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The Bursting Bubble: Behind on Mortgages and Car Loans—Is Chapter 13 an Option?

Eleanor William Dahar, Moderator
Victor W. Dahar, PA; Manchester, N.H.

Steven J. Boyajian
Boyajian, Harrington & Richardson; Providence, R.I.

Hon. Colleen A. Brown
U.S. Bankruptcy Court (D. Vt.); Rutland

John S. McNicholas
Ablitt & Charlton, PC; Plymouth, Mass.

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THE BURSTING BUBBLE: BEHIND ON MORTGAGES AND CAR LOANS -- IS CHAPTER 13 AN OPTION?

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WHAT'S LEFT OF AUTO LOAN CRAM DOWN UNDER THE "HANGING PARAGRAPH" ? AND ARE CREDITORS STILL BOUND TO ACCEPT THE TILL INTEREST RATE, POST-BAPCPA?

PRESENTATION BY HON. COLLEEN A. BROWN
U.S. BANKRUPTCY JUDGE, DISTRICT OF VERMONT

I. THE HANGING PARAGRAPH

A. What is it?

Hanging out at the end of § 1325(a), just under §1325(a)(9), and before § 1325(b) is a paragraph that is not numbered and does not appear to be part of either §1325(a) or (b). It has come to be known as "the hanging paragraph of BAPCPA." That paragraph is quite important in that it limits the use of the §1325(a)(5) "cram down" treatment of certain secured claims. It reads as follows:

> For purposes of paragraph (5), section 506 shall not apply to a claim described in that paragraph if the creditor has a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle (as defined in section 30102 of title 49) acquired for the personal use of the debtor, or if collateral for that debt consists of any other thing of value, if the debt was incurred during the 1-year period preceding that filing.

§ 1325(a) hanging paragraph. The paragraph denies debtors the right to cram down a claim secured by a motor vehicle, as would otherwise be permitted under § 1325(a)(5), **if**

1. the debt is secured by a purchase money security interest ("PMSI"),
2. the debt was incurred within the 910-day period preceding the date of the filing of the petition,
3. the collateral for that debt consists of a motor vehicle (as defined in § 30102 of title 49), AND
4. the vehicle was acquired for the personal use of the debtor.

AND, the hanging paragraph also denies the § 1325(a)(5) cram down for claims secured by collateral that is other than a motor vehicle **if**

1. the debt is secured by a PMSI,
2. the collateral for that debt consists of any non-motor vehicle thing of value, AND
3. the debt was incurred during the 1-year period preceding the bankruptcy filing.

This presentation will focus on the motor vehicle exception to cram down.

B. Does the HP Apply to an Auto Loan that Included Funds to Pay Off a Prior Vehicle?

The tricky question is how the inclusion of negative equity affects the application of this cram down exception. Courts are currently split on how to treat that portion of the secured claim attributable to funds loaned by the creditor (one who finances automobile transactions) to pay off the remaining balance

due on the vehicle the debtor trades in when purchasing a new vehicle. Is the negative equity part of the PMSI? Or, does it change the character of the security interest from a PMSI to a non-PMSI security interest (known in the UCC as the "transformation" of the security interest)? Or does it give the security interest what the UCC calls "dual status," which "allows a security interest to have both the status of a PMSI, to the extent that it is secured by collateral purchased with loan proceeds, and the status of a general security interest, to the extent that the collateral secures obligations unrelated to its purchase." Petrocci, 370 B.R. at 504. In essence, purchase money status is not destroyed as it is under transformation; it exists to the extent that loan proceeds were used to purchase the collateral.

A great deal of the debate focuses on the definition of PMSI, which is not defined in the Code. Most courts have looked to state UCC law; many states have incorporated the definition of PMSI from Revised Article 9. That definition refers to the "price" of the collateral or "value given to enable the debtor to acquire rights in or the use of the collateral. . ." Particularly important, the Official Comment to this section of the UCC explains that

> the 'price' of the collateral or the 'value given to enable' includes obligations for expenses incurred in connection with acquiring rights in the collateral, sales taxes, duties, finance charges, interest, freight charges, costs of storage in transit, demurrage, administrative charges, expenses of collection and enforcement, attorney's fees, and other similar obligations.

Using the same UCC definition and Official Comment as their baseline, courts have arrived at diametrically opposed results. In the Second Circuit, the case law seems to favor the position that the PMSI character of the security interest remains intact even if the amount of the loan includes funds to pay off the outstanding balance on a prior loan, in addition to the funds to purchase the instant collateral. See General Motors Acceptance Corp. v. Peaslee, 373 B.R. 252 (W.D.N.Y. 2007) (reversing In re Peaslee, 358 B.R. 545 (Bankr., W.D.N.Y. 2006)); In re Petrocci, 370 B.R. 489 (Bankr. N.D.N.Y. 2007).

In March, 2008, the bankruptcy courts of Maine weighed in on the issue: In In re Look, 383 B.R. 210 (Bankr., D.Me. 2008), the court held that the funds advanced by a creditor to pay off negative equity was neither part of the price of the new vehicle nor money advanced to enable the debtor to acquire rights in the new vehicle, and thus were not secured by a PMSI. It specifically ruled that if any portion of the claim was not PMSI then the hanging paragraph exception did not apply. Contrary to the holding of other cases, the Maine bankruptcy court decision says it is "an all or nothing" situation. Accordingly, in the Look case, the creditor's objection to the debtor's bifurcation and cram down of its claim was overruled.

In Vermont, the issue has been briefed and I am currently working on an opinion.

Suffice it to say that the question is still open and the Circuit Courts will have to decide the scope of the hanging paragraph's exception from cram down, and in particular, how to deal with secured claims that include sums not attributable to the purchase of the collateral.

C. Can Debtors Cram Down Auto Loans Post-BAPCPA?

Allowed secured claims in chapter 13 cases that arise from auto loans may still be crammed down if they are outside the reach of the hanging paragraph. Hence, the loan may be crammed down under § 1325(a)(5), **if**

1. the allowed claim is not secured by a purchase money security interest ("PMSI"), or
2. the allowed claim is secured by a PMSI but was not incurred within the 910-day period preceding the date of the filing of the petition, or
3. the vehicle was not acquired for the personal use of the debtor, i.e., was purchased for business use by the debtor or for the personal use of someone other than the debtor.

These are generally questions of fact and the burden is on the debtor to demonstrate facts that support his/her right to cram down the secured debt. See In re Finnegan, 358 B.R. 644 (Bankr. M.D. Pa. 2006); In re Brown, 244 B.R. 603 (Bankr. W.D.Va. 2000).

II. What Interest Rate Applies to the Secured Part of Crammed Downs Post- STPCPA?

A. Does *Till* Apply Post-BAPCPA?

In Till, 51 U.S. 465 (2004), the U.S. Supreme Court held that the appropriate rate of interest to apply to the secured portion of a stripped down allowed secured claim was the prime rate plus a 1-3% risk factor. The consensus post–BAPCPA is that the application of the hanging paragraph does not strip the allowed claim of secured status under § 506 or negate the debtor's obligation to pay interest on the secured portion of the claim.

To date one circuit court and two BAPs have addressed the question of what interest rate applies to the secured portion of the debt in light of the new hanging paragraph exception from cram down, and all of them have found that notwithstanding BAPCPA, Till applies to determine the interest rate to be applied to the secured portion of the claim, even when the claim is excepted from bifurcation and cram down under the hanging paragraph. See In re Drive Financial Services v. Jordan, 2008 WL 651547 (5th Cir., March 12, 2008); In re Trejos, 374. B.R. 210 (9th Cir BAP, July 30, 2007); In re Taranto, 365 BR 85 (6th Cir BAP, March 30, 2007). Additionally, all published bankruptcy and district court decisions appear to take this position. See, eg, In re Smith, 2007 WL 2092980 (D. Kan. 2007), In re Vandernick, 2008 WL 901685 (Bankr. N.D.W.Va. 2008), In re Burt, 378 BR 352 (Bankr. D. Utah, 2007), In re Thomas, 2007 WL 2462664 (Bankr. D. Kan, 2007), In re Hopkins, 371 BR 324 (Bankr., N.D. Ill. 2007), In re Andoh, 370 BR 377 (Bankr. D. Colo. 2007), In re Yelverton, 2007 WL 1521595 (Bankr. M.D. Ala., 2007).

B. What Impact Does The Vitality of *Till* Have on Chapter 13 Plans?

If a debtor is in default on an allowed secured auto loan post-BAPCPA, the debtor must first determine whether the hanging paragraph applies to except the allowed secured claim from modification under §1325(a)(5), and from bifurcation under § 506(a). Then, the debtor must compute the interest due the secured portion of the claim under Till, i.e. prime rate plus a risk factor of 1 to 3%, and apply this risk factor interest rate analysis regardless of whether the hanging paragraph prohibits cram down of the claim.

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HAS THE BUBBLE BURST ON BALLOON PAYMENTS? - AN ANALYSIS OF THE CASES INTERPRETING 11 U.S.C. SECTION 1325(a)(5)(B)(iii)(I), THE SO-CALLED EQUAL MONTHLY PAYMENT PROVISON

INTRODUCTION

These materials review the relatively few published decisions addressing the multitude of issues raised by the so-called equal payment provision as it appears in 11 U.S.C. Section 1325(a)(5)(B)(iii)(I) effective October 17, 2005, as part of the amendments to the Code enacted by BAPCPA. The entirety of Section 1325(a)(5) is as noted below:

"with respect to each allowed secured claim provided for by the plan—

(A) the holder of such claim has accepted the plan;

(B) (i) the plan provides that –

(I) the holder of such claim retain the lien securing such claim until the earlier of –

(aa) the payment of the underlying debt determined under nonbankruptcy law; or

(bb) discharge under section1328; and

(II) if the case under this chapter is dismissed or converted without completion of the plan, such lien shall also be retained by such holder to the extent recognized by applicable nonbankruptcy law; **and**

(ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; **and**

(iii) if—

(I) property to be distributed pursuant to this subsection is in the form of periodic payments, such payments shall be in equal monthly amounts; and

(II) the holder of the claim is secured by personal property, the amount of such payments shall not be less than an amount sufficient to provide to the holder of such claim adequate protection during the period of the plan; **or**

(C) the debtor surrenders the property securing such claim to such holder;"

IMPACT ON PLANS SEEKING TO MODIFY SECURED CLAIMS

In the midst of the subprime mortgage crisis, the prevailing economic slow-down and a wide-spread and continuing depreciation in real estate values the resolution of issues raised under the equal payment provision has serious implications for debtors and creditors alike. In the previous wave of declining real estate values as seen in the late 1980's and early 1990's, it was common for chapter 13 plans to effectuate a "cram-down" of mortgage claims that were not secured solely by the debtor's principal residence via modification of the claim pursuant to 11 U.S.C. Section 1322(b)(2) including a determination of the underlying security's fair market value as of the filing date of the petition pursuant to 11 U.S.C. Section 506(a). This afforded relief to owners of multifamily residences even in those instances where the debtor resided in one of the units.

Today the equal payment provision has effectively foreclosed many debtors from modifying what are otherwise clearly modifiable loans under Section 1322(b)(2) because their monthly incomes are woefully short of the total that would be required to amortize the modified secured claim in full over the term of the plan as required by 11 U.S.C. Section 1325(a)(5)(ii). Moreover, the monthly payments

on adjustable-rate notes, particularly those that are tied to the LIBOR index, are so substantial that many debtors with mortgage debt on a single-family home have insufficient income to cure their mortgage arrears under Section 1322(b)(5) without the ability to pay such claim on other than an equal, periodic distribution basis via graduated payments, fluctuating payments that can accommodate seasonal or sporadic incomes, balloon payments or some combination of these.

It is not surprising then that some creative lawyering has ensued in an effort to circumvent the equal payment provision.

DOES THE EQUAL PAYMENT PROVISON APPLY EXCLUSIVELY TO CLAIMS SECURED BY PERSONAL PROPERTY?

The Debtor in the case of *In re Lemieux*, 347 B.R. 460 (Bankr.D.Mass.2006) sought to pay short-term debt in full (that is debt which matured during the term of the plan) as evidenced by two mortgages secured only by the Debtor's single-family residence pursuant to 11 U.S.C. Section 1322(c)(2) which section creates an exception to the anti-modification language contained in 1322(b)(2). The Debtor proposed to pay the two mortgage claims through the plan via 59 equal payments of $1,081 with a balloon payment of $95,853.00 in the 60th month of the plan. The Court rejected the Debtor's argument that the entirety of 1325(a)(5)(B)(iii) applies only to personal property due to 1325(a)(5)(B)(iii)(II)'s explicit reference to personal property. The Court in *In re Wallace*, 2007 WL 3531551 (Bankr.M.D.N.C. 2007) summarily rejected the same argument made by the Debtor in that case. The argument that the equal payment provision does not apply to real property misses the forest for the trees. Section 1325(a)(5) opens as follows: "with respect to *each secured claim* provided for by the plan". It stands to reason that each subsection of (a)(5) applies to claims secured by personal and real property alike unless any particular subsection thereof should expressly provide otherwise as does

1325(a)(5)(B)(iii)(II). In contrast, 1325(a)(5)(B)(iii)(I) contains no such limitation.

MUST PERIODIC PAYMENTS TO A SECURED CREDITOR BEGIN WITH THE FIRST MONTH AFTER CONFIRMATION OF THE PLAN OR CAN THE INITIATION OF SUCH PAYMENTS TO THE SECURED CREDITOR BE DEFERRED TO A LATER MONTH IN THE PLAN TERM?

At this relatively early stage in the wake of BAPCPA there is no clear consensus on this issue. Yet, it is a question of critical importance to both debtors and creditors alike. If you conclude that deferral is permissible you give debtor's counsel some flexibility in crafting a plan. Conversely, from the creditor's perspective, however, if you glean from the Code or from court opinion's interpreting same an intent to allow deferral of the first "periodic" payment, then on what authority do you determine that a six-month deferral is permissible but a lone lump-sum payment in the 60th month of the plan is not? Or are there no limits on the length or manner of deferral at all?

In re DiSardi, 340 B.R. 790 (Bankr.S.D. Tex.2006) was one of the first cases to address this issue in the context of plans proposed by three different debtors each of which variously proposed a deferral of the initiation of periodic payments to the secured vehicle lender for periods ranging from five to seven months. In each instance the payments, once commenced, would continue until the entire allowed secured claim was paid in full. In two of the three cases the Debtor owed more than the vehicle was worth. In the case of the remaining debtor, the secured lender had a $1,000.00 equity cushion.

Although a precise breakdown of the distributions that would ultimately be made from the Debtor's plan payments during the respective deferral periods is not contained in the opinion, one takes from the opinion that the

deferral period was necessary in whole or in part to accommodate the debtors' counsels' administrative claims for attorneys fees under 11 U.S.C. Section 503(b)(1)(A) and Section 507(a)(2). Entitled though they were to administrative priority under Section 507(a)(2), counsel fees were still taking a back seat to the super-priority afforded adequate protection payments to the secured vehicle lenders under Section 507(b). The Court noted that the vehicle lenders in each case has misinterpreted the Debtor's plan as not providing for preconfirmation adequate protection payments. As a practical matter, the lenders may not have objected had they construed the plans correctly. Debtors' attorneys', on the other hand, wanted to be paid before any distributions were made to the vehicle lenders in the form of adequate protections payments or otherwise. Given the super administrative priority afforded the lender's adequate protection payments, it appears that the source of payments for the debtors' attorneys' fees was the differential between the scheduled distributions to the vehicle lenders under the proposed plans and the amount of the preconfirmation (and post-confirmation) adequate protection payments.

Two of the vehicle lenders argued that the equal payment provision requires equal payments beginning from the effective date of the plan (the confirmation date) and continuing for the life of the plan. They further reasoned that "a deviation from equal payments starting day one could lead to a patchwork of equal payment periods". Id, at 805. The Court in *DiSardi* disagreed:

"The equal payment provision does not state that its requirements must be met beginning in month one of the plan. Nor does the section state that payments must be equal "as of the effective date of the plan . . . The Court understands this clause to require payments to be equal once they begin, and to continue to be equal until they cease . . . Exactly when these level payments begin is case specific." Id at 805, 806.

The crux of the opinion in *DiSardi* was clearly the court's struggle with the tension and interplay between the equal payment provision and the Trustee's responsibilities under 11 U.S.C. Section 1326(b)(1) to pay claims afforded administrative priority under 507(a)(2) on an accelerated basis:

"Pursuant to Section 1326(b)(1), amounts payable to a car lender in excess of the amount of adequate protection may not be paid until all Section 507(a)(2) payments have been made". Id at 808.

While finding that the Trustee's responsibilities under 1326(b)(1) effectively trumped any interpretation of the equal payment provision that would render the Trustee's responsibilities "mathematically impossible" the Court went on to recognize the abuses that 11 U.S.C. Section 1325(a)(5)(B)(iii)(I) was designed to curb:

"The second perceived abuse was for a chapter 13 plan to propose a balloon payment at the end of the sixty month term of the plan. The interim payments would not fully amortize the car loan. At the end of the term, the car would be worth less than the balloon payment that was due. . . Section 1325(a)(5)(A)(iii)I) appears to be intended to address this balloon payment issue. By requiring full amortization over the life of the traditional plan payments, the debtor's feasibility burden was increased and the car lender's risk decreased." Id. at 810.

The problem with *DiSardi* is that the Court fails to explain how its interpretation of the statute does not encroach upon if not wholly eviscerate the purposes for which the statute was enacted. In the case of a vehicle, or even real estate given current market conditions, is it not possible, indeed likely, that the secured claimant's collateral will be worth less at the end of the deferral period, however long that might be, than in the first month after plan confirmation with little or no principal reduction occurring within the applicable deferral period?

The Bankruptcy Court in *In re Denton* 370 B.R. 441 (Bankr. S.D.Ga. 2007) recognized this problem in finding that secured creditors must begin receiving equal periodic payments "in the Trustee's first disbursement post-confirmation." *Id.* at 446:

"I depart from the view that concludes that Congress intended to permit differential payments by not specifying in Section 1325(a)(5)(B)(iii)(I) any date on which payments in equal monthly payments must begin. . . I reject this conclusion , because it implicitly incorporates the premise that 'periodic payments" is a defined term (authors note, i.e., meaning payment on the amortized debt only and not including preceding adequate protection payments) with which I do not agree. Second the rulings in *DiSardi, Hill and Blevins* invite litigation from secured creditors who would not receive any amortized payments on their claims until months or even years into the plan. " *Id.* at 446.

The plan at issue in *In re Luckett*, 2007 WL 3125278 (Bankr. E.D. Wis. 2007) proposed to treat the entire indebtedness secured by a mortgage on the debtor's principal residence via 35-39 monthly "adequate protection payments" with a balloon payment to be made at some point during the last four months of the plan term. In rejecting this proposal the Court appears to agree with the position taken in *Denton* that periodic payments must begin on the effective date of the plan:

"The Debtors have focused on the word "if" in Section 1325(a)(5)(B)(iii) suggesting that by stating that *if* the property is distributed in periodic payments, the payments must be equal, Congress is suggesting that there are alternatives to paying a secured claim in full other than with periodic payments. That may be true, but rather than Congress evisionsing a proposal for 36 months of adequate protection and a balloon payment at the end of the plan, the Court interprets this provision to allow treatment

in the form of one lump sum payment in the full amount of the claim on the effective date of the plan." *Id.* at 2.

CAN ONE ESCAPE THE APPLICATION OF THE EQUAL PAYMENT PROVISION BY MAKING "ADEQUATE PROTECTION PAYMENTS" IN LIEU OF DISTRIBUTIONS INTENDED TO AMORTIZE THE CREDITOR'S SECURED CLAIM?

This issue is of course inexorably intertwined with the question of whether or not equal periodic payments must begin on the effective date of the plan. The court in *DeSardi* obviously drew a distinction between adequate protection payments on the one hand and amortized payments on the underlying secured claim on the other. Calling the *DeSardi* court's attempt to "solve the attorney fee problem" a "tortured interpretation" of the equal payment provision the court in *Denton* refused to make what it categorized as an artificial distinction by narrowly interpreting "periodic payments" as payments made "on an amortized debt" and thus regarding them as something different than "adequate protection payments":

"The word 'periodic' simply describes payments that recur at regular intervals. Thus 'periodic payments' in Section 1325(a)(5)(B)(iii)(I) refers without distinction to *all* regularly-recurring post-confirmation payments on an allowed secured claim . . . It follows that pre-confirmation adequate protection payments may not be extended beyond the date of confirmation when the monthly amount of the adequate protection payment is less than the monthly amount of payment on the allowed secured claim under the plan." *Id* at 445,446.

Likewise, the Court in *Luckett* refused to treat adequate protection payments so-called as something other than "periodic payments":

"The Plan in this case proposes to pay the value, as of the effective date of the plan, of AMC's secured claim. Part of that payment is the interest component of the Debtors' monthly adequate protection payment. Accordingly, the Plan distributes property (the interest payments) to AMC pursuant to Section 1325(a)(5)(B), and that property is in the form of periodic payments. Calling the property distributed on the claim 'adequate protection payments' does not change the fact that this is property distributed on the claim. *In re Luckett, at 2.*

DOES 11 U.S.C. SECTION 1322(B)(5) CREATE AN EXCEPTION TO THE EQUAL MONTHLY PAYMENT PROVISION?

The case of *In re Davis*, 343 B.R. 326 (Bankr.M.D.Fla.2006) gave early hope to debtors seeking to cure prepetition arrearages on long-term debt secured solely by the debtor's principal residence under 11. U.S.C. Section 1322(b)(5). The Debtor proposed to treat what was less than a $6,000.00 mortgage arrears with no plan distributions in months 1 through 10, and then via payments of $122.23 per month in months 11 -57. Curiously the Court relied on its analysis of Section 1322(e) of the Code and that section's effective override of the Supreme Court's decision in Rake v. Wade, 508 U.S. 464 (1993) with respect to the payment of post-petition interest on prepetition mortgage arrears on long-term debt to conclude that the creditor's prepetition mortgage arrears claim "falls outside the ambit of requirements contained under Section 1325(a)(5)."

Subsequently, courts have been reluctant to follow the *Davis* court's lead. *In re Schultz*, 363 B.R. 902, the Debtor's plan proposed to pay the mortgagee's entire long-term debt secured only by the debtor's principal residence via monthly payments of principal and interest with a balloon payment of all remaining balances due at end of the 60-month term. The Debtor argued that the equal payment provision did not apply in his case because unlike *Lemieux* where short-term debt was being paid in its

entirety the secured claim in this case was long-term debt the prepetition arrearage portion of which could have been cured under Section 1322(b)(5). The *Schultz* court was not persuaded:

"Section 1322(b)(5) just means that the entire secured claim need not be paid in full under certain circumstances allowing cure of default, but the claim is still an allowed secured claim. This court holds that periodic payments must be equal, period. This applies when the default is cured and only current payments and the arrearage are being paid pursuant to the plan pursuant to 11. U.S.C. Section 1322(b)(5) and when long-term or matured debt are paid in full under the plan." *Schultz,* at 906.

Thus the court in *Schultz* concluded that the fact that the debtor could have proceeded under Section 1322(b)(5) did not place the debtor's treatment of the mortgagee's claim beyond the reach of Section 1325(a)(5)'s confirmation requirements.

Each of the two debtors whose plans were before the court in *In re. Melillo*, 2008 W.L. 987095 (Bankr.D.Mass.2008) also relied on the opinion in *Davis* in asserting that the equal payment provision does not apply to the treatment of long-term secured claims. One plan involved a scheme of graduated monthly payments over 59 months with a balloon payment of the loan balance in the 6oth month of the plan. The other plan proposed level payments on the secured claim for 59 months and a balloon in the 60^{th} month. The *Melillo* court found both plans in violation of the equal monthly payment provision and dispensed with the court's reasoning in *Davis* as follows:

"While 11 U.S.C. Section 1322(e) supercedes 11 U.S.C. 1325(a)(5)(B)(ii) with respect to the amount necessary to cure the default, there is nothing in that provision to suggest that it renders 11 U.S.C. Section 1325(a)(5) completely inapplicable when arrears on a long-term debt are cured

through the plan. Section 1322(e) refers only to the 'amount necessary to cure the default' and not the manner in which it is cured . . . As 11 U.S.C. Section 1325(a)(5)(B)(iii)(I) was enacted in 2005, eleven years after 11 U.S.C. Section 1322(e), Congress could have drafted the clause to be expressly inapplicable in curing arrears on a long-term debt if it had so intended. Moreover, *Davis* cites no authority for such a blanket override." *Melillo* at 3.

DOES THE EQUAL PAYMENT PROVISION APPLY WHEN A BALLOON PAYMENT IS PROPOSED OUTSIDE OF THE PLAN AFTER THE CONCLUSION OF THE CASE?

The mortgagee's claim in *In re Newberry*, 2007 WL 2029312 (Bankr.D.Vt. 2007) was secured solely by the Debtor's principal residence and matured prior to the filing of the debtor's chapter 13 petition. The plan proposed to treat the claim with level interest only payments throughout the plan term with a balloon payment of the entire secured claim balance via a refinance to occur beyond the 60th and final month of the plan.

Since the claim in question not only matured prior to the date on which the final payment was due under the plan but prior to the date on which the petition was filed the court in *Newberry* first had to address whether the claim could be modified and the maturity date effectively extended pursuant to the exception for short-term debt secured only by the debtor's principal residence pursuant to the exception created by 11 U.S.C. Section 1322(c)(2). Citing similar findings in *In re Padgett,* 273 B.R. 277 (Bankr.M.D.FL 2001) and *In re. Escue,* 184 B.R. 287 (Bankr.M.D. Tenn. 1995), the *Newberry* court concluded that the claim could indeed be modified under Section 1322(c)(2) provided that the debtor's treatment of the claim otherwise complied with the requirements of Section 1325(a)(5).

The court relied on the findings in both *Lemieux* and *In re Wagner,* 342 B.R. 766 (Bankr.E.D.Tenn. 2006) in concluding that the debtor's plan did not comply with the requirements of the equal payment provision. Both *Lemieux* and *Wagner* rejected plans that proposed to treat short-term secured claims under Section 1322(c)(2) via a series of equal monthly payments followed by a balloon payment to occur in the final month of the plan term. In *Newberry* the plan failed as proposed because it did not treat the entire claim *within* the plan term as required by 1322(c)(2). The court noted that even if the debtor were to amend her plan to include the balloon payment within the proposed 60-month term the plan would still fail as it would then violate the terms of Section 1325(a)(5)(B)(iii)(I).

DO A TRUSTEES' RESPONSIBILITIES UNDER 11 U.S.C. SECTION 1326(b)(1) EFFECTIVELY TRUMP A STRICT APPLICATION OF THE EQUAL PAYMENT PROVISION?

We have seen that the court in *DeSardi* answered this question in the affirmative. Recall that the *DeSardi* court based its finding on the fact that the equal payment provision does not specify that periodic payment must begin on the effective date of the plan and on its willingness to draw a distinction between adequate protection payments and periodic payments that amortized the underlying secured debt.

The court in *In re Erwin*, 376 B.R. 897 (Bankr.C.D.Ill.2007) came to the similar result that the Trustee's responsibilities under 11 U.S.C. Section 1326(b)(1) to pay priority administrative claims effectively trumps the requirements of Section 1325(a)(5) but for different reasons. Similar to the facts in *DeSardi* it was the accelerated payment of the debtor's attorneys fees (and, in this case, the trustee's commission) that would cause the monthly distributions to the secured vehicle lender to be unequal in the early stages of the plan. The *Erwin* court turned its attention *away* from the actual amount of the monthly distributions to the secured claimant via

the plan and instead focused its attention on the fact that under the plan the *debtor's monthly payments to the Trustee* would be level at $875.00 for the life of the plan. Contrast this with the court's discussion of this debtor payments versus trustee distributions issue in *Lemieux*:

"As stated in 8 *Collier on Bankruptcy* paragraph 1325.06[3][b][ii][A] at 1325-39 (15th ed. Revised 2005), Section 1325(a)(5)(B)(iii)(I) "refers to the *distributions (emphasis added)* to the holder of the allowed secured claim and not to the debtor's plan payments". *Lemieux* at 465.

The *Erwin* court's focus appears to borne out of an attempt to balance the practical issues confronted by trustees in making plan distributions and honoring administrative claim priorities on the one hand and the overall remedial purposes behind the enactment of the equal payment provision on the other *rather* than on a strict literal interpretation of the statute. Indeed the *Erwin* court fully recognized and discussed at some length the remedial purposes that the equal payment provision was designed to curb. In citing *Schultz, Lemieux* and *Wagner* the court stated:

"The results of these cases are readily explainable when the remedial purpose of the equal payment provision is considered . . . The equal payment provision prevents debtors from backloading payments to secured creditors or paying them other than on a monthly basis. It is easy to understand why the courts in *Schultz, Lemieux,* and *Wagner* had little difficulty denying confirmation of plans that called for balloon payments to secured creditors - a plan proposal clearly intended to be eliminated by the equal payment provision. Likewise, it is easy to understand the struggle of the *DeSardi* and *Hill* courts, who were faced not with backloaded plans, but with plans that merely proposed to the pay the debtor's attorneys fees over a shorter term than the secured claims, something that has always been permitted and is supported by sound policy reasons. In this Court's

view, the accelerated payment of debtor's attorney fees was not intended to be precluded by the equal payment provision and construing the provision as having that effect is incorrect." *Erwin*, at 901.

And remember the plans in *DeSardi* and in *Erwin* did not involve either graduated plan payments to the trustee or large balloon payments at the end of the plan term. The distribution to the secured creditor was simply less during the initial 5 to 12 month period during which the administrative claims for attorneys fees and trustee's commission were paid. Perhaps the *Erwin* court sums it up most appropriately in stating that "the equal payment provision is a broad-stroke proscription against abusive payment terms, not a tool to micromanage Chapter 13 Trustees." *Id.* at 903.

NOTWITHSTANDING A PLAN'S NONCOMPLIANCE WITH THE EQUAL MONTHLY PAYMENT PROVISION CAN THE PLAN BE CONFIRMED IF THE CREDITOR FAILS TO OBJECT TO THE PLAN?

At present there appears to be a split of authority on this issue. You will recall that the *Schultz* court found that the proposed plan did not comply with the equal payment provision. Nevertheless, the court in *Schultz* confirmed the Debtor's plan because the secured creditor did not object to the plan (the lone objection was filed by the trustee). Noting that the provisions of Section 1325(a)(5) were listed in the disjunctive and thus only one of the requirements stated therein had to be met (1325(a)(5)(A), (B) or (C), the court found that the requirements of subsection (A) ("the holder of such claim has accepted the plan") had been met. The court in *Schultz* cited the case of *In re Vankell,* 311 B.R. 205 (Bankr.E.D.Tenn.2004) for the proposition that since the secured claimant failed to object, it is deemed to have accepted the plan. *Schultz* at 904.

Conversely, the court in *Melillo* stated that it could "not infer a secured creditor's consent to treatment which is expressly prohibited by the

Bankruptcy Code from a lack of an objection because 'it has a reasonable expectation that I will not approve treatment which violates the Bankruptcy Code". *Mellilo*, at 4 citing *In re Bethoney*, No. 07-13609-WCH, 2008 WL 179509 (Bankr.D.Mass. 2008).

TOPIC FOR DISCUSSION: IN ATTEMPTING TO RECONCILE AND APPLY THE HOLDINGS OF THE VARIOUS CASES NOTED ABOVE CAN A DEBTOR PROPOSE TO MAKE A SINGLE LUMP-SUM PAYMENT TO A CREDITOR IN FULL SATISFACTION OF ITS ALLOWED SECURED CLAIM AND, IF SO, ARE THERE ANY LIMITATIONS ON WHEN SUCH PAYMENT MUST BE MADE ASSUMING SUCH PAYMENT IS MADE WITHIN THE TERM OF THE PLAN?

Being a creditor's counsel this one gives the author nightmares. I invite your insight and wisdom in assisting me to sort this all out.

ZERO PERCENT PLANS: SECURED DEBT AND DISPOSABLE INCOME

Presentation by Steven J. Boyajian
BOYAJIAN, HARRINGTON & RICHARDSON
182 Waterman Street
Providence, RI 02906

A "zero percent plan" is a chapter 13 plan which proposes to make no distribution (or a minimal distribution) to a debtor's unsecured creditors.

The following notes explore the potential utility of zero percent plans to debtors, explain some of the divergent case law concerning the calculations which allow for the proposal of zero percent plans and identify some hazards which may await debtors who propose zero percent plans.

Whether a zero percent plan is a viable option for debtors seeking to retain homes, cars or other collateral through a chapter 13 is uncertain in light of recent trends concerning the calculation of disposable income under BAPCPA.

I. The "best efforts" test of § 1325(b)

A. In order for a chapter 13 plan to be confirmed over the objection of an unsecured creditor or the trustee, the plan must either

1. Provide for the payment of all unsecured claims in full; or

2. Provide for the distribution of all of the debtor's "projected disposable income" over the "applicable commitment period" to holders of unsecured claims. See 11 U.S.C. § 1325(b)(1).

B. Prior to October 17, 2005 (the effective date of BAPCPA's disposable income calculation) whether a debtor's proposed plan represented the best effort to repay creditors depended upon an examination of schedules I and J.

1. The debtor's schedule I should have disclosed the debtor's income as of the petition date and should have disclosed any anticipated increase or decrease in income during the initial stages of his chapter 13 plan; and

2. The debtor's schedule J should have disclosed his projected expenses as of the petition date and disclosed any anticipated increase or decrease in those expenses in the initial stages of the plan.

C. BAPCPA implemented an equation under which "disposable income" = "current monthly income" (as defined by §101(10A)) – "amounts reasonably necessary to be expended…for the support of the debtor or a dependent of the debtor." See 11 U.S.C. § 1325(b)(2),

1. The result of the equation depends upon the definition of its variables.

   a. "[D]isposable income" is defined by §1325(b)(2) as "current monthly income" less "amounts reasonably necessary to be expended"

   b. "[C]urrent monthly income" is defined by §101(10A) as the total income received by the debtor over the six months preceding the petition date divided by six.

   c. The phrase "amounts reasonably necessary to be expended" is not explicitly defined in the Code.

      i. To compound the confusion which surrounds the expense component of disposable income under BAPCPA, it appears that "amounts reasonably necessary to be expended" may have different definitions depending upon whether the debtor's annualized household income exceeds the applicable median income. See 11 U.S.C. § 1325(b)(2) and (b)(3); see also In re McGillis, 370 B.R. 720, 730 (Bankr. W.D.Mich. 2007).

II. Zero percent plans

A. A zero percent plan results from a debtor's budget deficit on a monthly basis. Prior to BAPCPA a debtor whose reasonably necessary expenses exceeded his income could probably not have proposed a feasible chapter 13 plan. See 11 U.S.C. § 1325(a)(6).

B. Following BAPCPA, above median debtors may perform all the necessary calculations to demonstrate a lack of disposable income despite the economic reality that the debtor has a monthly budget surplus.

   1. The calculated deficit often results from the unlimited reduction in the debtor's disposable income on account of installment payments on secured debts.

   2. A zero percent plan recently proposed in Rhode Island included a $3,600 monthly mortgage payment for a single family residence with no equity. The applicable IRS housing allowance is $941 per month. The debtor's current monthly income is $4,275.

      a. For illustrative purposes, the calculation of disposable income is attached along with the debtor's schedules I and J.

C. Anecdotal evidence suggests that the calculation of a debtor's disposable income on form B22C has led to an increase in the number of chapter 13 cases in which debtors have no reported disposable income.

1. Practically speaking, the proposal of zero percent plans is rare in comparison to the number of debtors whose calculation of disposable income results in zero. The risk associated with litigating the issues surrounding zero percent plans may prompt debtors to offer token payments to avoid a challenge to their plans.

D. The disposable income calculation allows a debtor to propose a plan which provides no dividend to unsecured creditors while the debtor retains surplus earnings and continues to incur unnecessary expenses on account of secured obligations.

1. For example, in In re Phillips, 382 B.R. 153 (Bankr. D.Mass. 2007) a debtor proposed plan payments of $212 per month despite the fact that her schedules I and J disclosed over $800 per month in excess income. The discrepancy resulted from the debtor's abnormally low rent relative to the allowed IRS housing expense.

2. Following the Court' suggestion that the debtor's plan may not have been proposed in good faith, the debtor proposed an amended plan offering approximately $100 per month.

E. A zero percent plan may be a useful device for the retention of collateral by a debtor due in large part to the formulaic calculation of disposable income. It may allow debtors to:

1. Eliminate all unsecured debt, See In re Musselman, 379 B.R. 583 (Bankr. E.D.N.C. 2007);

2. Cure arrearages related to certain collateral without the expense of paying any significant dividend to unsecured creditors, See In re Brady, 361 B.R. 765 (Bankr. D.N.J. 2007);

3. Retain "luxury" items such as boats, timeshares and RVs despite the debtor's failure to pay any meaningful dividend to unsecured creditors. See In re Austin, 372 B.R. 668 (Bankr. D.Vt. 2007)(debtor able to retain a backhoe which was not used to produce income); In re Hays, No. 07-41285, 2008 WL 1924233 (Bankr. D.Kan. April 29, 2008)(debtor may retain a timeshare and reduce disposable income by the amount of the monthly payment); but see In re Hylton, 374 B.R. 579 (Bankr. W.D.Va. 2007)(debtor may retain pleasure boat only if he is able to demonstrate that the retention of the boat is not bad faith).

III. Four approaches to the secured debt deduction under the calculation of disposable income

A. The secured debt or lease payment deduction is unlimited and cannot be challenged on good faith grounds. See In re Austin, 372 B.R. 668.

1. In In re Austin the debtors' proposed plan paid a 4% dividend to unsecured creditors, counsel fees, a mortgage arrearage and a property tax arrearage through 60 monthly payments of $280. Id. at 671.

a. The plan as proposed included a monthly installment payment of $195 for the lease of a backhoe. The debtors' calculation of disposable income resulted in a monthly deficit of $110.15. Id.

b. The trustee objected to confirmation of the plan on two grounds

i. That the installment payment for the backhoe was not reasonably necessary for the support of the debtors (Id. at 672); and

ii. That the plan was not proposed in good faith. Id. at 682.

c. The Court confirmed the plan over the trustee's objections holding

i. That §1325(b)(3) and §707(b)(2)(A)(iii)(I) does not allow courts to determine which current secured debt expenses are reasonably necessary for a debtor in calculating disposable income (372 B.R. at 681); and

ii. That the Court could not deny confirmation on the ground that the plan was proposed in bad faith solely on the basis of the amount of the plan payment if the proposed payments satisfied the mandates of § 707(b)(2). Id. at 683.

iii. The Court noted that the result may be different if the debtors were proposing to cure an arrearage with respect to collateral which was not necessary for their support. Id. at 681. See also In re Hays, 2008 WL 1924233, at *5.

B. The secured debt deduction offers an unlimited reduction of disposable income, however that reduction may be challenged on good faith grounds. See In re Hylton, 374 B.R. 579; In re Martin, 373 B.R. 731 (Bankr. D.Utah 2007).

1. In In re Hylton, the debtors proposed a plan which called for 28 monthly installment payments of $221 on a boat loan and a projected dividend to unsecured creditors (totaling $73,986.90) of 12% over 36 months.

    a. The an unsecured creditor objected to the proposed plan on several grounds including the deduction of the boat payment from the debtors' disposable income on the ground that the boat was not reasonably necessary for the support of the debtors. Id. at 585.

    b. The Court held that the secured debt deduction on a current obligation was not limited by the fact that the boat was not reasonably necessary for the support of the debtors. Id. at 586.

    c. However, the Court determined that the debtors' retention of the boat in their proposed plan could be reviewed under the good faith requirements of § 1325. Id.

    d. Accordingly, the Court instructed the debtors to demonstrate that unsecured creditors would be better off if the secured obligation was repaid than if the boat were surrendered and any deficiency added to the pool of unsecured claims. Id.

C. The secured debt deduction is only available to the extent the collateral is reasonably necessary for the support of the debtor or his dependents. See In re Owsley, No. 07-44629-DML-13, 2008 WL 868044 (Bankr. N.D.Tex. March 31, 2008).

1. In In re Owsley, the debtors proposed a plan based upon a calculation of disposable income which deducted installment payments secured by an RV. The debtor's plan proposed to pay approximately 18% of the $166,000 in unsecured debt.

    a. An unsecured creditor objected to the proposed plan claiming, among other things that the debtors could not deduct a monthly payment of $559.57 for an RV which was not necessary for the support of the debtors.

    b. The Court determined that the debtors were not dedicating all of their disposable income to the plan because they were proposing to retain and pay for collateral which was not reasonably necessary for their support. Id. at *8.

D. The secured debt deduction is only available if the monthly expense falls within the IRS allowances which are provided by § 707(b). See In re

Long, No. 07-10728, 2008 WL 1883473 (Bankr. E.D.Tex. April 25, 2008); but see In re Edmondson, 371 B.R. 482 (Bankr. D.N.M. 2007)(holding that a debtor's expenses may be limited to reasonably necessary amounts but those limitations are not necessarily imposed by IRS allowances).

1. In In re Long, the debtor proposed a plan which would provide an 8.36% dividend to unsecured creditors through four payments of $210 and fifty six payments of $300. Id. at *1.

   a. In determining that she had no disposable income the debtor deducted an installment payment of $937 secured by an SUV which the debtor was planning to surrender. Id.

   b. The trustee objected to the proposed plan arguing that the debtor was not dedicating all of her disposable income to the plan, and could afford to pay a dividend of approximately 80% to unsecured creditors. Id. at *2.

   c. The Court determined that:

      i. Claimed deductions from disposable income, including secured debt deductions, must be reasonably necessary for both over and under median debtors (Id. at *6); and

      ii. In order for an above median debtor to claim a secured debt deduction, it must fit within the IRS allowance for that type of expense. Id. at *5.

IV. The applicable commitment period for a zero percent plan

A. BAPCPA also introduced a formulaic approach to the determination of a plan's length through amendments to § 1325.

B. According to §1325(b)(4), the plans of below median debtors must last three years while the plans of above median debtors must extend over five years unless unsecured claims are paid in full.

C. The formulaic approach of § 1325 has been questioned in the context of zero percent plans:

   1. A number of courts have determined that the "applicable commitment period" provisions of § 1325 are inapplicable if the debtor has no disposable income. See In re Brady, 361 B.R. at 777; In re Lawson, 361 B.R. 215, 220 (Bankr. D.Utah 2007); In re Alexander, 344 B.R. 742, 751 (Bankr. E.D.N.C. 2006).

a. These cases make zero percent plans an attractive option for debtors with secured debt arrearages or non-dischargeable priority debts. The debtors are free to propose plans that last only as long as necessary to deal with a particular arrearage.

2. Other courts have determined that a proposed plan must run the entire course of the applicable commitment period despite a debtor's lack of disposable income. See In re Musselman, 379 B.R. at 593-94; In re Hylton, 374 B.R at 579.

a. These courts reason that the "applicable commitment period" defined by § 1325 is a time period, not a number by which the debtor's disposable income must be multiplied.

b. Compelling a debtor to remain in a plan despite a lack of disposable income provides a trustee an opportunity to seek modification of the plan pursuant to § 1329 in the event the debtor's income and expenses change.

V. Conclusion

A. BAPCPA's changes to the previous best efforts analysis of chapter 13 have made chapter 13 a very attractive option for debtors with arrearages on secured debts.

B. The changes have been interpreted by a number of courts as allowing debtors to retain surplus income, retain nonessential property encumbered by secured debts, cure arrearages and exit bankruptcy as soon as the arrearages have been cured.

C. The use of chapter 13 solely as a means of dealing with secured debts seems antithetical to the familiar purpose of chapter 13: to allow debtors to retain their assets, exempt and non-exempt, in exchange their best effort to repay their debts.

D. An emerging line of cases, however, suggests that BAPCPA may have actually set forth a stringent set of guidelines for over median debtors that will force them to surrender non-essential assets and even those essential assets which cost more than the IRS allows.

ABI Northeast Conference 2008
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THE BURSTING BUBBLE: BEHIND ON MORTGAGES AND CAR LOANS -- IS CHAPTER 13 AN OPTION?

Eligibility to a be Debtor Under Section 109(g) - Dismissal or Not

Eleanor Wm. Dahar, Esq.

11 U.S.C. 109(g) states:

Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if –

(1) the case was dismissed by the court for willful failure of the debtor to abide by orders of the court, or to appear before the court in proper prosecution of the case; or

(2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

* Section 109 generally governs the definition of eligibility to be a debtor under the Code.

* Section 109(g) provides specific rules to deter abusive serial bankruptcy filings to prevent collection or payment of creditors.

* Section 109(g) applies to all bankruptcy filings under Title 11.

* Section 109(g) does not apply to first time filers.

* Section 109(g) is not jurisdictional.

* Section 109(g) uses the word "family farmer" reflecting Congress' intent to have the section apply to individuals and family farmers who may not be individuals. See Bogedian v. Eisen, 56 C.B.C.2d 713 (DC ED MI 2006).

Dismissal of Petition vs. Striking Filing of Petition

* Courts differ on whether a Debtor's filing should be stricken as opposed to dismissed so as to void the filing *ab* initio. See In Re Brown, 56 C.B.C.2d 172 (BC D MD 2006), In Re Rios, 336 B.R. 177 (Bankr. S.D.N.Y. 2005), In Re Hubbard, 333 B.R. 377 (Bankr. S.D.Tex 2005).

However, other courts have held that dismissal is the proper remedy. See In Re Tomco, 339 B.R. 145 (Bankr. W.D. Pa. 2006); In Re Ross, 338 B.R. 143 (Bankr. N.D. Ga. 2006); See In Re Salazar, 339 B.R. 622 (Bankr. S.D. Tex. 2006); *cf.* In Re Hawkins, 340 B.R. 642 (Bankr. D.D.C. 2006).

* The difference between current provisions of Section 109 under BAPCA and the former Act is the language. Section 109 now uses the wording "may be a debtor" which allows for fewer negative inferences and generally more inclusive application of the Code to any case.

* In both voluntary and involuntary bankruptcy filings, the issue of whether the bankruptcy should be dismissed under Section 109(g) only arises if a Debtor filed a second petition within 180 days of prior dismissal. In the event the Debtor files 181 days later, Section 109(g) does not apply.

Is Dismissal due to Willful Conduct of Debtor

* Pursuant to Section 109(g), the Debtor's conduct must be willful. Willful conduct includes Debtor failing to appear as required and case is dismissed.

* Issue of willful conduct does not arise at the hearing dismissing the first case. It usually becomes an issue in the second filing. At the first dismissal hearing, the debtor is not on notice that the court will consider the Debtor's willful conduct at a subsequent hearing on the motion to dismiss.

* Section 109(g) may not be determined without evidence that the Debtor willfully failed to obey Court order or willfully failed to complete the prior case.

* Willfulness is more than inadvertence or reckless disregard for Debtor responsibilities.

* Court must analyze all of the circumstances of each case to make a determination of willfulness under Section 109(g). See In Re Wolk (BC D.MD. 2007) (Based on totality of

circumstances, Court found no abuse under 109(g)(1), specifically stating Debtors were not "gaming the system", when case was converted to Chapter 11 from 7 by Debtors and Debtors filed renewed Motion to Reconvert to Chapter 7); In Rosetti v. Chase Home Finance LLC (BC ND TX 2007) (Mortgage/Creditor moved to dismiss Debtor's Chapter 13 with prejudice to re-file within 180 days based on prior dismissal arguing bad faith filing or ineligible under 109(g)(2); Court held mortgagee's motion not timely because Debtor's Plan had already been confirmed. Confirmation had *res judicata* effect on the mortgagee's claim); In Re Hess, 56 C.B.C.2d 761 (BC D. VT 2006) (In applying 109(g), courts have exercised discretion in ruling that individual may not be a debtor if certain circumstances occurred in prior filings, and have held that not every case that fits all of the characteristics of 109(g) must be dismissed; here Court found 109(g) analogous to 109(h)); In re Brown, 56 C.B.C.2d 172 (BC D MD 2006)(Debtor ineligible under 109(g), automatic stay does not stay any act to enforce any lien against for security interest in any real property); Kuo v. Walton, 167 B.R. 677 (M.D. Fla 1994)(Circumstances surrounding later case should be considered in determining whether 109(g) applies).

Courts have also held that a case meeting all of the elements of Section 109(g) need not be dismissed. See In Re Luna, 122 B.R. 575 (9th Cir BAP 1991) (109(g)(2) is discretionary and need not be applied if results unwarranted); In Re Copman, 161 B.R. 821 (Bankr. E.D. Mo. 1993) (causal connection between motion for relief and dismissal required); In Re Hamm, 157 B.R. 137 (Bankr. E.D. Mo. 1993); In Re Santana, 110 B.R. 819 (Bankr. W.D. Mich. 1990).

Motion for Relief

* If motion for relief filed or granted in first case, Debtor may not re-file within 180 days and stall creditors rights. See In Re Ulmer, 19 F.3d 234 (5th Cir. 1994)(Debtor cannot use repetitive filings thwart intent of statute and obtain continued protection from automatic stay).

* COMPARE, however, if a motion for relief is filed after Debtor files to dismiss first case, even if relief was granted after the case was dismissed, Courts have held 109(g)(2) shall not apply. See In Re Ransom, 60 B.R.19 (Bankr E.D. Pa 1986).

* It has been interpreted and argued that Congress intended for there to be a causal relationship between the motion for relief and the dismissal. The Court has focused on the wording of the statute: used "following" in Section 109(g), rather than "after" reflects the intent. See In Re Copman, 161 B.R. 821 (Bankr. E.D. Mo. 1993) (causal connection between motion for relief and dismissal required).

* It has been held that the goal to prevent filings is not satisfied without the causal relationship between the motion for relief and the dismissal. See In Re Beal, 347 B.R. 87 (E.D. Wis. 2006).(Plain language can be reconciled with intent of Congress by applying 109(g)(2) in all fact situations that fall within its term, thereby recognizing mandatory character except for certain limited and clearly defined circumstances where result produced clearly not intended by Congress; Section 109(g)(2) does not apply when motion for relief has been withdrawn, dismissed or denied).

* Section 109(g) **does not apply** to involuntary dismissal of a bankruptcy case after motion for relief filed.

* Section 109(g) **does not apply** when a case is voluntary dismissed and no motion for relief has been filed because there is no issue of willful failure of the Debtor to appear or obey court orders.

The Courts continue to grapple with the issue of whether the petition should be dismissed under Section 109(g) or whether it should be stricken. The Courts continue to be divided post BAPCA. It would appear that the final decision is fact specific on a case by case basis.

ABI Northeast Conference 2008
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THE BURSTING BUBBLE: BEHIND ON MORTGAGES AND CAR LOANS -- IS CHAPTER 13 AN OPTION?

Lien Stripping – Does it Apply to Debtor's Principal Residence?

Eleanor Wm. Dahar, Esq.

Contents of Plan - 11 U.S.C. § 1322(b) provides:

> Subject to subsections of (a) and (c) of this section, the plan may –
>
> (2) modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims;

Determination of Secured Status - 11 U.S.C. § 506(a) provides:

> (a)(1) An allowed claim of a creditor secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553 of this title, is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor's interest or the amount so subject to setoff is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest.
>
> (2) If the debtor is an individual in a case under chapter 7 or 13, such value with respect to personal property securing an allowed claim shall be determined based on the replacement value of such property as of the date of the filing of the petition without deduction for costs of sale or marketing. With respect to property acquired for personal, family, or household purposes, replacement value shall mean the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined.

Issue:

Whether a Chapter 13 Debtor can have a Chapter 13 plan confirmed using Section 506(a) to determine the secured status of a mortgage and then use Section 1322(b) to "strip down" a mortgage not fully secured by the real estate and treat the claim as unsecured.

Case Law:

In Nobleman v. American Sav. Bank, 508 U.S. 324, 113 S. Ct. 2106, 124 L.Ed. 2d 228, 28 C.B.C2d 977 (1993), the Supreme Court held that a Chapter 13 Debtor may not use Section 506(a) to "strip down" a partially secured mortgage secured only by real property that is the debtor's principal residence because such a stripdown would be a modification of the rights of the holder of an allowed secured claim violating section 1322(b)(2). Nobleman suggests that if a lien is completely undersecured and the creditor had a lien on property that had no value because the first mortgage fully encumbered the property value, then, creditor would not have been a "holder of a secured claim" entitled to protection by Section 1322(b)(2). 508 U.S. 324, 329. After Nobleman, other courts have held that fully undersecured claims are modifiable under Section 1322(b)(2).

In Domestic Bank v. Mann (In re Mann), 249 B.R. 831 (B.A.P. 1st Cir. 2000), the Court held that pursuant to 11 U.S.C. § 506(a) and 11 U.S.C. §1322(b)(2), and notwithstanding the anti-modification provision in the latter, Chapter 13 plans could void residential real property liens that were wholly unsecured.

See, Scarborough v. Chase Manhattan Mortgage Corp. (In re Scarborough), 461 F.3d 406, 411 (3d Cir. 2006) (§ 1322(b)(2) does not bar modification where claim secured by multifamily dwelling, and noting policy of reading § 1322(b)(2) "literally and narrowly"); Zimmer v. PSB Lending Corp (In re Zimmer), 313 F.3d 1220 (9th Cir. 2002) (Section 1322(b)(2)

does not bar modification where claim is wholly unsecured because of prior lien on primary residence); See also, Lane v. Western Interstate Bancorp (In re Lane), 280 F.3d 663 (6th Cir. 2002); In re Tanner, 217 F.3d 1357 (11th Cir. 2000); In re Pond, 252 F.3d 122 (2d Cir. 2001); In re McDonald, 205 F.3d 606 (3d Cir.), cert denied, 531 U.S. 822, 121 S. Ct. 66, 148 L.Ed. 2d 31 (2000); In re Bartee, 212 F.3d 277 (5th Cir. 2000); In re Mann, 249 B.R. 831 (B.A.P. 1st Cir. 2000).

But see Am. Gen. Fin., Inc. v. Dickerson (In re Dickerson), 222 F.3d 924, 926 (11th Cir. 2000) (Court followed In re Tanner because panel bound by it but stated: "[W]ere we to decide this issue on a clean slate, we would not so hold").

In re Mann, 249 B.R. 831 (B.A.P. 1st Cir. 2000), provides a detailed discussion of the case law among the Circuits. Circuits are split with respect to whether the Debtor may have the Court determine the secured status of a junior mortgage. Notwithstanding the anti-modification provision, the First Circuit permits debtors to determine the secured status of a mortgage and treat the fully unsecured mortgage claim as an unsecured creditor in the Chapter 13 plan pursuant to 11 U.S.C. § 506(a) and 11 U.S.C. §1322(b)(2), and void residential real property liens that were wholly unsecured.

See also, In re Lisa M. Pelosi, 382 B.R. 582 (2008 Bankr. LEXIS 401 02/21/08) (Under 11 U.S.C. Section 1322(b)(2) and the Nobelman decision, debtor could modify the rights of the second mortgage holder who held a lien against property but had "unsecured claim" under 11 U.S.C. Section 506(a) because no value to its interest in the property).

Eastern Savings Bank v. LaFata (In re LaFata), 483 F.3d 13 (1st Cir. 2007), (Court held Section 1322(b)(2) permitted Debtor to modify claims of mortgage lenders secured by a

principal residence when the residence in fact lies mostly on a lot abutting the mortgaged property).

In re Denise M. Curtis, 322 B.R. 470 (2005 Bankr. LEXIS 511, 03/31/05) (Where creditors, mortgagee and servicer, sought reconsideration of damages and judgment that second mortgage on debtor's residence had been discharged, court, denied motion to reconsider and found meritless creditors' defense that they were denied a 11 U.S.C. Section 506(a) hearing by insufficient service of the Chapter 13 plan because they filed no adversary proceeding or motions to vacate the orders confirming the plan).

But see Am. Gen. Fin., Inc. v. Dickerson (In re Dickerson), 222 F.3d 924, 926 (11th Cir. 2000) (Court followed In re Tanner because panel bound by it but stated: "[W]ere we to decide this issue on a clean slate, we would not so hold").

Notably, there are other instances where a Debtor may modify a debt secured by real estate that is Debtor's principal residence. Neither Section 1322(b)(2) nor Nobleman applies when the creditor ahs security other than a security interest in the Debtor's principal residence. In In re Hammond, 27 F.3d 52 (3d Cir. 1994), the Third Circuit Court held that a claim secured by other real estate, personal property of the Debtor or by property of another, may be modified by the Chapter 13 plan.

Similarly, in Lomas Mortgage v. Louis, the First Circuit Court held that a debtor could modify a creditor's security interest in a "mixed" property that had both residential and investment characteristics, because the security interest extended beyond property that was the debtor's principal residence alone. 82 F.2d. 1 (1st Cir. 1996). In this case, the creditor had a security interest in a three (3) family building where the Debtor lived in one of the units. See

also, Scarborough v. Chase Manhattan Mortgage Corp. (In re Scarborough), 461 F.3d 406 (3rd Cir. 2006).

The 2005 Amendment to the Bankruptcy Code added the definition of "debtor's principal residence" to Section 101 which is defined as a residential structure, whether or not it is attached to real property. 11 U.S.C. Section 101. The 2005 Amendment added Section 101(27B) to include "incidental property" defined as property commonly conveyed with a principal residence in the area where the property is located, easements, rights, appurtenances, fixtures, rents, royalties, mineral rights, oil or gas rights, profits, water rights, escrow funds or insurance proceeds, as well as replacements or additions. 11 U.S.C. 101, as amended by Pub. L. No. 109-8 (2005).

For purposes of Section 1322 (b)(2), the property rights listed are not considered additional collateral. The definition also clearly provides that other properties of the debtor are enough to deny protection against modification if the property is not conveyed with the debtor's principal residence in the area where the real property is located.

A creditor's secured claim may be modified even if the debtor's principal residence is not real property, but is a mobile home. See In re Johnson, 269 B.R. 246 (Bankr. M.D. Ala. 2001); See Cluxton v. Fifth bank (In re Cluxton), 327 B.R. 612 (B.A.P. 6th Cir. 2005) (mobile home part of real property).

The definition added by the 2005 Amendment does not change the results under 1322(b)(2). Therefore, a debtor may still modify a creditor's security interest in his/her principal residence, whether real property or otherwise, as long as it is fully unsecured by the value of the collateral and the Chapter 13 Debtor will be confirmed using Section 506(a) to determine the

secured status of a mortgage and then Section 1322(b) to "strip down" a mortgage not fully secured by the real estate and treat the claim as unsecured.