Chapter 7 Trustees Gone Wild?

Judge denies relief to aggressive trustee

By Craig D. Robins

As we all know, the key role of the Chapter 7 trustee is to garner assets for the benefit of creditors. However, the vast majority of Chapter 7 cases are no-asset cases leading trustees to constantly look for ways to bring money into the bankruptcy estate.

Trustees are especially motivated with a payday for doing so. They are entitled to statutory commissions on a sliding scale that begin with 25 percent of the funds collected, and they are also entitled to be paid for the legal work that they do, computed at their hourly rates.

During the past few years it appears that Chapter 7 trustees have become more desperate to look for ways to obtain funds. After all, it has become almost impossible to go after non-exempt equity in homes since 2011, when the New York State homestead exemption for Long Islanders increased significantly to $300,000 per couple.

Trustees have also been frustrated by the recent availability of federal exemptions to New York debtors, which also went into effect in 2011. These include a wildcard exemption of approximately $11,000, effectively permitting a great number of debtors to protect assets that were never before possible.

With the increased difficulty in pursuing funds for the estate, combined with a reduction in the number of bankruptcy filings over the past two years, have some trustees "gone wild" with weird, unexpected and unconventional theories to chase after assets? Are these new and novel theories meritorious?

Craig D. Robins

In this column I will discuss a new decision by Chief Judge Carla E. Craig in which she denied one trustee's bizarre and unprecedented attempt to label pre-petition school tuition payments as fraudulent transfers. I will continue the topic of whether trustees have gone wild, next month, by discussing the unusual efforts of another trustee who has been bringing adversary proceedings against debtors, seeking to deny their discharge, but offering to withdraw the proceedings if the debtors pay him a settlement.

In March 2011, Olaniyi Akanmu and his wife filed a typical Chapter 7 consumer bankruptcy petition in the Brooklyn Bankruptcy Court. For a number of years prior to that, the debtors' two minor children were students at Our Lady of Mt. Carmel-St. Benedicta School and Xaverian High School. During this period, the debtors paid several thousand dollars tuition each year to these private schools.

The trustee, Robert L. Geltzer of New York City, brought adversary proceedings against these schools, alleging that all of the $45,000 in tuition payments that the schools received in the six-year period prior to filing constituted fraudulent transfers, which had to be paid back to the bankruptcy estate.

A fraudulent transfer is basically when a debtor gives away something of value, but does not get reasonably equivalent value in exchange, and the transfer is done at a time when the debtor is insolvent or rendered insolvent by the transfer. In essence, the trustee was arguing that the parochial education was not worth anything and the debtors, as parents, did not benefit.

On December 4, 2013, Judge Craig, in a harshly-worded 21-page decision, dismissed the adversary proceeding and stated: "The trustee's claims are based on a fundamentally flawed legal theory that is, moreover, at odds with common sense. The education provided...to these minor children constitutes both a direct and indirect benefit to their parents, who, with their children, must be considered a single economic unit." *In re: Olaniyi L. Akanmu & Omolayo T. Suara* (Case No. 11-43771-cec, Adv. Proc. No. 13-01105-cec and 13-01107-cec, Bankr. E.D.N.Y.).

Although the trustee argued that debtors are not obligated to provide private school education, and could have satisfied their children's educational needs by sending them to public school, Judge Craig stated that "this argument misses the point." She opined that "it is irrelevant to this determination whether the debtors could have spent less on the children's education, or, for that matter, on their clothing, food, or shelter. To hold otherwise would permit a trustee to scrutinize debtors' expenditures for their children's benefit, and seek to recover from the vendor if, in the trustee's judgment, the expenditure was not reasonably necessary....The absurdity of this scenario is obvious."

The judge continued with some powerful words that we are sure to see cited in many future briefs and decisions: "A trustee is not granted veto power over a debtor's personal decisions, at least with respect to pre-petition expenditures." She also notes that: "nor does the fact that a debtor's pre-petition expenditures may have been unwise or ill-advised, without more, constitute grounds for avoidance of the transaction as a constructive fraudulent conveyance."

Judge Craig made another very profound point by distinguishing a Chapter 7 debtor's budget obligations from those in Chapter 13. In Chapter 13 cases a debtor must commit all of his projected disposable income to fund the plan, which is calculated by subtracting amounts that are "reasonably necessary." As a result, the court reviews a Chapter 13 debtor's expenses on a "going-forward basis" and must evaluate whether those projected expenses are reasonably necessary.

(Continued on page 20)

Chapter 7 *(Continued from page 12)*

However, she states "the reasonably necessary analysis is entirely inapplicable in a Chapter 7 case." She then notes that Chapter 7 trustees may not even address the concept of reasonably necessary expenses. "None of the chapters of the Bankruptcy Code authorize the trustee to review the reasonableness of a debtor's pre-petition expenditures or to seek recovery of expenditures deemed not reasonably necessary."

The judge did note that it was not clear that pre-petition payments on behalf of a college-age child would be recoverable as a fraudulent conveyance, but she summarized the court's position in this case by stating: "Here, however, the result is crystal clear."

Next month I will continue with a discussion concerning the efforts of one particular trustee in our district who has been trying to pursue a unique and rather unpopular theory in which he alleges that some debtors have not accurately stated information in their petitions regarding income or expenses, or the debtors filed an abusive bankruptcy in violation of 707(b) because they have more disposable income than that which was disclosed. He then brings adversary proceedings pursuant to Bankruptcy Code section 727, seeking to deny the debtors' discharges, yet he is really looking for settlements from the debtors so that they can get their discharges.

Is such a novel theory a bona-fide good faith effort in furtherance of the trustee's duties or, as some of my colleagues have categorized it, an attempt to shake down and extort funds from the debtor by seeking to sell them their discharge? So controversial is this practice that a number of colleagues have specifically requested that I write about it. Please feel free to contact me with immediate comments.

Editor's Note: Craig D. Robins, Esq., 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, West Babylon, Patchogue, 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.LongIsland-BankruptcyBlog.com.

CORRECTION

The photographer for the Pro Bono Foundation luncheon that appeared in our December issue was Barry Somolowitz. *The Suffolk Lawyer* regrets the error.