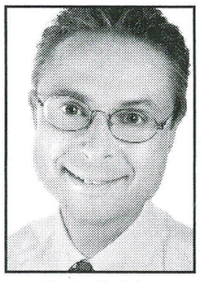
CONSUMER BANKRUPTCY

Debtor's Attorney Tries to be Creative – Unsuccessfully

By Craig D. Robins

After I wrote about some bankruptcy court decisions last month which involved some quirky and unusual facts, some of my colleagues requested that I continue to discuss similarly odd and interesting cases. Fortunately, we have one that is fresh off the docket.

On April 24, 2012, Judge Alan S. Trust, sitting in the Central Islip Bankruptcy Court, happened to issue a decision in just such a case, so we now have appropriate fodder for this month's column. The decision, which is just as interesting for what is says, as for what it does not, involves protecting a debtor's entitlement to receive funds, being creative with exemptions, and seeing how a client might suffer from attorney ineptitude for being unfamiliar with bankruptcy practice and procedure. It also leaves one thinking about how far a judge can go to assist counsel who is clueless. *In re Cho,* no. 11-75595-ast, (Bankr. E.D. New York 2012).



Craig Robins

In August 2011, Mr. and Mrs. Cho filed a typical Chapter 7 consumer bankruptcy petition here on Long Island. About a month before filing, the debtors' car lender repossessed their Honda. Unbeknownst to the debtors at the time, a week before the filing date, the lender sold the vehicle at auction, and the sale resulted in a surplus of $5,000.

The debtor's bankruptcy attorney, a lawyer from Queens who shall remain nameless, advised Chapter 7 Trustee Robert Pryor at the meeting of creditors that the debtors' vehicle had been repossessed pre-petition, resulting in a surplus, and that the debtors had received and deposited a check for the surplus post-petition.

The trustee soon demanded that the debtors turn over the entire surplus amount. Instead of doing that, the debtors amended their Schedule of Assets to include an ownership interest in the vehicle (which they no longer owned). They also amended their Schedule of Exemptions (which opted for New York State exemptions as opposed to the more liberal federal exemptions) to exempt the vehicle in the sum of $4,000 pursuant to C.P.L.R. § 5205(a)(8), and to also increase their cash exemption by $1,000 to cover the additional value of the surplus pursuant to C.P.L.R. § 5205(a)(9).

The trustee believed that he was nevertheless entitled to the full surplus amount, so he brought a motion to compel the debtors to turn it over. The debtors responded, acknowledging that they no longer owned the vehicle, but argued that they were entitled to exempt the surplus as cash. The trustee responded and pointed out that the amended schedules were improperly done and therefore fatally defective.

The trustee's observation was correct. Eastern District of New York Local Bankruptcy Rule 1009-1(iv) provides that in order for an amendment of exemptions to become effective, the debtor must first file and serve the amended exemptions on the U.S. Trustee, all creditors, and all other parties in interest, and then file proof of service with the court. Here, the debtors' attorney both neglected to file, and neglected to serve.

One would think that the debtors' attorney, after reading the trustee's papers alleging this neglect, would take immediate corrective action. However, he did not. At the hearing, which was held in December 2011, Judge

(Continued on page 23)

Consumer Bankruptcy *(Continued from page 18)*

Trust generously gave debtors' counsel a week to comply with the local rule requirement.

However, inexplicably, counsel then filed the amendments but neglected to serve them. This led the trustee to file supplemental objections. At a subsequent hearing, Judge Trust gave the debtors' counsel one last opportunity to meet the procedural requirements, which he finally did. The matter was now marked for submission.

The issue before the court was whether the debtors could exempt the surplus cash under New York law, and whether the debtors could exempt the vehicle.

In his decision, the judge first pointed out that New York residents who file bankruptcy after June 21, 2011 have an option of selecting either the New York State or federal exemptions, and that the debtors here chose to claim the New York State exemptions.

Bankruptcy attorneys know that a debtor can exempt up to $5,000 of cash pursuant to the New York State cash exemption set forth in Debtor and Creditor Law sec. 283(2), provided that the debtor does not utilize the homestead exemption.

Judge Trust determined that, at the time of filing, the debtors did not own cash. Under DCL § 283(2), "cash means currency of the United States at face value, savings bonds of the United States at face value, the right to receive a refund of federal, state and local income taxes, and deposit accounts in any state or federally chartered depository institution."

The judge, following the overwhelming majority of courts, determined that the debtors had a "pre-petition vested right to receive payment" of the surplus which did not constitute "cash." A right to receive payment as evidenced by a check in transit is not "cash."

In addition, since the debtors did not have an ownership interest in the vehicle on the date of filing, nor did they have a right of redemption, they could not exempt the vehicle.

However, Judge Trust indicated that the debtors could exempt $1,000 of the right to receive payment. This is because of the relatively new exemption under C.P.L.R. § 5205(a)(9) which permits debtors filing after January 21, 2011, to utilize a $1,000 wildcard exemption for any personal property, provided that the debtor does not claim a homestead exemption. Since the car was only in one spouse's name, and the debtors did not claim a homestead exemption, they were entitled to one, $1,000 wildcard exemption which could be applied to the surplus. The judge ordered them to turn over the balance of the surplus to the trustee.

Here's why I found the decision especially interesting. First, the debtors' counsel initially botched up amending the exemptions – not once – but twice. Judge Trust gave counsel two opportunities to correct the mistake. Counsel finally figured out what to do on the third try.

Of course, we will never know what Judge Trust was thinking, but one can't help but wonder if his granting counsel an opportunity to remedy the defective filings was also an opportunity for counsel to reconsider the exemption scheme counsel had elected.

Had counsel opted for the much more generous $10,825 federal wildcard exemption provided in the federal exemptions by Bankruptcy Code § 522(5), he would have been able to protect 100% of the surplus. In essence, it appears that counsel chose the wrong exemption scheme to the detriment of his clients.

However, a judge can and will only go so far in telling inept counsel what to do. Would it have been out of line for the judge to tell debtor's counsel that counsel didn't have a sufficient understanding of law and procedure and was not following the right legal strategy? This is not what judges are for.

If Judge Trust was aware of the choice of exemption issue I would assume that he felt that it was not his place to point out that counsel could have protected the entire surplus if the federal exemptions were used.

Based on my experience watching cases in court, this seems to be the way almost all judges handle such issues – they will not tell counsel how to practice law, even if that ultimately hurts an innocent client. Accordingly, the debtor-clients here suffered and had to turn over many thousands of dollars that they could have kept had their attorney had a better understanding of bankruptcy law and selected the better exemption scheme. And that point is not in the decision. A full copy of the decision can be read on my blog.

Note: Craig D. Robins, a regular columnist, is a Long Island bankruptcy lawyer who has represented thousands of consumer and business clients during the past twenty years. He has offices in Coram, Mastic, West Babylon, Patchogue, Commack, Woodbury and Valley Stream. (516) 496-0800. He can be reached at CraigR@CraigRobinsLaw.com. Please visit his Bankruptcy Website: www.BankruptcyCanHelp.com and his Bankruptcy Blog: www.LongIslandBankruptcyBlog.com.