

Value of License Plate Creates Battle Over Bankruptcy Plan

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The facts sound like a law-school hypothetical: an 86-year-old man files for Chapter 7 bankruptcy (total liquidation), and schedules no valuable assets.

When told his income is sufficient to pay back at least some debt, he converts his case to Chapter 13 and proposes to repay one-third of his debts over three years, totaling \$17,000. Suddenly, an anonymous letter appears. It says the debtor owns a two-digit, low number Delaware license plate worth over \$200,000; a friend gave it to him for free 45 years ago.

The debtor amends his plan, now proposing to sell the plate and pay off creditors in full. His Chapter 7 trustee moves to undo the conversion of the case to Chapter 13 and bring it back to Chapter 7 -- he wants the license plate so he can sell it for the benefit of creditors, and is aggrieved that the debtor never disclosed its existence.

The U.S. trustee asserts that the debtor does not belong in Chapter 7. The debtor wants to stay with his amended plan -- a sale at \$200,000 would net him \$146,000.00 after repaying all creditors in full, an utter and complete financial turnaround. His Chapter 13 trustee takes no position. All parties -- including these authors -- are astonished that someone would pay over \$200,000 for a license plate and that it would become a crucial part of an otherwise run-of-the-mill, gloomy consumer bankruptcy case. What result and why?

DELAWARE BANKRUPTCY COURT

Bankruptcy Judge Brendan L. Shannon recently faced this scenario in a real-life Delaware case (*In re Murray*, Case No. 07-10101 (BLS)). Shannon is being closely watched by the legal community as one of four new Delaware bankruptcy judges (three of whom came from private practice, including Shannon).

The court entertains hundreds of consumer bankruptcy petitions each year and has thousands pending. Substantially most of them involve poor and broken-down debtors with few assets and heavy debt; many debtors are going through wrenching divorces, job-loss situations and/or medical crises and require court protection from creditors.

CONSUMER BANKRUPTCY BASICS

In Chapter 7 cases a trustee is appointed to take over the debtor's financial affairs. He/she liquidates available assets for the benefit of creditors, most often with terrible results. In Chapter 13, by contrast, the debtor remains in control of his financial affairs, but under the supervision of a trustee who submits a plan to pay most disposable income to creditors over several years. Both types of trustee are duty-bound to search for valuable assets in the debtor's pile of belongings. Try as they might, Chapter 7 and 13 trustees rarely, if ever, find the "brass ring" or "pot of gold" and reverse the fortunes of these normally depressing cases. Here, though, it happened.

PUBLIC PERCEPTIONS OF DEBTORS

When some people think of consumer bankruptcy, they picture people driving expensive cars while refusing to pay legitimate creditors, and debtors buying flat-screen TVs on credit cards days before filing for bankruptcy. Many of the 2005 amendments to the bankruptcy code were driven in material part by the widely held notion that too many debtors were "scamming the system" – filing for bankruptcy when they didn't need to, and discharging debts that with effort could be repaid over a several-year period.

Whatever the relative merits of these positions, most judges and practitioners would say that tabloid-type stories bear little resemblance to the actual workings of a busy bankruptcy court.

In our case, Shannon finds, after reviewing the relevant factors, that there was no "bad faith" and allows the debtor to proceed with his Chapter 13 plan. The case is thus instructive as to what situations come before real-life bankruptcy practitioners. Sometimes the real facts are even stranger than the law-school hypothetical.

LEGAL ANALYSIS IN THIS CASE

The precise legal issue at hand was this: whether the debtor's failure to disclose the plate or its value in his bankruptcy schedules was "bad faith," which should have forbidden him from converting his Chapter 7 case to Chapter 13 in the first place.

The debtor's original right to convert from total liquidation/fresh start (Chapter 7) to partial repayment over time (Chapter 13) arises from Bankruptcy Code Section 706(a), and appears to be absolute, irrespective of such issues as strange facts, "bad faith" and the like. In a 2007 opinion (*Maramba*, 127 S.Ct. 1105), though, the U.S. Supreme Court held that section 706(a) must be read in conjunction with section 706(d) of the same statute. The latter provides that a debtor cannot convert a case to any chapter unless he/she would be eligible as

a debtor under that chapter. Here, as a legal matter the debtor's "eligibility" for Chapter 13 relief was in question, since (i) statutorily, Chapter 13 cases can be dismissed "for cause," and (ii) *Maramma* found that "cause" includes "bad faith." According to the Chapter 7 trustee, here (x) the debtor's failure to schedule the plate shows bad faith, hence (y) he was never eligible to file under Chapter 13, and (z) his conversion to that chapter was a mistake that should be undone and the plate turned over immediately. This, of course, raises the key question: was failing to disclose the plate "in bad faith?"

WHAT IS 'BAD FAITH?'

For purposes of Chapter 13 eligibility, the *Maramma* decision does not define "bad faith," except as "extraordinary" and "atypical" behavior. Other courts, though, have looked to (i) evidence of "good faith," (ii) whether the debtor can propose a viable plan, (iii) the harm that might befall various parties if the debtor is kept out of Chapter 13, (iv) administrative efficiencies and (v) whether allowing the debtor into Chapter 13 would "further an abuse" of the bankruptcy process.

On good faith, the leading local case is *Pakuris*. There, a Chapter 7 debtor sought conversion to Chapter 13 only after her Chapter 7 trustee caught her alleged failure to disclose certain valuable assets; in light of this timing the court denied the conversion on the grounds of "bad faith." There the debtor took ownership of the assets in a divorce proceeding contemporaneous to her bankruptcy, which suggests she was well aware of the assets' existence and value, and her failure to disclose it was intentional. *Maramma* involved a house the debtor "forgot" to disclose.

Here, though, the debtor took ownership of the plate 45 years ago. Since it is incredible that the plate is worth \$200,000, the court refused to assume the debtor knew its value or considered it a real asset. The debtor appeared to assign the plate only sentimental value, and in fact had previously declined a free, similar plate, a regrettable mistake. Bankruptcy schedules contain multiple specific lines requiring debtors to identify assets (e.g., real estate, jewelry, stock, etc.), but "license plates" is not one of them. As to timing, unlike the debtors in *Pakuris* and *Maramma*, here the debtor sought conversion to Chapter 13 not after the asset was disclosed and in an attempt to hide it, but before it was disclosed, and for a legitimate reason (the U.S. trustee's argument that he made enough money to pay some creditors). In short, the evidence showed the debtor was acting in good faith.

As to whether the debtor could propose a viable plan, the analysis was simple – a \$200,000 asset and \$54,000.00 in debt. As to the relative harms amongst the parties, the Chapter 7 trustee's argument was interesting: (i) since creditors often fail to file claims in bankruptcy cases, and (ii) by law the

Chapter 7 trustee is entitled to file claims on behalf of creditors who fail themselves to do so, (iii) it would benefit those non-filing creditors to convert the case to Chapter 7.

The court rejected this position, showing little sympathy for creditors who knowingly fail to file claims, and noting that under these financials all creditors who bothered to do so would be paid in full.

Administratively, the debtor's amended Chapter 13 plan – sell the plate, pay his debts in six months -- was already on the table, simple and efficient. The court found for the debtor on this point. Finally, as to “abuse of bankruptcy,” the only evidence the Chapter 7 trustee could point to was the undisclosed license plate. As set out above, the court found the debtor's conduct in good faith, and not an abuse.

CONCLUSION/APPLICATIONS

Practitioners won't normally see \$200,000 license plates in bankruptcy cases – that's not the point.

Still, several old lessons ring true in this case, whether you represent debtors, creditors or both. First, demand an exhaustive listing of every single piece of personal property the debtor owns or in which he/she may have an interest. Follow up on each one and don't assume from the word or category chosen that the property is valueless. How many readers of this article knew there was a prosperous market for license plates? Second, remember that the age of an asset cuts both ways – just because something is old doesn't mean it has depreciated, and ,indeed, here quite the contrary was true.

Third, revisit your “stock” answers to clients and “spring clean” your forms and correspondence sent to them. Debtor-side attorneys (especially) are often bombarded with client questions about specific personal property assets – is this one exempt, do I own that or is it jointly owned between me and my spouse, is this property of the bankrupt estate, is that a fixture or a removable item at my house, is it subject to insurance, to my mortgage, etc.

The basic question in a consumer case usually boils down to this: can I take it with me when I go? Here, debtor's counsel can hardly be faulted for not catching the plate in his intake process, but will surely adjust that process for future cases.

Finally, never judge a book by its cover. On first glance it appears that the debtor might have foisted a fraud on creditors and the court, and the average citizen would be outraged to learn of a bankrupt debtor with a \$200,000 license plate. Closer, dispassionate review, however, with the benefit of an

adversary system and the protections of a federal court, paint quite a different picture.