthly income, the debtor is allowed a margin of excess income as defined in section 707(b)(2)(A)(i). If the excess income over expenses exceeds this margin there is a presumption of abuse. Specifically, section 707(b)(2)(A)(i) provides a presumption of abuse if either (1) the debtor has at least \$166.67 in current monthly income available after allowed deductions (\$10,000 for five years) or (2) the debtor has

at least \$100 of such income (\$6000 for five years) and that excess income would be sufficient to pay at least 25% of the debtor's general unsecured debts over five years. As an aid to understanding the steps necessary to comply with the provisions of this section, a flow chart was designed and presented at the National Consumer Bankruptcy Attorneys conference held in San Diego. This chart, which details the mechanics of the section 707(b) means test, is available on the NACBA website at <http://nacba.org>.

New section 707(b)(2)(B) provides extensive provisions for demonstrating "special circumstances" that warrant the allowance of additional monthly expenses in order to avoid the presumption of abuse. These expenses must be entirely demonstrable and qualify as "special circumstances." For debtors pressed with extra necessary costs, however, it may be helpful to attempt to utilize the categories already established as IRS Other Necessary Expenses. It is likely the interplay between IRS standards and bankruptcy law will prove fertile ground for further development or dispute.

### III. NEW ELIGIBILITY REQUIREMENTS FOR CONSUMER DEBTORS

Both Chapter 7 and Chapter 13 debtors are required under the 2005 Reform Act to receive pre-bankruptcy credit counseling as a condition of filing<sup>10</sup>. Pursuant to new sections 109(h) and 521(b), debtors will be required to file a certificate from a non-profit credit counseling agency stating that the debtor has been provided a briefing on credit counseling and budget analysis during the 180-day period prior to the bankruptcy filing. If a debt repayment plan is prepared by the counseling agency, a copy of this repayment plan must be filed with the court along with the certificate. Pursuant to new section 111, the non-profit credit counseling agency will need to be approved by the United

## HUMOR

A customer sent an order to a distributor for a large amount of goods totaling a great deal of money. The distributor, noticing that the previous bill hadn't been paid, instructed the collections manager to contact the customer.

The collections manager made the call and left a voice-mail for them saying, "We can't ship your new order until you pay for the last one."

The next day the collections manager received a collect phone call from the customer who said, "Please cancel the order. We can't wait that long."

States Trustee and new forms and procedures are anticipated from the United States Trustee's Office in this connection. (The credit counseling briefing may be conducted by telephone or on the Internet.) If the United States Trustee's Office determines that the availability of approved nonprofit credit counseling services is inadequate in the particular district where the debtor lives<sup>11</sup>, the eligibility requirements of section 109(h) will not be applied.

A debtor may extend the eligibility requirements of section 109(h) for 30 days after the filing or a maximum of 45 days by court order. In order to receive such an extension, however, the debtor must (1) certify to "exigent circumstances" which are satisfactory to the court, and (2) certify that the debtor requested, but was unable to obtain, credit counseling from an approved counseling agency, as defined in section 111, within 5 days of his request<sup>12</sup>.

It should be noted that, under certain special circumstances, the efforts of an approved credit counseling agency on behalf of a debtor might result in a reduction of the amount of a particular claim. Pursuant to new section 502(k), if a debtor can prove by "clear and convincing evidence" that a creditor unreasonably refused a repayment offered on his behalf, the creditor's

claim will be reduced by up to 20%. Among other things, the offer of repayment must have been made more than 60 days before the petition date and have provided for repayment of at least 60 percent of the total amount owed.

#### IV. NEW DOCUMENTATION REQUIREMENTS

In both Chapter 7 and Chapter 13 cases, there are significant additional filing requirements for debtors. In addition to the usual Schedule of Assets and Liabilities (A-J) and Statement of Financial Affairs, amended section 521(a)(1) mandates that individual debtors file, inter alia, (1) copies of all pay stubs or other evidences of payment received within 60 days of the bankruptcy filing from any employers of the debtor, (2) a statement of net monthly income showing an itemization of how the amount was calculated, and (3) a statement disclosing any reasonably anticipated increase in income and expenses for the one-year period following the bankruptcy filing. New section 521(i)(1) provides that if the debtor fails to file all the information required under section 521(a)(1) within 45 days of the petition date, "the case shall be automatically dismissed<sup>13</sup>."

In accordance with new section 521(f)(4) and 521(g), in Chapter 13 cases, upon request of any interested party, the debtor shall be required to file each year an income and expense statement which details the debtor's income and support sources.

In both Chapter 7 and Chapter 13 cases, individual debtors must provide tax returns. In both cases, pursuant to new section 521(e), the debtor must provide to the trustee a copy of his tax return (or transcript) for the most recently concluded tax period at least seven days before the section 341 meeting. The debtor must also provide copies of the tax return to any creditor who so requests. If a debtor fails to comply with this production request, section 521(e) provides that the court shall dismiss the case, unless the debtor demonstrates the failure was caused by "circumstances beyond the

control of the debtor." In Chapter 7, 11 and 13 cases, pursuant to new section 521(f), as long as a case is pending, any party in interest may request that an individual debtor file with the court copies of his tax returns at the same time he files them with the taxing authorities. If requested, these returns must include returns for a tax period ending while the case is pending, as well as returns filed while the bankruptcy case is pending for past tax periods. Failure to timely file tax returns that become due while a case is pending is grounds for the appropriate taxing authority to request conversion or dismissal of the case pursuant to new section 521(j).

In Chapter 13 cases, new section 1308 requires the debtor to file with the appropriate taxing authorities all past unfiled tax returns that became due during the four-year tax period prior to the petition date. While this new section 1308 provides for extensions of time, a Chapter 13 plan can not be confirmed pursuant to new section 1325(a)(9) unless the debtor has filed all applicable tax returns. Furthermore, any party in interest can request dismissal of a Chapter 13 case under new section 1307(e) for failure to file such returns<sup>14</sup>.

#### V. EXEMPTIONS, HOMESTEADS, TRUSTS AND RESIDENCY

Under the new 2005 Reform Act, there are four new provisions which have a significant impact on a debtor's ability to assert a homestead exemption<sup>15</sup>. New sections 522(o), 522(p), and 522(q) became immediately effective upon the enactment of the 2005 Reform Act on April 20, 2005. A fourth provision, section 522(b)(3)(A), mandates that debtors satisfy certain residency requirements in order to be eligible to elect a particular state's exemption laws. These residency requirement provisions will become effective on October 17, 2005. Under the 2005 Reform Act, if a debtor has his home in Massachusetts with significant equity, it will no longer suffice to simply make sure that a declaration of homestead was recorded with the appropriate registry prior to the petition date. Now counsel will be required to review a

number of complicated issues and wrestle with statutory interpretation.

#### A. The 1215 Day Rule

In particular, under new section 522(p), if a debtor elects the so-called "state exemptions," his homestead exemption is capped at \$125,000.00 if he acquires the home within 1215 days (approximately 3 years and four months) of the bankruptcy filing. This cap applies to the debtor's or his dependent's residence, homestead, or burial plot as well as the debtor's personal property (e.g. trailer) or cooperative property (e.g. condominium) which is used as a residence. A recent bankruptcy court decision, however, has interpreted the language of new section 522(p) to be inapplicable in opt out states<sup>16</sup>.

There are two significant exceptions provided in section 522(p) for family farmers and for interests transferred from a previous principal residence in the same state acquired prior to the beginning of the 1215 day period. While it would appear that the "interests transferred" provisions of new section 522(p)(2)(B) are designed to permit debtors to buy a new residence in the same state, i.e. trading up as their family grows and trading down at retirement, there is no definition of "interests transferred." When a debtor sells and purchases on the same day and the money for the purchase comes from the sale proceeds, surely this would seem to qualify as "interests transferred" within the meaning of section 522(p)(2)(B). However, what if the debtor takes the sale proceeds, deposits them in a personal bank account, rents for a few months, and then buys a new house?

#### B. The Ten Year Look-Back For Fraudulent Transfers

New section 522(o) reduces the value of property claimed as a homestead to the extent such value

is on account of property intentionally fraudulently transferred during the 10 years period prior to petition date. However, there is an exception to this limitation if the property fraudulently conveyed could have been otherwise exempted by the debtor if it had been held by the debtor instead of disposed. Section 522(o) provides that the value of a debtor's interest in his homestead is reduced to the extent that such value is "attributable" to property disposed of by the debtor with the intent to hinder, delay, or defraud a creditor, provided the debtor could not have exempted such property. This section presents many unanswered questions. For example, to prove that a debtor's interest is "attributable" to fraudulently conveyed property, will a trustee in bankruptcy need to prove that the proceeds of that property are directly traceable into the homestead or will it suffice to demonstrate that the debtor would not have been able to buy or keep the homestead otherwise? Further, in order to take advantage of the exception for otherwise exempt property, will a debtor be required to establish a hypothetical exemption scheme - based on the assumption he had not disposed of the fraudulently conveyed property?

#### C. Delaying Discharge Where Felony, Securities Fraud or Severe Personal Injury Proceedings Pending

Pursuant to new section 522(q), if a debtor elects the state exemptions, his homestead exemption is capped at \$125,000.00 when (1) the bankruptcy court determines the debtor has been convicted of a felony under circumstances which demonstrate abuse of the bankruptcy provisions, (2) the debtor owes certain debts arising from securities violations, racketeering or fraud in connection with any security sales, or (3) the debtor owes debts arising from crimes or intentional torts that

cause serious physical injury or death in the preceding 5 years. The homestead exemption is reduced to \$125,000 based on debtor's status as a felon, but only if that status makes filing of the case an abuse. In addition to felons, new section 522(q)<sup>17</sup> singles out security fraud and personal injury debts for special treatment. However, the limitations imposed by section 522(q) are inapplicable if the homestead is reasonably necessary for the support of the debtor or any of his dependents.

The granting of a discharge in Chapter 7, 11 or 13 will be delayed if the debtor is subject to proceedings that might give rise to a limitation of his homestead for reasons such as felony, fraud, and causing severe personal injury as specified under section 522(q). In particular, under new section 727(a)(12), the court may not grant a discharge if it finds that there is reasonable cause to believe that section 522(q) applies and there is pending a proceeding in which the debtor may be found guilty of a felony of the type described in section 522(q)(1)(A). Under new section 1328(h)<sup>18</sup>, the court may not grant a discharge unless the court finds that there is no pending proceeding of the kind set forth in section 522(q). Such hearings are to be conducted "no more than 10 days before the date of the entry of the order granting discharge." The delay of discharge requirements will pose new administrative and procedural burdens on the bankruptcy court.

#### D. Residency Requirement For Eligibility To Claim State Exemption

Certain states, such as Massachusetts, permit debtors to select between (1) the federal exemptions provided under section 522(d) and (2) other applicable exemptions such as state exemptions. Under the 2005 Reform Act, a debtor may still select the federal or state exemptions; however, there is a

new residency requirement. New section 522(b)(3)(A) limits the debtor's choice of applicable state law to the state in which the debtor was domiciled for the last 2 years. If the debtor has relocated during this two year period, the determination rests on where the debtor resided for the longer portion of the 180 days prior to the two-year period. If this new residency requirement would render a debtor ineligible for any state exemption, then the debtor is allowed to choose the federal exemptions.

### E. Self-Settled Trusts

New section 548(e) permits the trustee to avoid any transfer within ten years of the bankruptcy filing of property by the debtor to a self-settled trust or similar devise if such transfer is made with "actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date of such transfer was made, indebted." It would appear that a trustee will need to establish that the transfer was intended to protect the asset from a least one specific creditor – a particular entity - rather than just as a general estate planning or asset protection scheme.

### VI. RELIEF FROM STAY

Pursuant to new section 362(c)(3), generally, if a Chapter 7, 11, or 13 case is filed within one year of the dismissal of an earlier case, the automatic stay in the second case terminates 30 days after the filing unless otherwise ordered by the court. Further, if a second repeat filing takes place within the one-year period, the automatic stay will not go into effect at all and the court, on request of any interested party, is required to promptly issue an order confirming the inapplicability of the automatic stay. There is a presumption that these repeat filings are not made in good faith. In order for a party to rebut this presumption, the party must convince the court by clear and convincing evidence that the filing of

the new case is in good faith "as to the creditors to be stayed."

Pursuant to new section 362(d)(4), the court's issuance of "in rem" relief from the automatic stay is authorized. Where a debtor (1) has transferred real property without the assent of the secured creditor or court approval, or (2) filed multiple bankruptcy proceedings, the court may issue an order for relief which binds all owners of the subject property for two years from the entry of the order. Once an in rem order is effective, new section 362(b)(20) creates an exception to the automatic stay for lien enforcement in later cases<sup>19</sup>.

### VII. REAFFIRMATION AGREEMENTS

Prior to the enactment of the 2005 Reform Act, reaffirmation agreements were governed solely by section 524(c). In essence, under prior law, section 524(c) required that the reaffirmation agreement:

- (1) be signed prior to the granting of a discharge (§524(c)(1));
- (2) contain clear and conspicuous language advising the debtor that the agreement may be rescinded prior to discharge or within sixty days after the agreement is filed with the court and that the agreement is not required by bankruptcy or non-bankruptcy law (§524(c)(2)); and
- (3) be accompanied by a declaration or affidavit signed by the debtor's attorney stating that the agreement represents a fully informed and voluntary agreement, that the agreement does not impose an undue hardship on the debtor, and that the attorney fully advised the debtor of the legal effect and consequences of the agreement (§524(c)(3)).

The 2005 Reform Act, however, replaces the relatively straightforward "clear and conspicuous statements" required by section 524(c)(2) with lengthy disclosures contained in a new section 524(k). These expanded

requirements include detailed disclosures concerning the amount of debt reaffirmed, the annual percentage rates imposed, the repayment schedule involved, and the meaning and effect of reaffirmation. If the debtor is *pro-se*, the reaffirmation agreement must be accompanied by a motion to approve such reaffirmation which contains language provided in new section 524(k)(7)<sup>20</sup>.

Finally, and of great interest to all attorneys practicing in the consumer law field, new section 524(k) continues to require a declaration or affidavit by debtor's counsel as set forth in section 524(c)(3). The new section 524(k), however, adds the provision that if a presumption of undue hardship arises (because the debtor's monthly income is insufficient) then debtor's counsel must certify "in the opinion of the attorney, the debtor is able to make the payment". Undue hardship is defined in new section 524(m)(1). Undue hardship is presumed if the debtor's monthly income less the debtor's monthly expenses, as reported on a statement required by §524(k)(6)(A), is less than the scheduled payments on the reaffirmed debt. This presumption extends for at least 60 days after a reaffirmation agreement is filed, unless ordered for a longer period by the court. The presumption may be rebutted in writing by the debtor if another source of income is available to make the agreed-upon payments. The provisions of §524(m)(1) do not apply to credit unions.

Pursuant to new section 521(a)(6), a debtor may not retain possession of personal property which is the subject of an allowed security interest for its purchase price unless the debtor enters into a reaffirmation agreement or redeems the subject property within a prescribed time period. The time period, under new section 521(a)(6), is specified as "not later than 45 days after the first meeting of creditors under section 341(a)." It is not clear whether this limitation is intended to constitute a 45-day period from the first scheduled meeting of creditors, from the date the first meeting of creditors is actually held, or from the

date the first meeting of creditors is concluded.

Further, section 521(a)(6) provides that if the debtor fails timely to reaffirm or redeem, the automatic stay shall terminate with respect to the subject property and the property shall no longer be property of the estate unless the court orders otherwise. New section 362(h)(1) also terminates the automatic stay with respect to, and removes from the estate, personal property subject to any security interest or unexpired lease if the debtor fails to file a required Statement of Intention under section 521(a)(2). Pursuant to new section 521(a)(2)(B), the debtor is required to perform his stated intention (i.e., reaffirm, redeem, relinquish) within 30 days of the first date set for the meeting of creditors unless otherwise ordered by the court.

Pursuant to new section 506(a)(2), for individual debtors the value of a secured claim against personal property "shall be determined based on the replacement value of such property as of the date of the filing of the petition without deduction for cost of sale or marketing." While this provision might at first glance appear to be advantageous to creditors, the application of this definition may prove otherwise. Section 506(a)(2) provides further that, for personal property used for family purposes, "replacement value shall mean the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined." For example, if the debtor had purchased an automobile a few months prior to the filing of this petition, the actual replacement value of this automobile on the petition date would likely be substantially less than the amount owed the secured lender<sup>21</sup>. Presumably, the creditor would hold only an unsecured claim for the balance owed over the "replacement value."

## VII. LIMITS ON LIEN AVOIDANCE

The 2005 Reform Act amends section 522(f) to alter and expand the language which prevents a debtor from avoiding the fixing of a judicial lien on

otherwise exempt assets for the payment of domestic support obligations. Domestic support obligations are newly defined in section 101(14A) to include any debt that accrues before, on or after the bankruptcy case in the nature of alimony, maintenance, support, without regard to whether it is expressly so designated. The new definition includes any interest that accrues on the debt as provided under applicable nonbankruptcy law. This provision clearly provides for the inclusion of accruing interest notwithstanding any other provision of the Bankruptcy Code to the contrary. The newly expanded definition of domestic support obligations is utilized in section 522(f)(1)(A) by reference to the new section 523(a)(5), which excludes domestic support obligations from discharge. In sum, a debtor may not avoid a judicial lien which arose as a result of domestic support obligations, nor are domestic support obligations dischargeable. Further, while a debtor may generally retain exempt property, under new section 522(c) the debtor's exempt property will remain subject to attachment or liability to satisfy domestic support obligations.

The 2005 Reform Act also limits the debtor's ability to avoid security interests on otherwise exempt household goods by amending section 522(f) to add a restrictive definition of what constitutes "household goods." Under new section 522(f)(4)(A), the term "household goods" for the purpose of lien avoidance is strictly defined to include only "clothing; furniture; appliances; 1 radio; 1 television; 1 VCR; linens; china; crockery; kitchenware; educational materials and equipment for minor dependents; medical equipment and supplies; furniture for children and elderly or disabled dependents; personal effects (including toys and hobby equipment of dependent children and wedding rings) of the debtor and the dependents of the

debtor; and 1 personal computer and related equipment." New section 522(f)(4)(A) specifically excludes from the definition of "household good" works of art, most electronic

entertainment equipment, antiques with aggregate fair market value of more than \$500, jewelry with an aggregate fair market value of more than \$500 (except wedding rings), a motor vehicle, boat, a motorized recreational device, conveyance, vehicle, watercraft, and a aircraft.

Under the 2005 Reform Act, these is a significant change in the consequences of lien stripping when a Chapter 13 case is converted to a Chapter 7 proceeding. Under new section 1325(a)(5), if the case is dismissed or converted to a Chapter 7 without completion of the plan, the lien shall be retained by the creditor "to the extent recognized by applicable nonbankruptcy law." This provision makes clear that any lien avoidance or strip down of a lien in a failed Chapter 13 plan is null and void. Upon conversion to Chapter 7 the secured creditor retains its lien upon the subject collateral to the same extent as would be recognized by nonbankruptcy law pursuant to new section 1325(a)(5)(B)(i)(II). In other words, the debt will have to be paid in the same amount that would have been paid if no bankruptcy had been filed.

## IX. DISCHARGE AND DISCHARGEABILITY

The 2005 Reform Act modifies the discharge provisions for debtors who file successive bankruptcy cases. Under new section 1328(f), there are two distinct time limitations: a four-year time limitation and a two-year time limitation. Pursuant to new section 1328(f)(1), no Chapter 13 discharge will be granted if the debtor previously received a discharge in a Chapter 7, 11 or 12 case within four years of the filing of the Chapter 13. This provision will have the effect of eliminating the possibility of a so-called "Chapter 20 case" in which a debtor files a Chapter 13 case immediately following his discharge in a Chapter 7 proceeding. The two-year time limitation applies where Chapter 13 proceedings are filed in succession. Under new section 1328(f)(2), no Chapter 13 discharge will be granted if the debtor previously received a discharge in a Chapter 13 proceeding

within 2 years of the filing of the instant Chapter 13 case. This provision eliminates the problem of serial Chapter 13 filers. In the Chapter 7 context, the time period is also increased by new section 727(a)(8) from six to eight years for the granting of a new Chapter 7 discharge after a prior Chapter 7 or Chapter 11 discharge.

To receive a discharge under Chapter 7 or Chapter 13, new sections 727(a)(11) and 1328(g) require that, after the filing of a petition, the individual debtor must attend a personal financial management instructional course approved by the United States Trustee. This debtor education program is a wholly new requirement. Pursuant to new section 111, these instructional courses must be thoroughly reviewed by the United States Trustee's Office to assure adequate qualifications. Such programs are not currently in existence in many locations. Accordingly, if the debtor lives in a district where the United States Trustee's Office has found that no adequate debtor education course is available, the new discharge limitations of sections 727(a)(11) and 1328(g) will not apply<sup>22</sup>.

New section 727(a)(12) and 1328(h) provide special prohibitions against the granting of a discharge to a debtor convicted of a certain kind of felony. As discussed previously, these new sections provide for delay of discharge if a felony proceeding is pending against a debtor.

The amendments to Chapter 13 effectively eliminate the "super discharge" formerly available to Chapter 13 debtors. In Chapter 13 cases, the 2005 Reform Act amends section 1328(a)(2) to make nondischargeable, among others, debts of the kind described in subsections 523(a)(2) and (4). Under the amendment, debts incurred for monies obtained by false pretenses, false representations, etc. as well as debts incurred by embezzlement, larceny or fraud while serving as a fiduciary will no longer be dischargeable in Chapter 13. In addition, certain tax penalties for unfiled, late filed or fraudulently

filed tax returns will no longer be dischargeable in Chapter 13. Further, new section 1328(a)(4) makes nondischargeable damages for willful or malicious conduct that causes personal injury or death.

Pursuant to an amendment to section 523(a)(2)(C), debts in excess of \$500.00 for luxury goods and services incurred within 90 days of the commencement of a Chapter 7 or Chapter 13 proceeding are presumed nondischargeable. This amendment is not an insignificant change, inasmuch as the amendment expands the look-back period from 60 to 90 days and reduces the subject amount from \$1225 to \$500. Further, under new section 523(a)(2)(C), cash advances of over \$750 received within 70 days of bankruptcy are presumed nondischargeable. The objecting party, however, will still need to bring a timely adversary proceeding to obtain a judgment of nondischargeability.

Under the Bankruptcy Code, prior to the 2005 Reform Act, debts incurred to pay nondischargeable taxes to the United States were nondischargeable. The 2005 Reform Act, while leaving this provision intact, adds new section 523(a)(14A), which provides that debts incurred to pay nondischargeable taxes to governmental units other than the United States are also nondischargeable. New section 523(a)(14A), thus, expands the category of nondischargeability to cover debts incurred to pay state or local taxing authorities.

Section 523(a)(15) is amended to make nondischargeable debts incurred to a spouse, former spouse or child in the course of a divorce or separation, or in connection with a separation agreement, divorce decree or other order or governmental determination. This amendment removes the affirmative defenses and balancing-of-benefits trials previously available for debtors who sought to discharge property settlements.



#### X. CHAPTER 13 PLANS, THE MEANS TEST, AND CONFIRMATION

Under new section 1325(a)(7), the court may only confirm a Chapter 13 plan that is filed in "good faith." The new imposition of a good faith standard in the Chapter 13 context may well prompt novel challenges by creditors to what were formerly standard Chapter 13 practices.

The 2005 Reform Act will significantly affect the duration of Chapter 13 plans. Under new section 1322(d), if the debtor and debtor's spouse's combined income is higher than a certain threshold amount established by use of U.S. Census information under a new Bankruptcy Code definition of the "median family income," then the debtor must submit his future earnings to the plan for a period of up to five years. If the debtor's income is below this same threshold, his plan may be for a period of up to three years with the maximum of five years allowed only by court order for cause.

Amendments to section 1325 replace the existing Chapter 13 disposable income test with the "means test." This means test is applicable to Chapter 13 cases for debtors whose income is above the median family income. The substantial

changes imposed by new section 707(b) in the 2005 Reform Act are designed to prompt debtors whose disposable income exceeds allowable expenses to file Chapter 13 plans<sup>23</sup>. Amended section 1325(b)(4) defines the “applicable commitment period” and details the methodology for determining the duration of the proceeding.

A Chapter 13 debtor is permitted to modify a Chapter 13 plan to reduce payments in order to purchase reasonable and necessary health insurance pursuant to new section 1329(a)(4).

Several new provisions of the 2005 Reform Act provide special favored treatment for domestic support obligations. As noted previously, this favored treatment is reflected in amendments to sections 522 and 523 regarding lien avoidance and dischargeability. In addition, pursuant to new section 1307(c)(11) a debtor’s Chapter 13 case may be dismissed for failure to pay domestic support obligations. Further, under new section 1325(a)(8), no Chapter 13 plan can be confirmed if the debtor has failed to pay domestic support obligations that became due since the filing of the Chapter 13 case. For debtors subject to domestic support obligations, a Chapter 13 discharge will not be entered pursuant to amended section 1328(a) unless the debtor certifies that all payments due on such obligations have been paid.

Even the basic section 341 meeting procedures for Chapter 13 cases may change under the 2005 Reform Act. Amended section 1324, for example, adds a new section 1324(b) which provides that a hearing on confirmation may be held no earlier than 20 days after the meeting of creditors and no later than 45 days after such meeting unless the court orders otherwise and no party objects<sup>24</sup>.

## XI. NOTICE

It should be noted, further, that notice requirements under new section 342 require debtors to utilize specific addresses (1) furnished by creditors to

debtors within 90 days of filing, (2) filed with the Court by the creditor and served on the debtor, or (3) filed by the creditor with the court for all bankruptcy cases. Without use of the correct address, notice is deemed ineffective. It will be important for debtors with real estate to record at the appropriate registry of deeds notice of their bankruptcy petition in order to provide additional notice to mortgage lenders.

## XII. CONVERSION

Section 348(f) has been amended to provide that when a case is converted from Chapter 13 to Chapter 7, the claim of a creditor holding security as of the petition date continues to be secured by that security, unless the claim was paid in full during the Chapter 13 case. As noted previously, valuation of property and allowed secured claims in the Chapter 13 case shall not be binding in the converted case<sup>25</sup>. Any prebankruptcy default not cured by the date of conversion is given the same effect it has under nonbankruptcy law.

## XIII. CERTIFICATION, SANCTIONS AND DISCLOSURES IMPOSED ON DEBTOR’S COUNSEL

### A. Sanctions

Section 707(b), as amended, imposes several new duties and liabilities on debtors’ counsel. In particular, new section 707(b)(4)(A) allows the court to award costs and fees, payable by debtor’s counsel, to a trustee who successfully pursues a section 707(b) motion against a debtor and persuades the court that the Chapter 7 filing violated Fed. R. Bankr. P. 9011.

Further, new section 707(b)(4)(B) specifies that if the court finds any violation of Rule 11 by the debtor’s counsel, it may award a civil penalty against the attorney, payable to the trustee, U.S. Trustee, or bankruptcy administrator. Under section 103(b), this provision is only applicable in Chapter 7 cases.

### B. Certification

Under new section 707(b)(4)(C) and (D), the signature of a debtor’s attorney constitutes a certification that (1) the attorney has “performed a reasonable investigation,” (2) the signed documents are “well founded in fact,” (3) the Chapter 7 petition does not constitute an abuse, and (4) “the attorney had no knowledge after an inquiry that the information in the schedules filed with such petition is incorrect.”

### C. Debt Relief Agency Disclosures

Pursuant to new section 526, debtors’ counsel are subject to loss of fees, damage claims, injunctive remedies, and the imposition of costs for any failure to meet new disclosure and record-keeping requirements posed of “debt relief agencies.” These “debt relief agencies,” as defined under new section 101(12A), include any person who provides bankruptcy assistance to any “assisted person” in return for money payment or other valuable consideration. An “assisted person” is defined under new section 101(3) to constitute “any person whose debts consist primarily of consumer debts and the value of whose nonexempt property is less than \$150,000.” Presumably, if a bankruptcy attorney represented only nonpaying consumer debtors, business owners or individual with over \$150,000 in non-exempt property, he would not be subject to the requirements imposed on debt relief agencies. However, for most consumer bankruptcy attorneys there are new do’s and don’ts imposed under section 526. For example, pursuant to section 526(a)(4), a debtor’s attorney shall not advise a debtor to incur more debt in contemplation of filing a bankruptcy case. Further, there are new disclosure requirements, attorney agreement requirements and advertising restrictions imposed under new sections 527 and 528. In addition, pursuant to

section 527, a debtor's attorney must retain copies for at least two years of each of the several notices required to be given to his clients.

#### XIV. CONCLUSION

While many of the new provisions of the 2005 Reform Act pose questions of interpretation, one can only hope that the strong sense of equity and fairness that has been paramount in bankruptcy courts will continue to prevail so that the new law will be reasonably and fairly implemented.

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#### Endnotes

<sup>1</sup> This section permits dismissal under circumstances such as bad faith without regard to whether the debtor has satisfied the means test.

<sup>2</sup> In early August, in the form of proposed amendments to the Federal Rules of Bankruptcy Procedure, the Advisory Committee on Bankruptcy Rules approved Interim Rules and Official Forms to implement the changes made by the 2005 Reform Act, subject to approval of the Judicial Conference (the "Interim Rules"). The Committee on Rules of Practice and Procedure of the Judicial Conference has since approved such Rules. These must still then be adopted by the bankruptcy courts as emergency orders. See <http://www.uscourts.gov/rules>. Interim Rules 1007, 1017 and 2002 address the changes discussed above.

<sup>3</sup> For example, if a married (and not separated) debtor files an individual bankruptcy case, his spouse's entire income will be utilized for the threshold determination of whether or not he is required to satisfy the means test. By

contrast, if this same married (and not separated) debtor has a non-debtor spouse who spends none of her income on household expenses for the debtor or the debtor's dependents, it would appear that her income would not be included for applying the means test calculation to determine abuse. See new section 707(b)(2) and the section of this article entitled "Applying the Means Test under Section 707(b)(2)."

<sup>4</sup> According to the National Standards, for example, a family of four with gross monthly income between \$2,500 to \$3,333 is allowed (1) \$528 for food, (2) \$54 for housekeeping supplies, (3) \$174 for apparel and services, (4) \$46 for personal care products, and (5) \$188 for miscellaneous (totaling \$990.00). See the IRS website at [www.irs.gov](http://www.irs.gov).

<sup>5</sup> For example, for a family of four living in Middlesex County, the housing and utility allowance is \$2,240, while it is \$1,378 for a family of four in Berkshire County.

<sup>6</sup> The Boston Metropolitan Statistical Area includes 8 counties, namely, Bristol, Essex, Hampden, Middlesex, Norfolk, Plymouth, Suffolk and Worcester. The allowable operating expense for one car in the Boston area is \$284.

<sup>7</sup> The allowable operating expense outside of the Boston area for one car is \$298. There is a separate car ownership allowance of \$475 for one car.

<sup>8</sup> Presumably this provision is intended to apply to unsecured debts inasmuch as certain secured debt payments are specifically allowed as monthly expenses in section 707(b)(2)(A)(iii) and certain priority debt payments are allowed in section 707(b)(2)(A)(iv).

<sup>9</sup> Section 707(b)(2)(A)(iii), however, defines "average monthly payments on account of secured debts" to be the amounts due for the next five years (i.e., 60 months). This may well pose a problem for debtors nearing the end of a vehicle loan or end of a mortgage obligation.

<sup>10</sup> This new requirement may have the perhaps unanticipated effect of eliminating involuntary individual Chapter 7 cases since the would-be debtors can merely fail to receive the required credit counseling.

<sup>22</sup> The United States Trustee's Office must review this determination annually.

<sup>12</sup> This provision would seem to mandate, under circumstances where an approved credit counseling agency was able to provide services within, for example, four days, that the debtor wait the four days and receive the counseling before filing his petition. In circumstances where foreclosure is imminent, this could be problematic. However, once online credit counseling becomes available, this problem may be easily avoided.

<sup>13</sup> Interim Rule 4002 has been amended to implement the provisions of the expanded obligations of the debtor to produce additional documentation including evidence of personal identity, current income and tax returns.

<sup>14</sup> Interim Rule 3002 is amended at (c)(1) to conform to section 502(b)(9) in connection with the time period for governmental units to file proofs of claim based upon tax returns filed in accordance with section 1308.

<sup>15</sup> While the amendments to homestead exemptions have prompted considerable attention, it should also be noted that there is a substantial increase in the allowed exemption of retirement funds. See new Sections 522(d)(12) and 522(n).

<sup>16</sup> While Massachusetts residents have the option of choosing federal or so-called "state" exemptions, more than thirty states have "opted out" of the federal set of exemptions. Since section 522(p) applies only "as a result of electing under subsection (b)(3)(A) to exempt property under state or local law," a bankruptcy court in Arizona ruled that section 522(p) is inapplicable in opt out states such as Arizona. *In re McNabb*, 326 B.R. 785 (Bankr. D. Ariz. 2005).

<sup>17</sup> Interim Rules 4004 and 4006 provide mechanisms for the delay of entry of discharge if the debtor failed to complete the financial management program or if the debtor has committed a felony or owes a debt as described in certain sections including section 727(a)(12) and 1328(h).

<sup>18</sup> See also new Section 1141(d)(5)(C) which imposes a similar court finding in the Chapter 11 context.

<sup>19</sup> Look to new Sections 362(b)(22), 362(b)(23), 362(l) and 362(m), regarding new landlord exceptions from the automatic stay.

<sup>20</sup> Interim Rule 4008 reflects the changes to sections 524(k)(6)(A) and 524(m) and now requires that the debtor file a signed statement together with a statement of income and expenses as set forth in Schedules I and J accompanied by an explanation of any differences.

<sup>21</sup> There is a marked decline in the value of an automobile once purchased from the showroom. It is no longer a "new" car and joins the uncertain ranks of other used cars.

<sup>22</sup> The United States Trustee's Office is also required to conduct an 18-month study of the effectiveness of certain educational programs.

<sup>23</sup> Pursuant to new Section 1129(a)(15) in Chapter 11 proceedings, where the debtor is an individual, Chapter 11 plans may be disallowed if the debtor fails to meet the same disposable income standards used in Chapter 13 cases under the means test and Section 1325(b)(2).

<sup>24</sup> In Massachusetts, under the current Bankruptcy Code, the meeting of creditors and confirmation hearing are typically held at the same time. This practice may have to change unless standing court orders are implemented and no party objects.

<sup>25</sup> This provision codifies the prohibition against "lien stripping" in Chapter 7 cases.

## THE U.S. AUTO INDUSTRY IN 2005 FROM A NON- DETROITER'S PERSPECTIVE

By: Daniel F. Dooley

This article examines the primary issues currently facing the U.S. automotive industry. The perspective is from a senior principal of a national middle-market workout firm where only about 15% of its business is in automotive. The author has worked for Tier One suppliers and has been CEO of Tier Two suppliers. This article warns that automotive suppliers must be very proactive and creative *right now* or they will likely be left behind and see their business die off.

### Over-capacity in basic component manufacturing

This allows the Big 3 and its Tier One to force continual price decreases down the supply chain because some underutilized manufacturer will always take existing sales at low margins to fill up excess capacity. Since it is common practice in the automotive industry for the customer to own the molds and tooling, switching vendors is not as much of a hurdle as it is in other manufacturing industries.

Currently, the U.S. automotive component industry is operating in the mid-60 percent utilization range, a full 15 to 20 percentage points below the 80 percent threshold that economists generally regard as the midpoint of a healthy industry. This condition almost surely will result in massive production consolidation and the

much needed closing of "many" U.S. plants.

Simple math implies approximately a 25% reduction in capacity is needed to "right size" the capacity. I would argue that *at least* 1 out of 4 U.S. plants needs to be closed as a most conservative estimate. This will be quite a blood letting and we are now at that point in my opinion.

### Massive outsourcing to the Pacific Rim

The auto component industry avoided the initial wave of outsourcing to the Far East (Japan and Taiwan) in the 80's for several reasons. First, there was tremendous cost that could be squeezed out of the existing supply base as the Big 3 were all basically engineering and marketing companies which had poorly managed operations. Enter Lopez at GM as the purchasing czar and the big squeeze on suppliers began. Second, the new emphasis on operations and the "partial" modeling of the successful Japanese manufacturing system tightened up the supply chain tremendously and resulted in the norm today of two days of inventory on hand at assembly plants and with most suppliers within 8 hours truck travel time (1 shift) of the plant. In this type of environment, it is very difficult to introduce any long lead time suppliers (i.e., Pacific Rim) to the assembly plant mix of suppliers as the logistical risk is too great. Finally, the Big 3 started to spin off major Tier One operations as stand-alone companies (Delphi, Visteon, etc.) and this further reduced costs.

So what's different today? Why will the automotive industry be forced to outsource this time? The cost, productivity and quality penalties of the Big 3 vs. the transplants have not been closed and, in fact, have gotten worse. There is serious concern that both GM and Ford could end up in bankruptcy with both now having their bonds recently downgraded to "junk" status by the major rating agencies. My personal view is that they won't end up in bankruptcy in this economic cycle, but they may the next time the cycle collapses if they don't take drastic action in the near-term.

The point is that with the high, fully loaded labor costs of the UAW plants that are standard at the OEM's and the Tier Ones and the fact that these manufacturers don't have the option to go south to avoid the union, I think you will see a big acceleration in the relocation of major component plants to the Pacific Rim under the "serving the local market" rationale. The bottom line to this is that U.S. component manufacturers had better get a substantial Pacific Rim manufacturing operation up and running or they will be left out in the cold.

Final note is that most other industries (with the notable exceptions of automotive and aerospace) made a major move to the Pacific Rim when China was granted free trade status in 2001. The major type of products moved to China, Korea, India and Vietnam during this aftermath were: commodity products (vs. special order), higher volume products, lighter weight/smaller products where freight cost is less of an issue, and products where there was low risk of engineering change. The general rule was that products in these categories often would result in 30% to 50% lower cost on a landed cost basis than domestically produced components. With savings of that magnitude the industry should come to a point where they are forced to move production overseas.

### Raw material cost risk vs. fixed price sales contracts

In addition to the industry standard fixed price sales contracts, vendors are faced with annual price give-backs that were cancelable upon "convenience": convenient only to the customer because only the supplier is bound and the buyer can opt out if someone offers a lower price. This deal is a little like a sports owner's deal with a professional athlete. Both totally put the risk of changing economics on one party – the supplier and the owner.

In the last year we have learned that steel and oil are pure commodities and that market prices can move up and down quickly and by large amounts. Smaller companies have no

## QUOTES OF THE MONTH

"Life is short and so is money."

- Bertolt Brecht

"One of the penalties of wealth is that the older you grow, the more people there are in the world who would rather have you dead than alive."

- C.H.B. Kitchin

"True, you can't take it with you, but then that's not the place where it comes in handy."

- Brendon Francis

purchasing leverage with the commodity producers to negotiate long-term agreements or to employ effective commodity hedging strategies. Many component manufacturers have over 50% material content on a sales dollar and larger organizations enjoy an estimated 10% or more lower raw material cost advantage which translates to at least a 5% full cost advantage in businesses that typically have gross margins of 20% maximum and often much less. The bottom line, again, translates to the need to create much bigger consolidated organizations. I think we're talking consolidated component organizations of \$1 billion or greater. With many of these companies now in the \$20 to \$200 million range, we're talking lots of big time roll-ups that are coming.

### Ability to finance component businesses

Two major changes have occurred that directly affect component manufacturers right now. First, GE had a financing ("Fast Pay" Program) deal with the Big 3 and Tier One that was killed by a recent Accounting Board ruling. Up until July 2004, GE was essentially factoring Tier One receivables with the Big 3 and paying the Tier Ones within 10 days despite being paid in say 60 days by the Big 3. The Big 3 got a discount for

participating and GE made a margin on the deal. However, the receivables were guaranteed by the Big 3. The accounting ruling would have forced the Big 3 to establish debt on their balance sheet equal to the amount they guaranteed. This killed the tactic and the Big 3 weaned the Tier Ones off this financing during late 2004. Although many Tier Ones replaced the Fast Pay deal with ABL facilities, it was too little cash too late.

The second thing that changed was that many metal suppliers were essentially forced by market circumstances to participate in the OEM's Steel Resale Programs as a way to at least partially mitigate the doubling of steel costs during 2004. Essentially, the Steel Resale Program is a long-term deal that the Big 3 have with the major steel mills for a fixed price long-term supply of steel. Historically, this price is like insurance in that the price is perhaps 10% higher than spot prices, but it is fixed. As you can imagine, many metal manufacturers bought steel on their own to save money. Of course, this was a great move until steel prices rose significantly. The bottom line is that most steel component manufacturers now buy steel under the Steel Resale Program, which means the legal buy-sell transaction is with the Big 3 customer. This was the only way to get partial pricing relief.

The change moved suppliers from vendor financing with 30-60 days accounts payable to customer financing of accounts payable where the customer accounts receivable has a direct "contra" effect on its borrowing base for the customer accounts payable. Given that most suppliers have asset-based lending facilities, this reduced "net" receivables and essentially forced suppliers to pay cash for steel. This is now a huge capital structure issue with almost all metal component manufacturers on a steel resale program.

### Value added services

To fight the pricing pressure there is a drastic need for automotive component manufacturers to do more than basic fabrication processes which

are the most easy to replicate and thus allow easier movement of products from one manufacturer to another. This means that the manufacturer's relatively safe harbor is a higher labor content doing more value added operations (welding, assembly, etc.). Manufacturers are constantly proposing re-design of existing processes, integrating their components and their customer's upstream processes as a cost reduction play for their customers. Again, this moves labor farther away from the Big 3 where the highest labor costs are and also cuts the total suppliers involved in the game. However, the ability to provide value added services is at the cost of additional engineering and support staff. Smaller organizations will struggle to provide the necessary support and be forced to compete on price. This provides another piece of evidence for the coming supplier consolidation.

### Continuing loss of market share

Trucks and SUV's have propped up domestic auto performance for the last five years. The higher-end Chrysler 300 and new Cadillac models are the only passenger cars made by the Big 3 making significant strides in new sales. The aging customer base of the Big 3 consumption has been strong throughout the recent recession due to heavy marketing incentives and the SUV craze. The demand has started to drop this year. The Big 3 will have to look to consolidate their lines and look to vendors to help with costs. Again, consolidation is coming.

So, what do I do if I'm a domestic automotive component manufacturer?

**Shut all but your strongest plants.** Jam plants together and get to fully utilized capacity. Ignore growth capacity for now.

**Move a significant portion of your production to the Pacific Rim** – 25% to 75%. You must be on the front end of this movement.

**Invest some time and money trying to pitch upstream integration of labor and value added to your customers, especially if you think you**

are selling to a plant that's likely to be closed in this downturn. Given the cost structures of the Big 3 and Tier One, you will see more outsourcing down to Tier Two.

#### **Manage accounts receivable tight.**

Don't be afraid to stop shipping when you're not paid on time or you have a payment dispute. The customers don't have the inventory to withstand credit holds for more than a week, so you have leverage.

**Diversify some portion of your business out of automotive.** Many suppliers are 100% or near so automotive dedicated. Few really are committed to chasing other industries. You need to pay an outsider to have any chance of doing this successfully. Do not use automotive sales people or you will fail.

The next three years will be a battlefield in automotive with lots of casualties. There will be a big consolidation of Tier Two and Tier Three suppliers. Personally, I don't see any of the Big 3 filing bankruptcy in this downturn, but I expect at least one to do so in the next industry down cycle as the legacy and labor costs simply create too large a cost disadvantage. This future potential bankruptcy of either GM or Ford would likely be in 2010 or later, in my view.

Let me close with a prediction that all of the Big 3 will establish sizable manufacturing capabilities in China over the next five years to serve the "local" market. Of course, these plants will be set up with lots of over-capacity to grow. At some point, one of the Big 3 will announce a "trial" program to "temporarily" import Chinese made vehicles into the U.S. The UAW backlash will be severe, which will accelerate the Big 3 move to shift even more production to China.

In essence, this will be a "union breaking" strategy and the UAW will react with a vengeance. I think it's likely we'll have, again, labor violence like this country saw in the 1920's and 1930's as the UAW fights for its very life.

Think of the irony that will have then developed. The Far East manufacturers (heavily Japanese) will be successfully making vehicles in the U.S. for the U.S. market; however, the U.S. Big 3 will be making vehicles in China for import into the United States.

**[Editor's Note:** Mr. Dooley, a Certified Turnaround Professional, is a crisis manager with twenty years of experience in general management, operations, finance and project management. He has served as 2005 President of the Chicago/Midwest Chapter of Turnaround Management Association and is a Principal of MorrisAnderson & Associates Ltd. in its Chicago office, 1111 East Torchy Avenue, Suite 286, Des Plaines, IL 60018 (tele: (847) 768-4408; email: [doooley@morris-anderson.com](mailto:doooley@morris-anderson.com)).]

## Section Leadership

The following is a roster of the Bankruptcy Law Section committee co-chairs as for the 2004-2005 program year. On September 1, 2005 the new Section co-chairs will be Christopher Mirick and Lynne Riley. Certain of the Section's committees will also see a change in leadership, as follows: Commercial Lending (Harry Ekblom and Paula Andrews); New Bankruptcy Act (Donald Lassman); Consumer Bankruptcy (Ann Brennan and Nina Parker); Public Policy and Legislative Affairs (Doug Rosner and John Loughnane); Membership (Pamela Harbeson and Leslie Su); Practice and Procedure (Christine Lynch and Lynne Xerras); Pro Bono (Adrienne Walker and Walter Oney); and Young Lawyers (Jennifer Doran and Jesse Redlener). The next issue will carry detailed contact information for the entire 2005 - 2006 leadership. Please feel free to contact any of the chairs if you would like to be involved in the work of a particular committee.

The Bankruptcy Law Section Steering Committee consists of Section and Committee Co-Chairs and all Members-At-Large.

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