The Cramdown

The Newsletter of the Tampa Bay Bankruptcy Bar Association
Editor-in-Chief, Adam Lawton Alpert, Esq.

Spring 2008

PRESIDENT'S MESSAGE

by Shirley C. Arcuri, Esq.
Shirley C. Arcuri, P.A.

Spring is here and with it the process of selecting next year's officers and directors. The slate of candidates were announced at the April meeting and elections will be held at the May meeting. The new board will be introduced at the Annual Dinner on June 12. Then, on July 1, the new officers and directors start the new bar year. As with most volunteer organizations, the officers and board members are just "the tip of the iceberg". The members are the heart of the organization and I very much appreciate all the time and talent given by the members this year to TBBBA projects.

At 315 members currently, TBBBA enjoys the support of almost every bankruptcy practitioner in the Tampa Division. I know that, with the number of bankruptcy filings on the rise, there are increasing demands on your time. But, consider what this organization does to benefit your professional life, and please make time to volunteer so that TBBBA continues to fulfill its mission for all of us.

Florida Bankruptcy Courts Split on the Negative Equity Issue Realted to 910-Day Claims

by Dennis LeVine, Esq.
Dennis LeVine & Asscociates, P.A.

In the 2005 Bankruptcy Amendments ("BAPCPA"), Congress added a provision which appeared to be designed to protect auto lenders who financed cars for debtors within 910 days of the bankruptcy filing. This provision sought to prevent the cramdown of these so-called 910 day loans in Chapter 13 cases, and was included in a section of the legislation entitled "Giving Secured Creditors Fair Treatment in Chapter 13." H.R. Rep. No. 109-31 at 72 (2005). Unfortunately, this provision was unnumbered and simply added at the end of Section 1325(a). Now known as the "hanging paragraph," the apparent mis-placement of this provision, together with its confusing language, has created extensive litigation on a number of issues.

To qualify for the statutory protection from cramdown in Chapter 13, a 910-day loan must, among other things, constitute a purchase money security interest ("PMSI"). Some Debtors have argued that lenders do not hold the requisite PMSI when the loan also finances debts unrelated to the "price" of the financed car, such as (1) a roll-over of negative equity owed on a trade-

continued on p. 3

Inside This Issue

The *Cramdown* can be accessed via the Internet at www.flmb.uscourts.gov and www.brokenbench.org

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910-Day Claims

continued from p. 1

in car, (2) pre-payment of "gap" insurance covering the difference between the new car's value and the total amount financed, and/or (3) pre-paid extended warranty contract premiums. Several Courts have adopted this argument and found that 910 day loans which finance these additional items are no longer PMSI, and thus not protected from cramdown by the "hanging paragraph". This article will explore the different positions taken by Bankruptcy Courts in Florida on the issue.

The term "purchase money security interest" is not defined in the Bankruptcy Code. Courts have looked to the definition of PMSI in state law, and more specifically the Uniform Commercial Code. Bankruptcy Courts which have looked at Florida law on this issue have come to different conclusions. In In re Blakeslee, 377 B.R. 724 (Bankr. M.D. Fla. 2007), the car loan was incurred within 910 days of filing. The loan included financing of negative equity in the Debtor's trade-in vehicle. Judge Funk in Jacksonville found that the "hanging paragraph" was inapplicable, and the Debtor could cramdown the secured claim. Judge Funk adopted the reasoning of a New York Bankruptcy Court in In re Peaslee, 358 B.R. 545, 551 (Bankr. W.D. N.Y. 2006), which held that the inclusion of negative equity in a loan means the loan is no longer a PMSI. In Peaslee, the Bankruptcy Court looked to New York law and found that a PMSI exists where the collateral secures an obligation "incurred as all or part of the price of the collateral or for part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral if the value is in fact so used." Judge Funk agreed, and found the term "price of the collateral" to equal the amount the collateral cost to buy – this price does not include the payoff of negative equity. Judge Funk noted that "negative equity is not used to enable a Debtor to acquire rights in the collateral". Instead, financing negative equity is merely an "accommodation" to facilitate the sale. In other words, there are two separate transactions and the payoff of the old loan is not a prerequisite to the new loan. **[ED. NOTE – as set out below, the Bankruptcy Court's holding in Peaslee has been reversed].**

Once Judge Funk in Blakeslee determined the obligation to be partially a PMSI and partially a non-PMSI (based on the inclusion of negative equity), the Court considered the next step --- how to apply the hanging paragraph to a claim that is only partially secured by a PMSI. The Court found under well established commercial law, it had discretion to determine the extent of the PMSI by applying either the "dual status rule " or the "transformation rule". The dual status rule provides that the secured lender has a purchase money security interest to the extent that the amount financed relates to the purchase price for the collateral. In re Price, 363 B.R. 734, 745 (Bankr. E.D. N.C. 2007). The transformation rule, however, "transforms" the entire secured obligation to non-PMSI (i.e. the non-purchase money component transforms the entire claim into a non-purchase money security interest). Id.

In Blakeslee, Judge Funk found that when a debtor finances negative equity in a 910-day loan, the entire security interest is ***transformed*** into a non-PMSI loan. The Court reasoned:

> "While the Court agrees that it does have the discretion as to whether to apply the dual status or the transformation rule to a partial purchase money security interest, the Court finds that with respect to negative equity, the transformation rule is the appropriate rule to be applied. As the court in Price pointed out, notwithstanding the fact that a sales contract may clearly state the amount of the purported purchase price of a vehicle, a vehicle's true purchase price and the amount of negative equity is difficult to compute and is in fact a "mystery", with the actual purchase price being affected by an unreasonably low allowance on a traded in vehicle. Price, 363 B.R. at 745. A creditor's burden of establishing the difference between the purchase price and advances to pay the debt on the traded in vehicle is "a virtually impossible task." Id. Moreover, a court is burdened with the task of the allocation of pre-bankruptcy payments to the purchase money and nonpurchase money portions of the secured debt. Id. The Court declines the task of "unwind[ing] the manipulations" which would be foisted upon it were it to apply the dual status rule to the financing of negative equity in retail installment contracts. See Peaslee, 358 B.R. at 560. Accordingly, the Court will apply the transformation rule to such situations. [footnote omitted] [The Creditor] is not secured by a purchase money security interest in any amount. Consequently, the prohibition against strip down in § 1325(a) does not apply and Debtor may therefore bifurcate [The Creditor's claim] into secured and unsecured components pursuant to 11 U.S.C. § 506(a)(1)."

On the same day he issued Blakeslee, Judge Funk issued a decision on a similar issue in In re Honcoop, 377 B.R. 719 (Bankr. M.D. Fla. 2007). In Honcoop, the

continued on p. 4

910-Day Claims

continued from p. 3

Debtor financed the purchase of a vehicle for $12,000 less than 910 days prior to filing bankruptcy. The Debtor also financed an additional $500 for "gap" insurance. The Debtor later filed Chapter 13, and filed a Motion to Value the creditor's secured claim at $4,570. The creditor opposed the valuation motion, arguing that its claim could not be modified based upon the protections of the hanging paragraph.

In Honcoop, Judge Funk applied the same analysis from Blakeslee and adopted the Bankruptcy Court's analysis in Peaslee. Judge Funk found that "gap" insurance was not part of the "price of the collateral". In Honcoop, however, Judge Funk applied the "dual status" rule and not the "transformation rule" because the Court found that the contract clearly allocated a **specific amount** paid for the "gap" insurance. The Court was able to calculate the creditor's PMSI by simply subtracting the cost of the "gap" insurance from the contract amount. Ironically, while the Debtor prevailed in Honcoop, the Debtor gained very little in the end. The PMSI portion of the secured claim turned out to be $11,500, which was protected by the "hanging paragraph" and had to be fully paid (with interest) in the Plan.

In January, 2008, Judge May in Tampa faced the same issues as in Blakeslee and Honcoop but came to the opposite conclusion. In In re Schwalm, --- B.R. ----, 2008 WL 162933 (Bankr. M.D. Fla. January 16, 2008), Judge May rejected the analysis used by Judge Funk in Blakeslee and Honcoop. In particular, Judge May was persuaded by the recent District Court opinion in In re Peaslee, 373 B.R. 252 (W.D. N.Y. 2007), where the District Court reversed the Bankruptcy Court decision relied upon by Judge Funk (i.e. the inclusion of negative equity in the loan took the vehicle out of the 910-day protections of the hanging paragraph). **[ED. NOTE: The Peaslee case currently is on appeal to the 2nd Circuit Court of Appeals.]** Judge May cited the following from the District Court opinion in Peaslee:

> "It is not apparent why a refinancing of rolled-in negative equity on a trade-in as part of a motor vehicle sale could not constitute an 'expense incurred in connection with acquiring rights in' the new vehicle. If the buyer and seller agree to include the payoff of the outstanding balance on the trade-in as an integral part of their transaction . . . it is in fact difficult to see how that could not be viewed as such an expense."

In Schwalm, Judge May pointed out that items such as negative equity and "gap" insurance are specifically authorized to be included in motor vehicle financing – not only under state law, but under the Federal Truth in Lending Law (15 U.S.C. §1601, *et seq.*) and Regulation Z (12 C.F.R. §226.18)(these specific items can be included in the "amount financed" in a motor vehicle retail installment contract). Taking a straight-forward approach to the issue, Judge May found that the Debtors negotiated a package financing in compliance with state law:

> "[In 2005] it was already common industry practice, sanctioned by state motor vehicle finance law, and the Federal Truth in Lending Law, for automobile dealers to offer buyers packaged financing, which includes the payoff of debt on the tradein vehicle, GAP insurance to protect repayment of that amount, and the cost of a service contract. These obligations, by the parties' negotiation, and sanctioned by Florida finance laws (as in other states), have the requisite 'close nexus' to the acquisition of the collateral and the secured obligation as explained by Comment 3 to Section 679-1031 [the Florida UCC]."

Judge May found further support for his decision in the legislative history of BAPCPA. Many courts have opined that there is scant, if any, legislative history regarding the 2005 BAPCPA amendments (e.g. there is no Conference Report accompanying the legislation). These courts, however, tend to overlook the apparent intent behind the change in the law – to give additional protections to auto lenders who made loans to Debtors within 910 days of the bankruptcy filing. As an example of this apparent intent, Judge May pointed to the title of the provision containing the hanging paragraph --"Giving Secured Creditors Fair Treatment in Chapter 13", and concluded:

> "[T]he 'hanging paragraph' was adopted to give favored treatment to a limited class of potentially under-secured creditors – those holding a purchase money security interest in a motor vehicle acquired for personal use within the 910 days preceding the bankruptcy petition date. 11 U.S.C. §1325(a). The debtors' argument carries with it the implicit conclusion that Congress intended the 'hanging paragraph' to be inoperative as to a substantial number of lawful auto finance transactions that were industry practice when BAPCPA was enacted. Such an

continued on p. 5

910-Day Claims

continued from p. 4

> interpretation is not compelled by the text of the 'hanging paragraph,' or by its legislative history."

The negative equity issue decided in Blakeslee and Schwalm currently is on appeal before the 11 Circuit in a Georgia case, Graupner v. Nuvell Credit Corp., 2007 WL 1858291 (M.D. Ga. 2007). In Graupner, the creditor argued that under state law the "price of the collateral" included the negative equity that was included in the total amount financed. The Bankruptcy Court agreed. The District Court affirmed, holding that the price of the collateral included the negative equity:

> "The trade-in of the vehicle was an integral part of the sales transaction. The value of that trade-in along with its accompanying debt affected the ultimate price that was paid for the new pick-up truck. The negative equity is inextricably intertwined with the sales transaction and the financing of the purchase. This close nexus between the negative equity and this package transaction supports the conclusion that the negative equity must be considered as part of the price of the collateral. [footnote omitted] Accordingly, the Court finds that the Creditor has a purchase money security interest for the full amount of its debt. Thus, § 506 shall not apply to modify the amount of the secured obligation."

Like Schwalm, the District Court in Graupner supported its conclusion by referring to the official comments of the drafters of the Uniform Commercial Code, which indicate that the price of collateral includes negative equity. *See* U.C.C. § 9-103 cmt. 3 (price of collateral includes "obligations for expenses incurred in connection with acquiring rights in the collateral."). The District Court in Graupner also referred to other statutory authority defining "sales price" in consumer transactions, such as the Federal Truth in Lending Act, 15 U.S.C. § 1601, *et seq.*, as implemented by Regulation Z, 12 CFR Pt. 226 (negative equity treated as part of total sales price), and the Georgia Motor Vehicle Sales Finance Act ("cash sales price" includes negative equity).

As these cases show, Courts across the country will continue to wrestle with the PMSI issue related to the hanging paragraph until the Circuit Courts of Appeal or the Supreme Court (hopefully) decide the issue.

People On The Go

by Andrew T. Jenkins, Esq.
Bush Ross, P.A.

Jennifer Hayes has joined **Foley & Lardner** as a member of the firm's Bankruptcy and Business Reorganizations Practice.

Bowdre Mays McAllister has joined **Donica Law Firm, P.A.** as an associate.

John H. Mueller has joined the law firm of **Smith, Clark, Delesie, Bierley, Mueller & Kadyk**. Mr. Mueller will continue to focus his practice on creditors' rights, bankruptcy, commercial litigation and construction law.

Submissions to **People on the Go** may be emailed to ajenkins@bushross.com

Real Estate Development Companies Filing Bankruptcy Beware

by Suzy Tate
Jennis & Bowen P.L.

With the plummeting real estate values and concurrent increase in foreclosure activity, more real estate development companies have sought (or are seriously considering) chapter 11 protection. Unless these companies are prepared to quickly file a reorganization plan that has a reasonable possibility of being confirmed or are able to commence making interest payments to what is usually their biggest (and sometimes most hostile) creditor, these debtors may find that the contemplated protection of the automatic stay is illusory, as more courts are defining these companies as single asset real estate ("SARE") debtors.

A SARE debtor has real property that constitutes a single property or project, which generates substantially all of the debtor's income, and the debtor is not involved in any substantial business other than the operation of the real property and incidental activities thereto. 11 U.S.C. § 101(51B). This definition was expanded under BAPCPA to remove a $4,000,000 cap of noncontingent, liquidated secured debts. Historically, the definition has been applied to debtors, such as the owner of a single apartment building because the operation of an apartment building generates substantially all of the owner's income and no substantial business is conducted by the owner except for activities incidental to the operation of the apartment building. See, e.g., In re Cambridge Woodbridge Apts., 292 B.R. 832 (N.D.Oh. 2003).

Courts applying the SARE definition have focused mainly on the requirement that the debtor not be involved in any substantial business other than the operation of the real property. For example, courts have found that a golf course is not a SARE because the debtor operates a pool, rents golf carts and sells concessions (In re Larry Goodwin Golf, Inc., 219 B.R. 391 (Bankr. M.D.N.C. 1997)); a hotel is not a SARE because it operates a bar, gift shop, and restaurant (Centofante v. CBJ Dev. Inc., (In re CBJ Dev. Inc.), 202 B.R. 467 (9th Cir. BAP 1996)); and a marina is not a SARE because it provides showers, sells gas and other amenities (In re Kkemko, Inc., 181 B.R. 47 (Bankr. S.D.Oh. 1995)).

continued on p. 8

Who's "SARE" Now?

continued from p. 7

However, the definition may be fluid and leaves much to be interpreted by the bankruptcy courts. Several bankruptcy courts have found that real estate development companies do not conduct any substantial business other than those that are incidental to the operation of the real property. One bankruptcy court held that a debtor, with its thirty-two affiliates that were formed to develop single family homes and condominiums on their real property, was a SARE because the debtor's activities of researching and developing land, conducting planning and construction of houses, marketing and selling the homes, and maintaining the developments were incidental to the operation of the real property. In re Kara Homes, Inc., 363 B.R. 399, 406 (Bankr. D.N.J. 2007); In re Webb Mtn., LLC, 2007 Bankr. LEXIS 3202 at *10, FN 2 (Bankr. E.D.Tenn. 2007)

The Kara Homes court stated that the test is whether the nature of the debtor's other activities "are of such materiality, that a reasonable and prudent business person would expect to generate substantial revenues from the operation activities—separate and apart from the sale or lease of the underlying real estate." Kara Homes, 363 B.R. at 406.

This definition of a debtor as a SARE may be critical to the life or death of a chapter 11 case. If the bankruptcy court determines a debtor to be a SARE, then the bankruptcy court shall grant relief from stay to a creditor whose claim is secured by an interest in the SARE debtor's real property, unless within 90 days of the entry of the order for relief, the debtor has (1) filed a reorganization plan that has a reasonable possibility of confirmation or (2) commenced monthly payments equal to the non-default interest on the value of the creditor's interest. 11 U.S.C. § 362(d)(3). This speeds up the time limit for filing a reorganization plan to 90 days from the date of the order for relief from the usual 120-day exclusivity period provided for in Chapter 11. Alternatively, the debtor could commence payments on a debt that may have been the reason for its bankruptcy filing to begin with.

With these decisions that real estate development companies are SAREs, more creditors may seek relief from stay from these types of debtors through Section 362(d)(e). A debtor's counsel would want to work on a reorganization plan that has a reasonable possibility of confirmation or determine whether the debtor can make interest payments on the secured creditor's interest sooner rather than later.

The C.A.R.E. program of the Tampa Bay Bankruptcy Bar Association extends its sincerest thanks to all who worked to make C.A.R.E. a success! The program, focusing on the pitfalls and advantages of credit card use, has been presented to juniors and seniors at 10 area Hillsborough County high schools and to approximately 850 students at the University of Tampa. We have heard tremendously positive feedback from the community about the program.

A special thanks to all of our bankruptcy judges, each of whom presented the program to students. The TBBBA wishes to especially thank Judge Rodney May who led the charge of this most worthwhile program! Make sure to catch Judge May's interview with News Channel 8 which is posted on the Court's website. Many Thanks Again!!!

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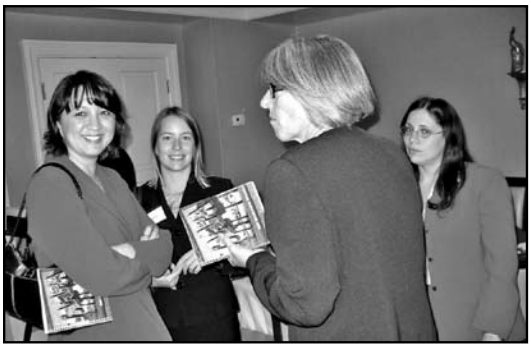
February Luncheon Meeting
Guantanamo Detainees

The TBBBA held its February Luncheon Meeting on February 12th at The Tampa Club. Naval Reserve JAG lawyer, Cmdr. John R. "Jack" Capra discussed his remarkable experiences as a military attorney in the Global War on Terror. Cmdr. Capra has been called to active duty no fewer than four times since September 11, 2001. During one of his two tours in Iraq, he earned the Purple Heart and the Combat Active Ribbon after his vehicle was struck by an IED. In July 2006, Cmdr. Capra was mobilized for an unprecedented fourth time to Joint Task Force-Guantanamo Cuba as deputy director, staff judge advocate and later as executive assistant to the JTF commander. Guantanamo Bay houses some of the world's most dangerous terrorists, including September 11 mastermind, Khalid Sheik Mohammed.



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Moderators
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June 19, 2008, 2:15 to 4:45 pm
(reception following)

at Florida Bar's 2008 Annual Meeting, Boca Raton

Hosted by: Federal Court Practice Committee of the Florida Bar
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March Luncheon Meeting

How to Discharge Income Taxes in Bankruptcy and Avoid Malpractice

The TBBA held its March Luncheon Meeting on March 11th at The University Club. Larry Heinkel, an experienced lawyer specializing in resolving state and federal tax problems for businesses and individuals, discussed the how to use Chapter 7 to discharge state and federal income taxes; why bankruptcy lawyers often fail their clients (and commit malpractice) by filing bankruptcy too soon; how lawyers can avoid such problems.

Mr. Heinkel discussed in depth how non-dischargeable tax debts can be turned into dischargeable tax debts; how debtors who have not filed income tax returns need to be represented; and what to do about payroll sales taxes owed by failed or failing businesses. This informative presentation provided TBBA members with a framework for identifying and analyzing the various methods to discharge income taxes in bankruptcy.

10th Annual TBBBA Golf Tournament

A great time was had by all at the Tenth Annual TBBBA Golf Tournament on April 25, 2008, at the Bay Palms Golf Course on MacDill Air Force base. A record crowd of 140 golfers participated in this year's event. First place went to the team of Steve Oscher, Jeff Warren, Mike Lapan and Rick Bowers. Second place to the team of Mike Markham, Chuck Buford, Charles Samarkos and Paul Wikle. Third place to the team of Greg Harrison, Ron Stepanik, Tim Sierra and Bill Hughes. Fourth place to the team of Kevin Dennis, Tom Wood, Andy Dogali and Jay Clark. Long drive men's winner went to Jay Clark. Long drive women's to Gloria Beyer. Closing to the pin men's went to Ray Alaee. Closing to the pin women's to Sara Aye. The putting contest was won by Kevin Dennis ($100) with second place going to Todd Boulenger ($50). In the contentious Judge's division, Chief Judge Glenn (with Judge Moody) returned to the top spot while Judge McEwen's team finished second. Next year's event is already set for May 1, 2009, at Bay Palms. Look forward to seeing you there.



















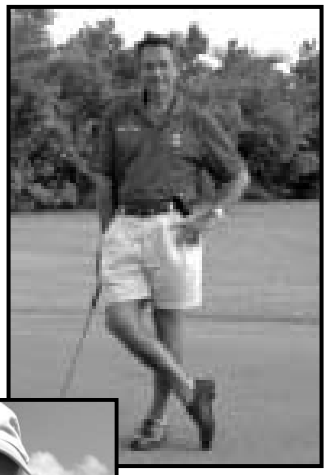
April Luncheon Meeting
Real Estate Issues in Bankruptcy

The TBBA held its April Luncheon Meeting on April 8th at The University Club. Rufus Dorsey IV, a Partner with Parker, Hudson, Rainer & Dobbs LLP in Atlanta discussed various real estate issues that arise in bankruptcy cases. Among other things, Mr. Dorsey discussed the use of receiverships, single asset real estate debtors, SARE issues, and section 363 issues.

This informative presentation provided TBBA members with a framework for identifying and analyzing the various real estate issues that commonly arise in bankruptcy.

10th Annual
TBBBA Golf Tournament







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