Legislative Update

Hogan Signed a Fast-track Foreclosure Law

Maryland Joins the Urban Fight Against Blight
Many communities are experiencing an increase in vacant properties, which quickly leads to problems. Maryland State Delegate Marvin Holmes points out that the greater the length of the vacancy, "the greater the chance problems will occur." Neighborhoods then fight vandalism, crime, and the lowering of their own property values.

In order to combat the problem, Governor Hogan has signed a bill which speeds up the foreclosure process, making it possible for the properties to move into the hands of a responsible property owner. Like a similar bill in Ohio, this bill specifically takes aim at reducing community blight.

Ohio-based Community Blight Solutions has been a strong proponent of the bill. Founder and chairman Robert Klein believes that the bills in Ohio and Maryland can provide incentive for communities around the country to tackle the problems associated with vacant properties.

Strong Legislative and Community Support
After debate in Ohio and Maryland, the fast-track foreclosure bills were approved unanimously. While it is rare in politics for everyone to agree, there is a growing awareness in legislatures and neighborhoods of the problems associated with leaving properties empty.

Robert Klein points out that communities have been dealing with community blight by reacting to problems after they occur. Instead of waiting for properties to be vandalized or turned into drug dens, this bill allows citizens to be proactive.

This may be just a first step, but it is a good start, as it gives other neighborhoods a goal and a way to stop problems before they happen.

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CASE REVIEW

How Bad Faith Can Lead a Bankruptcy Court to Dismiss a Filing

What is bad faith in a Chapter 7 bankruptcy filing?
An illustrative case is *In re Olen*, in which a bankruptcy judge sitting in Los Angeles granted a trustee's motion to dismiss a Chapter 7 filing.

A married couple filed for bankruptcy in December, 2013. The court identified five debts amounting to $1,575,000. This total included a judgment against the couple in the Los Angeles Superior Court, including significant attorneys' fees. The debtors declared a combined net income of about $4,500 per month — from employment with their own corporation and a law firm that served no clients other than the couple — and a negative monthly net income of approximately $10,000 after living expenses.

The court determined that the couple had purchased numerous extravagances, including international travel, dog boarding, and luxury fashion items, before filing.

In early 2014, the trustee moved to dismiss the Chapter 7 case for abuse and bad faith. The court had insufficient information about the debtors' finances to determine abuse of the bankruptcy code's provisions. Yet this same lack of information, combined with evidence of substantial eve-of-bankruptcy purchases, indicated bad faith, the court held.

Bad faith is an element within a finding of abuse; thus, the court could find bad faith without determining that the debtors had abused Chapter 7's provisions. As to "whether the granting of relief would be an abuse of the provisions of this chapter," the court stated, citing 11 U.S.C. § 707(b)(3), that it was required to "consider (A) whether the debtor filed the petition in bad faith; or (B) the totality of the circumstances ... of the debtor's financial situation demonstrates abuse."

The court noted that Chapter 7 is meant to provide a fresh start for the debtor and to maximize the creditors' returns. The court pointed to the debtors' failure to sufficiently document and explain their financial circumstances during and after filing to support its finding of bad faith.

CHAPTER 7 BANKRUPTCY BULLETIN

This Issue

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BANKRUPTCY FRAUD AND REAL ESTATE IN CHAPTER 7

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") has several built-in safeguards to prevent abusive practices by debtors. There are three main ways a debtor can abuse the bankruptcy process: (1) filing and dismissing multiple bankruptcy cases in a short span of time, (2) having too much income relative to debt to quality for bankruptcy protection, and (3) hiding or obscuring assets from the trustee and creditors. All of these tactics are used to thwart or delay creditors, and are a drain on the limited resources available to the bankruptcy court and trustees. We will look at each scenario in turn, and see when and how the United States Trustee steps in to investigate fraud.

Any time there is a presumption of abuse under 11 USC 362(c) (for serial filers), 11 USC 707(b) (for income exceeding the limits of Chapter 7 bankruptcy), or 11 USC 362(d) (for intentionally misleading the creditors or trustee), the United States trustee can step in and move to dismiss the case. The United States trustee must file his motion to dismiss for abuse within ten days of the close of the 341 hearing. For this reason, the interim trustee who hears the routing 341 hearings will hold the 341 hearing open to give time for the United States Trustee to investigate. Triggers at the 341 hearing that the interim trustee looks for include: real estate with no debt owed; expenses that exceed the norm for a household with the debtor's income; self-employed debtors who have substantial assets but do not list a history of income; and failing to list prior filings. In these cases, the debtor is usually trying to hide something. In that case, it is best to seal the recording of the 341 hearing for the United States trustee to review.

When the United States trustee steps in, it is usually to file a motion to dismiss in circumstances where the presumption of abuse cannot be rebutted by the debtor. The motion is usually filed under 11 USC 707(b). The bankruptcy judge can also raise the issue of abuse *sua sponte*.

A practical example of abuse is *In re* McKenzie (N.D. Ga. [2010]). In McKenzie, a married couple purchased a house for over $800,000 with a mortgage. They did not make any payments on the mortgage. When the lender began nonjudicial foreclosure proceedings pursuant to state law, both McKenzies filed Chapter 7 bankruptcy. They did not file schedules and the case was dismissed. The lender tried to foreclose again. The McKenzies then deeded the house to a family member who filed Chapter 7 bankruptcy herself. When that case was dismissed for failing to file schedules, the pattern continued. No less than 12 bankruptcy cases were filed among three people in varying combinations. All were dismissed. In the last (deciding) case, the debtors filed schedules. They failed to list how the one significant asset of the estate, the house, was passed around, or that prior bankruptcy cases had been filed, and claimed in their schedules that there was no mortgage on the house. The interim Chapter 7 trustee reviewed the prior filings and found other instances where the house was scheduled with a mortgage. After many hearings and motions, the judge ordered *in rem* relief from stay, barring a stay as to the property, for a period of two years. The United States trustee opened an investigation, but ultimately did not prosecute. While the bankruptcy judge issued a find on the record of a willful intent to defraud creditors and the trustee, this particular United States trustee did not find sufficient cause to prosecute.

In 2016, the United States trustee referred eight debtors in a ring of five bankruptcy cases to the U.S. attorney's office for prosecution. In these cases, the debtors all liquidated assets and hid the case immediately before filing bankruptcy. This was an abuse because the intent was to hide assets from creditors. Selling off assets prior to bankruptcy isn't, in and of itself, abuse. What made the fraud worse was that the debtors transferred the assets within 90 days of filing their bankruptcy cases without noting that in their schedules. The debtors attempted to conceal, in total, $3 million in assets.

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