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09-BK-148

Mr. Peter G. McCabe
Secretary of the Committee on Rules of Practice and Procedure
Judicial Conference of the United States
Washington, D.C. 20544

RE: Proposed changes to Rule 3001 of the Rules of Bankruptcy Procedure

Dear Mr. McCabe and Members of the Committee:

Thank you very much for providing the opportunity for interested parties to comment on the proposed rules. Bass & Associates, P.C. is a law firm with over 20 years of nationwide collections and bankruptcy industry experience. We have national experience in filing proofs of claim for institutional creditors, and in fact file a volume each month on behalf of our various clients. Because we work so closely every day with Rule 3001 on a nationwide basis, we have a perhaps unique knowledge of its working on a national scale. While we appreciate the reasons behind the proposed changes given the mortgage and real estate secured lending crisis that currently we find ourselves in, it is our feeling that the proposed Rule presents both logistical and operational challenges to legitimate creditors that may not be reasonable. In addition, the proposed changes are sometimes confusing in what they ask for, and arguably the remedies are in direct contravention of the bankruptcy code and existing jurisprudence. It is for those reasons that we submit this comment for your review.

The first proposed change is to Rule 3001(c)(1):

> *When a claim is based on an open-end or revolving consumer credit agreement, the last account statement sent to the debtor prior to the filing of the petition shall also be filed with the proof of claim.*

The rule as written requires the creditor to file a document that is necessarily in the possession of the debtor and normally was provided to the debtor as recently as at or about the time of filing of the bankruptcy case. What apparently is intended is that the creditor files a copy or reproduction of the last statement sent to the debtor. But even under this formulation, the proposed change will raise issues. From our experience in the industry, we know that creditor's statement systems vary greatly. Almost no creditor images or otherwise copies the exact account statement that is sent to the debtor. Instead, they maintain the information that is presented on the statement in electronic form. When a statement is reproduced using that information, it is often reproduced using a

system other than the one that prints the actual statements. In fact, many creditors outsource that job and thus they may not be able to access the statement system at other times. When the statement is reproduced on a system other than the one that originally produced it, the original formatting is lost, there may be preprinted writing on the statement form that is not included, and generally the reproduced statement does not look anything like the one that the debtor received (even though it contains exactly the same information). If the aim of the rule change is to ensure that proofs of claim are supported by appropriate information, we would recommend that the rule make it clear that the creditor attach evidence of its claim, and in the case of an open-end or revolving consumer credit account, the state of the debtor's account on the day the petition was filed. That would allow a creditor to furnish this information in different forms, including a facsimile, a reprint, or a screen print of the debtor's account history contained in its account system.

Our second concern involves the operation of proposed section (c)(2)(A) when the debt arises out of a revolving account such as a credit card:

> *If, in addition to its principal amount, a claim includes interest, fees, expenses, or other charges incurred before the petition was filed, an itemized statement of the interest, fees, expenses, or charges shall be filed with the proof of claim.*

With a mortgage or closed end loan, the production of such an itemized statement should be within the capabilities of most loan servicing systems. However, in the credit card realm, without making certain assumptions, such a statement most likely is not within the capabilities of the major processing systems in use by most creditors. That is because of the unique operation of credit card accounts and the methods for applications of payments. Without accepting the proposition that once an interest charge or fee or any portion thereof goes unpaid it becomes part of the principal balance, most credit card systems will be unable to produce such a statement.

In overly simplified terms, minimum required credit card payments are generally applied first to current cycle fees and charges, then to current cycle interest, and finally to a percentage of current cycle "principal." However, that "principal" may include unpaid interest, charges, and fees from previous cycles. Payments are applied against that principal, usually in a first in – first out manner. As that process repeats, cycle after cycle, it soon becomes extremely difficult, if not impossible, to determine what part of that principal balance is actually attributable to interest and fees. Because of that fact, credit card agreements generally provide that the principal includes unpaid fees and interest.[1]

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[1] For example, consider the following selection from the cardholder agreement of a major lender:

Periodic Interest Charge Calculation-Daily Balance Method (including current transactions):
We figure periodic interest charges for each billing cycle.
• We begin with each existing balance for each type of transaction (for example, purchases, balance transfers, cash advances, overdraft advances, and each promotion). We may combine different transaction types with the same daily interest rates.

In order to prevent future confusion and ultimately litigation, we would strongly suggest making the proposed Rule 3001(c)(2)(A) applicable to closed end loan debts only. At a minimum, an amendment or drafting note should be included clarifying that the principal balance in the case of a revolving account refers to the balance as indicated on the last periodic statement prior to filing, and the interest fees and charges on a revolving account consist of the current interest, fees, and charges appearing on that statement.

By far our greatest area of concern is the proposed penalty for violating the rule found in subsection (c)(2)(D):

> *If the holder of a claim fails to provide any information required by this subdivision (c), the holder shall be precluded from presenting the omitted information, in any form, as evidence in any hearing or submission in any contested matter or adversary proceeding in the case, unless the court determines that the failure was substantially justified or is harmless. In addition to or in lieu of this sanction, the court may, after notice and hearing, award other appropriate relief, including reasonable expenses and attorney's fees caused by the failure. (Emphasis added).*

• We figure the 'daily balance' for each transaction type. We take the beginning balance for each day. We add any periodic interest charge from the prior day's daily balance. This results in daily compounding of interest charges. We then add any new transactions or other debits (including fees and unpaid interest charges), and subtract any payments or credits. We treat any net credit balance as a zero balance. This gives us the daily balances for each type of transaction.

• We figure the periodic interest charges on your Account by multiplying the daily interest rate by the "daily balance" of your Account for each transaction type, each day in the billing cycle.

• The total periodic interest charges for the billing cycle are the sum of the daily periodic interest charges for each transaction type for each day during that billing cycle. If any periodic interest charge is due, we will charge you at least the minimum interest charge, plus any other finance charges (for example, transaction fees).

We add a new purchase, cash advance, balance transfer or overdraft advance, if applicable, to the daily balance on the date of the transaction, or a later date of our choice. We add a new cash advance check or balance transfer check to the daily balance on the date the payee deposits the check or a later date of our choice. We add fees either on the date of a related transaction, the date they are posted to your Account, or the last day of the billing cycle, whichever we may choose.

For each transaction type we calculate a Balance Subject to Interest Rate for the billing cycle by adding all your daily balances and dividing that amount by the number of days in the billing cycle. We may use mathematical formulas that produce equivalent results to calculate the Balance Subject to Interest Rate, periodic interest charges and related amounts.

By adding the interest or fees into the balance on the day they are assessed and charging interest on the resulting amount the next day, this agreement makes them part of the principal.

In our opinion these penalties far exceed what is required to ensure compliance with the proposed rule. Additionally, the language of the proposed rule appears to contradict the language of the Bankruptcy Code, and calls into question the significance (and, in fact, incentive) of and for a debtor to list a debt on her schedules.

Decades of claim jurisprudence in some circuits, as well as a recent United States Supreme Court decision, hold that a claim may be disallowed only for those reasons set forth in section 502(b) of the Bankruptcy Code. The proposed rule, however, would give a new basis for disallowance of a claim. This proposed language would therefore alter parties' substantive rights related to the claims allowance process. *See, e.g., Travelers Casualty & Surety Co. of America v. Pacific Gas & Electric Co.*, 549 U.S. 443, 1227 S.Ct. 1199 (2007); *In re Dove-Nation*, 318 B.R. 147, 151 (8th Cir. BAP 2004); *In re Heath*, 331 B.R. 424 (9th Cir. BAP 2005).

28 U.S.C. §2075 states:

> The Supreme Court shall have the power to prescribe by general rules, the forms of process, writs, pleadings, and motions, and the practice and procedure in cases under title 11. *Such rules shall not abridge, enlarge, or modify any substantive right....*
> (Emphasis added).

Currently, a claim or interest is deemed allowed as filed unless a party in interest objects. 28 U.S.C. §502(a). Section 502 (b) states, "...if such objection is made, the court, after notice and hearing, shall determine the amount of such claim...as of the date of the filing of the petition, and shall allow such claim in such amount, except to the extent that--...." The statute goes on to list nine specific reasons for claim disallowance, none of which mention the documentation attached to the original filings.

The language of the proposed rule 3001(c) requires that the creditor attach the last account statement sent to the debtor prior to the bankruptcy filing. As discussed in other sections of this Comment, these statements on a revolving account contain the claim amount at the time of the filing, as well as information about interest, fees and charges. The proposed rule also demands a separate itemization of interest, fees, and arrearages. By precluding the use of that account information "in any form" if a creditor fails to attach such very specific documentation (which was already once provided to the debtor by the creditor prior to the bankruptcy), the proposed sanction listed in 3001(c)(2)(D) (preclusion of later presentation of the proof in any form) would have the effect of precluding the creditor from proving up its claim once a contested matter is initiated by an objection to the claim.

The U.S. Supreme Court recently stated that claims could be disallowed only in reliance on §502 of the bankruptcy code. *Travelers Casualty & Surety Co. of America v. Pacific Gas & Electric Co. supra.* Section 502 currently does not contemplate the failure to attach documentation to the proof of claim form to be grounds for claims disallowance,

and the *Travelers* decision is clear that only those grounds in Section 502 may be used to disallow a claim.

Moreover, the proposed rule creates a rebuttable presumption that this evidence will be forever disallowed unless the creditor can show harmlessness or substantial justification. These standards for claims allowance are not found anywhere in the statutes enacted by Congress. As the Supreme Court stated in *Travelers*, "'where Congress has intended to provide...exceptions to provisions of the Bankruptcy Code, it has done so clearly and expressly.'" *Travelers,* 549 U.S. 443 at 453, 127 S.Ct. 1199 at 1206, *citing FCC v. NextWave Personal Communications, Inc.*, 537 U.S. 293, 123 S.Ct. 832 (2003). The Court noted that Congress had "the power to amend the Bankruptcy Code by adding a provision expressly disallowing claims for attorney's fees incurred by creditors in the litigation of bankruptcy issues. But because no such provision exists, the Bankruptcy Code provides no basis for disallowing Travelers' claim on the grounds stated by the Ninth Circuit." *Travelers* at 453, 1206.

The proposed rule, therefore, appears to circumvent the language of the Bankruptcy Code, and arguably impinges on the rights of the creditor to have its claim decided on the merits, by enlarging the statutory reasons for claim disallowance. While the rule itself may not explicitly state that the claim is disallowed if the proposed new documentation requirements are not met, the practical effect of the proposed new language can be nothing other than claim disallowance since the creditor cannot later introduce any evidence to prove its claim. We urge this committee to review §502 and the *Travelers* decision, as the proposed rule seems to suggest a result that differs from that code section and holding.

As troubling to us as the proposed rule's possible conflict with the bankruptcy code is the disincentive this rule provides to debtors to list debts on their schedules. By listing a debt on sworn schedules, a debtor is admitting that it exists. However, given the penalties in this proposed rule, the burden of proof in essence is shifted to the creditor to prove its claim before any objections are filed. If it does not, then a simple objection will be enough to wipe it out, as the creditor would be precluded from presenting its proof in answer to the objection. Thus, the incentive is for a debtor to <u>not</u> list debts that they know they owe, if they think that the creditor may not have all of its documentation. It is the intent and purpose of the bankruptcy code for debtors to honestly self report. In fact, under 11 U.S.C. 1111, a chapter 11 debtor's self report is expressly self authenticating. This proposed rule offers debtors a strong incentive to frustrate the code's intent.

Finally, we would like to comment on why a creditor might file a proof of claim before it has all of the documentation for that claim. As a nationwide processor of bankruptcy claims, we are in a unique position to so comment. In fact, there can be many legitimate reasons why a creditor might initially file a proof of claim without complete documentation attached. This portion of this comment focuses on those creditors who have a security interest in personal property of the debtor that was taken as a result of the debtor's use of a revolving credit account.

Generally, creditors are permitted under Article 9 of the Uniform Commercial Code to take a purchase money security interest in personal property. *See, e.g.,* (List various states' UCC provisions). It is our experience that frequently, in cases involving a non-mortgage purchase money security interest in personal property purchased on a revolving account, Chapter 13 debtors and their attorneys fail to acknowledge these security interests in their Chapter 13 plans. As a result, creditors must file objections to confirmation to force plan treatment of their secured claims.

In some jurisdictions, including, but not limited to, the Northern, Central, and Southern Districts of California, the Western District of Kentucky, the Eastern and Western Districts of Tennessee, and some parts of Idaho and Indiana, a creditor who wishes to object to the plan treatment of his or her claim must do so prior to the 341 meeting of creditors. This is a far shorter timeline than the 90 days after the first date set for the 341 meeting that is the current rule as the bar date for claim filing. Frequently, the short period between the time that a creditor receives notice of the bankruptcy and the deadlines for enforcing secured claim treatment is insufficient to allow a creditor to retrieve all archived documents related to the account. While the creditor may well be able to retrieve these documents at some point in the near future, not all documents will necessarily be available to file the secured claim prior to the 341 meeting. Under the proposed rule, an untreated secured creditor in these jurisdictions will face a Catch 22: Either file the secured claim and object to plan treatment with full intent and ability to produce the necessary documentation during the discovery process, or wait until all documents can be gathered, which will have the effect of relegating the claim to unsecured treatment. Such a scenario creates a Hobson's choice indeed. In summary, we believe that the sanctions contained in the proposed rule are excessive for its purpose, and need to be changed or eliminated.

Thank you very much for allowing us the opportunity to comment on this proposed rule. We believe that given our practice, our comments have much validity. We have confidence that they will be carefully considered.

Sincerely,

Patti H. Bass