

Nuts and Bolts of Bankruptcy Law

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CHAPTER 13...“LET’S GET REORGANIZED HERE”

Chapter 13 of the Bankruptcy Code is titled “Adjustment of Debts of an Individual with Regular Income.” Unlike Chapter 7, which is the chapter chosen by most individuals who do not choose chapter 13, chapter 13 permits a debtor to deal extensively with both unsecured and secured debts. In general, Chapter 13 provides for the debtor’s rehabilitation through a court-confirmed plan under which creditors are paid in whole or in part, usually under the supervision of a Chapter 13 trustee and usually out of earnings or other monies received by the debtor after the filing of the petition.

I. Chapter 13 – Overview and Purpose

A Chapter 13 plan sets out the manner in which the debtor desires to make payments to various creditors. Of course, the plan must contain terms within the statutory scheme for plan confirmation.¹ Payments are generally made out of the debtor’s post-petition income rather than assets, nevertheless, a Chapter 13 plan may provide for liquidation of property.² Chapter 13 gives the debtor more flexibility in the formulation of a plan; it defines the rights of creditors, especially secured creditors, more clearly; it is available to a wider class of debtors; it places limits on the length of a plan; and it relieves indirect pressure on the debtor through his friends or relatives by protecting co-debtors.

Usually, the debtor makes the majority of the plan payments to the Chapter 13 trustee. Once the trustee receives the payments from the debtor, the trustee then disburses the payments to creditors pursuant to and in accordance with the terms and provisions of the confirmed plan.³

The purpose of chapter 13 is to enable an individual, under court supervision and protection, to develop and perform under a plan for repayment of debts over an extended period. In some cases, the plan may call for full repayment; in others it may offer repayment of a percentage in full settlement. During the repayment period, creditors may not harass the debtor or seek to collect their debts. They must receive their payment only under the plan. Chapter 13 of the Code is completely voluntary. An involuntary petition

¹ 11 U.S.C. §§ 1322, 1325.

² 11 U.S.C. § 1322(b)(8).

³ 11 U.S.C. §§ 1322, 1326.

under Chapter 13 is forbidden, as is conversion from Chapter 7 (liquidation) to Chapter 13, unless the debtor so requests, because the Code provides that "an involuntary case may be commenced only under Chapter 7 or 11."⁴

A Chapter 13 bankruptcy is also called a wage earner's plan. Typically, debtors propose a repayment plan to make installments to creditors over three to five years. If the debtor's current monthly income is less than the applicable state median, the plan will be for three years unless the court approves a longer period "for cause."⁵ If the debtor's current monthly income is greater than the applicable state median, the plan generally must be for five years; however, in no case may a plan provide for payments over a period longer than five years.⁶ During this time the law forbids creditors from starting or continuing collection efforts.

(a) Who May be a Chapter 13 Debtor

Any individual, even if self-employed or operating an unincorporated business, is eligible for chapter 13 relief as long as the individual's unsecured debts are less than \$336,900 and secured debts are less than \$1,010,650.⁷ These amounts are adjusted periodically to reflect changes in the consumer price index. A corporate entity or partnership may not be a chapter 13 debtor.⁸

A chapter 13 is limited to individuals that have "regular income."⁹ Section 101(30) defines an "individual with regular income" as one whose income is sufficiently stable to enable the individual to make payments under a chapter 13 plan. Furthermore, and pursuant to section 1328(f), an individual is prohibited from obtaining a chapter 13 discharge in a case filed within two years of the filing of a prior chapter 13 case in which a discharged was granted or within four years of the filing of a prior chapter 7, 11 or 12 in which a discharge was granted.

⁴ 11 U.S.C. § 303.

⁵ 11 U.S.C. § 101(10A).

⁶ 11 U.S.C. § 1322(d).

⁷ 11 U.S.C. § 109(e).

⁸ *Id.*

⁹ 11 U.S.C. § 109(e).

An individual cannot file a petition under chapter 13 or any other chapter under the Bankruptcy Code for that matter, if during the preceding 180 days, the individual filed a prior bankruptcy petition that was dismissed due to the debtor's willful failure to appear before the court or comply with orders of the bankruptcy court or was voluntarily dismissed after creditors sought relief from the court to recover property of the estate upon which they held liens.¹⁰ Further, no individual may be a debtor under chapter 13 or any chapter of the Bankruptcy Code unless he or she has, within 180 days before filing, received credit counseling from an approved credit counseling agency either in an individual or group briefing.¹¹ There are exceptions in emergency situations or where the U.S. trustee (or bankruptcy administrator) has determined that there are insufficient approved agencies to provide the required counseling.¹²

(b) The Chapter 13 Filing Process

A chapter 13 case begins by filing a petition with the bankruptcy court in the judicial district in which the domicile, residence, principal place of business in the United States, or principal assets in the United States, of the debtor have been located for a longer portion of the 180 days immediately preceding the chapter 13 petition than any other district.¹³ Generally, the debtor must also file with the court: (1) schedules of assets and liabilities; (2) a schedule of current income and expenditures; (3) a schedule of executory contracts and unexpired leases; and (4) a statement of financial affairs.¹⁴ The debtor must also file a certificate of credit counseling and a copy of any debt repayment plan developed through credit counseling; evidence of payment from employers, if any, received 60 days before filing; a statement of monthly net income and any anticipated increase in income or expenses after filing; and a record of any interest the debtor has in federal or state qualified education or tuition accounts.¹⁵ The debtor must provide the chapter 13 case trustee with a copy of the tax return or transcripts for the most recent tax

¹⁰ 11 U.S.C. §§ 109(g), 362(d) and (e).

¹¹ 11 U.S.C. §§ 109, 111.

¹² <http://www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter13.html#returntoone>

¹³ 28 U.S.C. § 1408.

¹⁴ Fed. R. Bankr. P. 1007(b).

¹⁵ 11 U.S.C. § 521.

year as well as tax returns filed during the case (including tax returns for prior years that had not been filed when the case began).¹⁶ Lastly, a husband and wife may file a joint petition or individual petitions.¹⁷

In order to complete the Official Bankruptcy Forms¹⁸ that make up the petition, statement of financial affairs, and schedules, the debtor must compile the following information:

- (i) A list of all creditors and the amounts and nature of their claims;
- (ii) The source, amount, and frequency of the debtor's income;
- (iii) A list of all of the debtor's property; and
- (iv) A detailed list of the debtor's monthly living expenses, *i.e.*, food, clothing, shelter, utilities, taxes, transportation, medicine, etc.¹⁹

Married individuals must gather this information for their spouse regardless of whether they are filing a joint petition, separate individual petitions, or even if only one spouse is filing.²⁰ In a situation where only one spouse files, the income and expenses of the non-filing spouse is required so that the court, the trustee and creditors can evaluate the household's financial position.²¹

II. Differences Between Chapter 13 and Chapter 7

Bankruptcy proceedings under Chapter 7 and Chapter 13 are distinctly different in the means each employs to accomplish similar goals. Chapter 7 liquidating bankruptcy proceedings offers debtors limited relief in exchange for the surrendering of their nonexempt assets for distribution among creditors. Liquidating bankruptcy proceedings are intended to achieve an equitable distribution to all creditors and to relieve debtors of personal liability for dischargeable debts. However, Congress recognized that in enacting the Bankruptcy Code that liquidation in the past had offered limited relief for consumer

¹⁶ *Id.*

¹⁷ 11 U.S.C. § 302(a).

¹⁸ The Official Forms may be purchased at legal stationery stores or downloaded from the Internet at www.uscourts.gov/bkforms/index.html.

¹⁹ www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter13.html

²⁰ *Id.*

²¹ *Id.*

debtors as a result of overbroad security interests, limited state exemption laws, and litigation over the dischargeability of certain debts, among other issues.²²

Even though debtor protections were enhanced by the Code, debtors were still having difficulty in dealing with certain issues, specifically with large secured claims against property of the estate or where a debtor owned nonexempt assets.²³ Therefore, chapter 13 was designed to allow for adjustments of all types of debts of individuals with regular income through extension and composition plans funded out of future income, under the protection of the bankruptcy court. Chapter 13 allows for creditor interests to be promoted through ratable recoveries from post-petition income, which is not available to creditors under Chapter 7.²⁴

(a) Property of the Estate: Chapter 13 v. Chapter 7

A chapter 13 case begins by the filing of a petition with the bankruptcy court serving the area where the debtor has a domicile or residence.²⁵ The commencement of a chapter 13 case creates an estate.²⁶ Pursuant to section 541 of the Bankruptcy Code, property of the estate includes all legal and equitable interests of the debtor on the day of the filing of the bankruptcy petition, certain interests acquired postpetition, exclusive of postpetition earnings, property acquired by the use and enforcement of the trustee's or debtor's avoidance powers, property acquired by the estate post-petition and other miscellaneous property interests.²⁷ Section 1306(a) of the Bankruptcy Code modifies section 541 by including property and earnings of the debtor acquired during the pendency of a chapter 13 case.²⁸

Unlike chapter 7, property of the estate under chapter 13 includes all of the kinds of property detailed in section 541, plus property acquired by the debtor during the pendency of the chapter 13 case.²⁹ Furthermore, property of the estate for a chapter 13

²² H.R. Rep. No. 595, 95th Cong. 1st Sess. 117 (1977).

²³ 8 COLLIER ON BANKRUPTCY § 1300.02, at 1300-12 (Lawrence P. King ed., 15th ed. rev.).

²⁴ *Id.*

²⁵ 11 U.S.C. §§ 101, 301, 302

²⁶ 11 U.S.C. § 541(a)

²⁷ *Id.*

²⁸ 11 U.S.C. § 1306(a).

²⁹ *Id.*

case also includes income from services of the debtor performed during the pendency of the chapter 13 case.³⁰ It is clear that proceeds, product, offspring, rents and profits of or from property of the estate acquired by a debtor in a chapter 13 case postpetition engaged in business are also property of the chapter 13 estate.³¹ Generally, the post-petition earnings of a nondebtor spouse of the debtor are not included in this definition; however, there are exceptions in certain cases filed in community property states.³²

Section 1306(a) limits the property coming into the chapter 13 estate to property and earnings acquired before the case is closed, dismissed or converted, whichever occurs first.³³ As such, any property acquired by the debtor after a chapter 13 case is dismissed never becomes property of the estate.³⁴ Moreover, all property of the estate reverts in the debtor after a chapter 13 case is dismissed, closed or converted, which serves the purpose of undoing the bankruptcy case and restoring all property rights to the debtor as they were prior to the filing of the bankruptcy petition.³⁵

Lastly, section 1327(b) provides that except as otherwise provided in a chapter 13 plan or an order of confirmation, confirmation of a plan vests all of the estate property in the debtor.³⁶ This section implements a major theme of chapter 13 by preserving to the debtor ownership, as well as possession, of all property, whether acquired before or during the chapter 13 case, except as otherwise required to effectuate the confirmed plan.³⁷

(b) Advantages of Chapter 13

Chapter 13 offers individuals a number of advantages over liquidation under chapter 7. Perhaps most significantly, chapter 13 offers individuals an opportunity to save their homes from foreclosure.³⁸ By filing under this chapter, individuals can stop

³⁰ 11 U.S.C. § 1302(a)(2).

³¹ 11 U.S.C. §§ 103(a), 541(a)(6), 1306(a).

³² See *In re Nahat*, 278 B.R. 108, 116 (Bankr. N.D. Tex. 2002).

³³ 11 U.S.C. 1306(a).

³⁴ 8 COLLIER ON BANKRUPTCY § 1306.02[4], at 1306-5 (Lawrence P. King ed., 15th ed. rev.).

³⁵ See *id.* at 1306-6.

³⁶ 11 U.S.C. 1327(b).

³⁷ *Id.*

³⁸ www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter13.html

foreclosure proceedings and may cure delinquent mortgage payments over time.³⁹ Nevertheless, they must still make all mortgage payments that come due during the chapter 13 plan on time.

Another advantage of chapter 13 is that it allows individuals to reschedule secured debts (other than a mortgage for their primary residence) and extend them over the life of the chapter 13 plan. Doing this may lower the payments.⁴⁰ Chapter 13 also has a special provision that protects third parties who are liable with the debtor on "consumer debts", which is known as the "co-debtor automatic stay." This provision may protect co-signers. The co-debtor stay is discussed extensively in the next section. Lastly, chapter 13 acts like a consolidation loan under which the individual makes the plan payments to a chapter 13 trustee who then distributes payments to creditors.⁴¹ Debtors will have no direct contact with creditors while under chapter 13 protection.

III. The Automatic Stay

One of the main benefits for a debtor filing a bankruptcy petition is obtaining the protection of the automatic stay provided in Section 362 of the Bankruptcy Code.⁴² The purpose of the automatic stay is to give the debtor some time for rehabilitation.

(a) Scope of the Stay

The automatic stay is broad in scope. The stay is applicable to all "entities," including governmental units.⁴³ The filing of the bankruptcy petition automatically stays the commencement or continuation of most judicial, administrative, or other proceedings against the debtor.⁴⁴

Filing the petition under chapter 13 "automatically stays" (stops) most collection actions against the debtor or the debtor's property.⁴⁵ Filing the petition does not, however, stay certain types of actions listed under 11 U.S.C. § 362(b), and the stay may be effective only for a short time in some situations. The stay arises by operation of law

³⁹ *Id.*

⁴⁰ www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter13.html

⁴¹ *Id.*

⁴² 11 U.S.C. § 362.

⁴³ 11 U.S.C. §§ 101(15), (27).

⁴⁴ 11 U.S.C. § 362.

⁴⁵ *Id.*

and requires no judicial action. As long as the stay is in effect, creditors generally may not initiate or continue lawsuits, wage garnishments, or even make telephone calls demanding payments. The bankruptcy clerk gives notice of the bankruptcy case to all creditors whose names and addresses are provided by the debtor.⁴⁶

(b) The Codebtor Automatic Stay

The commencement of a case filed under Chapter 13 operates as a stay of civil law collection actions against certain codebtors of the debtor.⁴⁷ Creditors are barred from attempting to collect a consumer debt from a non-business codebtor.⁴⁸ Pursuant to section 101(8) of the Bankruptcy Code, a “consumer debt” is defined as a “debt incurred by an individual primarily for a personal, family or household purpose.”⁴⁹ Unless sooner modified or terminated under section 362(c), the stay continues in effect until the chapter 13 case is closed, dismissed or converted to a chapter 7 or 11 case.⁵⁰ When a Chapter 13 case is closed, dismissed, or converted to Chapter 7 or 11, relief from the stay is automatically imposed.⁵¹

There are essentially three situations listed under section 1301(c) in which a creditor may obtain relief from the codebtor stay and they are as follows:

(i) Codebtor Received the Consideration

First, if the debtor was not really the primary obligor, i.e., between the debtor and the codebtor the latter received the consideration for the claim held by the debtor, the stay will be lifted as to the codebtor.⁵² However, when the debtor received a portion of the consideration in the transaction, relief from the stay will be granted.

(ii) Plan Does Not Propose to Pay Claim in Full

Secondly, relief from the stay may be obtained to the extent that the plan filed by the debtor does not propose to satisfy the creditor’s claim in full.⁵³ To the extent that full

⁴⁶ www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter13.html

⁴⁷ 11 U.S.C. § 1301.

⁴⁸ *Id.*

⁴⁹ 11 U.S.C. § 101(8).

⁵⁰ 11 U.S.C. § 1302(a)(2).

⁵¹ 11 U.S.C. § 1301(a)(2).

⁵² 11 U.S.C. § 1301(c)(1).

⁵³ 11 U.S.C. § 1301(c)(2).

payment is not proposed, a creditor may obtain relief from the codebtor stay, but only to the extent the claim is proposed not to be paid.⁵⁴ A creditor who seeks relief on this ground is given a procedural advantage by section 1301(d). The procedure set forth in subsection (d) dispenses with the necessity of obtaining a court order if neither the debtor nor codebtor, within 20 days, files and serves upon the party seeking relief a written objection. If such an objection is not timely filed and served, the codebtor stay with respect to the party requesting relief automatically terminates.

(iii) Irreparable Harm to Creditor's Interest

Lastly, relief may be obtained under section 1301(c)(3) if the creditor would suffer irreparable injury by continuation of the stay as to the codebtor. The creditor must show more than delay caused by the stay, such as the financial deterioration of the codebtor.⁵⁵

The creditor's substantive rights against the codebtor are not affected by the automatic stay.⁵⁶ Essentially, only the time and manner in which a creditor may collect payment are affected.⁵⁷ In addition, section 108(c) extends the statute of limitations on actions to collect against a codebtor by allowing a stayed creditor the greater of either: 30 days after the termination or expiration of the automatic stay; or the end of period of the applicable limitations time frame.⁵⁸ However, section 1301 "prevents a creditor with psychological security –that is, the leverage on the debtor resulting from the ability to pressure the debtor's relative, friend, or employer- from exerting undue influence to extract preferential treatment under the plan."⁵⁹

IV. Trustee's Role as Administrator

There must be a trustee in every Chapter 13 case. If the United States trustee appoints a standing trustee, that trustee serves; if no standing trustee is appointed, the

⁵⁴ *In re Schaffrath*, 214 B.R. 153 (B.A.P. 6th Cir. 1997).

⁵⁵ H.R. Rep. No. 595, 95th Cong., 1st Sess. 11 (1977).

⁵⁶ Treister, *Fundamentals of Bankruptcy Law*, at 339 (5th ed. 2004).

⁵⁷ *Id.*

⁵⁸ 11 U.S.C. § 108(c).

⁵⁹ Treister, *Fundamentals of Bankruptcy Law*, at 339 (5th ed. 2004).

United States trustee shall appoint a person to serve as trustee in the case.⁶⁰ The trustee's duties are enumerated in section 1302(b): the trustee is accountable for all property received; must ensure that the debtor shall perform the debtor's intention as specified in section 521(2)(B); investigate the debtor's financial affairs; if a purpose would be served thereby, examine and object to improper claims; oppose the discharge of the debtor if advisable; unless the court orders otherwise, furnish information concerning the estate and its administration as is requested by interested parties; and make and file a final report and account.⁶¹ In addition, the trustee must appear and be heard at any hearing concerning the value of property subject to a lien; the hearing on confirmation of a plan, or modification of a plan after confirmation. The trustee is to advise (other than on legal matters) and assist the debtor in performance under the plan.⁶²

(a) Duties of Chapter 13 Trustee

Notwithstanding a few exceptions, a chapter 13 trustee is required to perform most of the duties imposed upon a chapter 7 trustee in a liquidation case.⁶³ Since the debtor usually remains in possession of the estate property, the chapter 13 trustee is not required to collect or reduce to money all property of the estate, which is normally achieved by a chapter 7 trustee in a liquidation case.⁶⁴ Moreover, chapter 13 does not generally contemplate the liquidation of property of the estate.⁶⁵ Unlike in a chapter 7 case, a chapter 13 trustee is not required to ensure that the debtor performs intentions with respect to secured debts set forth in its statement filed under section 521(2)(B). Further, the debtor, rather than the trustee, is required to file reports and summaries of the operation of the business of a debtor engaged in business.⁶⁶

The chapter 13 trustee must make sure that the debtor begins making payments to creditors no later than 30 days after filing of the plan, unless otherwise ordered by the

⁶⁰ 11 U.S.C. § 1302(a).

⁶¹ 11 U.S.C. §§ 704, 1302(b)(1).

⁶² 11 U.S.C. § 1302(b).

⁶³ 11 U.S.C. §§ 704, 1302(c).

⁶⁴ *Id.*

⁶⁵ 8 COLLIER ON BANKRUPTCY § 1302.03, at 1302-8 (Lawrence P. King ed., 15th ed. rev.).

⁶⁶ 11 U.S.C. § 1304(c).

Court.⁶⁷ Additionally, the chapter 13 trustee is required to send notices to the obligee and the state child support enforcement agency of any domestic support obligation debts of the debtor.⁶⁸

(i) Account for Property Received

The chapter 13 trustee is to account for all property received during the administration of the chapter 13 case.⁶⁹ A chapter 13 plan must provide for the submission to the control of the trustee of whatever portion of the future income of the debtor is required to effectuate the plan.⁷⁰ All such income received from the debtor by the chapter 13 trustee must be accounted for and distributed to creditors pursuant to a confirmed chapter 13 plan. A chapter 13 plan may provide for the payment of claims against the debtor, in whole or in part, from property of the estate or of the debtor.⁷¹ Essentially, the chapter 13 trustee is accountable for any such property in the event a confirmed chapter 13 plan calls for its distribution or liquidation by the trustee in complete or partial satisfaction of a claim against the debtor. In that regard, Bankruptcy Rule 2015(a)(2) requires a chapter 13 trustee to keep a record of all receipts and the disposition of money and property received throughout the duration of the chapter 13 plan.⁷² A chapter 13 trustee is liable for monies or property improperly distributed, which could include distributions paid to the wrong creditor or distributions that should not have been made at all.

(ii) Investigate Financial Affairs of Debtor

The chapter 13 trustee is required to investigate the financial affairs of the debtor.⁷³ The trustee generally investigates the financial affairs of the debtor to be equipped with knowledge to fulfill its duties with regard to confirmation and/or modification of the plan.⁷⁴ An investigation into the financial affairs of the debtor is

⁶⁷ 11 U.S.C. § 1302(b)(4) & (5).

⁶⁸ 11 U.S.C. § 1302(b)(6).

⁶⁹ 11 U.S.C. §§ 704(2) , 1302(b)(1).

⁷⁰ 8 COLLIER ON BANKRUPTCY § 1302.03[1][a], at 1302-9 (Lawrence P. King ed., 15th ed. rev.).

⁷¹ 11 U.S.C. § 1322(b)(8).

⁷² Bankr. R. 2015.

⁷³ 11 U.S.C. § 704(a)(4).

⁷⁴ 11 U.S.C. §§ 1302(b)(2)(B), 1325(a).

regularly conducted when a trustee believes a chapter 13 plan was proposed in bad faith or if a proposed plan is not feasible.⁷⁵

(iii) Examine and Object to Claims

Section 704(a)(5) directs a trustee to examine proofs of claims and to object to the allowance of claims the trustee believes to be improper.⁷⁶ A chapter 13 trustee may assert defenses and counterclaims on behalf of the debtor and may also use the avoiding powers provided by chapter 5 of the Code.⁷⁷

(iv) Oppose Discharge

If advisable, the chapter 13 trustee is to oppose the discharge of the debtor.⁷⁸ Chapter 13 provides two types of discharge, which includes the full compliance discharge and a hardship discharge.⁷⁹ Generally, a trustee has no grounds to oppose a full compliance discharge under 1328(a) once the debtor has completed all payments and requirements under the chapter 13 plan.⁸⁰ However, when a debtor seeks a “hardship discharge” under 1328(b) the chapter 13 trustee may oppose the allowance of a “hardship discharge”, if: (1) the failure of the debtor to complete the payments was due to circumstances for which the debtor should justly be held accountable, (2) it is practicable to modify the plan or (3) the holders of allowed unsecured claims have received less under the chapter 13 plan than they would have received in a chapter 7 liquidation case.⁸¹

(v) Provide Information Regarding the Estate

But for a few exceptions, the chapter 13 trustee is generally required to provide information concerning the estate to any party in interest, if requested.⁸² This information usually includes the status of the plan and/or the status of the debtor’s progress in performance under the chapter 13 plan.

(vi) Final Report and Accounting

⁷⁵ *Id.*

⁷⁶ 11 U.S.C. § 704(a)(5).

⁷⁷ 8 COLLIER ON BANKRUPTCY § 1302.03[1][d], at 1302-14 (Lawrence P. King ed., 15th ed. rev.).

⁷⁸ 11 U.S.C. §§ 704(a)(6), 1302(b)(1).

⁷⁹ 11 U.S.C. § 1328.

⁸⁰ 11 U.S.C. § 1328(a).

⁸¹ 11 U.S.C. § 1328(b).

⁸² 11 U.S.C. §§ 704(a)(7), 1302(b)(1).

Similar to the duties of a liquidation trustee prior to the closing of a chapter 7 case, a chapter 13 trustee must prepare and file a final report and accounting after the chapter 13 case has been fully administered.⁸³ After this report has been filed, there is a presumption that the bankruptcy estate has been fully administered unless an objection is filed by the United States Trustee or an interested party within thirty days from the filing of the final report. If no objection is filed, the chapter 13 case is usually closed.

(vii) Advise Debtor on Financial Matters

A chapter 13 trustee is required to advise and assist the debtor in the preparation of a plan, to the extent that such counseling is financial rather than legal in nature.⁸⁴ The statutory mandate that the chapter 13 trustee advise the debtor on non-legal matters was designed to provide continuing counseling complementary to that available through the debtor's legal counsel. For example, some chapter 13 trustees conduct regular budgeting and/or consumer counseling classes, which a debtor is required to attend for a debtor to be eligible for a chapter 13 discharge.⁸⁵

(viii) Assist Debtor in Performance under the Plan

Pursuant to section 1302(b)(4), the chapter 13 trustee must assist the debtor in performance under a confirmed plan. The trustee is required to assist the debtor by advising of the means available to the debtor to fulfill the terms of the confirmed plan, including, but not limited to advice regarding matters such as reductions and suspensions of payments, post-petition collection attempts by creditors, postpetition credit issues and the assumption or rejection of executory contracts.⁸⁶

(ix) Assist in Valuation of Collateral

As set forth in section 1302(b)(2)(A), the chapter 13 trustee is to appear and be heard by the court on any hearing in relation to the valuation of property subject to a lien. Furthermore, a chapter 13 trustee usually is very knowledgeable in appraising various kinds of property commonly constituting collateral under a chapter 13 case. As such, an

⁸³ 11 U.S.C. § 704(a)(9).

⁸⁴ 11 U.S.C. § 1302(b)(4).

⁸⁵ 11 U.S.C. § 1328(g).

⁸⁶ 8 COLLIER ON BANKRUPTCY § 1302.03[1][j], at 1302-20 (Lawrence P. King ed., 15th ed. rev.).

experienced chapter 13 trustee can provide important assistance to the court in valuating collateral as required by section 506.

(x) Appear for Confirmation and Modification of Plan

Per section 1302(b)(2), the chapter 13 trustee is required to appear before the court for all hearings regarding confirmation of a proposed chapter 13 plan and any later hearing related to modification of a confirmed plan. The trustee has the power to object to a proposed plan under the ability-to-pay test and the right to request a modification of a confirmed plan.⁸⁷ Moreover, case law is well-settled that the duty to appear and be heard provides the trustee the power to object to any aspect of a chapter 13 plan that does not comply with the Bankruptcy Code.⁸⁸

(xi) Ensure Prompt Commencement of Payments

Under section 1307(c)(6), the chapter 13 trustee must monitor the debtor's payments under a confirmed plan, so that if there is a default in payments, the trustee can take appropriate action such as the filing of a motion to dismiss or convert the case to a chapter 7 liquidation. In addition, section 1326(a)(1) requires the trustee to make sure the debtor begins payments proposed by the plan within 30 days after the plan is filed. Moreover, the trustee has a duty to ensure that the debtor makes payments with respect to personal property leases and payments that provide adequate protection to creditors with purchase money security interest in personal property.⁸⁹

(xii) Provide Notices Regarding Domestic Support Obligations

Section 1302(b)(6) requires the trustee to provide specific notices in cases in which there is a claim against the debtor for a domestic support obligation.⁹⁰ This requirement applies when the debtor is the obligor on such an obligation, not an obligee. The 2005 Amendments to the Bankruptcy Code added this requirement to enhance the ability of child support claimants and state child support enforcement agencies to assert their claims in the bankruptcy case.

⁸⁷ 11 U.S.C. §§ 1325(b), 1329.

⁸⁸ *In re Davis*, 411 B.R. 225 (Bankr. D. Md. 2008) (citing *Andrews v. Loheit (In re Andrews)*, 49 F.3d 1404 (9th Cir. 1995).

⁸⁹ 11 U.S.C. § 1326(a)(1)(B) & (C).

⁹⁰ 11 U.S.C. § 101 (d) (defining "domestic support obligation").

V. Establishing Priority of Claims

Unless the court grants an extension, the debtor must file a repayment plan with the petition or within 15 days after the petition is filed.⁹¹ A plan must be submitted for court approval and must provide for payments of fixed amounts to the trustee on a regular basis, typically biweekly or monthly.⁹² The trustee then distributes the funds to creditors according to the terms of the plan, which may offer creditors less than full payment on their claims. There are three types of claims: secured, priority and unsecured.⁹³

(a) Secured Claims

Secured claims are those for which the creditor has the right to take back certain property (*i.e.*, the collateral) if the debtor does not pay the underlying debt. If the debtor wants to keep the collateral securing a particular claim, the plan must provide that the holder of the secured claim receive at least the value of the collateral. Any excess of the allowed claim over the value of the property securing the lien is an unsecured claim.⁹⁴ To the extent that the value of the property securing the lien exceeds the amount of an allowed secured claim, the allowed secured claim may be augmented to include interest and reasonable fees, costs and charges authorized under a contract.⁹⁵ If the obligation underlying the secured claim was used to buy the collateral (e.g., a car loan), and the debt was incurred within certain time frames before the bankruptcy filing, the plan must provide for full payment of the debt, not just the value of the collateral (which may be less due to depreciation).⁹⁶ Payments to certain secured creditors (*i.e.*, the home mortgage lender), may be made over the original loan repayment schedule (which may be longer than the plan) so long as any arrearage is made up during the plan.

⁹¹ Fed. R. Bank. P. 3015.

⁹² www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter13.html

⁹³ *Id.*

⁹⁴ *In re Powell*, 15 B.R. 465 (Bankr. N.D. Ga. 1981).

⁹⁵ 11 U.S.C. § 506(b); *see also United States v. Ron Pair Enters., Inc.*, 489 U.S. 235 (1989).

⁹⁶ 11 U.S.C. § 1325(a).

(b) Priority Claims under § 507

Priority claims are those granted special status by the bankruptcy law, such as most taxes and the costs of the bankruptcy proceeding.⁹⁷ The plan must pay priority claims in full unless a particular priority creditor agrees to different treatment of the claim or, in the case of a domestic support obligation, unless the debtor contributes all "disposable income" to a five-year plan.⁹⁸

The term "priority" is often used in the nonbankruptcy context to refer to the relative rights of two or more different secured parties who have perfected security interests in the same property. However, with certain limited exceptions, the elaborate scheme of priorities set forth in the Bankruptcy Code applies only to unsecured claims.⁹⁹ Generally, claims granted priority under the Bankruptcy Code remain subordinate in distribution to claims that are secured by a perfected lien against the debtor's property.¹⁰⁰ In this sense, liens have priority over unsecured priority claims.¹⁰¹

A grant of priority insures that distribution will be made on account of the particular claim before distribution to general, nonpriority unsecured creditors, thus increasing the likelihood that the priority claim will be paid in full.¹⁰² Priority status is afforded to claims specified in the applicable statute dealing with priorities without regard to the timeliness of the filing of those claims.

The first and most common exception to the general policy of equality of distribution in bankruptcy is the grant of priority to certain claims which, for reasons of policy, are regarded as meritorious or otherwise deserving of special status in bankruptcy proceedings. Under the Bankruptcy Code, the following unsecured claims are entitled to priority in distribution, generally in the following order:

- (1) domestic-support obligations and trustee's administrative expenses related to the collection of these obligations;

⁹⁷ *Id.*

⁹⁸ 11 U.S.C. § 1322(a).

⁹⁹ 11 U.S.C. § 507.

¹⁰⁰ *In re Darnell*, 834 F.2d 1263 (6th Cir. 1987).

¹⁰¹ *Id.*

¹⁰² *Id.*

- (2) administrative expenses and judicial fees and costs;
- (3) "involuntary-gap" claims;
- (4) claims for wages, salaries, commissions, and similar items;
- (5) claims for unpaid contributions to employee benefit plans;
- (6) claims for grain and fish assets;
- (7) claims for consumer deposits;
- (8) claims for taxes and customs duties and liabilities related to such claims;
- (9) claims for depository institution capital-maintenance commitments; and
- (10) claims for death or personal injury resulting from unlawful operation of motor vehicle or vessel due to intoxication.¹⁰³

The first priority in distribution is given to allowed unsecured claims for domestic-support obligations that, as of the date of the filing of the petition in a case under the Bankruptcy Code, are owed to or recoverable by a spouse, former spouse, or child of the debtor, or such child's parent, legal guardian, or responsible relative.¹⁰⁴ This priority is given without regard to whether the claim is filed by such person or is filed by a governmental unit on behalf of such person, on the condition that funds received under this provision by a governmental unit after the date of the filing of the petition shall be applied and distributed in accordance with applicable nonbankruptcy law.¹⁰⁵ Subject to these claims are allowed unsecured claims for domestic-support obligations that, as of the date of the filing of the petition are assigned by a spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative to a governmental unit (unless the obligation is assigned voluntarily for the purpose of collecting the debt) or are owed directly to or recoverable by a governmental unit under applicable nonbankruptcy law.¹⁰⁶ However, the funds received by a governmental unit after the date

¹⁰³ 11 U.S.C. § 507.

¹⁰⁴ 11 U.S.C. § 507(a)(1)(A).

¹⁰⁵ *Id.*

¹⁰⁶ 11 U.S.C. § 507(a)(1)(B).

of the filing of the petition must be applied and distributed in accordance with applicable nonbankruptcy law.¹⁰⁷

This subsection permits a Chapter 13 plan to subordinate and pay less than the full amount of a claim made priority by § 507(a)(1)(B), if the plan provides for the commitment of all of a debtor's disposable income to fund a plan over a full five-year period. This permits a plan to differentiate between domestic support obligations held by individuals and those owed to a governmental unit, such as where the ability to recover child support is assigned to a state when a custodial parent receives public welfare benefits.

The second priority in distribution is given to allowed administrative expenses and any fees and charges assessed against the estate under Chapter 123 of Title 28, which include United States trustee quarterly fees.¹⁰⁸ Generally, a claim will be accorded administrative priority in distribution if it is determined that: (1) the claim is a postpetition liability which was incurred by the estate; and (2) the claim was incurred in exchange for consideration which has benefited the estate.¹⁰⁹ A claim which arises entirely prepetition is not entitled to administrative priority.¹¹⁰ Postpetition expenses which primarily benefit a particular creditor are similarly denied priority status as administrative expenses.¹¹¹ Rather, administrative-expense status in distribution is granted only to those who either help preserve and administer the estate or assist with rehabilitation of the debtor to the benefit of all creditors.¹¹² Thus, a Chapter 13 debtor's counsel has been allowed an administrative expense as compensation for work that is beneficial and necessary to the debtor, without proof of benefit or necessity to the Chapter 13 estate or creditors.¹¹³ Other than the fees of the trustee and the debtor's

¹⁰⁷ 11 U.S.C. § 507(a)(1)(B).

¹⁰⁸ 11 U.S.C. § 507(a)(2).

¹⁰⁹ *In re Metro Fulfillment, Inc.*, 294 B.R. 306 (B.A.P. 9th Cir. 2003).

¹¹⁰ *In re Mr. D Realty Co.*, 27 B.R. 359 (Bankr. S.D. Ohio 1983).

¹¹¹ *In re O.P.M. Leasing Services, Inc.*, 56 B.R. 678 (Bankr. S.D. N.Y. 1986).

¹¹² *In re Tri-L Corp.*, 65 B.R. 774 (Bankr. D. Utah 1986).

¹¹³ *In re Argento*, 282 B.R. 108 (Bankr. D. Mass. 2002).

attorneys, most of the other types of administrative expenses set forth in § 503(b) would rarely occur in a chapter 13, except for a case filed by a debtor engaged in business.¹¹⁴

Nevertheless, priority claims enumerated in Code § 507 also include certain wage claims and claims for contributions to employee benefit plans, special claims concerning grain and fish storage and processing, consumer debts arising from the deposit of money, income taxes for which a return was due “after three years before the date of the filing of the petition,” property taxes, excise taxes, customs duties, penalties to the extent of actual pecuniary loss, and claims for death or personal injury resulting from the operation of a vehicle while intoxicated. Code § 1322(a)(2) requires payment in full of only claims entitled to the Code § 507 priority. This may include taxes incurred during the pendency of a previous case.¹¹⁵

(i) Payment of Priority Claims

The Chapter 13 plan must provide for full payment, in deferred cash payments, of all claims entitled to priority under Code § 507, other than priority claims of the type described in § 507(a)(1)(B) if the debtor is proposing a full five-year plan, unless the holder of a claim agrees to different treatment.¹¹⁶ The full payment of priority claims requirement has been strictly enforced by the courts: in the absence of agreement from the holder of a priority claim, the courts have refused to confirm Chapter 13 plans that do not provide for full payment of all priority claims.¹¹⁷ It has been held that a priority claim holder's failure to object to a plan which proposes a treatment other than that called for in § 1322(a)(2) constitutes an “agreement” to such other treatment.¹¹⁸

The failure of a claimant to raise an objection may result in a discharge of such obligation without payment under the plan if the plan terms so provide.¹¹⁹ The use of the phrase “in deferred cash payments” in Code section 1322(a)(2) has been interpreted by

¹¹⁴ 8 COLLIER ON BANKRUPTCY § 1300.73, at 1300-154 (Lawrence P. King ed., 15th ed. rev.).

¹¹⁵ *In re Pagnac*, 223 B.R. 185, (Bankr. D. Minn. 1998), *aff'd*, 228 B.R. 219 (B.A.P. 8th Cir. 1998).

¹¹⁶ 11 U.S.C. 1322(a)(2) and (4); *see also In re Turner*, 168 B.R. 882 (Bankr. W.D. Tex. 1994).

¹¹⁷ *Id.*

¹¹⁸ *In re Puckett*, 193 B.R. 842 (Bankr. N.D. Ill. 1996).

¹¹⁹ *In re Pardee*, 218 B.R. 916 (B.A.P. 9th Cir. 1998), *judgment aff'd*, 193 F.3d 1083, (9th Cir. 1999).

the courts to allow chapter 13 debtors to spread the payment of priority claims over the life of the plan.¹²⁰ The power to defer the payment of priority claims is an attractive feature of chapter 13, and it has been held that a chapter 13 debtor is not prohibited from proposing a chapter 13 plan for the purpose of dealing with priority tax claims.¹²¹

(c) Unsecured Claims

In contrast to secured claims, unsecured claims are generally those for which the creditor has no special rights to collect against particular property owned by the debtor.¹²² The plan need not pay unsecured claims in full as long it provides that the debtor will pay all projected "disposable income" over an "applicable commitment period," and as long as unsecured creditors receive at least as much under the plan as they would receive if the debtor's assets were liquidated under chapter 7.¹²³ In chapter 13, "disposable income" is monthly income (other than certain payments for the benefit of a child such as child support received by the debtor) less amounts reasonably necessary for the maintenance or support of the debtor or dependents and less charitable contributions up to 15% of the debtor's gross income.¹²⁴ If the debtor operates a business, the definition of "disposable income" excludes those amounts which are necessary for ordinary operating expenses.¹²⁵ The "applicable commitment period" depends on the debtor's current monthly income. The applicable commitment period must be three years if current monthly income is less than the state median for a family of the same size - and five years if the current monthly income is greater than a family of the same size.¹²⁶ The plan may be less than the applicable commitment period (three to five years) only if unsecured debt is paid in full over a shorter period.

VI. Conversion or Dismissal: When and Why?

Section 1307 provides for the conversion or dismissal to a different chapter of a chapter 13 bankruptcy case. Conversion or dismissal may be initiated by the debtor or

¹²⁰ *In re Bird*, 1994 WL 738644 (Bankr. D. Idaho 1994).

¹²¹ *In re Goeb*, 675 F.2d 1386 (9th Cir. 1982).

¹²² www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter13.html.

¹²³ 11 U.S.C. § 1325.

¹²⁴ www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter13.html.

¹²⁵ 11 U.S.C. § 1325(b)(2)(A) and (B).

¹²⁶ 11 U.S.C. § 1325(d).

upon motion by a party in interest such as a creditor or the trustee. A chapter 13 case may be commenced only on a voluntary basis by a debtor.¹²⁷ In the same regard, only the debtor may file a chapter 13 plan.¹²⁸ Section 1307 continues this voluntary theme by permitting the debtor to voluntarily convert a chapter 13 case to chapter 7 at any time.¹²⁹ Furthermore, section 1307 alternatively permits a debtor to dismiss its chapter 13 case.¹³⁰

As previously mentioned, a party in interest such as a creditor or the trustee may move for dismissal or conversion of a chapter 13 case to chapter 7 for “cause.”¹³¹ Examples of “cause” are listed in section 1307(c) of the Bankruptcy Code. In addition, dismissal may also be obtained on motion of a party in interest if the debtor fails to file a tax return required under section 1308.¹³²

(a) Conversion to Chapter 7

A chapter 13 debtor may convert its case to a chapter 7 liquidation case at any time. A debtor’s right to convert to a chapter 7 liquidation case may not be waived and is unqualified.¹³³ Section 1307(a) states that the debtor may convert a case to chapter 7 and it is unnecessary for the court to review the merits of the conversion because there are no preconditions on the debtor’s right to convert. Basically, once the notice of conversion is filed by the debtor, the conversion is automatic and the court cannot delay the debtor’s decision to convert its case to a chapter 7 liquidation.¹³⁴

(b) Procedure for Conversion to Chapter 7

Federal Bankruptcy Rule 1017(f) governs the procedure for conversion. Rule 1017 is clear that the debtor may convert to chapter 7 without a motion or court order. The debtor is required to file nothing more than a notice of conversion to initiate the conversion process.¹³⁵ Generally, new schedules are not required to be filed in the

¹²⁷ 11 U.S.C. § 303(a).

¹²⁸ 11 U.S.C. § 1321.

¹²⁹ 11 U.S.C. § 1307.

¹³⁰ *Id.*

¹³¹ 11 U.S.C. § 1307(d).

¹³² *Id.*

¹³³ 11 U.S.C. § 1307(e).

¹³⁴ 8 COLLIER ON BANKRUPTCY § 1307.02, at 1307-5 (Lawrence P. King ed., 15th ed. rev.).

¹³⁵ Fed. R. Bankr. P. 1017(f).

converted case unless directed by the court to do so.¹³⁶ However, the debtor is required to file a supplemental schedule of debts that shows debts that have arisen since the chapter 13 case was filed.¹³⁷ This filing is required because these debts are dischargeable in the converted case.¹³⁸

New deadlines are issued in the chapter 7 converted case for filing claims and objecting to discharge.¹³⁹ Notably, claims actually filed in the chapter 13 case are deemed filed in the chapter 7 case.¹⁴⁰ Soon after the notice of conversion is filed, the chapter 13 trustee must turn over to the chapter 7 trustee all records of the estate and nonexempt property.¹⁴¹ Usually, the chapter 7 trustee will not desire possession, since the property will not be property of the estate.¹⁴² If the conversion order is entered after confirmation of a chapter 13 plan, the debtor must file a schedule of unpaid debts incurred after confirmation and before conversion.¹⁴³ Also, a schedule of executory contracts entered into or assumed after the filing of the chapter 13 petition and before the conversion to the chapter 7 case must be filed in the converted case.¹⁴⁴

(c) *Right of Debtor to Dismiss Chapter 13 Case Originally Commenced Under Chapter 13*

In a case originally filed as a chapter 13 case, the debtor is entitled to obtain a dismissal of the chapter 13 case at any time.¹⁴⁵ Comparatively, in a case originally commenced under chapter 7, chapter 11 or chapter 12, which is subsequently converted to a chapter 13, the debtor does not have the unqualified right of dismissing the chapter 13 case. A debtor's right to a dismissal of a chapter 13 case originally commenced in chapter 13 cannot be waived, nor may it be denied by the court.

¹³⁶ Fed. R. Bankr. P. 1019(1)(A).

¹³⁷ Fed. R. Bankr. P. 1019(5)(B).

¹³⁸ *Id.*

¹³⁹ Fed. R. Bankr. P. 1019(2)-(3).

¹⁴⁰ *Id.*

¹⁴¹ Fed. R. Bankr. P. 1019(4).

¹⁴² 8 COLLIER ON BANKRUPTCY § 1307.02, at 1307-7 (Lawrence P. King ed., 15th ed. rev.).

¹⁴³ Fed. R. Bankr. 1019(5).

¹⁴⁴ *Id.*

¹⁴⁵ 11 U.S.C. § 1307(b).

Federal Rule of Bankruptcy Procedure 1017(f)(2) provides the procedure for dismissal as a matter of right under section 1307(b). The chapter 13 debtor may initiate the dismissal by way of the filing of a motion.¹⁴⁶ However, since there is no right to contest the dismissal, no hearing is required as set forth in Bankruptcy Rule 9014. Unless the court has reason to believe that the case was not originally filed as a chapter 13 case, the court must enter the dismissal order immediately upon the filing of the motion.

(d) Dismissal of Chapter 13 Case Originally Filed Under Another Chapter

There is no absolute right on the part of the debtor to have its chapter 13 case converted to a chapter 7 case, if the debtor's case was initially filed under another chapter other than chapter 13, i.e., chapter 7, 11, or 12.¹⁴⁷ However, the debtor, a creditor or the chapter 13 trustee may request dismissal or conversion of the chapter 13 case by way of motion. After a motion is filed with the court, notice is given and a hearing held, the court may dismiss or convert the case to chapter 7, or to chapter 11 or chapter 12 prior to the confirmation of a chapter 13 plan.¹⁴⁸

(e) When Dismissal or Conversion Not Absolute Right

There are a number of situations when dismissal or conversion is not an absolute right.¹⁴⁹ In these situations, the debtor, a creditor or the chapter 13 trustee may file a motion with the Court requesting a dismissal or conversion of a chapter 13 case to chapter 7.¹⁵⁰ However, most courts have held that a bankruptcy court cannot dismiss a case on its own initiative under section 1307.¹⁵¹ The procedure for dismissals that are not a matter of right is governed by Rule 1017 of the Federal Rule of Bankruptcy Procedure. Notice and a hearing is required by Rule 1017 in all cases. Other than a motion to dismiss a case that is filed by a debtor as a matter of right, a motion to dismiss is treated by the rules as a contested matter under Rule 9014 of the Federal Rules of Bankruptcy Procedure. At a hearing on a motion to dismiss, it is imperative that a debtor opposing

¹⁴⁶ Fed. R. Bankr. P. 1017(f)(2).

¹⁴⁷ 11 U.S.C. § 1307(b).

¹⁴⁸ 11 U.S.C. § 1307(d).

¹⁴⁹ 11 U.S.C. § 1307(c).

¹⁵⁰ *Id.*

¹⁵¹ 8 COLLIER ON BANKRUPTCY § 1307.04, at 1307-10 (Lawrence P. King ed., 15th ed. rev.).

dismissal or conversion to controvert evidence submitted by the moving party.¹⁵² At such a hearing, if the court finds the debtor to be ineligible for chapter 13, the court has discretion to either dismiss or convert the case, depending on the best interests of the creditors and the estate.¹⁵³

Section 1307 sets forth eleven (11) specific acts or omissions which constitute grounds for the dismissal or conversion of a chapter 13 case to a chapter 7 case. The occurrences enumerated in subsections 1307(c)(1) through (11) are not exclusive.¹⁵⁴ In addition, the court has the authority to dismiss a chapter 13 case if the debtor is ineligible to file a chapter 13 case because of the failure to satisfy one or more of the many requirements set forth in section 109 of the Bankruptcy Code. Section 109 enumerates a number of requirements an individual must satisfy in order to become a chapter 13 debtor. Furthermore, courts have held that a chapter 13 case can be dismissed or converted if the case is not filed in good faith.¹⁵⁵ Moreover, 1307(e) states that a chapter 13 case can be dismissed for a debtor's failure to file tax returns with certain taxing authorities.

The eleven (11) occurrences, which constitute sufficient cause for the dismissal or conversion of a chapter 13 case to chapter 7, that are set out in section 1307 are as follows:

- (1) Unreasonable delay by the debtor; section 1307(c)(1);
- (2) Nonpayment of filing fees or other charges; section 1307(c)(2);
- (3) Failure to make timely filing of a plan; section 1307(c)(3);
- (4) Failure to commence making timely payments proposed in a plan; section 1307(c)(4);
- (5) Denial of confirmation and of additional time for filing another plan; section 1307(c)(5);
- (6) Material default under confirmed plan; section 1307(c)(6);

¹⁵² See *id.* at 1307-12.

¹⁵³ See *Rudd v. Laughlin*, 866 F.2d 1040 (8th Cir. 1989).

¹⁵⁴ 11 U.S.C. § 102(3).

¹⁵⁵ See *In re Love*, 957 F.2d 1350 (7th Cir. 1992); see also *In re Cabral*, 285 B.R. 563 (BAP 1st Cir. 2002).

- (7) Revocation of order of confirmation for fraud and denial of confirmation of a modified plan; section 1307(c)(7);
- (8) Termination of confirmed plan due to condition specified in plan; section 1307(c)(8);
- (9) Debtor's failure to file section 521 information (*i.e., schedules, statement of financial affairs, list of creditors, etc.*); 1307(c)(9) and (10);
- (10) Other cause, including lack of good faith; and
- (11) Failure to pay current domestic support obligations.

(e) Effect of Conversion

In general, the conversion of a chapter 13 case has the effect of vacating any order confirming a chapter 13 plan.¹⁵⁶ Importantly, debts incurred by the debtor after the filing of the chapter 13 petition, but before conversion to chapter 7 are dischargeable because they are treated as prepetition claims.¹⁵⁷ In addition, all property of the chapter 13 estate becomes property of the chapter 7 estate.¹⁵⁸ As such, property acquired by the debtor after the filing of the chapter 13 petition, but prior to the conversion order is not considered part of the bankruptcy estate in the chapter 7 case, except when a court finds that the case was converted in bad faith.¹⁵⁹

(f) Effect of Dismissal

The dismissal of a chapter 13 case does not affect the dischargeability in a subsequent bankruptcy case of debts that were dischargeable in the dismissed chapter 13 case, unless otherwise ordered by the court for cause.¹⁶⁰ A dismissal is without prejudice in refiling of the same and there is no limitation on filing a new chapter 13 case.¹⁶¹ Unless the court for cause orders otherwise, the dismissal of a chapter 13 case has the effect of undoing the case dismissed as concerns avoided transfers, voided liens, and the

¹⁵⁶ 8 COLLIER ON BANKRUPTCY § 1307.08, at 1307-28 (Lawrence P. King ed., 15th ed. rev.).

¹⁵⁷ 11 U.S.C. § 348(d).

¹⁵⁸ 11 U.S.C. § 348(f).

¹⁵⁹ *Id.*

¹⁶⁰ 11 U.S.C. § 349(a).

¹⁶¹ *Id.*

vesting of property of the estate.¹⁶² However, the sale of property to a good faith purchaser will not be undone.¹⁶³ The purpose of section 349 is to restore property rights to the same status as they were prior to the filing of the chapter 13 petition.¹⁶⁴ Accordingly, upon dismissal the trustee has the obligation of returning the debtor's property that was held by the trustee.

VII. Enforcement and Modification of Chapter 13 Plan

Section 321 of the Bankruptcy Code requires the debtor to file a proposed chapter 13 plan with the bankruptcy petition or within the period set by the Federal Rules of Bankruptcy Procedure.¹⁶⁵ The Federal Rules of Bankruptcy Procedure permit the debtor to file a chapter 13 plan as late as fifteen (15) days after the filing of the bankruptcy petition or as otherwise permitted by the court based on cause shown by the debtor.¹⁶⁶ The exclusive right of filing a chapter 13 plan is reserved for the debtor.¹⁶⁷ The chapter 13 trustee may advise and assist the debtor in preparing a plan, and the trustee may even provide a suggested form for the debtor to use for preparation and filing.¹⁶⁸ If the debtor fails to timely file a plan, such omission is sufficient cause for dismissal or conversion of the chapter 13 case to chapter 7. Nevertheless, a court has discretion to excuse noncompliance with this requirement under certain circumstances.¹⁶⁹

(a) Filing of Chapter 13 Plan

Pursuant to section 1321, the debtor is required to file a proposed plan either with the petition or within 15 days after filing the petition, or as otherwise permitted by the court. The chapter 13 debtor has the exclusive right to file a plan. Creditors may not file a plan under any circumstances.¹⁷⁰

(b) Contents of Chapter 13 Plan

¹⁶² 11 U.S.C. § 349(b).

¹⁶³ 8 COLLIER ON BANKRUPTCY § 1307.09, at 1307-31 (Lawrence P. King ed., 15th ed. rev.).

¹⁶⁴ *Id.*

¹⁶⁵ 11 U.S.C. §§ 301, 302 and 1321.

¹⁶⁶ Fed. R. Bankr. P. 3015(b).

¹⁶⁷ *See In re Spiser*, 232 B.R. 669 (Bankr. N.D. Tex 1999).

¹⁶⁸ Fed. R. Bankr. P. 3015(d).

¹⁶⁹ 11 U.S.C. § 1307(c)(3).

¹⁷⁰ Fed. R. Bankr. P. 3015(d).

Chapter 13 was designed to provide for the adjustments of debts of an individual with regular income through a repayment plan funded primarily from future income. Mandatory provisions required to be in a chapter 13 are set out in section 1322(a) and permissive provisions are set out in section 1322(b).

(i) Future Earnings or Income- § 1322(a)(1)

Section 1322(a)(1) requires that a chapter 13 plan must contain a provision that provides for the submission to the trustee of whatever future income or earnings of the debtor are necessary for fulfillment of the plan terms. To the extent the chapter 13 plan is to be funded from future income, the debtor must allow the trustee to take control of the debtor's future income that would satisfy the plan requirements. Generally, chapter 13 plans are funded out of the debtor's future income. However, a chapter 13 plan may propose to satisfy one or more claims from property of the estate or of the debtor.¹⁷¹ Alternatively, a chapter 13 plan may propose to make certain payments to be made directly to a creditor, rather than through the trustee.

All postpetition income from property of the estate and all earnings from postpetition services of the debtor are property of the chapter 13 bankruptcy estate. Furthermore, the debtor remains in possession of all of the assets of the bankruptcy estate, except as otherwise ordered by the court.¹⁷² The confirmation of the chapter 13 plan vests all of the bankruptcy estate property in the debtor, unless otherwise ordered by the court.

(ii) Treatment of Priority Claims- § 1322(a)(2)

Pursuant to section 1322(a)(2), a chapter 13 plan must propose to pay in full all priority claims, unless a priority claim holder consents to something different or if the priority claim is a domestic support obligation that has been assigned to a governmental unit or is owed directly to a governmental unit. If one of the above exceptions is applicable, the debtor need not pay that obligation in full as long as the chapter 13 plan provides that all of the debtor's disposable income over the five years will be committed to the plan. Generally, debtors wish to pay priority claims in advance of other unsecured

¹⁷¹ 11 U.S.C. § 1322(b)(8).

¹⁷² 11 U.S.C. § 1306(b).

creditors. However, it is usually to the debtor's advantage to pay secured claims prior to unsecured priority claims because a debtor can be required to pay present value interest on some secured claims. Unsecured priority claims usually do not accrue postpetition interest.

(iii) Same Treatment of All Claims Within a Class- § 1322(a)(3)

Pursuant to section 1322(a)(3), the debtor must propose the same treatment of each claim within a particular class of unsecured creditors designated under section 1322(b)(1). A chapter 13 plan cannot treat creditors within the same class differently nor may a plan place creditors with similar claims in different classes.

(iv) Designation of Different Classes of Unsecured Claims- § 1322(b)(1)

As set out by section 1322(b)(1), a debtor may establish one or more classes of unsecured claims as long as the creditors within each class have claims that are substantially similar. Furthermore, a chapter 13 plan cannot unfairly discriminate against any class of claims.¹⁷³ However, section 1322(b)(1) does permit a debtor to separately classify and treat differently a consumer debt, if there is a codebtor liable on such debt with the debtor. Although a debtor may separate nondischargeable debts into a class separate from other unsecured claims because it furthers the debtor's legitimate interest in not being burdened with substantial nondischargeable debt at the completion of the plan.¹⁷⁴

(v) Modification of Rights of Secured Creditors- § 1322(b)(2)

Pursuant to section 1322(b)(2), a chapter 13 plan may modify the rights of the holder of a secured claim, unless said claim is secured by a security interest only in real property that is the principal residence of the debtor. However, if a creditor is secured by a security interest in the principal residence of the debtor plus additional collateral, the rights of the secured creditor may be modified in a chapter 13 plan.¹⁷⁵ The chapter 13 plan may modify terms such as the amount to be paid on the claim, the timing of the payments, and the applicable interest rate. The debtor may decide to provide for one or

¹⁷³ 11 U.S.C. § 1122(a).

¹⁷⁴ *In re Tucker*, 159 B.R. 325 (Bankr. D. Mont. 1993).

¹⁷⁵ *In re Hammond*, 27 F.3d 52 (3d Cir. 1994).

more secured claims outside of the plan by making payment to the secured creditors directly.¹⁷⁶

(vi) Modification of Rights of Unsecured Creditors

A chapter 13 plan may modify the rights of holders of unsecured claims. The only restrictions on the modification of unsecured claims is that priority claims must be paid in full, unless their holders agree otherwise or section 1322(a)(4) applies; each unsecured claim of the same class are treated identical; the chapter 13 plan does not propose to unfairly discriminate against a certain class of unsecured claims; and each unsecured creditor has the opportunity to demand that it be paid no less than the amount it would receive in a chapter 7 liquidation case.¹⁷⁷

(vii) Cure or Waive Defaults- § 1322(b)(3)

Section 1322(b)(3) permits the inclusion in a chapter 13 plan of a proposal to cure or waive any default on a claim. Generally, this section relates to secured claims because proposals to cure or waive defaults are of little practical significance in relation to unsecured claims. Furthermore, a default with respect to a lien on a debtor's principal residence may be cured under section 1322(b)(3) notwithstanding section 1322(b)(2).

(viii) Cure Default on Long-Term Debt- § 1322(b)(5)

Section 1322(b)(5) allows a debtor to include a provision in the chapter 13 plan proposing to cure any default and to maintain payments during the pendency of the chapter case on any secured or unsecured claim on which the last payment is due after the due date of the final payment of the plan. This section allows the debtor to take advantage of the full term of the underlying debt obligation if it extends out further than the chapter 13 plan, which said plan may not exceed five years. By proposing to cure the default within a reasonable time, a debtor may continue and maintain the contract payments during the course of the plan without acceleration based upon a prepetition default. Even though the long-term debt is secured only by a security interest in real property that is the principal residence of the debtor, the debtor may take advantage of section 1322(b)(5). Generally, a long-term debt in which the debtor deals with by taking

¹⁷⁶ *In re Case*, 11 B.R. 843 (Bankr. D. Utah 1981).

¹⁷⁷ 11 U.S.C. §§ 1322, 1325

advantage of section 1322(b)(5) is excepted from discharge and the creditor's lien floats through the bankruptcy case intact.¹⁷⁸ The debtor's right to cure defaults on long-term debts applies to all long-term contracts. Section 1322(b)(5) is most commonly used in situations where there has been default on a residential mortgage and said section may be used to cure prepetition and postpetition defaults.¹⁷⁹ Importantly, the curing of defaults pursuant to section 1322(b)(5) is a separate right from the cramdown provision of section 1322(b)(2), which allows a debtor to modify the rights of a secured creditor by reducing total payout on the secured claim or in other ways.

(ix) Prepetition Acceleration or Judgment

A debtor's plan may provide for curing a default notwithstanding a prepetition acceleration of the debt.¹⁸⁰ The Fifth Circuit has held that even though a debt had been accelerated or had been merged into a judgment, it was still a claim upon which the last payment was due after the due date for the final plan payment.¹⁸¹ Furthermore, section 1322(c)(1) provides that notwithstanding section 1322(b)(2) and applicable nonbankruptcy law, a default with respect to, or that gave rise to, a lien on the debtor's principal residence may be cured under section 1322(b)(3) or (5) until the residence is sold at a foreclosure sale.

(x) Postpetition Claims- § 1322(b)(6)

Pursuant to section 1322(b)(6), a chapter 13 debtor may propose to make payment of all or part of any postpetition tax claim or of any consumer debt claim incurred after the filing of the bankruptcy petition. However, the debtor is not required to provide for postpetition claims in a plan because section 1322(b)(6) is optional like the other provisions of section 1322(b).

(xi) Executory Contracts or Unexpired Leases- § 1322(b)(7)

Section 1322(b)(7) provides that the debtor may assume, reject or assign an executory contract or unexpired lease under the plan, if the chapter 13 trustee has not yet

¹⁷⁸ 11 U.S.C. § 1328.

¹⁷⁹ *In re Mendoza*, 11 F.3d 1264 (5th Cir. 1997).

¹⁸⁰ *Grubbs v. Houston First Am. Sav. Ass'n*, 730 F.2d 236 (5th Cir. 1984).

¹⁸¹ *Id.*

rejected the same prior to confirmation under section 365(d)(2). Usually, an executory contract or lease may be assumed by a debtor if the debtor has any remaining rights under the same. If the debtor must cure a default in order to assume the contract or lease, the amount required to cure is calculated pursuant to the underlying contract and/or applicable nonbankruptcy law.¹⁸² Generally, a residential lease may be assumed despite a prepetition judgment for possession in favor of the lessor, as long as the debtor has not lost all rights to possession of the premises, which depends on applicable state law. This normally occurs when there has been an execution of a writ possession.¹⁸³

(xii) Payment of Claims from Estate or Debtor- § 1322(b)(8)

A chapter 13 debtor may propose in a plan to pay all or part of a claim against the debtor out of property of the bankruptcy estate or property of the debtor, which would include property of the estate that is exempt under section 522. Pursuant to section 1322(b)(8), a debtor may convey or liquidate and transfer the proceeds from the sale of property of the estate or property of the debtor to a creditor holding a claim against the debtor. Moreover, a debtor is permitted to file a chapter 13 plan that proposes liquidation of property of the estate or property of the debtor, not necessarily from future earnings or future income.¹⁸⁴

(xiii) Vest Property of the Estate- § 1322(b)(9)

Pursuant to section 1322(b)(9), a chapter 13 plan may propose to vest property of the estate in the debtor or in another entity at the date of confirmation or at a later date. Section 1327(b) vests all property of the bankruptcy estate in the debtor upon confirmation of the plan by operation of law unless either the confirmed plan or the order confirming the plan provides otherwise. Section 1322(b)(9) permits the debtor to provide for the vesting of property of the estate in any entity, including the debtor or the chapter 13 trustee. A plan may provide that the property of the estate will not vest in the debtor until the case is closed.

¹⁸² 8 COLLIER ON BANKRUPTCY § 1322.11[1], at 1322-46 (Lawrence P. King ed., 15th ed. rev.).

¹⁸³ *In re Stolz*, 197 F.3d 625 (2d Cir. 1999).

¹⁸⁴ *In re Lapin*, 302 B.R. 184 (Bankr. S.D.Tex. 2003) (plan funded from debtor's IRA account).

(xiv) Payment of Interest on Unsecured Claims- § 1322(b)(10)

Section 1322(b)(10) allows debtors to pay accruing interest on unsecured claim that are nondischargeable under section 1328(a) if the debtor has disposable income available to pay such interest after making provision for full payment of all allowed claims. Debtors may want to take advantage of this provision to pay accruing postpetition interest on such claims in order to avoid a large accumulation of interest at the conclusion of the chapter 13 plan. Section 1322(b)(10) requires that a chapter 13 plan provide for full payment of all allowed claims; however, this section does not require that all allowed claims actually be paid before interest can be paid on nondischargeable claims. Interest on the nondischargeable claims can be paid before, concurrently with or after the other allowed claims, as long as the plan provides for full payment of those other claims.¹⁸⁵

(xv) Duration of Chapter 13 Plan- § 1322(d)

Pursuant to section 1322(d)(1), a debtor must propose a chapter 13 plan that has a five year commitment period if (1) the trustee or the holder of an allowed unsecured claim objects to confirmation, (2) the plan does not provide for payment in full of allowed unsecured claims over a shorter period and (3) the current monthly income of the debtor and the debtor's spouse combined is over specified state median family income thresholds.¹⁸⁶

For debtors whose current monthly income is below the applicable state median family income threshold set forth in section 1322(d)(2), these debtors must obtain court approval of a plan that proposes payments over a period in excess of three years and the plan may not propose payments over a period in excess of five years.¹⁸⁷ It has been held that the five year maximum period for plan payments does not commence until confirmation of the plan.¹⁸⁸

¹⁸⁵ 8 COLLIER ON BANKRUPTCY § 1322.13A, at 1322-52 (Lawrence P. King ed., 15th ed. rev.).

¹⁸⁶ 11 U.S.C. 101 (defining "current monthly income" and "median family income").

¹⁸⁷ *Id.*

¹⁸⁸ *West v. Costen*, 826 F.2d 1376 (4th Cir. 1987).

(c) Confirmation of Chapter 13 Plan

(i) Confirmation Hearing

Section 1324(a) of the Bankruptcy Code states that the court shall hold a hearing on the confirmation of chapter 13 plan. The only hearing that the court is required to conduct in a chapter 13 case is the confirmation hearing required by section 1324. Notably, section 524(d) allows the court to conduct a discharge hearing in any chapter 13 case in which the debtor is granted or denied a discharge. In addition, section 524(d) requires the court to conduct a hearing if the debtor desires to reaffirm a debt and is not represented by an attorney in negotiating the reaffirmation agreement.

(ii) Right to Object to Confirmation

Section 1324(a) states any party in interest including any secured or unsecured holder of an allowed claim may object to confirmation of a chapter 13 plan. Also, the chapter 13 trustee has standing to be heard regarding confirmation of the plan.¹⁸⁹ Sufficient basis for which to object to confirmation includes an objection based on any material way in which the plan is not in compliance with section 1325, or any other provision of chapter 13 or any other applicable provision of Title 11.¹⁹⁰ A creditor's right to object to confirmation of the plan is generally a creditor's only opportunity to contest the debtor's treatment and possible discharge at any other time.¹⁹¹

(d) Evaluation of Proposed Plan by Unsecured Creditor

The debtor must file a proposed plan along with the petition or at least within 15 days thereafter. The unsecured creditor, upon receipt of the proposed plan, should promptly review the plan to determine the debtor's stated intentions with regard to its claims.

(i) Best Interest of Creditors Test

The plan qualifies for confirmation only if the payments offered unsecured creditors have a value, as of the effective date of the plan, of not less than the amount the

¹⁸⁹ 28 U.S.C. § 586(a)(3)(C).

¹⁹⁰ 11 U.S.C. § 1325(a)(1).

¹⁹¹ 11 U.S.C. §§ 727(c), 1328.

unsecured creditors would receive if the debtor were liquidated under chapter 7.¹⁹² However, the “best interests of creditors test” provides little to no protection for unsecured creditors. Generally, the liquidation of chapter 13 debtor’s assets under chapter 7 would yield no dividend for unsecured creditors. In a chapter 7 liquidation, secured creditors would be paid the full amount of their claims, then the expenses of the bankruptcy case would be paid in full, the other priority creditors would be paid in full and only the remaining balance, if any, would be distributed to general unsecured creditors. In the vast majority of chapter 7 cases, there is no distribution to unsecured creditors. Therefore, a chapter 13 debtor could propose a plan that offers no payments to unsecured creditors and the plan would still meet the “best interests of creditors test.” In the rare case in which the debtor’s property could be liquidated in chapter 7 for more than enough to pay creditors in full, creditors are entitled to interest on their claim at the legal rate.¹⁹³ To determine whether such property exists, the place to begin is the debtor’s schedules. Further investigation might include a conversation with the chapter 13 trustee, oral examination of the debtor at the meeting of creditors, or a view of the property.

(ii) Disposable Income Test

Chapter 13 debtors who have projected income in excess of what is “reasonably necessary” to main themselves and their families must propose to pay the entire excess to creditors for a period of three to five years.¹⁹⁴ A debtor may devote less than all disposable income to payments under the plan only if the plan proposes to pay all creditors in full, with interest.

The starting point in assessing whether a plan complies with the disposable income test is the schedules of income and expenditures. In the schedules the debtor discloses the amount of its income and proposes the amounts to be reserved for living expenses. Any surplus of income over expenses must be offered to creditors under the plan. For calculating the required payment, “disposable income” includes exempt

¹⁹² 11 U.S.C. § 1324(a)(4)

¹⁹³ *Beguelin b. Volcano Vision, Inc.*, 220 B.R. 94 (B.A.P. 9th Cir. 1998).

¹⁹⁴ 11 U.S.C. § 1325(b).

property if it is in the form of a stream of payments.¹⁹⁵ Debtors who wish to minimize their payments to unsecured creditors generally have little difficulty preparing schedules that show no surplus. To challenge the payments offered under the plan, it is usually necessary to challenge the expenditures proposed in the schedules as not reasonably necessary to support the debtor, the debtor's family or the continued operation of the business.¹⁹⁶

(iii) Payments to Secured Creditors

Any reductions that can be achieved in the amounts of payments to secured creditors during the period of the plan will accrue directly to unsecured creditors. The main legal basis for reducing payments to secured creditors is the requirement that a plan be proposed in "good faith."¹⁹⁷ Reductions might be achieved through (i) reductions in the allowed amount of secured claims, (ii) stretching payments on secured claim over longer periods of time or (iii) elimination of secured claims through surrender of collateral.¹⁹⁸

(iv) Delayed Payments

A plan that proposes to pay secured creditors before unsecured creditors should be considered suspect even though secured creditors are usually thought of as having "priority" over unsecured creditors.¹⁹⁹ The risk is that the debtors, before paying the unsecured creditors, will resolve the problems that caused them to seek relief under chapter 13 and then convert the case to chapter 7 where the unsecured claims will be discharged. Holders of allowed unsecured claims can possibly avoid these issues by demanding that the plan provide for substantial payments to unsecured creditors beginning with the effective date of the plan.

¹⁹⁵ *In re Schnabel*, 153 B.R. 809 (Bankr. N.D. Ill. 1993).

¹⁹⁶ *In re Rimgale*, 669 F. 2d 426 (7th Cir. 1982).

¹⁹⁷ 11 U.S.C. § 1325(a)(3).

¹⁹⁸ LoPucki and Mirick, *Strategies for Creditors in Bankruptcy Proceedings* § 15.03, at 744 (5th ed. 2007).

¹⁹⁹ *See id.* at 745.

(e) Evaluation of Proposed Plan by Secured Creditor

Confirmation of a chapter 13 plan is binding on creditors, even if the plan provisions are clearly inadequate so that the plan should not have been confirmed.²⁰⁰ Accordingly, the secured creditor should review carefully the proposed treatment of the creditor's claim.

(i) Creditor Should Retain All Lien Rights

The secured creditor is entitled to have the plan provide that the creditor retain the lien securing the claim.²⁰¹ This provision in the proposed plan should be worded in a manner that would make certain that all of the terms of the security agreement will remain in effect, except as specifically modified by the plan. To potentially avoid a debtor's attempt to later classify a portion of the claim as unsecured, the plan should make clear that the entire amount of the debt is secured based on the value of the collateral. Lastly, the proposed plan should state that the lien will not be released unless and until the debtor completes all plan payments to all creditors under the plan. In this regard, section 1325(a)(5) sets forth that the chapter 13 plan may not be confirmed unless it provides that secured creditors shall retain their liens until the earlier of payment in full of the underlying debt as determined under applicable nonbankruptcy law or discharge of the debtor under section 1328, and that secured creditors retain their liens following conversion or dismissal of the case if the plan is not completed. In relation to purchase-money security interests, the chapter 13 plan, must also provide for payment in full if the debt was incurred in the prior year, or in the prior 910 days for motor vehicle loans.

(ii) Modification of Payment Schedule

If a chapter 13 debtor chooses to retain the collateral, but modify the original loan payment schedule, the proposed plan must offer the secured creditor payments that have a value, as of the effective date of the plan not less than the allowed amount of the secured claim.²⁰² Therefore, the plan must propose to pay the amount of the allowed secured claim as of the date of confirmation plus interest at the current market rate from the date

²⁰⁰ *In re Brenner*, 189 B.R. 121 (Bankr. N.D. Ohio 1995).

²⁰¹ 11 U.S.C. § 1325(a)(5)(B).

²⁰² *Id.*

of confirmation until the debt has been paid in full.²⁰³ The “current market rate” is usually the national prime rate plus a 1% to 3% adjustment.²⁰⁴ Section 1325(a)(5)(B) requires in effect that the creditor make a new loan to the debtor in the amount of the value of the collateral and entitles the creditor to interest on this loan at current market rates—a result referred to as a “cram down.”

To begin, a secured creditor should determine what the amount of the allowed secured claim will be at the date of confirmation. If the collateral is valued more than the amount of the underlying debt, that value will be the principal amount of the debt plus interest at the contract rate up to the date of confirmation and any reasonable attorneys’ fees and expenses of the creditor provided for in the security agreement of applicable nonbankruptcy law.²⁰⁵ On the other hand, if the value of the collateral is less than the amount of the underlying debt, then the secured claim is equal to only the value of the collateral as of the date of confirmation.²⁰⁶ The balance of the claim will be allowed as an unsecured claim and no pendency interest or attorneys’ fees will be allowed on either the secured or the unsecured portions of the claim.²⁰⁷ Once the value of the collateral has been determined, the creditor should determine whether the payments proposed have a present value, as of the date of confirmation, at least as great as the amount of the creditor’s allowed secured claim.

(iii) Reinstatement of Original Payment Schedule

A chapter 13 debtor has the option of proposing to cure any default under a repayment agreement, undo any acceleration of payments and reinstate the original payment schedule.²⁰⁸ A debtor may elect to use this option if: (i) the debtor cannot pay the entire amount of the debt within a three to five year period of a chapter 13 plan and the debtor desires to repay the debt over a longer period of time; (ii) the interest rate on the original loan is below the current market rate; or (iii) the claim is only secured by a

²⁰³ *Id.*; see also *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004).

²⁰⁴ See *id.* at 479.

²⁰⁵ 11 U.S.C. § 506(b).

²⁰⁶ *In re Davis*, 215 B.R. 824 (Bankr. N.D. Tex. 1997).

²⁰⁷ 11 U.S.C. § 506(b).

²⁰⁸ 11 U.S.C. § 1322(b)(3) and (5).

security interest on the principal residence of the debtor and therefore, the debtor cannot reschedule payments on the claim.²⁰⁹

The chapter 13 debtor who elects to reinstate must propose in the plan to resume, as of the date of confirmation, making the monthly payments required by the original loan agreement and to cure any default by paying arrearages within a reasonable time.²¹⁰ The amount of arrearage that is determined to be due and owing as of the date of confirmation should include interest on the entire debt calculated at any default rate specified in the original loan agreement and any late charges as required by the agreement.²¹¹

(iv) Security Interest Only in Debtor's Principal Residence

As previously discussed, section 1322(b)(2) prohibits modification of the rights of an allowed secured claim holder in which its claim is secured only by the debtor's principal residence. Based on this provision, debtors are encouraged to reinstate the mortgage by curing any defaults and continuing payments on the debt under the original repayment schedule. The purpose of this provision is to protect mortgage lender's rights, which includes the rights of junior lien holders. However, courts have consistently held that a junior lien that is wholly unsecured may be stripped from the collateral.²¹² The United States Supreme Court has held that section 1322(b)(2) prohibits plans that attempt to modify the unsecured portions of principal residence mortgages.²¹³ However, if the mortgage is secured by the debtor's principal residence and other collateral, the mortgage holder is not entitled to protection under section 1322(b)(2).²¹⁴ Furthermore, section 1322(c) allows modification of a principal residence mortgage if the last payment under the original contract is due before the last payment under the bankruptcy plan.

²⁰⁹ 11 U.S.C. § 1322(b)(2) and (5).

²¹⁰ *Id.*

²¹¹ LoPucki and Mirick, *Strategies for Creditors in Bankruptcy Proceedings* § 16.08(c), at 827 (5th ed. 2007).

²¹² *Pond v. Farm Specialist Realty*, 252 F.3d 122 (2d Cir. 2001) (discussing collection of cases).

²¹³ *Nobleman v. American Sav. Bank*, 508 U.S. 324 (1993).

²¹⁴ *Wilson v. Commonwealth Mtg. Corp.*, 895 F. 2d 123 (3d Cir. 1990).

(v) Timing of Payments to Other Creditors

A secured creditor should object to confirmation of a chapter 13 plan that proposes to pay secured creditors on payment schedules that begin only after the debtor has made one or more payments to other claim holders. Secured creditors have been successful in resisting such proposals.²¹⁵

(vi) Feasibility of Debtor Making Payments Under Plan

To confirm a plan, the court must find that the debtor will be able to make all payments under the plan and comply with the plan provisions.²¹⁶ The plan may not meet this feasibility requirement if it is based on the debtor's proposed plan to sell or refinance collateral, if the debtor's income is not sufficiently regular to enable the debtor to make the payments, or if the debtor has not presented to the court a budget demonstrating that sufficient income is available.²¹⁷

(vii) Payments Made Outside the Plan

A proposed chapter 13 plan generally provides that the debtor's payments will be made directly to the chapter 13 trustee.²¹⁸ Ordinarily, the trustee keeps a fixed percentage (usually 8% to 10%) of the payments as compensation for the trustee's services and reimbursement of expenses. Thereafter, the trustee distributes the balance to creditors. Debtors have the ability to propose payments to specific creditors outside of the plan to reduce the amount of the fees payable to the trustee.²¹⁹ This occurs often in relation to the debtor's payments to its home mortgage claim holder. If the plan is confirmed by the court as proposed with payments to be made directly to a creditor, the trustee's fixed percentage does not apply to the specific payment made to directly to the creditor because they are not actually received by the trustee.²²⁰ A secured creditor could possibly avoid

²¹⁵ *Money, Inc. v. Begley*, 7 B.R. 108 (Bankr. S.D. Ohio 1980); see also *In re Gavia*, 24 B.R. 573 (B.A.P. 9th Cir. 1982).

²¹⁶ 11 U.S.C. § 1326(a)(6).

²¹⁷ LoPucki and Mirick, *Strategies for Creditors in Bankruptcy Proceedings* § 16.08(F), at 831 (5th ed. 2007)(citing *First Nat'l Bank of Boston v. Fantasia*, 211 B.R. 420 (B.A.P. 1st Cir. 1997); *In re Tucker*, 34 B.R. 257 (Bankr. W.D. Okla. 1983)).

²¹⁸ 11 U.S.C. § 1322(a).

²¹⁹ *In re Aberegg*, 961 F.2d 1307 (7th Cir. 1992).

²²⁰ *In re Wright*, 82 B.R. 422 (Bankr. W.D. Va. 1988).

problems that ensue when the debtor makes timely payment to the trustee, but the trustee fails to timely convey the payment to the creditor.²²¹ A secured creditor should take into consideration its future relations with the trustee when deciding whether to cooperate with the debtor's attempt to reduce the trustee's fees.²²²

(f) Modification of Confirmed Chapter 13 Plan

The weakening of the debtor's financial condition during the pendency of the chapter 13 plan generally leaves only four options, which are as follows: (i) conversion; (ii) application for a hardship discharge; (iii) dismissal; or (iv) modification of the chapter 13 plan.²²³ Rule 3015(g) of the Federal Rules of Bankruptcy Procedure prescribes the procedure for modification after confirmation of a chapter 13 plan. Any time after confirmation and before completion of plan payments, the debtor, the trustee or the holder of an allowed unsecured claim may file a motion with the court requesting the plan be modified.²²⁴ A plan may be modified by altering plan payments to a specific class, extending or reducing the time for payments to be made, by altering the distribution to a creditor to take into account any payment received by the specific creditor outside the plan or plan payments may be reduced for purposes of purchasing health insurance for the debtor and dependents.²²⁵ Furthermore, a modified plan is subject to the same time restrictions as an initial plan.²²⁶ Generally, a plan is modified if after notice and a hearing said proposed modification is approved by the court.²²⁷

(i) Debtor May Request Modification

A confirmed plan may be modified by the debtor under certain circumstances after notice and hearing and prior to completion of plan payments.²²⁸ A debtor may desire to modify a confirmed chapter 13 plan for a wide array of reasons. A debtor may wish to modify a plan by reducing plan payments based on a decrease in income after

²²¹ *In re Foster*, 670 F.2d 478 (5th Cir. 1982).

²²² LoPucki and Mirick, *Strategies for Creditors in Bankruptcy Proceedings* § 16.08(G), at 832 (5th ed. 2007).

²²³ 11 U.S.C. §§ 1307, 1328(b), 1329(a).

²²⁴ 11 U.S.C. § 1329.

²²⁵ *Id.*

²²⁶ *Id.*

²²⁷ 11 U.S.C. § 1329(b)(2).

²²⁸ 11 U.S.C. §§ 1322 and 1323.

confirmation of the plan.²²⁹ Also, a debtor may default in mortgage payments postpetition and said debtor may seek to modify the chapter 13 plan to provide for a cure of the default. In addition, a debtor may seek a modification of a plan based on the surrendering of collateral which results in the creditor being unsecured.

Section 1329 of the Bankruptcy Code does not require a debtor to show cause in order to modify a confirmed plan. However, the chapter 13 trustee or a party whose rights are negatively affected by the requested modification may object to the modification on the grounds that the modification renders the plan out of compliance with the requirements for plan confirmation.²³⁰

(ii) Trustee or Unsecured Creditor May Request Modification

Section 1325(b) provides for a trustee or an unsecured creditor to request a modification of a debtor's chapter 13 plan. However, a secured creditor may not request for modification of a plan.²³¹ With regard to the right of a trustee or unsecured creditor, it is limited to situations in which there has been a significant change in the debtor's income or expenses, which said change was unanticipated and not apparent at the time of the confirmation hearing. The party moving for modification bears the burden of proving that there has been a substantial change in the debtor's ability to make payments since the initial confirmation hearing. Furthermore, the moving party must show that the prospect of the change was unanticipated prior to the confirmation hearing.²³² It is possible that a court could decide to increase a debtor's plan payments based on a significant and unanticipated increase in the debtor's income. Section 1325(b) provides that the debtor's ability to pay is determined by the debtor's "currently monthly income." "Currently monthly income" is based on a calculation involving the debtor's income during the six month period prior to the filing of the bankruptcy petition.²³³

²²⁹ *In re Mendoza*, 111 F.3d 1264 (5th Cir. 1997).

²³⁰ 8 COLLIER ON BANKRUPTCY § 1329.02, at 1329-5 (Lawrence P. King ed., 15th ed. rev.).

²³¹ *In re Szostek*, 93 B.R. 399 (Bankr. E.D. Pa. 1988), *aff'd*, 886 F.2d 1405 (3d Cir. 1989).

²³² *In re Euerle*, 70 B.R. 72 (Bankr. DN.H. 1987).

²³³ 11 U.S.C. § 101.

(g) Allowed Modifications

Section 1329(a) sets forth permissible modifications that may be made after confirmation of a chapter 13 plan. Those modifications permitted by section 1329(a) are as follows:

(i) Change of Amount of Payments

Pursuant to section 1329(a)(1), a debtor, trustee or an unsecured creditor may propose to increase or decrease the percentage payable on claims belonging to one or more classes designated by the debtor's plan. It has been held that a reduction of the amount owed to a creditor after confirmation may be grounds for a modification that changes the amount or classification of a claim after confirmation.²³⁴ Furthermore, a secured claim may be reclassified as unsecured after confirmation and the amount of payment on such claim may be modified.²³⁵ Section 1325(a)(5) states that the plan is to provide that the holder of the allowed secured claim retains its lien until the claim is paid in full under applicable nonbankruptcy law or until the discharge. The same section states that when the debtor does not surrender the property and the creditor does not accept the plan, the plan is entitled to confirmation only if the plan provides certain protections for the creditor such as adequate protection.

(ii) Change of Time of Payments

Pursuant to section 1329(a)(2), a confirmed chapter 13 plan may be modified to either lengthen or shorten the time within which payments to one or more classes of claims are to be made post confirmation. However, timing of payments may not be extended any further than the duration of the confirmed plan as set forth in section 1329(c).

(iii) Change of Distribution to Holder of Claim

Pursuant to section 1329(a)(3), a debtor may modify a confirmed plan to change the amount of any distribution to the holder of a particular claim to show credit for any payment receive by the creditor outside of the confirmed plan. Payments could be made

²³⁴ *In re Zieder*, 263 B.R. 114 (Bankr. D. Ariz. 2001); see also *In re Day*, 247 B.R. 898 (Bankr. M.D. Ga. 2000).

²³⁵ *In re Williams*, 108 B.R. 119 (Bankr. N.D. Miss 1989).

to a creditor outside of the plan by way of a codebtor, guarantor or the disposition of collateral.

(iv) Modification for Purchase of Health Insurance

Section 1329(a)(4) allows for the modification of a confirmed plan when the debtor desires to purchase health insurance. In order to take advantage of this permissible modification, the debtor must satisfy the following:

1. Document the cost of the insurance;
2. Demonstrate that the expenses are reasonable and necessary;
3. If the debtor previously had insurance, the debtor must show that the cost of the new insurance is not materially larger than the cost debtor previously paid;
4. If the debtor did not previously have insurance, the debtor must demonstrate that the cost is not materially larger than the amount that would be incurred by a debtor similarly situated;
5. Demonstrate that the amount is not otherwise allowed for the purposes of determining disposable income; and
6. Provide proof that a health insurance policy was actually purchased.²³⁶

(h) Requirements for Modified Plan

A modified plan must conform to the requirements of section 1322(a) and (b) which pertain to chapter 13 plan contents. In addition, section 1329(b)(1) makes the same acceptance prerequisites that apply to pre-confirmation plan modifications under section 1323(c) applicable to the approval of post-confirmation modifications under 1329(b)(2). Only the holders of certain secured claims provided for by the chapter 13 plan are required to accept the plan.²³⁷ In that regard, the holder of a secured claim whose acceptance of the confirmed plan was a prerequisite for the debtor to be entitled to confirmation is deemed to have accepted the plan as modified, unless the modification changes the secured creditor rights and the holder withdraws its prior acceptance.²³⁸

²³⁶ 11 U.S.C. § 1329(a).

²³⁷ 11 U.S.C. §1325(b)(1).

²³⁸ 11 U.S.C. § 1323(c).

Section 1329(b)(1) states that a chapter 13 plan modified after confirmation is subject to the same criteria for the confirmation of an original chapter 13 plan as set forth in section 1325(a). As such, the best interests test again must be satisfied with respect to each allowed unsecured claim belonging to any class to receive reduced or later payments under a modified plan.

Pursuant to section 1329(c), the modified plan may not provide for payments beyond the applicable commitment period under section 1325(b)(1)(B) after the due date of the first payment under the plan as originally confirmed. However, the court for cause may approve a longer payment period which may not extend more than five years from the due date of the first payment under the original confirmed plan.²³⁹

VIII. Discharge Options

(a) The Chapter 13 Full Compliance Discharge

The bankruptcy law regarding the scope of the chapter 13 discharge is complex and has undergone major changes. A chapter 13 debtor is entitled to a discharge upon completion of all payments under the chapter 13 plan so long as the debtor: (1) certifies (if applicable) that all domestic support obligations that came due prior to making such certification have been paid; (2) has not received a discharge in a prior case filed within a certain time frame (two years for prior chapter 13 cases and four years for prior chapter 7, 11 and 12 cases); and (3) has completed an approved course in financial management (if the U.S. trustee or bankruptcy administrator for the debtor's district has determined that such courses are available to the debtor).²⁴⁰ However, the court will not grant a discharge until it determines, after notice and a hearing, that there is no reason to believe there is any pending proceeding that might give rise to a limitation on the debtor's homestead exemption.²⁴¹

The discharge releases the debtor from all debts provided for by the plan or disallowed (under section 502), with limited exceptions.²⁴² Creditors provided for in full

²³⁹ 11 U.S.C. § 1329(c).

²⁴⁰ www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter13.html.

²⁴¹ 11 U.S.C. § 1328(h).

²⁴² www.uscourts.gov/bankruptcycourts/bankruptcybasics/chapter13.html.

or in part under the chapter 13 plan may no longer initiate or continue any legal or other action against the debtor to collect the discharged obligations.²⁴³

Debts not discharged in chapter 13 include, but are not limited to certain long term obligations (such as a home mortgage), debts for alimony or child support, certain taxes, debts for most government funded or guaranteed educational loans or benefit overpayments, debts arising from death or personal injury caused by driving while intoxicated or under the influence of drugs, and debts for restitution or a criminal fine included in a sentence on the debtor's conviction of a crime.²⁴⁴ To the extent that they are not fully paid under the chapter 13 plan, the debtor will still be responsible for these debts after the bankruptcy case has concluded. Debts for money or property obtained by false pretenses, debts for fraud or defalcation while acting in a fiduciary capacity, and debts for restitution or damages awarded in a civil case for willful or malicious actions by the debtor that cause personal injury or death to a person will be discharged unless a creditor timely files and prevails in an action to have such debts declared nondischargeable.²⁴⁵

(b) Effect of Full-Compliance Discharge

The discharge in a chapter 13 case is somewhat broader than in a chapter 7 case. Debts dischargeable in a chapter 13, but not in chapter 7, include debts for willful and malicious injury to property (as opposed to a person), debts incurred to pay nondischargeable tax obligations, and debts arising from property settlements in divorce or separation proceedings.²⁴⁶ A discharge for full compliance under section 1328(a) discharges not only debts provided for by the plan, but also debts disallowed under section 502. Section 1328(a)(2) excepts from a full-compliance discharge debts that are specified in section 507(a)(8)(C) and in paragraphs (1)(B), (1)(C), (2), (3), (4), (5), (8) and (9) of section 523(a). Those debts listed in section 523(a) that section 1328(a) does not explicitly except from a full-compliance discharge remain dischargeable in a chapter 13 case, even though the same debts remain nondischargeable in a chapter 7 case.

²⁴³ *Id.*

²⁴⁴ *Id.*

²⁴⁵ 11 U.S.C. §§ 1328, 523(c); Fed. R. Bankr. P. 4007(c).

²⁴⁶ 11 U.S.C. § 1328(a).

(c) Debts Excepted from Full-Compliance Discharge

The debts that are excepted from a Full-Compliance Discharge include, but may not be limited to the following:

- (i) Long Terms Debts Provided under Section 1322(b)(5); §§ 1322(b)(5) and 1328(a)(1).*
- (ii) Certain Taxes; §§ 507(a)(8)(C), 523(a)(1)(B) & (C) and 1328(a)(2).*
- (iii) Debts Incurred Through Fraud; §§ 523(a)(2) and 1328(a)(2).*
- (iv) Debts Not listed or Scheduled by the Debtor; §§ 523(a)(3) and 1328(a)(2).*
- (v) Debts Incurred Through Fraud as a Fiduciary; Embezzlement or Larceny; §§ 523(a)(4) and 1328(a)(2).*
- (vi) Debts for Domestic Support Obligations; §§ 523(a)(5) and 1328(a)(2).*
- (vii) Debts for Educational Loans; §§ 523(a)(8) and 1328(a)(2).*
- (viii) Debts for Death or Personal Injury Caused by Debtor's Operation of Motor Vehicle While Intoxicated; §§ 523(a)(9) and 1328(a)(2).*
- (ix) Debts for Restitution or Fine Included in Sentence on Debtor's Conviction of Crime; § 1328(a)(3).*
- (x) Debts for Restitution or Damages Awarded for Willful or Malicious Injury or Death; § 1328(a)(4).*
- (xi) Postpetition Debts Not Provided for by Plan.*
- (xii) Postpetition Consumer Debts Incurred without Trustee's Approval; § 1328(d).*
- (xiii) Debts Made Nondischargeable by Other Statutes; 42 U.S.C. § 288-5 (certain obligations arising from health education programs); 37 U.S.C. § 302(f)(certain obligations arising from retention bonuses paid to military officers).*

(d) The Chapter 13 Hardship Discharge

After confirmation of a plan, circumstances may arise that prevent the debtor from completing the plan. In such situations, the debtor may ask the court to grant a

"hardship discharge."²⁴⁷ Generally, such a discharge is available only if: (1) the debtor's failure to complete plan payments is due to circumstances beyond the debtor's control and through no fault of the debtor; (2) creditors have received at least as much as they would have received in a chapter 7 liquidation case; and (3) modification of the plan is not possible. Injury or illness that precludes employment sufficient to fund even a modified plan may serve as the basis for a hardship discharge. The hardship discharge is more limited than the full-compliance discharge described above and does not apply to any debts that are nondischargeable in a chapter 7 case.²⁴⁸

²⁴⁷ 11 U.S.C. § 1328(b).

²⁴⁸ 11 U.S.C. § 523.