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Post-Confirmation Changes in Income and Circumstances In Chapter 13 Cases

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POST-CONFIRMATION CHANGES IN INCOME AND CIRCUMSTANCES IN CHAPTER 13 CASES

Most attorneys representing chapter 13 debtors would be absolutely delighted if, upon confirmation of the chapter 13 debtor's plan, their work was complete. However, life just doesn't work that way, and frequently debtors encounter additional financial problems after their chapter 13 case is confirmed. These financial difficulties may require modification of the confirmed chapter 13 plan.

Section 1329 of the Bankruptcy Code[1] provides for the modification of confirmed chapter 13 plans, as follows:

§ 1329. Modification of plan after confirmation

> (a) At any time after confirmation of the plan but before the completion of payments under such plan, the plan may be modified, upon request of the debtor, the trustee, or the holder of an allowed unsecured claim,[2] to --
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> (1) increase or reduce the amount of payments on claims of a particular class provided for by the plan;
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> (2) extend or reduce the time for such payments; or
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> (3) alter the amount of the distribution to a creditor whose claim is provided for by the plan to the extent necessary to take account of any payment of such claim other than under the plan.
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> (b) (1) Sections 1322(a), 1322(b), and 1323(c) of this title and the requirements of section 1325(a) of this title apply to any modification under subsection (a) of this section.
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> (2) The plan as modified becomes the plan unless, after notice and hearing, such modification is disapproved.

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[1] Title 11 of the United States Code.

[2] Prior to the 1984 amendments to § 1329, only the debtor could request modification of a chapter 13 plan. The Bankruptcy Amendments and Federal Judgeship Act of 1984 made it clear that the Trustee or the holder of an unsecured claim is also authorized to request a modification of a confirmed chapter 13 plan.

> (c) A plan modified under this section may not provide for payments over a period that expires after three years after the time that the first payment under the original confirmed plan was due, unless the court, for cause, approves a longer period, but the court may not approve a period that expires after five years after such time.

In 1993, Federal Rule of Bankruptcy Procedure 3015(g) was added to provide further guidance relating to the process involved in seeking modification of a confirmed plan. Fed. R. Bankr. P. 3015(g) states:

> **(g) Modification of Plan after Confirmation.** A request to modify a plan pursuant to § 1229 or § 1329 of the Code shall identify the proponent and shall be filed together with the proposed modification. The clerk, or some other person as the court may direct, shall give the debtor, the trustee, and all creditors not less than 20 days notice by mail of the time fixed for filing objections and, if an objection is filed, the hearing to consider the proposed modification, unless the court orders otherwise with respect to creditors who are not affected by the proposed modification. A copy of the notice shall be transmitted to the United States trustee. A copy of the proposed modification, or a summary thereof, shall be included with the notice. If required by the court, the proponent shall furnish a sufficient number of copies of the proposed modification, or a summary thereof, to enable the clerk to include a copy with each notice. Any objection to the proposed modification shall be filed and served on the debtor, the trustee, and any other entity designated by the court, and shall be transmitted to the United States trustee. An objection to a proposed modification is governed by Rule 9014.

This article will discuss some of the causes for, and the remedies to, some of the more frequent changes in the debtor's situation that would necessitate the filing of a plan modification, such as: (1) the debtor falling behind on postpetition mortgage payments and then seeking to modify the plan to provide for a cure of the postpetition default;[3] (2) a decrease in the debtor's income that would necessitate a reduction in plan payments, (3) seeking a modification to increase the amount or number of payments in order to provide for a postpetition claim;[4]

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[3] *In re Mendoza*, 111 F.3d 1264 (5th Cir. 1997); *In re Hoggle*, 12 F.3d 1009 (11th Cir. 1994); *In re McCullom*, 76 B.R. 797 (Bankr. D. Or. 1987); *In re Mannings*, 47 B.R. 318 (Bankr. N.D. Ill. 1985); and *In re Johnson*, 708 F.2d 865 (2d Cir. 1983).

[4] *In the Matter of Nelson*, 27 B.R. 341 (Bankr. M.D. Ga. 1983).

(4) seeking the sale or refinancing of property, the payments for which are being provided for under the confirmed plan; (5) seeking a modification to decrease the payments to a secured creditor due to a payment outside the plan[5] or (6) to modify the plan for the surrender of collateral to a creditor which would render that creditor unsecured.[6]

Plan Amendments Based Upon Change of Circumstances

It should be noted that a showing of substantially changed circumstances is not a prerequisite to modification of a confirmed chapter 13 plan.[7] The plain reading of the statutory language certainly imposes no such requirement. However, local practice may impose a requirement for a change in circumstances, or such a change will nonetheless be considered by the court to justify the necessity for the modification. Furthermore, the majority of the bankruptcy courts have held that the right of a *trustee* or an *unsecured creditor* to move for modification of a confirmed chapter 13 plan should be limited to situations in which there have been unanticipated changes in the debtor's income and/or expenses.[8]

It should also be noted that the language of §1329 does not allow for a *secured* creditor to seek modification of a confirmed chapter 13 plan. In fact, it is widely held that an order confirming a chapter 13 plan is a final order, and absent a timely filed appeal, such an order is

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[5] *In re Tucker*, 35 B.R. 35 (Bankr. M.D. Tenn. 1983).

[6] *In re Day*, 247 B.R. 898 (Bankr. M.D. Ga. 2000); *In re White*, 169 B.R. 526 (Bankr. M.D. N.Y. 1994); *but see Chrysler Fin. Corp. v. Nolan* (*In re Nolan*), 232 F.3d 528 (6 Cir. 2000).

[7] *In re Sounakhene*, 249 B.R. 801 (Bankr. S.D. Cal. 2000) citing *In re Powers*, 202 B.R. 618, 622 (B.A.P. 9th 1996). *But see In re Martin*, 232 B.R. 29 (Bankr. D. Mass. 1999).

[8] *In re Arnold*, 869 F.2d 240 (4th Cir. 1989); *In re Wilson*, 157 B.R. 389 (Bankr. S.D. Ohio 1993) (denying trustee's modification motion because change in circumstances was not unanticipated or substantial); *In re Fitak*, 19 C.B.C. 2d 1387, 92 B.R. 243 (Bankr. S.D. Ohio 1988), *aff'd*, 121 B.R. 224 (S.D. Ohio 1990). *But see Barbosa v. Solomon*, 235 F.3d 31 (1st Cir. 2000) (while modification does not require unanticipated change in circumstances, parties requesting modifications of chapter 13 plans must advance a legitimate reason for doing so, and they must strictly conform to the three limited circumstances set forth in section 1329); *Matter of Witkowski*, 16 F.3d 739 (7th Cir. 1994) (no change of circumstances need be shown); *In re Brown*, 219 B.R. 191 (B.A.P. 6th Cir. 1998) (unanticipated change of circumstances not prerequisite to modification motion); *In re Powers*, 37 C.B.C. 2d 192, 202 (B.R. 618) (B.A.P. 9th Cir. 1996) (substantial and unanticipated change of circumstances is not a prerequisite for a modification motion, but court can consider whether there has been such a change in deciding whether to grant the motion).

res judicata and the terms of the plan are not subject to collateral attack.[9] Even if the debtor seeks to modify a confirmed plan, the terms of the original plan will be held to be *res judicata* as to any creditor whose rights and payments remain unaffected by the proposed modification.[10]

One of the most problematic post confirmation issues derives from the concern over what effect is to be given to the order of confirmation emanating from the initial chapter 13 plan. Take, for example, the situation where, at the beginning of the chapter 13 debtor's case, the debtor has a house and two vehicles -- all of which have payments in arrears. The initial plan, as filed by the debtor, provides for a cure of the arrears on the homestead property, as well as a cure of the arrearages that have accrued on the two vehicles. Once the plan is confirmed, the values of the real and personal properties are established, as are the payments on a going forward basis. Subsequent to confirmation, the debtor faces a change in circumstances and has a drop in income. He defaults on the postpetition payments. It becomes apparent that he can no longer go forward with payments on both vehicles and wishes to delete one car from his plan -- that is, he wishes to return one car and continue with the plan only as it pertains to the mortgage on the real property and the payment on the one remaining vehicle. Can the debtor modify the plan to provide for surrender of the second car and the treatment of the resulting debt as an unsecured claim? The case law in this area is divided. The Sixth Circuit, and some bankruptcy courts, have stated that, once the plan is confirmed it cannot be modified to change what was initially a partially secured debt into an unsecured debt based upon the post-petition return of the

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[9] *In re Goos*, 253 B.R. 416 (Bankr. W.D. Mich. 2000), *citing In re Dunlap*, 215 B.R. 867, 869 (Bankr. E.D. Ark. 1997) (*citing Piedmont Trust Bank v. Linkous* (*In re Linkous*), 990 F.2d 160, 162 (4th Cir. 1993); *In re Szostek*, 886 F.2d 1405, 1413 (3rd Cir. 1989), 8 Collier on Bankruptcy 1327.02[1] (Lawrence P. King, 15th ed. 1996)). *See generally Stoll v. Gottlieb* 305 U.S. 165, 59 S. Ct. 134, 83 L.Ed. 104 (1938); *Sanders Confectionery Prod., Inc. v. Heller Fin., Inc.*, 973 F.2d 474 (6th Cir. 1992).

[10] *In re Evora*, 255 B.R. 336 (D. Mass. 2000); *In re Stage*, 79 B.R. 487 (Bankr. S.D. Cal. 1987).

collateral.[11] Other courts will allow such a modification, and will authorize the return of the second car and the treatment of the remaining debt (emanating from the return of the vehicle), as an unsecured debt to be handled under the chapter 13 plan as modified.[12] In jurisdictions where no modifications of secured debt are allowable, the debtor may have no choice but to convert the case to a chapter 7, or to dismiss the pending chapter 13 case and refile. The outcome may be the same even if, at the beginning of the chapter 13 case, the debtor was paying a secured debt on a vehicle and the vehicle was later substantially damaged or totally destroyed, in an uninsured accident. The inability to modify the plan, in these circumstances, puts the debtor in the position of having to pay a claim in excess of the amount attributable to said claim, or in excess of the percentage paid to other similar claims.

The case law is equally divided as to whether a debtor can modify a plan to include payments on previously unrecognized debt obligations. For example, if the debtor was current on the payments on his homestead property at the time he filed his bankruptcy petition (in a jurisdiction that allows for all current payments on secured debt to be paid outside the chapter 13 plan) and after confirmation of the chapter 13 plan, the debtor defaults on this mortgage obligation, can the debtor simply modify the chapter 13 plan, and include the curing of the post-petition arrearages on this mortgage under the chapter 13 plan as modified? Some courts will

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[11] *Chrysler Fin. Corp. v. Nolan* (*In re Nolan*), 232 F.3d 528 (6th Cir. 2000), *Sharpe v. Ford Motor Credit Co.* (*In re Sharpe*), 122 B.R. 708 (E.D. Tenn. 1991); *In re Meeks*, 237 B.R. 856 (Bankr. M.D. Fla. 1999); *In re Coleman*, 231 B.R. 397 (Bankr. S.D. Ga. 1999); *In re Dunlop*, 215 B.R. 867 (Bankr. E.D. Ark 1997), *In re Banks*, 161 B.R. 375 (Bankr. S.D. Miss. 1993), *Matter of Abercrombie*, 39 B.R. 178 (Bankr. N.D. Ga. 1984) and *In re Goos*, 253 B.R. 416 (Bankr. W.D. Mich. 2000) (all stating that § 1329 does not permit postconfirmation modification by surrender of collateral and reclassifying secured claim balance as unsecured).

[12] *In re Townley*, 256 B.R. 697 (Bankr. D.N.J. 2000); *In re Day*, 247 B.R. 898 (Bankr. M.D. Ga. 2000); *In re Waller*, 224 B.R. 876 (Bankr. W.D. Tenn. 1998); (*In re Nolan*), 232 F.3d 528 (6th Cir. 2000), (all stating a debtor may use § 1329 to surrender a vehicle and reclassify any deficiency claim as unsecured); *see also In re Zieder*, 263 B.R. 114 (Bankr. D. Ariz. 2001) (granting the modification in light of reconsideration of the claim that reduced the amount of the allowed secured claim to zero).

allow the plan to be amended to cure post-petition defaults;[13] other courts will only allow the debtor to add these new arrearages to an ongoing plan if the secured creditor does not object to the proposed modification. If the creditor objects, in these jurisdictions which only allow modification upon consent of the secured creditor, again the only remedy that may be available to the debtor is to dismiss the current chapter 13 case and refile a new case, or convert the pending chapter 13 case to a case under Chapter 7, receive a discharge of the unsecured debt, and then file a new chapter 13 case to deal with the new arrearages on the mortgaged property.

Debtors' counsel need be ever mindful of local rules and practices as to modification issues. In the Southern District of Florida, the bankruptcy court is fairly strict in entering orders of dismissal in chapter 13 cases, and usually provides, absent compelling circumstances, that the cases are dismissed with six months prejudice. The bankruptcy court in the Southern District of Florida also provides that the chapter 13 debtor can only have a maximum of 60 months to cure arrearages on secured debt, measured from the date of the filing of the initial chapter 13 case. These procedures were implemented to help alleviate the real or perceived problem of stacking -- that is the debtor filing one chapter 13 case, partially funding same and then dismissing the case and re-filing another case, which would effectively begin the repayment period on secured debt all over again. However, due to these more stringent dismissal rules, the Southern District of Florida is a little more lenient than other jurisdictions in allowing modifications to confirmed chapter 13 plans, particularly as it relates to secured claims. These rules may be unique to the Southern District of Florida, so it is essential that debtors' counsel be aware of local practice and procedure.

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[13] *In re Hoggle*, 12 F.3d 1008 (11th Cir. 1994) where court held that § 1322(b)(5) permits plan to cure any default, including those occurring post-petition. In this case, the Eleventh Circuit held that the debtor could use provisions of § 1329 to modify the plan to cure post-petition default.

In the cases where the debtors accumulate new unsecured debt during the chapter 13 proceeding, another practice pointer may be the consideration of a conversion of the chapter 13 case to a chapter 7 case, just prior to completion of the chapter 13 plan, in order to take advantage of § 348(d) of the Bankruptcy Code which provides for the discharge of debt incurred post-petition.[14] By virtue of this enactment, the valuation of the debtor's assets will be determined as of the date the bankruptcy petition is filed (with any increase in the valuation to be retained for the debtor's benefit); while additional debt incurred post-petition may be discharged upon conversion of the chapter 13 case to a case under Chapter 7.

Although rare, a chapter 13 plan could be modified to *increase* payments to creditors. The rationale for this upwards modification would likely be based upon a substantial increase in the debtor's disposable income or a substantial increase in the valuation or accumulation of

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[14] The relevant provisions of 11 U.S.C. § 348 provide:

§ 348(b): "Unless the court for cause orders otherwise, ... "the order for relief under this chapter" in a chapter to which a case has been converted under section 706, 1112, 1208, or 1307 of this title means the conversion of such case in such chapter.

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§ 348(d): "*A claim against the estate or the debtor that arises after the order for relief but before conversion in a case that is converted under section* 1112, 1208, or *1307 of this title,* other than a claim specified in section 503(b) of this title, *shall be treated for all purposes as if such claim had arisen immediately before the date of the filing of the petition.*" (emphasis added)

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§ 348(f):

> (1) Except as provided in paragraph (2), when a case under chapter 13 of this title is converted to a case under another chapter under this title --
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> (A) Property of the estate in the converted case shall consist of property of the estate, as of the date of filing the petition, that remains in the possession of or is under the control of the debtor on the date of conversion; and
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> (B) Valuations of property and of allowed secured claims in the chapter 13 case shall apply in the converted case, with allowed secured claims reduced to the extent that they have been paid in accordance with the chapter 13 plan.
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> (2) If the debtor converts a case under chapter 13 of this title to a case under another chapter under this title in bad faith, the property in the converted case shall consist of the property of the estate as of the date of conversion.

assets. Debtor's counsel, however, frequently seek modifications of chapter 13 plans for *decreases* in plan payments, brought about by a debtor's loss of income or because of unanticipated changes in circumstances.

Debtor's Responsibility for Reporting Changes and Modifying Plans

No existing Code section mandates a duty on the debtor or debtor's counsel to report changes in income and expenses. However, there are provisions that provide for the amendment of the debtor's schedules;[15] and failure to be cognizant of developing case law in this area may affect the debtor's future rights, in the absence of such amendments. It is essential to note here that if the debtor does not list pre-petition assets in his chapter 13 Schedules as initially filed with the Court, or subsequently file amendments to his schedules to list any assets obtained thereafter, the debtor may risk losing his entitlement to said assets. For example, in a case where a debtor accrued the right to a personal injury lawsuit post-petition, but failed to amend his schedules to reflect same, the Court held that the debtor could not preserve his rights in that potential suit, and his state court case was dismissed.[16]

Since the Code only requires the listing of *estimated* future income, there also appears to be no obligation, on the debtor's part, to report *increases* or *decreases* in income. However, chapter 13 trustees around the country are now requiring debtors to file copies of yearly tax returns with their offices (particularly in "suspect" situations) and if those returns reflect an increase of income beyond a certain percentage, the trustee will seek to have the plan modified to account for these increases in the debtor's disposable income. It is not surprising, however, that most of the modifications sought based on a *decrease* in income are initiated by the debtor and

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[15] F.R. Bankr. P. 1009.

[16] *In re Barr,* 207 B.R. 168 (Bankr. N.D. Ill. 1997), *In re Lundy,* 216 B.R. 609 (Bankr. E.D. Mich. 1998) but see *In re Ross*, 278 B.R. 269 (Bankr. M.D. Ga. 2001).

debtor's counsel as it soon as it becomes apparent that the debtor lacks the financial wherewithal to continue funding the chapter 13 plan as proposed.

Procedure for Seeking Plan Modifications

Jurisdictions also differ as to how post-petition modifications to chapter 13 plans may be handled. Federal Rule of Bankruptcy Procedure 2002(a) (5) provides for 20 days' notice to creditors (and the chapter 13 trustee) of the time fixed to accept or reject a proposed modification of the plan. Federal Rule of Bankruptcy Procedure 3015(g) requires notice of the deadline for objections to a proposed modification and, if an objection is filed, the hearing on the objection must be sent to the debtor, the trustee and all creditors unless the court orders otherwise. At a minimum, the notice must be sent to those creditors whose rights are to be changed by the proposed modification. Local rules of practice will dictate who is to receive notice of the proposed plan modifications.[17] Therefore, some jurisdictions may only require notice to be served on the affected creditor; while some may require a more formal motion and noticing procedure including notice to *all* creditors before any modification will be approved. [18] Furthermore, certain courts will allow modifications to confirmed chapter 13 plans involving secured debt only if the affected secured creditor demonstrates actual approval and consent to the proposed modification.[19] Still other jurisdictions may allow for modifications confirmed Chapter 13 on a negative notice basis -- i.e., a hearing will not be held unless an objection is filed; otherwise the modification is approved as filed.

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[17] *See* 8 *Collier on Bankruptcy* ¶ 1329.05[2] p.1329-10 (15th Ed. Rev. 1999)

[18] *See* F.R. Bankr. P. 3015(g).

[19] *In re AWUA*, 1997 WL 1524800 (Bankr. E.D. Va. 1997).

Under the plain language of the statute, the plan as modified becomes the plan unless, after notice and hearing, such modification is disapproved.[20] The language states that the modification *is* the plan unless disapproved. Accordingly, the debtor, after filing the modification and giving notice, could immediately begin making payments under the plan as modified because the modified plan becomes the plan unless (or until) it is disapproved.[21] Again, local practice will govern whether this approach is acceptable to the chapter 13 trustee and/or the court.

In some jurisdictions, where the debtor is faced with payments on secured debt subject to variable interest rates, modifications to the plan to account for these variations may be handled by a letter to the trustee and a simple increase/decrease in the plan payments, to reflect those periodic adjustments. However, debtor's counsel must, once again, always be mindful of the local practice. In the Southern District of Florida, the chapter 13 trustees take the position that the trustee can only disburse funds pursuant to a confirmed plan. Accordingly, these chapter 13 trustees require a plan modification each and every time the variable interest rate changes on the secured debt payments. Nonetheless, one trustee in the Southern District of Florida will consider accepting additional nominal payments from the debtor, in the initial plan as proposed, earmarked for future fluctuations in the interest rate. However, this trustee mandates that it would be the debtor's responsibility to monitor the payments remitted under the plan and the increases required by the change in interest rates, and to modify the plan if the initial funds ever prove insufficient to cover the fluctuations over the term of the plan. Further, if the variable interest rate does not increase as expected, the question could later arise -- would the excess funds the debtor paid be treated as disposable income and simply increase the distributions to the

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[20] 11 U.S.C. § 1329(b)(2).

[21] *In re Taylor*, 215 B.R. 882 (Bankr. S.D. Cal. 1997); *In re Eves*, 67 B.R. 964 (Bankr. N.D. Ohio 1986).

unsecured creditors; or would the debtor be able to pay off his plan earlier than originally anticipated, by virtue of the excess payments? In the situations where these variable interest rate debts occur, it is an administrative burden on all the parties involved to require a formal plan modification each time there is a change in the rates, but it appears as if there is no clear answer or quick solution currently available to remedy this concern.

Trustee's Investigation of Increases in Income During Pending Plan

In general, the chapter 13 trustee will continue to investigate increases in disposable income for the first 36 months of any confirmed chapter 13 plan. How the trustees conduct these investigations is very much the subject of local practice. In most jurisdictions, the trustees will require the filing of copies of the debtor's annual tax returns -- but the degree to which these returns are scrutinized and actions taken based upon them, is also subject to local practice. In most jurisdictions, the trustees have in mind a generally defined percentage increase in income levels that is acceptable without modification of the plan. However, these trustees will seek to have the plan modified based on significant changes in the debtor's disposable income, if the disposable income exceeds these frequently unstated and ill-defined parameters.

The trustees will also investigate other sources of non-wage increases. For example, if the debtor should receive an amount of money in post-petition lottery winnings, the chapter 13 trustees will very likely take the position that such winnings have increased the debtor's disposable income and should be used to fund additional payments to unsecured creditors under a chapter 13 plan.[22]

Another source of contention arises when, post-petition, a debtor seeks to sell property that is subject to the terms and conditions of a chapter 13 plan, or to refinance real property that

[22] *In re Koonce*, 54 B.R. 643 (Bankr. D. S.C. 1985).

is covered under a plan. Again, when the debtor seeks to pay off a confirmed chapter 13 plan during the first 36 months the plan is pending, the trustee will first investigate the source of the funds being used by the debtor to pay off the plan. If this investigation reflects that the debtor has come into a certain sum of money that is sufficient to pay off the plan as proposed, but the proposed plan calls for less than a 100% distribution to unsecured creditors, the trustee may then require that, in addition to applying these "payoff" amounts into the plan, the debtor must continue with the ongoing monthly payments for the remainder of the first 36 months of plan payments as called for under the plan as originally confirmed. It is generally the trustee's position that this sale or refinancing does not affect the debtor's ability to continue to commit his *future* income to fund the plan. These excess amounts (ie. what the debtor anticipated would be the "payoff" amount) would then be paid to the unsecured creditors, thereby increasing the ultimate return to the unsecured creditors. Under these circumstances, it may also be the trustee's position that this "newly discovered income", derived from the sale or refinancing, constitutes excess disposable income. However, the bankruptcy court in the Southern District of California, has held that a chapter 13 debtors' equity in their home was a capital asset and not "disposable income" which the debtors, absent their decision to refinance their home and voluntarily apply these loan proceeds to prepayment of their confirmed plan, could not have been compelled to apply toward the plan payment.[23]

The tension caused by the issue of what exactly constitutes a pre-petition asset as opposed to what constitutes disposable income can also arise when a debtor lists as an asset, a pre-petition cause of action (for example, a potential personal injury claim) in his schedules at a stated value. Later, during the course of the confirmed plan, the debtor actually recovers funds

[23] *In re Sounakehene*, 249 B.R. 801 (Bankr. S.D. Cal. 2000); *see also In re Burgie*, 239 B.R. 406, 408-09 (B.A.P. 9th Cir. 1999); *In re Martin*, 232 B.R. 29 (Bankr. D. Mass. 1999); *but see In re Muessel*, 292 B.R. 712 (1st Cir. BAP 2003) for a discussion of a debtor's attempt to refinance his property gone bad.

from the personal injury case. The chapter 13 trustees have taken the position that the income from the lawsuit, the estimated amount of which was previously considered in the liquidation analysis in order to arrive at confirmation of the plan, now constitutes disposable income, the excess of which should be used by the debtors to increase distributions under the chapter 13 plan. The debtors, of course, argue that the lawsuit was listed and valued as an asset at the time the case was filed, and considered in determining how much the debtor must pay to his unsecured creditors in order to meet the liquidation test required by 11 U.S.C. § 1325(a)(4). To now treat the proceeds of the suit as disposable income would make the debtor pay twice for the same asset, and still bear all of the risk of recovery. The courts are inconsistent in their determinations regarding this issue.[24]

Further complicating matters is the issue of whether disposable income is to be considered at all, by any court considering modifications to confirmed chapter 13 plans. There is currently a split in the case law dealing with this issue.[25]

A similar issue frequently arises when a debtor seeks to refinance real property that is covered under a confirmed chapter 13 plan. Here, the debtor generally seeks to refinance property treated in a plan in order to: (1) reduce the interest rate being paid and/or (2) to bring down the amount of monthly payments required under the plan, and/or (3) to cure either pre- or post-petition arrearages due under the original mortgage. In other words, the debtor generally has a specific monetary reason to seek the post-petition re-financing of his property interests. However, as stated above, chapter 13 trustees have successfully argued that any excess money

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[24] *In re Smith,* 2004 W.L. 41401 Bankr. W.D. Mo.) and *In re* Ferretti, 203 B.R. 796 (Bankr. S.D. Fla. 1996).

[25] *See In re*: *Sounakhene* 249 B.R. at 801, *In re Forbes*, 215 B.R. 183, 191 (B.A.P. 8th Cir.1997) and *In re Moss,* 91 B.R. 563 (Bankr. C.D. Cal. 1988). (Disposable income test of 1325(b) is not listed in 1329(b)(1) and court should not apply disposable income test to debtor's proposed modification), *but see In re Martin*, 232 B.R. 29, 35-36 (Bankr. D. Mass. 1999).

that is ultimately obtained from the refinancing should be applied to unsecured debt, particularly during the first 36 months of the plan. This result would certainly serve as a disincentive for any debtor contemplating refinancing his property interests, post-petition. Furthermore, some title companies will refuse to fund a refinance unless the debtor first obtains a discharge of his chapter 13 case, which, of course, requires the complete funding of the chapter 13 plan as originally proposed or as modified. Accordingly, if the trustee insists on a modification to a confirmed chapter 13 plan to require not only the application of funds derived from the refinancing, but the continuation of monthly payments required under the first 36 months of the plan as originally confirmed, seeking such a refinancing of the debtor's property interests may actually result in a disservice to the client's overall financial interests.

Another issue comes to the forefront when a debtor contemplates selling a parcel of real property, where payments are being remitted to the secured creditor under a confirmed chapter 13 plan. The issue in this situation deals with who gets any increase in equity in the property that has accumulated since the time of the filing of the bankruptcy petition. In Florida, which is a 100% homestead exemption state,[26] if the debtor sold his homestead property outside of the bankruptcy proceeding, he would be entitled to retain all of the equity as his homestead exemption. Other states, with different homestead exemptions, require that any excess equity be used to fund the chapter 13 plan and virtually reclassifies this increase in equity as increased disposable income payable to unsecured creditors. At least one bankruptcy judge in the Southern District of Florida has held that any accumulated appreciation goes to the debtor, after confirmation, and any increase in equity accrues for the benefit of the debtor rather than

[26] Fla. Stat. §222.25 and Article X, Section 4 of the Florida Constitution.

becoming disposable income subject to creditor claims. This result appears consistent with the provisions of 11 USC § 348(f)(1)(A).[27]

The Effect and Timing of Conversions

At the onset of the chapter 13 case, the debtor may seek to lien strip the value of certain secured collateral (such as liens encumbering real and personal property – most particularly liens encumbering vehicles). If the chapter 13 case is later converted to a case under Chapter 7, who gets the benefit of the lien strip or does the effect of the lien strip disappear upon conversion? In one unreported case, one bankruptcy judge in the Southern District of Florida[28] was presented with a fact scenario in which the debtors were seeking an order of the court, in their converted chapter 7 case, avoiding the mortgage lien on their homestead which the debtors asserted was previously "stripped"[29] under the chapter 13 plan. The debtors relied on 11 U.S.C. § 348(f)(1)(b) to support their position. However, the bankruptcy court ruled that a creditor should not be bound by a chapter 13 plan when the debtors have failed to comply with it themselves citing to *In re Pearson*, 214 B.R. 156, 161 (Bankr. N.D. Oh 1997). The court further stated . . . [A]llowing debtors to strip liens that are not subject to redemption in chapter 7 cases before completion of the plan would amount to an abuse of the bankruptcy process in light of this Court's understanding of the Bankruptcy Code and the Supreme Court cases on the subject of lien stripping." citing *Pearson*, 214 B.R. at 161 (omitting citations).

The issue is further complicated by the question of when the court will issue a recordable order on a lien strip, particularly as it relates to real property. Some bankruptcy courts will not

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[27] *See* 11 U.S.C. § 348.

[28] *In re Marante, Order Denying Motion for Recordable Order Avoiding Lien*, Case No. 02-13969-BKC-AJC, April 16, 2003.

[29] In the Southern District of Florida, debtors can "strip off" non-purchase money liens on homestead property where there is no value in the collateral to secure said lien. *In re Baez*, 244 B.R. 480 (Bankr. S.D. Fla. 2000).

enter such an order, or allow the order to be recorded in the public records, until all payments under the chapter 13 plan are completed in order to prevent the debtor from entering into a chapter 13 case, stripping a lien off of a piece of property, obtaining a recordable order that reduces or eliminates the value of the lien, and then converting to a Chapter 7 proceeding. In another unreported case from the Southern District of Florida, another bankruptcy judge denied the debtor's request for the entry of a recordable order, allowing for a strip off of a second mortgage on real property, once the chapter 13 case had been converted to one under chapter 7.[30] However, other Courts will allow the orders to be recorded early on in the process; frequently as soon as the debtor's initial chapter 13 case is confirmed.

Dismissal of Chapter 13 Cases

Some of the triggering events which would cause debtors to consider dismissal of a chapter 13 include the following: (1) the inability to continue to fund the chapter 13 plan; (2) the post-petition sale of assets where the debtor wishes to retain the equity; and (3) the accumulation of post-petition assets which would negate the necessity for the chapter 13 proceeding. These are some of the most frequent events which prompt the motion for dismissal of a pending chapter 13 case. However, there are other times and triggering events that may make dismissal appropriate.

Some dismissals of chapter 13 cases are voluntary; some are not. Bankruptcy courts are becoming much more aggressive in dismissing chapter 13 cases for bad faith; particularly where repetitive filings occur.[31] The courts are also dismissing cases for bad faith where other questionable practices are demonstrated. For example, in the case of *In re Love*, 957 F.2d 1350

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[30] *See In re Tucker*, Order Denying Motion by Debtor For Recordable Order Stripping Off Second Mortgage In Accordance With Confirmed Chapter 13 Plan, Case No. 00-25155-BKC-RBR, March 7, 2003.

[31] *See In re Eisen*, 14 F.3d 469 (9th Cir. 1993), *but see In re Barker*, 129 B.R. 287 (M.D. Fla. 1991)

(7th Cir. 1992) the circuit court upheld the bankruptcy court's dismissal of a chapter 13 case on grounds of bad faith, where a tax protestor had proposed several plans that did not indicate a serious intent to repay any of the tax debt.[32]

On the voluntary front, the Code appears to give debtors the absolute right to dismiss their chapter 13 cases at any time.[33] However, some bankruptcy courts are carefully scrutinizing the debtor's right to dismiss chapter 13 proceedings, particularly when there are motions for conversion pending[34] or where repetitive filings have occurred.

In addition, some courts have assessed attorney's fees against the debtor and/or debtor's counsel for the act of filing certain chapter 13 cases, where the court has found that the filing constituted bad faith.[35]

The message here is clear: debtors' counsel need be wary of dismissing and re-filing chapter 13 cases. If the debtor seeks modification to a confirmed chapter 13 plan in order to achieve a certain result, and if those efforts to modify are not successful (such as seeking refinancing of real property in order to pay off a confirmed plan), the decision to simply dismiss the pending chapter 13 case and re-file may not constitute an unchallenged alternative and should be investigated carefully.

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[32] *See also In re Maurice*, 167 B.R. 114 (Bankr. N.D. Ill. 1994) (where the bankruptcy court held that the debtor's neglecting to file a plan, unrealistic contents of plan when filed, and tactic of mailing plan to incorrect location supported conclusion that chapter 13 petition was filed in bad faith to stave off enforcement of a state court judgment without having to file a supersedeas bond; the case was dismissed for bad faith and sanctions were imposed against the debtor and debtor's attorney).

[33] *11 U.S.C. § 1307(b)*; *See In re Neiman*, 257 B.R. 105 (Bankr. S.D. Fla. 2001) *citing Barberi v. RAJ Acquisition Corp. (In re Barbieri),* 199 F.3d 616 (2nd Cir. 1999); *In re Patton*, 209 B.R. 98 (Bankr. E.D. Tenn. 1997); *In re Haper-Elder*, 184 B.R. 2d 403 (Bankr. D.D.C. 1995).

[34] *In re Gaudet*, 132 B.R. 670 (D.R.I. 1991); *Molitor v. Eidson (In re Molitor)*, 76 F.3d 218, 220 (8th Cir. 1996); *In re Johnson*, 228 B.R. 663 (Bankr. N.D. Ill. 1999); *In re Vieweg*, 80 B.R. 838 (Bankr. E.D. Mich. 1987) and *In re Powers*, 48 B.R. 120 (Bankr. M.D. La. 1985).

[35] *In re Maurice*, 167 B.R. at 126; *In re Armwood*, 175 B.R. 779 (Bankr. N.D. Ga. 1994*); In re Peia*, 145 B.R. 749 (Bankr. D. Conn. 1992); *In re Mergenthaler*, 144 B.R. 632 (Bankr. E.D.N.Y. 1992*); In re Standfield*, 152 B.R. 528 (Bankr. N.D. Ill. 1993) and *In re Huerta*, 137 B.R. 356 (Bankr. C.D. Cal. 1992); *but see Barker*, 129 B.R. at 289.

Conclusion

It is becoming increasingly more apparent that chapter 13 trustees are no longer simply satisfied that the debtor has met the liquidation test (i.e., the debtors are paying back to unsecured creditors the full value of any retained non-exempt collateral), but are also fully investigating all of the debtor's anticipated and unanticipated disposable income, and are pushing the debtors to fund higher and higher returns to unsecured creditors, even after confirmation of the chapter 13 plan.

It is therefore essential that debtors' counsel be fully aware of the state of the law and the practices and procedures followed by bankruptcy judges before whom they may appear. These practices and procedures may vary greatly, depending on the issues involved. Accordingly, it is more important than ever that debtors' counsel take an active and aggressive role in reviewing the particulars of the debtor's assets, income and liabilities.

Most attorneys engaged in chapter 13 filings find that debtors frequently understate their liabilities and overstate their income in their initial contact with counsel. A thorough review of the debtor's documents (such as tax returns, pay stubs, etc.) will reflect a more realistic view of the debtor's income and can also pinpoint areas for further investigation -- i.e., whether past overtime employment shall continue, etc. Further, a detailed review of the debtor's current living expenses and the amount of their pre-petition debt frequently reflects that the debtors are in worse financial straits than they would first admit. This intensive document review also provides debtors' counsel with an opportunity to reinvestigate, and perhaps recategorize assets and liabilities, such that the debtor can more easily participate in and realistically fund a chapter 13 plan, and hopefully limit the need to seek post-confirmation modifications of a confirmed plan.

Nonetheless, confirmed chapter 13 plans can be and should be modified as the debtors' needs change. But, debtors' counsel must be aware of the requirements and the restrictions that are imposed by the statutes, the case law and local practice and procedure. Counsel should also provide the same level of preparation and scrutiny to considerations involved in the modification of a chapter 13 plan, as they would provide in the initial stages of any chapter 13 case.