

Takeaways From 2022's Top Bankruptcy Trends

By **Alan Hochheiser** (January 11, 2023)

Over the past year, the ebb and flow of bankruptcy filings has been an interesting one. Through 11 months, the number of bankruptcy filings has decreased from 2021, which was already at its lowest level since the 1980s.

The total number of bankruptcy filings through November stands at 346,760. Based on a recent monthly uptick in both consumer and commercial filings, we should expect the year to end with approximately 385,000, a 4% decrease from the 401,291 filings in 2021.



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As monthly filings have gone up and down throughout the year, it is difficult to determine trends. In October 2022, total filings decreased 2% from September of this year. However, in November total filings increased 6% from the prior month.

The commercial sector has had a major impact on monthly bankruptcy filing numbers. In November alone, commercial bankruptcy cases increased by 17%, to over 1,838 filings compared to November 2020 filings.

Consumer filings remained at lower levels, but the 12,862 Chapter 13 filings in November 2022 represent an increase of 25% from November 2021. Will this be a trend or just a blip on the radar? And more importantly, how are supply chain issues, inflation and increased remote work affecting businesses?

As we attempt to determine any trends, the total number of commercial bankruptcy filings must be analyzed carefully. Recently we have seen an increase in filings of cryptocurrency entities, including several due to FTX Trading Ltd.

Based on its corporate structure, there were over 100 FTX cases that were included in the number of filings. The cases have been consolidated, but it skews the number substantially. It is not uncommon, when reviewing the daily commercial filings, for an entity to have multiple related entities, each of which is counted as a separate filing.

On the consumer side we will continue to see fluctuations state by state.

Which states have holiday moratoriums on garnishments and foreclosures? Which state's courts are just getting back up to speed and moving cases along? Are creditors staffed to proceed to send out lawsuits and foreclosure actions? How will the continued rise in interest rates affect consumers? Will increased inflation and the costs for necessities force individuals into default? Will the student loan moratorium on payments, which continues to be extended, stem the tide of bankruptcy filings by providing more cash for consumers to spend?

All these considerations make it difficult to predict filing trends for 2023.

In 2022, we continued to see ongoing litigation regarding bankruptcy issues. Whether the cause is recent favorable court decisions for debtors, an aggressive debtors' bar or attempts to correct improper actions, we have seen an increase in the number of actions.

Stay Violations

We continue to see the spinoffs from the U.S. Supreme Court's 2021 ruling in the City of Chicago v. Fulton.[1]

The Supreme Court in Fulton held that the retention of a vehicle by a creditor prepetition with no further action did not violate the automatic stay. We have seen a bevy of cases where debtors have commenced actions for stay violations and contempt against creditors for the failure to release attachments. The courts have continued to find that maintaining the status quo is not a stay violation.

Rule 9011

Another area seeing increased litigation involves Federal Rule of Bankruptcy Procedure 9011 orders to show cause issued by a court on their own initiative. The February 2020 case in the U.S. Bankruptcy Court for the Eastern District of California of In re: Legrand is an example where the Eastern District of California had concerns relative to a stay violation occasioned by an attorney's failure to discontinue a wage execution.[2]

Aside from directing the attorney to show cause why sanctions should not be imposed, it also required the underlying creditor to appear and show cause why it should not be held in contempt under Rule 9011 for the actions of its attorneys.

The creditor, by showing the court the detailed processes and procedures it had in place to educate, inform and audit its counsel, avoided potential Rule 9011 sanctions. The lengthy decision detailed the steps taken by this creditor and what an outside counsel program should look like. Documentation, education and enforcement of a local counsel network are the key processes that must be in place and documented.

Rule 3001

We also continue to see increased litigation relative to Federal Rule of Bankruptcy Procedure 3001 and the information required in a proof of claim. The ongoing issue as to providing the breakout of interest, fees and costs continues. To date, there have been no appellate court decisions, and we seem to be a long way off from getting some clarity.

For now, it is the interpretation of each judge whether a creditor has complied with Rule 3001's requirement.

Although Rule 3001 does not allow for the disallowance of claims, it opens the door for a potential award of attorney's fees and the inability to present evidence when an objection to a claim is filed under Section 502 of the Bankruptcy Code.

When looking at the evidence presented to support a prima facie valid proof of claim, the Bankruptcy Appellate Panel for the U.S. Court of Appeals for the Ninth Circuit, reviewing a bankruptcy case out of Nevada in 2022 in In re: Meyers, required a creditor to provide a sworn statement of the amounts due and owing, in order to show prima facie validity of a proof of claim.[3]

The court looked to Nevada state law and held that compliance with state law to establish a balance is required, despite the language of Rule 3001. The case is currently pending before the Ninth Circuit.[4] This could potentially cause a clash between the Federal Rules of Bankruptcy Procedure and state law in the context of what is needed to satisfy Rule 3001.

Creditors need to monitor the results of this case and state law statutes in order to potentially avoid disallowance of its proof of claims.

The Fourth Option

Other issues surrounding state law conflicts arise in California as it pertains to a debtor's statement of intention.

Section 521 of the Bankruptcy Code requires a debtor to state his or her intentions when a Chapter 7 bankruptcy is filed. Prior to the first meeting of creditors, with respect to secured collateral, the debtor must state whether he or she is reaffirming, redeeming or surrendering the collateral.

The intention must then be complied with within 30 days of the first meeting of creditors. Failure to comply with this provision will cause the stay to be removed as to the collateral without a further court order.

No fourth option of retain and pay is available. However, California has enacted legislation that once again puts into play the fourth option. A creditor in California may not repossess the collateral if there is not a monetary default. California has overridden the clear language of Section 521 and provided its residents with an alternative fourth option to complying with the Bankruptcy Code.

Homestead Exemptions

The Ninth Circuit also provided extraordinary relief for bankrupt debtors to the detriment of judgment lien creditors. In 2022, in *Barclay v. Boskoski*, the Ninth Circuit upheld the Bankruptcy Appellate Panel's decision that a judgment lien impaired the homestead exemption of a California debtor by applying the amount of the current exemption a debtor was entitled to, and not the exemption entitlement existing when the judgment lien was filed.[5]

This decision could cause an increase in the number of motions to avoid liens as impairments of exemptions in 2023 under Section 552(f).

Student Loans

Finally, the treatment of student loans in bankruptcy proceedings and otherwise continued to attract our attention in 2022 and will in the year to come. The Biden administration's student loan relief is currently on hold as several circuit courts have stayed its implementation. The U.S. Supreme Court will address the issue of whether federally backed student indebtedness can be forgiven by executive order. In the interim, the moratorium on student loan payments continues.

The Bankruptcy Code currently provides under Section 523(a)(8) that unless it would create an undue hardship, an educational benefit or loan made or guaranteed by a governmental agency is nondischargeable. Although there have been attempts in Congress to amend the Bankruptcy Code to make it easier to discharge student loans, the changes in the makeup of Congress in 2023 make that very unlikely.

Until the Supreme Court speaks, it remains to be seen what the effect of the moratorium will be on the number of consumer filings.

Do fewer individuals see the need to file because they are not burdened with making a substantial monthly payment? Are consumers using the cash they would use for those payments to cover essential costs? Are they counting on the U.S. Department of Justice's initiative to not push objections to hardship discharge?

These unanswered questions ultimately have a direct impact of the number of bankruptcy cases to be filed in 2023.

Conclusion

The past year has had bankruptcy issues across the board, arising in both consumer and commercial matters. Despite fewer bankruptcies, practitioners and judges have been kept busy addressing issues that affect the bankruptcy world.

What will 2023 look like? With all the external forces affecting the economy, politics and lifestyles, we can only say that it will be another interesting and busy year.

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Disclosure: Maurice Wutscher was counsel for creditors in the LeGrand matter.

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[1] *City of Chicago v. Fulton*, 208 L. Ed. 2d 384, 141 S. Ct. 585 (2021).

[2] *In Re LeGrand*, 638 B.R. 151 (Bankr. E.D. Cal. 2022).

[3] *Myers v. LVNV Funding, LLC (In re Myers)*, BAP NV-22-1005-LBT, (B.A.P. 9th Cir. Jul. 19, 2022).

[4] Docket Number 22-60037.

[5] *Barclay v. Boskoski*, 52 F.4th 1172 (9th Cir. 2022).