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# M&P In Brief

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## Bankruptcy Reform

The passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Act") is an effort to curb abuses of the consumer bankruptcy system, and with it comes sweeping changes. This new legislation was enacted on April 20, 2005, and will go into effect on October 17, 2005, though a few provisions have already been implemented. This article touches broadly on the more significant reforms.

A consumer debtor will typically elect to file a Chapter 7 or a Chapter 13. If the debtor files a Chapter 7, unsecured assets are surrendered and sold to satisfy the claims of unsecured creditors. Any unsecured debts that cannot be paid by the sale of the assets are discharged, and the debtor is provided a "fresh start." This is distinguished from a Chapter 13, wherein the debtor works with his creditors and the Court to create a repayment plan, funded by the debtor's disposable income, which will repay the creditors to the greatest extent possible.

### Credit Counseling Requirement

Under the Act, debtors are required to undergo credit counseling within 180 days prior to the filing date, though this requirement can be waived if the debtor can certify to exigent circumstances or

show that s/he was denied service from an approved counseling agency. Any debt management plan developed must be filed with the Court. Additionally, completion of an instructional course in personal money management is required before discharge is granted.

### Accuracy of Petitions and Schedules

Debtor's counsel or Bankruptcy Petition Preparers now have to make a reasonable inquiry into the correctness of the information contained in the bankruptcy petitions to ensure the information is well grounded in fact. Upon filing, the debtors have to provide the certificate of counseling, proof of wage earnings, tax returns, a statement of monthly net income, photo identification and more. Failure to file the required documents within 45 days after filing the petition results in an automatic dismissal, though a few exceptions do exist.

### The Means Test

The Act curbs an individual's ability to file for Chapter 7 protection, as the debtor must now demonstrate eligibility to file under that Chapter. If a debtor files a Chapter 7, the "Means Test" provides bankruptcy Courts a mathematical equation by which to determine if a debtor's

bankruptcy should be dismissed or converted to a Chapter 13. If the debtor's income is lower than the state median income, the debtor is allowed to stay in the Chapter 7. However, if the income of the Chapter 7 debtor is greater than the state median, the Means Test is applied. The Means Test takes into consideration the amounts of the debtor's secured obligations and other allowable expenses. If the end result demonstrates that the debtor can repay at least \$100 a month to his creditors, then abuse is presumed. The matter is then either dismissed or the debtor is forced into a Chapter 13. All creditors will receive notice if the presumption of abuse arises. The trustee or any creditor may move to dismiss if the debtor fails to pass the Means Test, but the presumption of abuse can be rebutted by demonstrating special circumstances that justify the need for Chapter 7 protection. The Means Test notwithstanding, the Court may still find that the totality of the circumstances demonstrates abuse or bad faith. It is speculated that the Means Test will only result in pushing about 7-10% of filers into a Chapter 13, but that could still result in significant recovery to unsecured creditors overall.

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# Legislative Summary

The 2005 Regular Session of the Kentucky General Assembly opened on Monday, January 3, 2005, and adjourned on Monday, March 21, 2005. During that time, the Senate introduced 225 Bills, of which 66 became law, and the House introduced 516 Bills, of which 92 became law. Several of the Bills passed will have a direct impact on the business of many M&P clients.

House Bill 248 amends KRS 427.170 to allow federal bankruptcy exemptions to apply in Kentucky. This Bill was introduced in the House on February 2, 2005, by Representatives Webb, Farmer and Wayne. It was passed in the House on February 24, 2005, and in the Senate on March 4, 2005. The federal bankruptcy exemptions can be found in 11 U.S.C. §522(d). This will be a significant change for many creditors as, for example, the present federal homestead exemption is \$18,450 as opposed to Kentucky's homestead exemption of \$5,000. However, once the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 goes into effect on October 17, 2005, the maximum federal homestead exemption will increase to \$125,000. This was certainly not the intent of the General Assembly and we are hopeful that this issue will be re-examined in the 2006 Regular Session.

Senate Bill 27 is an Act relating to repossession of collateral by secured parties. It amends KRS 329A.070 to exempt from licensing requirements of private investigators any secured party, or person acting on behalf of the secured party, engaged in repossession of collateral pursuant to KRS 355.9-609. This Bill was introduced in the Senate by Senator Tom Buford, Chairman of the Senate Banking and Insurance Committee. It becomes law on June 20, 2005, the effective date for all bills without an emergency clause. KRS 329A.070 already allows this licensing exemption for government employees, certified public accountants, attorneys, insurance companies and others when operating within the scope of their occupation.

Senate Bill 100 amends KRS 376.230

to extend from 30 to 60 days the period during which a lien for labor, materials or supplies may be filed. The former law stated that a lien had to be filed 30 days after the last day of the month in which the last date of labor, materials or supplies were furnished. KRS 376.230 concerns only liens on public property.

It is worth mentioning Senate Bill 114, which was introduced in the Senate on February 3, 2005, by Senator Tom Buford. It was an Act relating to commercial transactions and would have amended KRS 355.9-706, which deals with the transition from old Article 9 to Revised Article 9, to allow the inclusion of the "minor errors" rule from KRS 355.9-506.

Among other things, it would have also fashioned a new section of KRS 190.090 to 190.140 to create a 6 year statute of limitations for filing actions relating to retail installment contracts. As noted in the Fall 2004 M&P Newsletter, the Kentucky Court of Appeals has recently held that the 4 year statute of limitations period under Article 2 applies to the enforcement of motor vehicle retail installment contracts. Unfortunately, Senate Bill 114 stalled in House committee.

For further information on the 2005 Regular Session of the Kentucky General Assembly, please visit the Kentucky Legislature Home Page at [www.lrc.ky.gov](http://www.lrc.ky.gov).

*Melinda T. Sunderland*

## Servicemembers Civil Relief Act

Enacted December 19, 2003, the "Servicemembers Civil Relief Act" (SCRA), substantially rewrote the Soldiers' and Sailors' Civil Relief Act of 1940. The main objective of SCRA is to permit servicemembers to suspend or postpone some civil obligations so they can devote full attention to military duties. SCRA expands the range of protections for military members, Reservists, and National Guard while on active duty and for a period after service ends. In addition to the traditional areas of pre-service debt and protection against default judgment, SCRA also offers protections for life, health, and professional liability insurance, allows deferments of property and income taxes, and protects against evictions.

With Reservists continuing to receive calls to active duty, and with the 101st Airborne preparing to redeploy to Iraq, a review of some highlights of SCRA is timely.

- Upon request, interest rates over 6% on debt incurred prior to military service must be reduced to 6%, retroactive to the start of service. Interest above 6% is forgiven. Amortized loans must be re-amortized. A court may grant a creditor relief

from reduction if the servicemember's ability to pay the obligation is not materially affected by his service. Rate reduction does not apply to debt incurred *during* service.

- Servicemembers and dependents may not be evicted from most residential real property, except on court order.
- Personal property leases or installment contracts (including automobiles) entered into prior to service may not be accelerated for default nor may any collateral be repossessed except on court order. This rule does not apply to leases or contracts entered into *during* service.
- Liens for storage fees may not be foreclosed during service or 90 days thereafter, except on court order.
- For real property leases (residential or business premises occupied by servicemembers or dependents), servicemembers may elect to terminate (i) any pre-service lease, and (ii) any lease entered into during service if there is a permanent station change or a deployment of at least 90 days.
- For automobile leases (personal or business use by servicemembers or de-

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## **Bankruptcy Reform**

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### **Reaffirmation Agreements**

Reaffirmation agreements will require more detailed disclosures regarding the rights the debtor has and the particulars of the debt being reaffirmed, such as the interest rate, when payments will begin, the debtor's take home pay, monthly expenses, etc. Except for instances when a debt is reaffirmed with a credit union, the debtor has to present an explanation as to how he can afford to satisfy the debt, if the reaffirmed debt and his expenses exceed his income.

### **Statement of Intent and the Automatic Stay**

The debtor's statement of intent to surrender, redeem, or reaffirm secured debts must be completed within 45 days after the first scheduled meeting of creditors on all collateral in which a creditor holds a Purchase Money Security Interest ("PMSI"). Failure to do so results in the automatic termination of the stay, and the creditor may exercise its available remedies. The trustee, however, can request an extension of the automatic stay but must provide adequate protection to the creditor.

### **Serial Filings and the Automatic Stay**

Serial filing has always been an indicator of bad faith to creditors. Now, unless a Chapter 7 case is dismissed as a result of the Means Test, the filing of a bankruptcy petition within a year of the last bankruptcy dismissal will result in the termination of the stay within 30 days. However, the debtor or another party in interest may move to extend the stay by providing clear and convincing evidence of good faith.

In contrast, the stay does not go into effect at all upon filing if the Debtor had two or more cases dismissed during the prior year under any Chapter. In such a situation, the Court will conduct a hearing on the debtor's good faith, and it may thereafter impose the automatic stay.

A debtor who has received a discharge

under Chapter 7 may not receive another discharge under Chapter 7 for eight years.

A Chapter 13 debtor will be denied a discharge if the debtor has received a discharge under Chapter 7, 11, or 12 during the 4-year period prior to the current petition date. If the debtor has filed a prior Chapter 13, another discharge will not be granted if the subsequent Chapter 13 is filed within two years from the date of the prior discharge.

### **Treatment of Claims**

Currently, the issue of whether or not a creditor is able to retain its lien after its secured portion is paid in a Chapter 13 is subject to the District in which the petition is filed. Now, under the Act, a secured creditor retains its lien until the entire claim is paid or discharge is entered.

If a creditor has a PMSI in a motor vehicle, the claim may not be "crammed down" into payment of a secured and unsecured portion in a Chapter 13, as long as the car was purchased within 910 days of filing the petition. If the creditor has a PMSI in something other than a motor vehicle, the claim may not be crammed down if purchased within one year of filing.

If it is necessary to make a determination of the value of the collateral, such as a redemption motion in a Chapter 7 or a cram down in a Chapter 13, the value is the retail cost, as of the time of filing, without any deduction for costs of sale or marketing.

Consumer debts to a single creditor for luxury items or services in excess of \$500 incurred within 90 days of filing are presumed non-dischargeable. Similarly, cash advances in excess of \$750 within 70 days of the filing are considered non-dischargeable.

### **Time Frames within Chapter 13 Filings**

If the state median family income for a same or smaller sized family is greater than the debtor's combined income, the plan term need not exceed 3 years. However, if the debtor's combined income is greater than the state median family in-

come for a same or smaller sized family then, in the absence of earlier full payment of all claims, the plan term must be 5 years.

All confirmation hearings must be held no less than 20 days but no more than 45 days after the meeting of creditors.

### **Chapter 11 Issues**

If a creditor holds a disproportionately large claim in light of the Chapter 11 debtor's revenue, or if necessary to ensure adequate representation of creditors or equity secured holders, a party in interest may move for an order to change membership of a committee.

The Chapter 11 Plan must include an analysis of the potential tax consequences of the Plan. Further, all tax, priority, and secured claims must be paid in regular cash installments for a period not exceeding 5 years from the date of petition and in a manner more favorable than the most favored unsecured non-priority claim. All distributions to the unsecured claims must not be less than the current value of the allowed claim or less than the projected disposable income during the first 5 years of plan payments.

The grounds for dismissal or conversion also create grounds for the appointment of a trustee or examiner. Expanded grounds for dismissal or conversion include gross mismanagement of the estate, unauthorized use of cash collateral, failure to maintain adequate insurance and failure to timely file or pay post-petition taxes.

### **Summary**

It is important to remember that, as with any new law, many issues and questions will arise upon implementation of the Act. Being aware of the freedoms and limitations a creditor or debtor has under the Act and remaining abreast of the case law as it develops is the best way of ensuring your claim is treated in a proper manner.

*Molly E. Rose*

## Firm News

We are pleased to announce the addition of several new attorneys. Scott White, a 1986 graduate of the University of Kentucky, College of Law, has joined the firm as Of Counsel. Scott is licensed to practice in Kentucky, West Virginia and North Carolina. Scott's primary focus will be on commercial litigation. Prior to joining M&P, Scott worked as the Assistant Deputy Attorney General for the Commonwealth of Kentucky and served as counsel for the Kentucky Board of Elections.

James S. Scrogan, a 1977 graduate of the University of Louisville, Brandeis School of Law, has joined the firm as an associate. Jim was admitted to the Kentucky Bar in 1977 and the Indiana Bar in 2004. Prior to joining M&P, Jim was a sole practitioner. Jim will focus his practice at M&P on subrogation and creditors' rights.

Emily H. Cowles, a 2003 graduate of the Capital University Law School, has joined the firm as an associate. Prior to joining M&P, Emily worked as an attorney in the Office of General Counsel for the Administrative Office of the Courts and was a clerk for Judge Laurance B. VanMeter at the Kentucky Court of Appeals. Emily will focus her practice on commercial and retail collections and foreclosure.

In other firm news, M&P is proud to announce that John McGarvey has been selected for the 2005 class of Leadership Kentucky.

On April 27, 2005, John McGarvey and Mindy Sunderland conducted a telephonic seminar entitled "Common Mistakes in UCC Filings". The seminar was sponsored by BankersOnline Learning Connect and webcast to 96 locations across the nation.

Garret Hannegan will serve on the bankruptcy panel for the ICLEF Masters

Series Advanced Chapters 7 & 13 Roundtable, which will be held on June 24 and 25, 2005, and will be moderated by Judge Basil H. Lorch, III.

John McGarvey and Tom Fenton were asked to participate in the 2005 Conference on Legal Issues for Financial Institutions hosted by the University of Kentucky, College of Law, Department of Continuing Legal Education. Tom presented on recent developments under the Uniform Commercial Code.

On April 15 and 16, 2005, John

### SCRA

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pendents), servicemembers may elect to terminate (i) any pre-service lease if they are called for or actually serve a period of at least 180 days, and (ii) any lease entered into during service if there is a permanent station change outside the continental US or a deployment of at least 180 days.

- For pre-service mortgage debt, a servicemember whose ability to fulfill the obligation is materially affected by military service may apply for a stay of enforcement up to the period of service plus the remainder of the term of the obligation, thus extending the maturity of the debt and protecting the servicemember from all defaults except payment default post-service.

- For non-mortgage debt incurred before service, a servicemember whose ability to comply with the obligation is materially affected by military service may apply for a stay of enforcement up to the period of service, thus extending the maturity of the debt.

- If a servicemember is personally liable

McGarvey participated on a panel for the National Association of Retail Credit Attorney's and discussed Default, Remedies and Enforcement Under Revised Article 9 in Boston, Massachusetts.

On April 28, 2005, Margie Loeser and Mindy Sunderland presented an all-day program on AIA Contracts for Lorman Educational Services. Margie Loeser will also present a program on Mechanic's and Materialman's Liens for the local chapter of the Construction Specifications Institute in May.

on a business obligation, his non-business assets are not available as collateral for that obligation during the period of military service.

- No creditor may use a servicemember's request for or receipt of any benefit under SCRA to deny or revoke credit, declare default, or make an adverse credit report. No creditor may note in any credit file or credit report, nor report to any credit reporting agency, any person's status as a member of Reserve or National Guard.

- Judicial proceedings can be subjected to stays to allow a defense attorney to attempt to contact the servicemember, for the period that the servicemember's duties prevent his or her appearance, and for periods when the ability of the servicemember to comply with a judgment or other order is materially affected by his or her military service.

- Rights under SCRA can be waived. Waiver is effective only if in a writing separate from the obligation which specifies the obligation, and the writing is executed during or after the period of service.

*Emily H. Cowles  
Thomas C. Fenton*

*Actual resolution of legal issues depends upon many factors, including variations of facts and state laws. This newsletter is not intended to provide legal advice on specific subjects, but rather to provide insight into legal developments and issues. The reader should always consult with legal counsel before taking action on matters covered by this newsletter. If you have any questions about this newsletter, or suggestions for future articles, contact Carolyn M. Bauer, Editor, at the firm.*

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