Chapter 13: Developing Issues and the Challenges for Debtors, Creditors and Trustees

Randy J. Creswell, Moderator
Perkins Thompson; Portland, Maine

Peter C. Fessenden
Standing Chapter 13 Trustee (D. Me.); Brunswick

Hon. Enrique S. Lamoutte
U.S. Bankruptcy Court (D. P.R.); San Juan

Marques C. Lipton
Law Office of Nicholas F. Ortiz, P.C.; Boston

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Should Trustees or Debtors File Surrogate Claims On Behalf of Secured Creditors? Procedures and Considerations

Randy J. Creswell, Esq.
Perkins Thompson, P.A., Portland, Maine

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I. Introduction

This paper addresses the processes by which debtors and Chapter 7 trustees may file proofs of claim on behalf of prepetition creditors pursuant to § 501(c) of the United States Bankruptcy Code (the "Code") and Federal Rule of Bankruptcy Procedure 3004 – such claims being otherwise known as "surrogate claims" – and the reasons why such surrogate claims can be useful in furthering the debtor's interests in his or her case or the trustee's interests in administering the bankruptcy estate. This paper will also address why filing surrogate claims can be an effective tool in dealing with such secured creditors and their claims in any bankruptcy case, and Chapter 13 cases in particular.

II. The Surrogate Claim Process Generally – 11 U.S.C. § 501(c) and Federal Rule of Bankruptcy Procedure 3004

Section 501 of the Code, which is implemented through Federal Rule of Bankruptcy Procedure 3004, addresses the filing of proofs of claims or interests in bankruptcy cases, including claims filed by debtors or trustees on behalf of creditors pursuant to § 501(c). Section 501 provides in its entirety as follows:

> **Filing of proofs of claims or interests**
>
> (a) A creditor or an indenture trustee may file a proof of claim. An equity security holder may file a proof of interest.
>
> (b) If a creditor does not timely file a proof of such creditor's claim, an entity that is liable to such creditor with the debtor, or that has secured such creditor, may file a proof of such claim.
>
> (c) If a creditor does not timely file a proof of such creditor's claim, the debtor or the trustee may file a proof of such claim.
>
> (d) A claim of a kind specified in section 502(e)(2), 502(f), 502(g), 502(h) or 502(i) of this title may be filed under subsection (a), (b), or (c) of this section the same as if such claim were a claim against the debtor and had arisen before the date of the filing of the petition.

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> (e) A claim arising from the liability of a debtor for fuel use tax assessed consistent with the requirements of section 31705 of title 49 may be filed by the base jurisdiction designated pursuant to the International Fuel Tax Agreement (as defined in section 31701 of title 49) and, if so filed, shall be allowed as a single claim.

11 U.S.C. § 501.

It is under § 501(c) of the Code that trustees and debtors find the statutory authority to file proofs of claim on behalf of creditors, including secured creditors, in the event that such creditors for whatever reason fail to file such claims themselves. *See, e.g., In re Nat'l Cattle Cong.*, 247 B.R. 259, 271 (Bankr. N.D. Iowa 2000) ("A secured creditor may be dragged into the bankruptcy involuntarily by way of the trustee or debtor filing a proof of claim on the creditor's behalf. . . . The Code authorizes a debtor to file a proof of claim on the creditor's behalf in order to protect the debtor by causing the creditor's secured claims to be considered in the bankruptcy action.") (citations omitted).

Federal Rule of Bankruptcy Procedure 3004 provides the following process for filing surrogate claims:

> If a creditor does not timely file a proof of claim under Rule 3002(c) or 3003(c), the debtor or trustee may file a proof of the claim within 30 days after the expiration of the time for filing claims prescribed by Rule 3002(c) or 3003(c), whichever is applicable. The clerk shall forthwith give notice of the filing to the creditor, the debtor and the trustee.

Generally speaking, non-governmental proofs of claim are timely submitted if filed within 90 days of the first date set for the debtor's meeting of creditors under § 341 of the Code. *See* Fed. R. Bank. P. 3002(c). Where a creditor timely files a proof of claim in a debtor's bankruptcy case, a surrogate claim is not permitted. *Id.*; *see also* 11 U.S.C. § 501(c).

Importantly, debtors and trustees only have a narrow window of time – 30 days from the expiration of the proof of claim bar date – to file surrogate claims on behalf of creditors that have failed to, or elected not to, timely file proofs of claim in the debtor's case. *See* Federal Rule of Bankruptcy Procedure 3004. Moreover, an untimely surrogate claim is just as susceptible to disallowance as is a creditor's untimely proof of claim. *See In re Gonzalez*, 490 B.R. 642, 650 (B.A.P. 1st Cir. 2013) (citations omitted) ("[S]ince the amended Rule 3004 took effect [2005]. . . the courts have strictly construed the bar date of Rule 3004, as they have other bar dates in bankruptcy.").

Notably, neither § 501(c) of the Code nor Rule 3004 apply to creditors (or their claims) who have not been scheduled or been given notice of the bankruptcy case, as such creditors are not subject to any bar date established in the case. *See, e.g., In re Pena*, 46 B.R. 527, 528 (Bankr. S.D. Fla. 1985) ("That provision [*i.e.*, § 501(c) of the Code] is not applicable with respect to an unscheduled creditor whose claim is not subject to any bar date."). Accordingly, and as will be discussed further below, it is important (for a whole host of reasons in addition to any surrogate claim filing considerations) that all debtor's creditors be scheduled and that such creditors receive notice of the filing of the debtor's bankruptcy case.

Debtors or trustees filing surrogate proofs of claim are subject to the same requirements of proof and substantiation as any creditor would be in filing a proof of claim in any bankruptcy case. *See* 11 U.S.C. § 501; *see also* Federal Rule of Bankruptcy Procedure 3001(a), (c), (d), and (e). If such surrogate claims are timely filed and properly supported, then such claims are entitled to the presumption of *prima facie* validity. Federal Rule of Bankruptcy Procedure 3001(f).

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Finally, after the Bankruptcy Court Clerk has provided notice of the surrogate claim to the creditor, the Chapter 7 trustee, and the debtor, *see* Rule 3004, the creditor may seek leave of the Bankruptcy Court to amend the surrogate claim.[1] *See* Advisory Notes to 2005 Amendments to Fed. R. Bankr. P. 3004 ("[S]ince the debtor and trustee cannot file a proof of claim until after the creditor's time to file has expired, the rule no longer permits the creditor to file a proof of claim that will supersede the claim filed by the debtor or trustee. The rule leaves to the courts the issue of whether to permit subsequent amendment of such proof of claim.").

III. Reasons for Filing Surrogate Claims Generally

While Chapter 7 trustees often have good reasons for filing surrogate claims in the cases they are administering in order to further or aid that administrative process (*e.g.*, to eliminate contingent claims under § 502(e)(1)(B) of the Code),[2] § 501(c)'s statutory authority to file surrogate claims in cases was "designed principally to prevent creditors from depriving debtors of the benefit of a discharge under [the Code.]" *In re Hemingway Transport, Inc.*, 993 F.2d 915, 927 (1st Cir. 1993) (citations omitted).

For instance, if a debtor schedules in an asset case an otherwise nondischargeable tax debt (pursuant to § 727 of the Code in Chapter 7 cases), and the relevant taxing authority neglects or fails for whatever reason to timely file a proof of claim for that tax debt, then the debtor has the economic incentive to file a timely surrogate claim on behalf of that taxing

[1] *See, e.g., In re Kelley*, 259 B.R. 580 (Bankr. E.D. Tex. 2001) (Bankruptcy Court declined use of § 105 equitable powers to deem secured creditor's late claim as "amending" rather than "superseding" surrogate claim filed by chapter 13 debtor).

[2] *See* 11 U.S.C. § 502(e)(1)(B) ("Notwithstanding subsections (a), (b), and (c) of this section and paragraph (2) of this subsection, the court shall disallow any claim for reimbursement or contribution of an entity that is liable with the debtor on or has secured the claim of a creditor, to the extent that— . . . (B) such claim for reimbursement or contribution is contingent as of the time of allowance or disallowance of such claim for reimbursement or contribution[]"). This section arises frequently in the context of CERCLA and environmental cases, such as in the First Circuit's seminal decision in *In re Hemingway Transport, Inc., supra.*

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authority so that its unsecured claim (with likely priority status under § 507(a)(8)) would be paid, in whole or in part, in the bankruptcy case. That way, that debtor's post-discharge tax obligation would be reduced or eliminated in furtherance of the Code's policy of providing that debtor with a fresh start.

> The debtor often has an incentive to file a claim on behalf of a creditor if that creditor's claim may be excepted from discharge. If a claim is excepted from discharge the creditor will have the right to continue pursuing the debtor, notwithstanding the discharge entered in the bankruptcy proceeding. Therefore, the debtor has an incentive to maximize the distribution from the bankruptcy estate to a creditor holding such a claim, and to thereby minimize the remaining claim which may be enforced against the debtor after the proceeding.

2 Bankruptcy Litigation § 10:15 (July 2014).

Other instances in which a debtor (or a trustee) would, or should, consider filing a surrogate claim on behalf of prepetition creditor are as follows:

(1) To provide a mechanism by which the debtor or trustee can seek the resolution of a dispute with a certain creditor through the Code's claims allowance and disallowance process;

(2) To provide some payment, in whole or in part, of certain claims that may otherwise be entirely dischargeable (such as a loan from a family member);

(3) To prevent a surplus case and otherwise prevent a windfall for the debtor (from the perspective of a trustee);[3]

(4) To prevent, or aid in the objection of, contingent claims pursuant to § 502(e)(1)(B) of the Code, which, in effect, prevents the potential of double-recoveries under certain circumstances (in many instances concerning guarantors or sureties of the debtor); and

(5) As stated above, to prevent creditors from depriving the debtor of the benefit of her discharge under the Code through the payment of otherwise non-dischargeable debts.[4]

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[3] For instance, in *Yoon v. VanCleef*, 498 B.R. 864 (N.D. Ind. 2013), the United States District Court reversed the Bankruptcy Court's finding that the Chapter 7 Trustee exceeded her authority in filing surrogate proofs of claim on behalf of all creditors scheduled in the case that had not filed claims in order to head off an anticipated surplus case. There, the District Court specifically noted that the trustee had not breached any fiduciary duties by filing the surrogate claims on behalf of the creditors, although thereby necessarily delaying the administration of the estate, as the Bankruptcy Court had intimated.

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This is by no means an exhaustive list of the general reasons why trustees or debtors may want to file surrogate claims in their cases, and creative and astute debtors, trustees, and their counsel should look for opportunities to take advantage of the surrogate claims process for the benefit of their clients and in furtherance of their obligations under the Code.

IV. Reasons for Filing Surrogate Claims on Behalf of Secured Creditors

For many of the same reasons identified in § 3 above concerning the filing of surrogate claims generally, debtors or trustees may also want to file surrogate claims on behalf of secured creditors in the debtor's case. Simply because a creditor is partially or wholly secured does not insulate it or change the analysis for whether, for example, a debtor would want a partially undersecured creditor (such as a taxing authority with prepetition tax liens against exempt property of the debtor) to receive distributions in the bankruptcy case and thereby reducing that creditor's post-discharge claim against the debtor. Consequently, trustees, and debtors in particular, should be mindful of the general considerations ordinarily applicable to the filing of surrogate claims when determining whether to file such a claim on behalf of a secured creditor.

That said, the primary reason many trustees or debtors may wish to file a surrogate claim on behalf of a secured creditor is to aid the surrogate filer in the administration of the bankruptcy case, particularly in the context of Chapter 13 cases with respect to mortgage lenders. Without belaboring the well-documented reasons here, in recent years it has become more and more apparent that many sprawling, national mortgage lenders and their servicers are woefully inadequate when it comes to their meaningful (or any) participation in Chapter 13 cases for purposes of presenting their secured claims (through the claim-filing process) and otherwise presenting credible arrearage figures and amounts so that a Chapter 13 debtor can put forth a

[4] *But see, e.g., In re Nettles*, 251 B.R. 899 (M.D. Fla. 2000) (finding that trustee only permitted to file surrogate claims with respect to non-dischargeable debts).

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viable plan of reorganization. Those deficiencies and lack of participation on the part of such mortgage lenders or their servicers also create serious problems for Chapter 13 trustees seeking to administer and distribute plan payments pursuant a confirmed Chapter 13 plan or perhaps in the form of adequate protection payments pending such confirmation. Without a timely proof of claim on file for such a secured lender demonstrating amounts due, arrearages, and proper documentation supporting the claim, in many instances, the ability of Chapter 13 trustees to administer their cases and a debtor's ability to put forth a viable plan or reorganization stalls, languishes for months on end, or stops completely – and all at the expense of debtors seeking to avail themselves of their rights under the Code and the Bankruptcy Court's limited time and resources.

One potential solution for this situation is the filing of surrogate claims on behalf of such secured-mortgage lenders in Chapter 13 cases by, in most instances, debtors who are in the best position to determine prepetition arrearage amounts, amounts due on the underlying obligation, interest rates, and the value of the collateral (*i.e.,* their residence). This way, debtors can bring recalcitrant or oblivious lenders into the bankruptcy process and force them to meaningfully participate in the case. *See, e.g., Matter of Penrod*, 50 F.3d 459, 462 (7th Cir. 1995) ("A secured creditor may be dragged into the bankruptcy involuntarily, because the trustee or debtor (if there is no trustee), or someone who might be liable to the secured creditor and therefore has an interest in maximizing the creditor's recovery, may file a claim on the creditor's behalf.").

Further, once the surrogate claim is filed in the case, and assuming it otherwise satisfies all the requirements for a claim entitled to the presumption of validity, the Chapter 13 trustee is free to make distributions to that creditor in accordance with the filed claim as appropriate depending on the status of the Chapter 13 case. The existence of the surrogate claim will also

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allow the bankruptcy process to proceed at an appropriate pace, thereby reducing the administrative costs to debtors, trustees, and the Court's time and resources. Finally, it will force the mortgage lender to participate meaningfully in the case and, if it still elects to sit on the sidelines or refuses to engage, the surrogate claim as filed by the debtor will become the economic reality for that mortgage lender for purposes of the case, which may also have important consequences for that lender in the confirmation process and likely at the conclusion of the case under Federal Rule of Bankruptcy Procedure 3002.1.

In fact, some of these considerations caused the Bankruptcy Court for the District of Massachusetts to issue its Standing Order 2015-03 (effective May 1, 2015), whereby debtors *are required* to file surrogate claims on behalf of so-called "Designated Creditors" (*i.e.,* "a named creditor which has been separately treated in a plan (e.g., a secured creditor, priority creditor, a creditor with a non-dischargeable claim or a creditor to whom section 1301 applies)") who do not timely file proofs of claim by the applicable bar date. A copy of Standing Order 2015-03 is attached for reference. It will be interesting to see how this new Standing Order impacts Chapter 13 practice in the Massachusetts Bankruptcy Court, and at this time, no other Bankruptcy Courts in the First Circuit have adopted similar measures with respect to the mandatory filing of surrogate claims for certain creditors.

One final note on the filing of surrogate claims for secured creditors whose claims are not secured by the debtor's residence or other collateral susceptible to being crammed down under § 506 of the Code (*e.g.,* equipment, certain vehicles, and the like). Because a surrogate claim can be filed in certain instances by the debtor on behalf of the secured creditor, so long as the claim is filed based upon the best information available to the debtor and in good faith, the debtor can control the narrative with respect to potential valuation issues in reference to the collateral; this

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could be quite valuable to the debtor in the context of either valuation hearings under § 506 of the Code or a motion to allow or disallow the claim.

For instance, if a properly filed surrogate claim with respect to collateral subject to cramdown is not challenged by the trustee or superseded by the secured creditor, then the debtor may be able to control the valuation figure for the collateral for purposes of paying off the lien during the bankruptcy case, thereby causing the collateral to be free and clear of the lien post-bankruptcy for the debtor's benefit. *Matter of Penrod*, 50 F.3d at 462 (citing 11 U.S.C. § 506(d)) ("If the secured creditor's claim is challenged in the bankruptcy proceeding and the court denies the claim, the creditor will lose the lien by operation of the doctrine of collateral estoppel."). Nevertheless, a debtor cannot seek to use the surrogate claim process to artificially invalidate a secured creditor's lien or secured claim by filing an *unsecured* claim on behalf of a creditor with a legally-existing secured claim. *See In re Mansaray-Ruffin*, 530 F.3d 230, 235 (3d Cir. 2008) (footnote omitted) ("A debtor cannot invalidate a secured creditor's lien by filing an unsecured claim on behalf of the creditor."). Nor is the filing of a surrogate claim on behalf of a creditor the equivalent of that creditor's consent to the Bankruptcy Court's jurisdiction over the claim. *See In re Nat'l Cattle Cong.*, 247 B.R. at 271.

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UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS

STANDING ORDER 2015-03

Unless otherwise ordered by the court, for all cases commenced on or after May 1, 2015, Rule 13-13 is amended to provide new language for subsections (a), (b), (c) and (d). The language of the current subsections (c), (d), (e) and (f) will remain unchanged except it will now be contained in lettered subsections (e), (f), (g) and (h). The amended rule is as follows:

(a) All secured, priority, or unsecured creditors of the debtor must have an allowed claim in order to participate in distributions under the plan. To be eligible to have an allowed claim, a creditor, including a secured creditor who holds a mortgage on the debtor's property, must timely file a proof of claim that conforms to Official Form B10 and Fed. R. Bank. P. 3001, unless a surrogate proof of claim is timely filed by the debtor or chapter 13 trustee in accordance with Fed. R. Bankr. P. 3004. A proof of claim, other than a proof of claim filed by a governmental unit, is timely filed if filed no later than 90 days after the first date set for the meeting of creditors or the order of conversion to a chapter 13 case, unless the court grants an extension of time to file a secured proof of claim. A proof of claim filed by a governmental unit is timely filed if it is filed within 180 days after the date of the order for relief or the order of conversion to a chapter 13 case, unless the court grants a motion for an extension of time to file the proof of claim.

(b) On motion filed by a creditor before the expiration of the time to file a proof of claim, the court may extend the deadline by not more than 30 days from the date of the order granting the motion (the original or extended original deadline being the "Initial Filing Deadline"). If a named creditor which has been separately treated in a plan (e.g., a secured creditor, a priority creditor, a creditor with a non-dischargeable claim or a creditor to whom section 1301 applies) (a "Designated Creditor") does not timely file a proof of claim, the debtor must file a surrogate proof of claim for that creditor pursuant to Fed. R. Bankr. P. 3004 within 30 days after the expiration of the Initial Filing Deadline (the "Surrogate Filing Deadline"). In the event the plan provides for payment to a Designated Creditor with an unfiled claim and no surrogate claim has been filed by the Surrogate Filing Deadline, the deadline for filing a surrogate claim for that Designated Creditor shall be deemed extended for an additional 30 days (the "Extended Surrogate Filing Deadline"); and the chapter 13 trustee must (a) file an objection to confirmation of the plan if the plan is not confirmed or a motion to dismiss the case no later than 10 days after the Surrogate Filing Deadline, on the grounds that the plan is not feasible because of the proposed distribution to a claimant for whom a claim has not been filed, and (b) seek an expedited or emergency determination and/or a hearing to be set prior to the

Extended Surrogate Filing Deadline. The debtor or trustee may seek a further extension of time for filing a surrogate proof of claim by filing, prior to the expiration of the Extended Surrogate Filing Deadline, a motion to further extend that deadline. In the event a Designated Creditor does not timely file a proof of claim and a surrogate claim is not timely filed in accordance with the foregoing deadlines, the chapter 13 trustee shall not distribute any monies to such creditor even though the creditor is listed in the debtor's schedules or the plan provides for payment to such creditor. Failure by debtor's counsel to file a surrogate proof of claim for a Designated Creditor who has not timely filed a proof of claim may be a factor in the Court's determination of the compensation due to that attorney.

(c) If a claim is secured by a mortgage or other collateral, the claimant shall attach a copy of the original note, mortgage or security agreement to the proof of claim. If the claimant is not the original holder of the note and mortgage or security agreement, in addition to the documents described above, the claimant shall attach copies of any and all assignments or other appropriate documentation sufficient to trace the chain of ownership of the note, mortgage, or security agreement, and to establish its standing to file the proof of claim. In addition, a proof of secured claim shall include a separate document setting forth a detailed itemization of all amounts asserted to be due. The itemization shall set forth an accounting of the principal, interest, costs and all expenses charged under the agreement or statute under which the claim arose, including but not limited to an itemization of expenses of any notices, foreclosure sales, advertisements, appraisals, and attorneys' fees charged. The Court, in its discretion, may order a claimant or a claimant's attorney to file an application for compensation and reimbursement of expenses in accordance with MLBR 2016-1 or an accounting of any and all amounts due, including prepetition or postpetition arrearages.

(d) A debtor or trustee filing a surrogate claim in accordance with Fed. R. Bankr. P. 3004 shall affix such documentation to support the claim as may be available but shall be excused from the provisions of (a) above and Fed. R. Bankr. P. 3001(c)(2) and, in the event the surrogate claim is in connection with a claim secured by a security interest in the debtor's principal residence, the filing of Official Form B10 (Attachment A).

(e) Only the provisions of MLBR 3007-1(a), (c), (d) and (f) apply to chapter 13 cases. A party objecting to claims shall attach a notice to the objection filed with the Court, which shall advise claimant(s) that a response to the objection must be filed within 30 days of the filing of the objection with the Court. The objecting party shall serve the objection and the notice on the claimant at the address noted on the proof of claim or any subsequent address provided to the Court by the claimant and upon any other party entitled to notice together with a certificate of service.

(f) Within seven (7) days after filing a response to an objection to a proof of claim, the objecting party (whether the trustee, counsel to the debtor, or a pro se debtor) shall confer with counsel to the claimant, either in person or by telephone conference to make a good faith effort to resolve or narrow disputes as to the contents of the objection to claim. Counsel to the objecting party, the chapter 13 trustee or the pro se debtor shall be responsible for initiating the conference by telephone, facsimile, email, first class mail, or in person. Such communications shall be for the purposes of initiating the conference only, and the conference must be held either in person or by telephone. The Court shall not schedule a hearing on an objection to claim unless counsel to the objecting party or a pro se debtor files a certificate stating that the conference was held, together with the date and time of the conference, and the names of the participating parties. If the conference is not held despite timely efforts to initiate the conference, the party initiating the conference must file a statement attesting to the efforts made to initiate the conference. In the event the parties do not hold the required conference, the Court may order appropriate sanctions, including sustaining or overruling the objection to claim or awarding monetary sanctions. The requirement of a conference shall not apply in the event the Court determines that expedited or emergency consideration of the objection to claim is warranted.

(g) Objections to claims shall be served and filed with the Court within thirty (30) days after the deadline for filing proofs of claim or within such additional time as the Court may allow upon the filing of a motion to extend time and for good cause shown. Any claim to which a timely objection is not filed shall be deemed allowed and paid by the chapter 13 trustee in accordance with the provisions of the confirmed plan. The Court, in its discretion, may overrule an untimely objection to a proof of claim.

(h) If the Court has determined the allowed amount of a secured or unsecured claim in the context of a valuation hearing pursuant to 11 U.S.C. § 506, the debtor or trustee need not file an objection to a secured creditor's proof of claim that varies from the Court's determination, and the chapter 13 trustee shall make distribution in accordance with the Court's order.

Melvin S. Hoffman, Chief Judge

Judge William C. Hillman

Judge Joan N. Feeney

Judge Henry J. Boroff

Judge Frank J. Bailey

Dated: April 15, 2015

Can a Chapter 13 Debtor Receive a Discharge When They Have Not Maintained Direct Payments to Their Mortgage Holder?

Marques C. Lipton, Esq.
Law Office of Nicholas F. Ortiz, P.C., Boston, Massachusetts

I. Introduction

This paper addresses the question of whether a Chapter 13 debtor that has failed to make all direct post-petition payments under a cure and maintain plan may still receive a discharge under Section 1328 of the Bankruptcy Code. Recent case law has held that such a debtor is not entitled to a discharge. This paper also provides guidance to practitioners in advising their clients of the ramifications of failing to make all direct payments and ways to mitigate the problems that may arise.

II. Scenario

A Chapter 13 debtor has a cure and plan as allowed under Section 1322(b)(5). After completion of all payments "inside the plan," the Chapter 13 trustee files a report indicating debtor has made all payments due. Pursuant to Rule 3002.1(g), the mortgagee is then required to file a statement indicating that the debtor either has or has not made all of their direct post-petition mortgage payments. If the mortgagee states that the debtor has not made all of their post-petition direct payments and the debtor does not dispute that they have missed payments, can the Court grant a discharge pursuant to Section 1328?

Section 1328 provides that the Court shall grant a discharge once all of the payments have been made "under the plan. Are regular monthly mortgage payments to a secured creditor considered payments "under the plan?"

III. In re Heinzle, 511 B.R. 69 (W.D. Texas 2014).

In Heinzel, the chapter 13 debtors' confirmed plan provided for them to cure mortgage arrears over 60 months and to make regular monthly payments directly to the mortgagee. During the course of the case, the debtors fell behind on their mortgage payments, but continued to make regular payments to the trustee. After receiving all of the debtors' plan payments, the trustee filed the Notice of Final Cure Payment pursuant to Fed. R. Bankr. P. 3002.1(f). The mortgagee then filed a response under Fed. R. Bankr. P. 3002.1(g), asserting that the debtors were $33,467.35 in arrears, post-petition. The debtors did not dispute the mortgagee's statement and the trustee filed a motion to deny the debtors' discharge on the grounds that the debtors had failed to make all payments under the plan.

The Trustee argued that, under the plan, the debtors assumed the duties of the trustee to make direct payments, the direct payments were "payments under the plan" and the failure to make such payments was a default that should preclude the debtors' discharge.

The debtors argued that the language of Section 1328 requires the Court to grant a discharge once the trustee has certified that all payments due under the plan had been made. They pointed out because Section 1328(a)(1) excluded post-petition mortgage arrears from their general discharge, the mortgage holder's rights and interests would not be affected by the discharge, and the mortgage holder was still free to pursue its state law remedies. With that being the case, the debtors asked; if the mortgage holder and unsecured creditors are not adversely affected by the discharge, why should the trustee, or the court, have any objection to the debtors receiving a discharge? Additionally, the debtors argued, because Section 1329 precludes modification of the plan after the completion of all payments, there is a conflict between the Code sections where the plan is "completed" under Section 1329(a) but not under Section 1328 (a).

The "linchpin" question for the Court then, was whether the direct payments to the mortgage holder constituted "payments under the plan?" Citing a number of cases addressing the specific question of what the term "payment under the plan" means, the Court concluded that direct payments to mortgage holders were "payments under the plan." The Court noted that the terms "outside the plan" and "inside the plan" are confusing and not technically accurate. Instead, one should refer to "payments through the trustee" or "direct payments." Each of these would be payments under the plan. It follows then, that if a debtor hasn't made all payments "under the plan" the court should not grant them a discharge.

Heintzle is not binding in the First Circuit, and there doesn't appear to be binding authority on the issue. At least one trustee in the First Circuit has indicated that they will not object to discharge in these situations, however, some judges may deny a motion for discharge if the debtor isn't current with post-petition payments.

IV. Client Counseling and Practitioner's Tips

a) Clients filing cure and maintain plans should be advised prior to filing that failing to make payments directly to the mortgage holder may have an impact on their discharge. Clients should further be advised to contact their bankruptcy attorney as soon as they start missing payments so that the issue can be addressed before it is too late.

b) When this situation does arise after the plan term has ended, debtors may consider converting the case to Chapter 7 in order to receive a discharge under Section 727. The means test, presumption of abuse and non-exempt property (acquired pre-or post-petition) are things that should be looked at before deciding whether to convert a case to Chapter 7 after the expiration of the plan term. Remember that under Section 1306, property of the estate includes property acquired after the commencement of the case.

c) Even if there is no objection to the discharge, and the court allows a discharge, one should still advise the client that the mortgage claim is excepted from discharge. If the debtor is in default at the time of discharge, and the mortgage holder subsequently forecloses, the debtor will be liable for any deficiency.

Complications That May Arise By a Secured Creditor's Failure to File a Proof of Claim in a Chapter 13 Case

Marques C. Lipton, Esq.
Law Office of Nicholas F. Ortiz, P.C., Boston, Massachusetts

In a Chapter 13 case, the trustee will generally only pay out claims that are allowed under Section 502. Where a debtor's plan provides for curing arrears on a secured claim, the amount of arrears stated in the plan is generally based on the best information available to the debtor at the time of filing, usually the amount shown on the most recent mortgage statement or credit report. Once the secured creditor files its proof of claim, and the claim is allowed, the amount of arrears stated in the proof of claim, not the plan, controls what the trustee will distribute. The secured creditor's total arrearage will often be higher than the amount provided for in the plan due to legal and other fees that may be imposed pursuant to the promissory note. Where a proof of claim states higher arrears than the plan, the debtor must either amend the plan to provide for full payment of the arrears as stated in the claim or object to the claim. Often times, the secured creditor will object to confirmation of the plan if it does not provide for full payment of the arrears. However, sometimes they will not object and the plan will be confirmed with the amount of arrears in the plan differing from the amount stated in the proof of claim. Once the plan is confirmed with the pre-petition arrears differing from the amount in the claim, the trustee will usually move to dismiss the case for feasibility, or request a modification of the plan. In a case where the secured creditor has not filed any claim, the debtor should file a surrogate claim so that the arrears can be paid through the plan.

Pursuant to the District of Massachusetts' Standing Order 2015-03, for all cases commencing after May 15, 2015, all secured, priority and unsecured creditors must file a timely proof of claim in order to participate in plan distributions. If a secured creditor fails to file a proof of claim, the debtor (or trustee) must file a surrogate claim in order for the claim to be paid. The deadline for filing surrogate claims is thirty days after the deadline for filing claims. In the event no claim or surrogate claim is filed and the plan provides for separate treatment of that creditor's claim (i.e. a secured, priority or creditor with non-dischargeable claim), then the trustee must file an objection to the plan, if the plan has not been confirmed, or a motion to dismiss for feasibility, if the plan has already been confirmed. The trustee must also seek expedited or emergency determination. If no claim or surrogate claim is filed, the trustee may not make distributions to that creditor, even if they are provided for in the plan. Further, the failure of debtor's counsel to file a surrogate claim may be a factor in the court's determination of the attorney's compensation.

Debtors' counsel in all districts should always be aware of proof of claim deadlines and monitor claim filings to ensure that claims provided for in the plan are filed by creditors and if not, ensure that surrogate claims are filed.

DEVELOPING ISSUES IN CHAPTER 13

AMERICAN BANKRUPTCY INSTITUTE
NORTHEAST CONFERENCE
Falmouth, Massachusetts
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Materials Prepared by
Peter C. Fessenden, Esq.
Standing Chapter 13 Trustee – District of Maine

These materials were prepared for an educational program and do not necessarily reflect the opinion of the author, nor do they preclude any position that he may assert in a specific case.

PAY BY PROOF OR PAY BY PLAN?

Early in every bankruptcy case, the debtor files schedules, statements and a plan. Schedules D, E and F list secured creditors, priority unsecured creditors and general unsecured creditors, respectively. Creditors are given notice of the bankruptcy filing and are informed of the bar dates by which they must file proofs of claim. Official Form 9I, captioned "Notice of Chapter 13 Bankruptcy Case, Meeting of Creditors, & Deadlines," is sent to all scheduled creditors as listed on the matrix submitted with the original petition, and as thereafter supplemented or amended. Official Form 9I states on the front: "Deadline to File a Proof of Claim: For all creditors (except a governmental unit): [date]. Governmental units have 180 days from the date of filing the case or the date of conversion to file proof of claim (except as otherwise provided in Fed.R.Bankr.P. 3002(c)(1)." An "Explanation" on the reverse of the form states, in relevant part:

> If you do not file a Proof of Claim by the "Deadline to File a Proof of Claim" listed on the front side, you might not be paid any

> money on your claim from other assets in the bankruptcy case. *To be paid, you must file a Proof of Claim*, even if your claim is listed in the schedules filed by the debtor. [emphasis added]

Like all official forms, 9I is a creature of the bankruptcy rules themselves. It was proposed to and approved by the Supreme Court and, after notice, was not set aside by any action of Congress.

Section 1325(a) requires that a claim be "allowed" in order to be paid. Section 1325(a)(4) addresses *allowed* unsecured claims; §1325(a)(5) provides for *allowed* secured claims. Section 502(a) says, "A claim or interest, proof of which is filed under section 501…, is deemed allowed unless a party in interest … objects." It does *not* say that filing is a condition of allowance or that allowance cannot be effected by some other means.

The rules say otherwise with respect to unsecured claims in Chapter 13. Fed.R.Bankr.P. 3002(a) provides, "An unsecured creditor … must file a proof of claim … for the claim … to be allowed, except as provided in Rules 1019(3), 3003, 3004 and 3005." (None of the exceptions excuses the requirement of filing a proof; each offers an alternative method by which a proof is filed – carried over to Chapter 7 if filed prior to conversion (R.1019(3)); procedures in Chapters 9 and 11 (R.3003); filing by debtor or trustee (R.3004); filing by guarantor, surety, indorser or codebtor (R.3005).) Fed.R.Bankr.P. requires that "after a plan is confirmed, distribution shall be made to creditors whose claims have been allowed…"

Despite Rules 3002(a) and 3021, §1327(a) provides broadly: "The provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan." Given the maxim that the statute trumps rules, a court order confirming the debtor's plan which provides for payment of a claim without a filed proof would be valid, binding and operative.

Supreme Court and recent First Circuit case law supports that principle. In *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 130 S.Ct. 1367, 176 L.Ed2d 158 (2010), a unanimous Court held that where the bankruptcy court had jurisdiction over the parties and the subject matter, its order was final and binding, irrespective of its legal error, in the absence of a timely appeal by the disgruntled student loan creditor.

More recently, the First Circuit BAP ruled that a confirmation order providing for payment of a creditor's claim trumped a conflicting order disallowing the same claim. In *DiRuzzo v. Pawtucket Credit Union*, __ B.R. __ (1st Cir. BAP 2015) (Cary, B.J.), the debtors' plan was confirmed before the bar date. Following stripoff of the creditor's wholly unsecured junior mortgage, the confirmation order included the following language:

> The second mortgage claim by Pawtucket Credit Union will be allowed as a wholly unsecured claim pursuant to the Order Granting Motion to Modify Secured Claim … Notwithstanding anything in the confirmed Chapter 13 Plan to the contrary, the proposed strip-off or modification of the second mortgage in favor of Pawtucket Credit Union on the Debtors' property … shall not be effective unless and until a discharge has been entered on the Bankruptcy Court's Docket in the Chapter 13 case.

General unsecured creditors were to "receive not less than 67% of the amount of their claims duly proved and allowed by the Court."

Pawtucket did not file a proof of claim until five months after the bar date, to which the trustee objected on the grounds of timeliness. In the absence of response, the court sustained the trustee's objection.

Despite his own objection and the disallowance of the credit union's claim, the trustee paid over $41,000 to Pawtucket. Believing that he had erred, the trustee filed a motion with the bankruptcy court to recover the money. On the grounds that both parties contributed to an erroneous distribution/receipt of funds, Judge Finkel exercised the Wisdom of Solomon and ordered Pawtucket Credit Union to return half of the funds to the estate. *In re DiRuzzo,* 513 B.R. 422 (Bankr.D.R.I. 2014). Neither party was satisfied. Both appealed.

In a unanimous decision by Judge Cary, the First Circuit Bankruptcy Appellate Panel discussed the conflicting standards between the filing of claims ("Disallowed claims will not participate in the case or receive any payment with regards to that claim." Citing *In re Ruiz Martinez*, 513 B.R. 779, 783 (Bankr.D.P.R. 2014)) and the binding effect of a confirmed plan ("There must be finality to a confirmation order so that all parties may rely upon it without concern … of a later change…" *New Hampshire v. McGrahan*, 459 B.R. 869, 874 (1st Cir. BAP 2011)). Citing *United States v. Monahan*, 497 B.R. 642, 651 (1st Cir. BAP 2013) and *Factors Funding Co. v. Fili*, 257 B.R. 370, 373 (1st Cir. BAP 2001), as underscored by the United States Supreme Court in *United Student Aid Funds, Inc. v. Espinosa*, supra., the panel reaffirmed the latter.

So long as all parties had full notice of the provisions of the plan, and the confirmation order was drafted by the Chapter 13 trustee, Due Process was satisfied.

> Thus, although PCU failed to comply with the provisions of the Bankruptcy code and Bankruptcy Rules which require an unsecured creditor to file a proof of claim in order to have an allowed claim and receive distributions, it is clear that, in light of *Espinosa* and its progeny, the binding effect of the confirmed plan trumps the claims allowance process in this case.

Pawtucket Credit Union v. Boyajian, __ B.R. __ (1st Cir. BAP 2015) (Slip Op. at 14.). The BAP gave the whole baby to the credit union which was not required to return any funds to the trustee.

New England practice has varied from district to district in the past. In Massachusetts, provisions of the confirmed plan routinely substituted for the filing of a proof of claim, and trustee administration was comfortable with that approach. No claims are paid without a proof of claim in Connecticut, but there is no possibility of conflict between the confirmation order and a filed claim because confirmation does not occur until after the date. In Maine, confirmation occurs early and payments may flow before the bar date, but the requirement of a proof of claim as a precondition for payment is part of the plan; local rules require a claims allowance motion to address all claims in detail after the bar date. New Hampshire confirms early but, like Connecticut, does not pay until after the bar date when a disbursement (claims allowance) motion provides specificity.

The purpose underscoring the requirement of a proof of claim is to ensure accuracy and to prevent mis-disbursements. The proof of claim form is submitted under pains and penalties of perjury. It specifies an amount and offers both a contact address and a payment address. It should be submitted by an identifiable individual who provides his or her telephone number. It is reassuring to the trustee's auditors.

That being said, from time to time in the trajectory of some Chapter 13 cases, it is necessary to provide for payments to creditors and claimants in the absence of a proof of claim. All parties in interest – and especially the Chapter 13 trustee – should take pains to ensure that any court order authorizing and directing payments in the absence of a filed proof of claim provides an audit trail as close as possible to that offered by a proof of claim. At minimum, the order should state the precise dollar amount of the allowed claim (articulating interest computations, if any, if it is a secured claim), any collateral if secured, its priority status if any, and the address to which payments are to be sent. The order should also state the method by which a change of address for payments could be made during the travel of the case.

Plan Payment Defaults for "Non-Plan" Payments

Section 1307(c) provides that the bankruptcy court may dismiss a Chapter 13 case or convert it to proceeding under another chapter "for cause." It then lists eleven non-exclusive causes. They include, "(4) failure to commence making timely payments under §1326," "(6) material default by the debtor with respect to a term of a confirmed plan," and "(11) failure of the debtor to pay any [post-petition] domestic support obligation." Section 1328(a) sets forth a requirement for discharge that a debtor must complete "all payments under the plan." Clearly, "plan payments" include payments made by a debtor to the Chapter 13 trustee for distribution to creditors. It is not so clear what other kinds of payments may be "plan payments," which if not made would justify dismissal, conversion or denial of discharge.

Section 101 offers no help. Neither "payment" nor "payment under the plan" is a defined term. Section 1326 bears the caption, "Payments" but offers no definition. Section 1326(a) would seem to permit the inference that "payments" are limited to the three kinds of payments set forth in subsections (A), (B) and (C): proposed by the plan to the trustee; scheduled in a lease of personal property directly to the lessor; and, that provide pre-confirmation adequate protection to a secured creditor. However, neither §1307(c)(4) nor §1326(a) state that they are exclusive.

The sweeping provisions of §1327(a) bring into play both §1307(c)(6) and §1328(a). If the provisions of the confirmed plan require payments other than those made to the Chapter 13 trustee, *a fortiori* they are payments under the plan. For instance, in the proposed national Chapter 13 form plan, Part 3/§3.1 includes a provision that "debtors will maintain the contractual installment payments on the claims listed below…" Similar provisions are included in many form plans currently in use throughout the country. A plan requirement becomes binding once the court grants confirmation based on that plan. If the order confirming the plan requires a direct payment, it becomes a plan payment within the rubric of §1307(c) and §1328(a).

In addition, expenses that appear on Schedules I and J may be deemed to be plan payments, and failure to pay them may justify denial of discharge and dismissal of the case. *In re Roberts*, 279 F.3d 91 (1st Cir. 2002), held that the debtors were not entitled to a discharge of their pre-petition debts and their case was properly dismissed when they amassed substantial post-petition tax obligations, despite the fact that they paid the full amount of their confirmed plan obligation to the trustee. The facts in *Roberts* are not directly on all fours with this issue, since the monies paid by the debtors during the arc of their Chapter 13 case were disbursed by agreement toward the post-petition tax debt rather than for their pre-petition creditors. Not addressed is the situation where post-petition taxes went unpaid but plan distributions were administered according to the original confirmation order. Current sophistication and attentiveness among creditors and Chapter 13 trustees means that it will be very rare for a debtor to complete payments to the trustee if s/he is accruing significant post-petition debt.

The separate articulation of failure to pay post-petition DSO obligations as a cause for either dismissal under §1307(11) or denial of discharge under §1328(a) could imply that failure to pay unidentified post-petition obligations would not have those consequences. However, the DSO protections were added in 2005 as part of BAPCPA and more likely reflect a "belt and suspenders" approach for the protection of DSO creditors.