To: Advisory Committee on the Bankruptcy Rules

09-BK-149

From: Alane A. Becket, Becket & Lee LLP

Date: February 16, 2010

Re: Follow up Comments Regarding Proposed Amendments to Bankruptcy Rule 3001

As a follow up to my testimony of February 5, 2010 and the questions posed by the Committee, please consider the following additional comments:

I. After the hearing, one Committee Member commented that if unsecured creditors, and credit card issuers and purchasers in particular, aver that interest, fees and other charges "roll into" principal each month, those creditors can merely argue that the requirement is inapplicable to such claims as there are no such charges to itemize. The Committee Member also noted that the "itemization" requirement is currently a part of the Official Form and that because it is largely not litigated at this time, the unsecured creditors' concern over this requirement may be overstated.

Response:

- There seems to be no purpose for the imposition of this requirement on unsecured claims, even before the current proposed amendments, since all components of the debt are general unsecured claims. This may be one reason why this item was rarely litigated. However, the rule as now proposed provides an incentive for litigation. Specifically, it allows for the possibility of awards of sanctions, including reimbursement of attorney's fees, unless the creditor defends itself in court and shows the failure to include an itemization was substantially justified.

  Debtors with credit card accounts receive an account statement each month itemizing the charges assessed to the account during the previous cycle. All interest and other charges cease as of the date of the filing of the petition. While the requirement to itemize a claim has been shown to be important for mortgage

claims, there is no indication from the Committee as to why this requirement is necessary for unsecured claims.

- Capitalization of interest is not widely understood by debtors. Even professionals in the bankruptcy community with whom I have spoken assume that a national bank can, with the push of a button, break an account balance into its individual components. The testimony before the Committee on February 5, 2010 was to the contrary.

> *An 'amount' that is due can include principal, interest, penalties, attorneys' fees, and other components. Interest then can be added to that total. . . . And we know from Wahl v. Midland Credit Management, Inc., No. 08-1517, 556 F.3d 643, 2009 U.S. App. LEXIS 3530 (7th Cir. Feb. 23, 2009), that there would be no falsity even if the 'amount due' had been described as 'principal due'--for Wahl observes that when interest is compounded, today's interest becomes tomorrow's principal, so all past-due amounts accurately may be described as 'principal due'.*

Hahn v. Triumph P'Ships LLC, 557 F.3d 755, 756-57 (7th Cir. 2009).

> *This Court holds that a proof of claim filed for a credit card debt is not required to include an itemized statement of all interest and additional charges, even though finance charges are included in the amount of the claim. Credit card finance charges are calculated periodically on the unpaid principal balance, which principal balance generally includes any finance charges from prior periods which have not been paid. In other words, finance charges are capitalized or compounded. This is in contrast to many loans, such as closed end bank loans, where interest accrues only on unpaid principal. Although such lenders maintain separate accountings of outstanding principal and interest, credit card companies generally do not do so for open end credit. Further, for purposes of the allowance of unsecured claims, the Code makes no distinction between principal and accrued finance charges. An itemized statement of all interest and additional charges is not required.*

In re Osborne, Case No. 03-25176, Memorandum And Order Denying Debtor's Objections To Proofs Of Claim at 12 (Bankr. D. Kan. Apr. 25, 2005) (footnote omitted).

- Even though the requirement for an itemization may be inapplicable to many unsecured claims, the movement of that requirement from the Official Form to Rule 3001 appears to elevate its importance to the Rules Committee. This will most certainly result in increased litigation over the lack of an itemization. Creditors will be forced to argue this point repeatedly in many cases and courts, at the risk of being sanctioned pursuant to the Rule's penalty provisions. Whether a claim is allowed will be inconsistently and variably decided based on each court's interpretation and/or understanding of the nature of revolving credit accounts and what an itemization must include. This will result in a significant cost to creditors and disallowance of otherwise undisputed debts. Rule 3001 should be amended specifically to exclude unsecured claims from the itemization requirement.

II. I was asked at the hearing what, if anything, in the proposed Rule would cause a lack of documentation to result in disallowance of the claim, when the grounds for disallowance set forth in 11 U.S.C. § 502(b) do not include a lack of documentation.

Supplemental Response:

In addition to my practical experience, there is a minority of case law which holds that a claim lacking documentation can be, and often is, disallowed. *Heath v. American Express Travel Related Services Co., Inc.* (*In re Heath*), 331 B.R. 424, 434 (B.A.P. 9th Cir. 2005). For example, if the creditor chooses to respond to the objection but cannot obtain additional documentation, the claim may be disallowed. Further, many undisputed claims are disallowed by default for lack of documentation, even though the debtor does not dispute the underlying obligation. In these cases, creditors have either been unable to obtain additional documentation and have therefore not responded to the objection, or have determined that it is not cost effective to incur the expense to defend the claim. The proposed Rule's penalty provision will shift the current weight of case law from disallowance as a minority position to disallowance being the typical result of an objection.

Fed. R. Bankr. P. 3001(f) establishes an evidentiary presumption that a claim accompanied by sufficient documentation is *prima facie* valid. A debtor bears the burden of production ("going

forward") when objecting to a claim that is *prima facie* valid. *In re Cluff*, 313 B.R. 323, 336 (Bankr. D. Utah 2004) ("If a proof of claim enjoys this evidentiary presumption, the objecting party has the burden of coming forward with evidence to support its objection and rebut the proof of claim.") (footnote omitted), *aff'd sub nom. Cluff v. eCAST Settlement Corp.*, No. 2:04-CV-00978-TS, 2006 U.S. Dist. LEXIS 71904 (D. Utah Sept. 29, 2006); *Allegheny*, 954 F.2d at 173; *McGee v. O'Connor* (*In re O'Connor*), 153 F.3d 258, 260 (5th Cir. 1998); *In re Multiponics, Inc.*, 622 F.2d 709, 714 (5th Cir. 1980).

A claim that the court deems to be insufficiently documented is not considered *prima facie* valid. *eCAST Settlement Corp. v. Tran* (*In re Tran*), 369 B.R. 312, 317 (S.D. Tex. 2007). Therefore, many courts allow a debtor to object to such claims for no reason other than "insufficient documentation." This places the initial burden of proof on the creditor. By precluding the use of account documentation in a subsequent proceeding, the creditor will be unable to even attempt to sustain its burden of proof. The inevitable result will be disallowance of the claim for failure to meet the creditor's initial burden.

III. While the Committee seeks to clarify what documentation is required to accompany certain proofs of claim, it has not specified that the "writing" requirement of Rule 3001 is satisfied if the new requirements are met. This omission leaves the door open to the continued use of Rule 3001 as a means to object to claims based on the lack of a "writing." Whatever decision is ultimately reached by the Committee, it should be clear that compliance with any new requirements satisfies the "writing" requirement and precludes a "documentation" objection based on Rule 3001.

IV. Conclusion: In addition to ensuring the integrity of the bankruptcy process, the Rules should work to streamline practices and deter litigation. I have experienced, thousands upon thousands of times, how Rule 3001 is used to disallow valid claims. I would again encourage the Committee to reconsider the application of the amendments to unsecured claims, and conduct further study to determine whether a problem exists, the exact nature and scope of the problem, and the fairest way to address it for both creditors and debtors.