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Flip You For It: Who Gets the Undistributed Funds Held by the Chapter 13 Trustee After Conversion?

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Of all the parties interested in a Chapter 13 case, no one is more disappointed to see a Chapter 13 case fail resulting in a conversion to Chapter 7 than the receiving Chapter 7 trustee. The debtor may be disappointed that his financial plan to get him back on the straight and narrow went down in flames but secretly, he is probably relieved that he doesn't have to make those monthly plan payments anymore. The creditors are likely annoyed as they will no longer get any distributions on their claim. However, they can at least write off the obligation as a bad debt. What about the Chapter 13 trustee? No more monthly statutory fee from this debtor but on the flip side; no more "baby-sitting" a debtor that couldn't make his plan payments if his life depended on it. That administrative hassle is over! But what about the Chapter 7 trustee? How does she even fit into this picture?

In many chapter 13 cases, the Chapter 13 Trustee is holding funds in preparation of distributing them to creditors pursuant to a confirmed plan of reorganization. Within 44 days of filing a Chapter 13 case, the debtor must commence making plan payments to the Chapter 13 Trustee[2]. Generally speaking, the Chapter 13 Trustee must hold those funds and cannot disburse them absent a court order. Typically that order is the order confirming the Chapter 13 plan. These plan payments made by the debtor and held by the Chapter 13 trustee pending a court order can be significant if the case has never been confirmed or if the confirmation order provides that funds be held pending some future event. These funds are property of the bankruptcy estate pursuant to 11 U.S.C. §1306(a)(2). But what happens when the debtor or the court converts the case to one under Chapter 7? Don't these "post-conversion funds" get turned over the Chapter 7 trustee for administration? The answer is mostly likely a resounding "NO."

Before 1994, these "post-conversion funds" went in any of three directions: (1) back to the debtor (<u>In re Boggs</u>, 137 B.R. 408 (Bkrtcy.Ct W.D.Wash. 1992)); (2) to the creditors pursuant to the confirmed chapter 13 plan (In re Waugh, 82, B.R. 394 (Bkrtcy.Ct.W.D.Pa. 1988)); or (3) to the newly created Chapter 7 estate (In re Calder, 973 F.2d 862 (C.A. 10 1992) and In re Lybrook, 951 F.2d 136 (C.A. 7 1991))[3]. So depending on what circuit you were in, it was possible that the Chapter 7 trustee would get the post-conversions funds to administer. In 1994, Congress gave us 11 U.S.C. §348(f). This section clearly changed the playing field. If the post-conversion funds were made from post-petition earnings of the Debtor, none of those funds belonged to the Chapter 7 trustee. The assets of the estate are determined as of the date of the petition, NOT the date of conversion[4]. Assets in a chapter 7 case are defined by 11 U.S.C. §541(a)(1). Under this section, only assets that existed as of the date of commencement are property of the estate. Clearly, post-petition earnings are not property of a Chapter 7 the estate. So the newly created Chapter 7 case is deemed to have been commenced months or even years earlier when the original bankruptcy petition was filed. Consequently, all of the post-petition payments to the Chapter 13 trustee that have accumulated to become the post-conversion funds do not belong to the Chapter 7 trustee[5].

So who gets these post-conversion funds? The U.S. Supreme Court recently decided Harris v. Viegelahn, 135 S.Ct. 1829 (2015) to answer that question. Simply put, absent a showing of bad faith, the debtor gets the funds[6]. What about the confirmed plan? Isn't that a binding contract between the debtor and the creditors?[7] What about court orders for approved administration expenses under 11 U.S.C. §503(b)? Shouldn't the Chapter 13 trustee use the post-conversion funds to comply with those pre-conversion court orders? According to Harris, the answer is "NO."

The crux of the issue is that immediately upon conversion of the case from Chapter 13 to Chapter 7, the services of the Chapter 13 trustee are terminated[8]. But what exactly does "termination" mean? Some believed that the Chapter 13 trustee could still abide by previously entered court orders to distribute plan payments per a confirmed plan or pay administrative orders for legal fees, etc. Taking a step back, the Harris court looked at what exactly were the services of the Chapter 13 trustee[9]. It found that the Chapter 13 services was the disbursement of payments to creditors[10] via the distribution of payments in accordance with the plan[11]. Again, once the case was converted, those services were terminated by §348(e). Thus, any previous orders by the court confirming the plan and approving §503(b) claims were no longer binding on the Chapter 13 trustee. She can no longer make distribution to any creditors, administrative or otherwise.

What about the Chapter 13 trustee's obligation after conversion? According to the Rules, the Chapter 13 trustee has 30 days to file and transmit to the U.S. Trustee a final report and account[12] and turn over any records and estate assets to the Chapter 7 trustee[13]. There does not appear to be any duty of the Chapter 13 trustee to distribute the post-conversion funds, as again, they are not estate assets. So, how does the debtor become entitled to them? Simply put, "returning undistributed wages to the debtor, . . . renders no Chapter 13 authorized "service"[14]. Returning funds to the debtor is not a Chapter 13 trustee services as it is not making a "payment to creditors."[15]

In summary, upon conversion from Chapter 13 to Chapter 7, the Chapter 13 trustee is no longer able to provide any trustee services. That includes paying any creditors; secured, administrative or otherwise. She is divested of all of her trustee duties other than preparing a final accounting and turning records and property of the estate over to the successor Chapter 7 trustee. However, returning the post-conversion funds to the debtor is not a "service" and is permissible[16]. Creditor can protect themselves from this outcome by requiring the plan to provide for regular disbursements[17].

1. Ms. Krohn has been a licensed bankruptcy attorney in the District of Nevada for 22 years and a Chapter 7 panel trustee for 4 years.

2. 11 U.S.C. §1326(a)(1) requires plan payments to commence within 30 days of the plan being filed with the court. Absent a court order after notice and a hearing, Fed. R. Bankr. P. 3015(b) requires that a plan be filed within 14 days after the order for relief or afer entry of an order converting the matter to a chapter 13 case.

3. Harris v. Viegelahn, 135 S.Ct. 1829 (2015).

4. *See* 11 U.S.C. §348(f)(1)(A).

5. You may get a different result if the post-conversion funds can be traced back to proceeds from the sale of an asset or from tax refunds.

6. Harris, 135 S.Ct. at 1835.

7. *See* 11 U.S.C. §1327(a).

8. *See* 11 U.S.C. §348(e) and Harris, 135 S.Ct. at 1836.

9. Harris, 135 S.Ct. at 1838.

10. Harris, 135 S.Ct. at 1838.

11. Harris, 135 S.Ct. at 1838.

12. Fed. R. Bankr. P. 1019(5)(B)(ii).

13. Fed. R. Bankr. P. 1019(4).

14. Harris, 135 S.Ct. at 1838.

15. Harris, 135 S.Ct. at 1838.

16. Harris, 135 S.Ct. at 1838.

17. Harris, 135 S.Ct. at 1839-1840.

135 S.Ct. 1829
Supreme Court of the United States

Charles E. HARRIS, III, Petitioner
v.
Mary K. VIEGELAHN, Chapter 13 Trustee.
No. 14–400. | Argued April 1, 2015. | Decided May 18, 2015.

Synopsis
Background: Following conversion of his case from Chapter 13 to Chapter 7, debtor filed motion to compel Chapter 13 trustee to turn over undistributed funds that had been collected pursuant to confirmed Chapter 13 plan. The United States Bankruptcy Court for the Western District of Texas granted the motion, and trustee appealed. The District Court, David Alan Ezra, Senior District Judge, 491 B.R. 866, affirmed. Trustee appealed. The Fifth Circuit Court of Appeals, James E. Graves, Jr., Circuit Judge, 757 F.3d 468, reversed and remanded. Certiorari was granted.

[Holding:] The Supreme Court, Justice Ginsburg, held that undistributed plan payments made by a debtor from his or her wages and held by the Chapter 13 trustee at the time of the case's conversion to Chapter 7 must be returned to the debtor, not distributed to creditors.

Reversed and remanded.

West Headnotes (33)

[1] Bankruptcy
Discharge

Bankruptcy Code provides diverse courses overburdened debtors may pursue to gain discharge of their financial obligations, and thereby a "fresh start."

Cases that cite this headnote

[2] Bankruptcy
Voluntary Cases

Chapter 7 of the Bankruptcy Code allows a debtor to make a clean break from his financial past, but at a steep price: prompt liquidation of the debtor's assets.

1 Cases that cite this headnote

[3] Bankruptcy
Creation of estate; time
Bankruptcy
Operation and effect

When a debtor files a Chapter 7 petition, his assets, with specified exemptions, are immediately transferred to a bankruptcy estate. 11 U.S.C.A. § 541(a)(1).

Cases that cite this headnote

[4] Bankruptcy
Representation of debtor, estate, or creditors
Bankruptcy
Sale or Assignment of Property
Bankruptcy
Distribution

Chapter 7 trustee is charged with selling the property in the estate and distributing the proceeds to the debtor's creditors. 11 U.S.C.A. §§ 704(a)(1), 726.

Cases that cite this headnote

[5] Bankruptcy
After-acquired property; proceeds; wages and earnings

Chapter 7 estate does not include the wages a debtor earns or the assets he acquires after the bankruptcy filing. 11 U.S.C.A. § 541(a)(1).

1 Cases that cite this headnote

[6] Bankruptcy
After-acquired property; proceeds; wages and earnings

While a Chapter 7 debtor must forfeit virtually all his prepetition property, he is able to make a "fresh start" by shielding from creditors his postpetition earnings and acquisitions. 11 U.S.C.A. § 541(a)(1).

1 Cases that cite this headnote

[7] Bankruptcy
Individual Debt Adjustment

Chapter 13 is a wholly voluntary alternative to Chapter 7 which allows a debtor to retain his property if he proposes, and gains court confirmation of, a plan to repay his debts over a three- to five-year period. 11 U.S.C.A. §§ 1306(b), 1322, 1327(b).

1 Cases that cite this headnote

[8] Bankruptcy
Property of Estate in General
Bankruptcy
After-acquired property; proceeds; wages and earnings

Chapter 13 estate from which creditors may be paid includes both the debtor's property at the time of his bankruptcy petition, and any wages and property acquired after filing. 11 U.S.C.A. § 1306(a).

Cases that cite this headnote

[9] Bankruptcy
Representation of debtor, estate, or creditors
Bankruptcy
Distribution

Chapter 13 trustee is often charged with collecting a portion of a debtor's wages through payroll deduction, and with distributing the withheld wages to creditors. 11 U.S.C.A. § 1322(a)(1).

Cases that cite this headnote

[10] Bankruptcy
Voluntary Conversion; Request by Debtor

Recognizing the reality that many debtors fail to complete a Chapter 13 plan successfully, Congress accorded debtors a nonwaivable right to convert a Chapter 13 case to one under Chapter 7 "at any time." 11 U.S.C.A. § 1307(a).

Cases that cite this headnote

[11] Bankruptcy
Nature and form; adversary proceedings
Bankruptcy
Proceedings

To effectuate a conversion from Chapter 13 to Chapter 7, a debtor need only file a notice with the bankruptcy court; no motion or court order is needed to render the conversion effective. 11 U.S.C.A. § 1307(a); Fed.Rules Bankr.Proc.Rule 1017(f)(3), 11 U.S.C.A.

Cases that cite this headnote

[12] Bankruptcy
Effect; proceedings in converted case

Conversion from Chapter 13 to Chapter 7 does not commence a new bankruptcy case; rather, the existing case continues along another track, Chapter 7 instead of Chapter 13, without effecting a change in the date of the filing of the petition. 11 U.S.C.A. § 348(a).

1 Cases that cite this headnote

[13] Bankruptcy
Effect; proceedings in converted case

Conversion from Chapter 13 to Chapter 7 immediately "terminates the service" of the Chapter 13 trustee, replacing her with a Chapter 7 trustee. 11 U.S.C.A. § 348(e).

1 Cases that cite this headnote

[14] Bankruptcy
After-acquired property; proceeds; wages and earnings
Bankruptcy
Effect; proceedings in converted case

In a case converted from Chapter 13 to Chapter 7, a debtor's postpetition earnings and acquisitions do not become part of the new Chapter 7 estate, absent a bad-faith conversion. 11 U.S.C.A. § 348(f)(1)(A), (f)(2).

Cases that cite this headnote

[15] Bankruptcy
Effect; proceedings in converted case

Absent a bad-faith conversion, the Bankruptcy Code limits a converted Chapter 7 estate to property belonging to the debtor "as of the date" the original Chapter 13 petition was filed. 11 U.S.C.A. § 348(f).

Cases that cite this headnote

[16] Bankruptcy
Effect; proceedings in converted case

Undistributed plan payments made by a debtor from his or her wages and held by the Chapter 13 trustee at the time the case is converted to Chapter 7 must be returned to the debtor, not distributed to creditors. 11 U.S.C.A. § 348(f).

1 Cases that cite this headnote

[17] Bankruptcy
After-acquired property; proceeds; wages and earnings
Bankruptcy
Effect; proceedings in converted case

By excluding postpetition wages from the converted Chapter 7 estate, the subsection of the Bankruptcy Code governing the effect of conversion of a Chapter 13 case removes those earnings from the pool of assets that may be liquidated and distributed to creditors. 11 U.S.C.A. § 348(f)(1)(A).

Cases that cite this headnote

[18] Bankruptcy
Effect; proceedings in converted case

If a debtor converts his Chapter 13 case in bad faith, such as by concealing assets in unfair manipulation of the bankruptcy system, the converted Chapter 7 estate consists of the property of the Chapter 13 estate as of the date of conversion. 11 U.S.C.A. § 348(f)(2).

Cases that cite this headnote

[19] Bankruptcy
Post-petition transactions
Bankruptcy
Effect; proceedings in converted case

Debtors who convert their Chapter 13 cases in bad faith are penalized by having their postpetition wages available for liquidation and distribution to creditors. 11 U.S.C.A. § 348(f)(2).

Cases that cite this headnote

[20] Bankruptcy
Effect; proceedings in converted case

When the conversion of a case from Chapter 13 to Chapter 7 is made in good faith, no penalty is exacted from the debtor. 11 U.S.C.A. § 348(f), (f)(2).

1 Cases that cite this headnote

[21] Bankruptcy
After-acquired property; proceeds; wages and earnings

Shielding a Chapter 7 debtor's postpetition earnings from creditors enables the "honest but unfortunate debtor" to make the "fresh start" the Bankruptcy Code aims to facilitate. 11 U.S.C.A. § 541(a)(1).

1 Cases that cite this headnote

[22] Bankruptcy
Representation of debtor, estate, or creditors
Bankruptcy
Mode of repayment; third-person payments

A core service provided by a Chapter 13 trustee is the disbursement of payments to creditors. 11 U.S.C.A. § 1326(c).

Cases that cite this headnote

[23] Bankruptcy
Effect; proceedings in converted case

The moment a case is converted from Chapter 13 to Chapter 7, the Chapter 13 trustee is stripped of authority to provide "service." 11 U.S.C.A. § 348(e).

2 Cases that cite this headnote

[24] Bankruptcy
Representation of debtor, estate, or creditors
Bankruptcy
Mode of repayment; third-person payments
Bankruptcy
Effect; proceedings in converted case

Returning funds to a debtor is not a Chapter 13 trustee "service," as is making payment to creditors. 11 U.S.C.A. § 1326(c).

Cases that cite this headnote

[25] Bankruptcy
Mode of repayment; third-person payments
Bankruptcy
Conclusiveness; res judicata; collateral estoppel
Bankruptcy
Effect; proceedings in converted case

Once case was converted from Chapter 13 to Chapter 7, the sections of the Bankruptcy Code instructing trustee to distribute payments in accordance with the confirmed plan and providing that the plan bound the debtor and each creditor ceased to apply. 11 U.S.C.A. §§ 1326(a)(2), 1327(a).

1 Cases that cite this headnote

[26] Bankruptcy
Effect; proceedings in converted case

When a debtor exercises his statutory right to convert from Chapter 13 to Chapter 7, the case is placed under Chapter 7's governance, and no Chapter 13 provision holds sway. 11 U.S.C.A. §§ 103(i), 1307(a).

2 Cases that cite this headnote

[27] Bankruptcy
Representation of debtor, estate, or creditors
Bankruptcy
Mode of repayment; third-person payments
Bankruptcy
Conclusiveness; res judicata; collateral estoppel
Bankruptcy
Effect; proceedings in converted case

Following conversion of case from Chapter 13 to Chapter 7, the Chapter 13 plan was no longer binding, and former Chapter 13 trustee lacked authority to distribute payments in accordance with the plan. 11 U.S.C.A. §§ 348(e), 1236(a)(2), 1327(a).

1 Cases that cite this headnote

[28] Bankruptcy
Property of Estate in General
Bankruptcy
Effect

Confirmed Chapter 13 plan does not give creditors a vested right to funds held by a trustee; no provision in the Bankruptcy Code classifies any property, including postpetition wages, as belonging to creditors.

Cases that cite this headnote

[29] Bankruptcy
Representation of debtor, estate, or creditors
Bankruptcy
Liabilities in general; accounting
Bankruptcy
Effect; proceedings in converted case

Federal Rules of Bankruptcy Procedure specify what a terminated Chapter 13 trustee must do post-conversion: (1) she must turn over records and assets to the Chapter 7 trustee, and (2) she must file a report with the United States Trustee (UST). Fed.Rules Bankr.Proc.Rule 1019(4), (5)(B)(ii), 11 U.S.C.A.

Cases that cite this headnote

[30] Bankruptcy
Representation of debtor, estate, or creditors
Bankruptcy
Mode of repayment; third-person payments
Bankruptcy
Effect; proceedings in converted case

Post-conversion, continuing to distribute funds to creditors pursuant to the defunct Chapter 13 plan is not an authorized "wind-up" task of a terminated Chapter 13 trustee. Fed.Rules Bankr.Proc.Rule 1019, 11 U.S.C.A.

Cases that cite this headnote

[31] Bankruptcy
After-acquired property; proceeds; wages and earnings
Bankruptcy
Property of estate

Where, pursuant to Chapter 13 plan providing that, upon confirmation, all property of the estate was not to vest in the debtor, but would remain as property of the estate, debtor's wages may have been "property of the estate" while his case proceeded under Chapter 13, such wages did not become property of creditors until they were distributed to creditors. 11 U.S.C.A. § 1327(b).

Cases that cite this headnote

[32] Bankruptcy
Effect; proceedings in converted case

Where order confirming debtor's Chapter 13 plan provided that, upon conversion to Chapter 7, "[s]uch property as may revest in the debtor shall so revest," property formerly in the Chapter 13 estate that did not become part of the Chapter 7 estate revested in the debtor.

Cases that cite this headnote

[33] Bankruptcy
Mode of repayment; third-person payments
Bankruptcy
Effect; proceedings in converted case

Creditors may gain protection against the risk of excess accumulations in the hands of Chapter 13 trustees upon any future conversion of the case to Chapter 7 by seeking to include in a Chapter 13 plan a schedule for regular disbursement of funds the trustee collects.

Cases that cite this headnote

*1832 *Syllabus*[*]

Individual debtors may seek discharge of their financial obligations under either Chapter 7 or Chapter 13 of the Bankruptcy Code. In a Chapter 7 proceeding, the debtor's assets are transferred to a bankruptcy estate. 11 U.S.C. § 541(a)(1). The estate's assets are then promptly liquidated, § 704(a)(1), and distributed to creditors, § 726. A Chapter 7 estate, however, does not include the wages a debtor earns or the assets he acquires *after* the bankruptcy filing. § 541(a)(1). Chapter 13, a wholly voluntary alternative to Chapter 7, *1833 permits the debtor to retain assets during bankruptcy subject to a court-approved plan for payment of his debts. Payments under a Chapter 13 plan are usually made from a debtor's "future income." 1322(a)(1). The Chapter 13 estate, unlike a

Chapter 7 estate, therefore includes both the debtor's property at the time of his bankruptcy petition, and any assets he acquires after filing. § 1306(a). Because many debtors fail to complete a Chapter 13 plan successfully, Congress accorded debtors a nonwaivable right to convert a Chapter 13 case to one under Chapter 7 "at any time." § 1307(a). Conversion does not commence a new bankruptcy case, but it does terminate the service of the Chapter 13 trustee. § 348(e).

Petitioner Harris, indebted to multiple creditors and $3,700 behind on his home mortgage payments to Chase Manhattan, filed a Chapter 13 bankruptcy petition. His court-confirmed plan provided that he would resume making monthly mortgage payments to Chase, and that $530 per month would be withheld from his postpetition wages and remitted to the Chapter 13 trustee, respondent Viegelahn. Trustee Viegelahn would make monthly payments to Chase to pay down Harris' mortgage arrears, and distribute remaining funds to Harris' other creditors. When Harris again fell behind on his mortgage payments, Chase foreclosed on his home. Following the foreclosure, Viegelahn continued to receive $530 per month from Harris' wages, but stopped making the payments earmarked for Chase. As a result, funds formerly reserved for Chase accumulated in Viegelahn's possession. Approximately a year after the foreclosure, Harris converted his case to Chapter 7. Ten days after this conversion, Viegelahn distributed $5,519.22 in Harris' withheld wages mainly to Harris' creditors. Asserting that Viegelahn lacked authority to disburse his postpetition wages to creditors postconversion, Harris sought an order from the Bankruptcy Court directing refund of the accumulated wages Viegelahn paid to his creditors. The Bankruptcy Court granted Harris' motion, and the District Court affirmed. The Fifth Circuit reversed, concluding that a former Chapter 13 trustee must distribute a debtor's accumulated postpetition wages to his creditors.

Held : A debtor who converts to Chapter 7 is entitled to return of any postpetition wages not yet distributed by the Chapter 13 trustee. Pp. 1836 – 1840.

(a) Absent a bad-faith conversion, § 348(f) limits a converted Chapter 7 estate to property belonging to the debtor "as of the date" the original Chapter 13 petition was filed. Because postpetition wages do not fit that bill, undistributed wages collected by a Chapter 13 trustee ordinarily do not become part of a converted Chapter 7 estate. Pp. 1836 – 1837.

(b) By excluding postpetition wages from the converted Chapter 7 estate (absent a bad-faith conversion), § 348(f) removes those earnings from the pool of assets that may be liquidated and distributed to creditors. Allowing a terminated Chapter 13 trustee to disburse the very same earnings to the very same creditors is incompatible with that statutory design. Pp. 1837 – 1838.

(c) This conclusion is reinforced by § 348(e), which "terminates the service of [the Chapter 13] trustee" upon conversion. One service provided by a Chapter 13 trustee is disbursing "payments to creditors." § 1326(c). The moment a case is converted from Chapter 13 to Chapter 7, a Chapter 13 trustee is stripped of authority to provide that "service." P. 1838.

(d) Section 1327(a), which provides that a confirmed Chapter 13 plan "bind [s] the debtor and each creditor," and *1834 § 1326(a)(2), which instructs a trustee to distribute "payment[s] in accordance with the plan," ceased to apply once the case was converted to Chapter 7. § 103(i). Sections 1327(a) and 1326(a)(2), therefore, offer no support for Viegelahn's assertion that the Bankruptcy Code *requires* a terminated Chapter 13 trustee to distribute to creditors postpetition wages remaining in the trustee's possession. Continuing to distribute funds to creditors pursuant to a defunct Chapter 13 plan, moreover, is not one of the trustee's postconversion responsibilities specified by the Federal Rules of Bankruptcy Procedure. Pp. 1838 – 1839.

(e) Because Chapter 13 is a voluntary alternative to Chapter 7, a debtor's postconversion receipt of a fraction of the wages he earned and would have kept had he filed under Chapter 7 in the first place does not provide the debtor with a "windfall." A trustee who distributes payments regularly may have little or no accumulated wages to return, while a trustee who distributes payments infrequently may have a sizable refund to make. But creditors may gain protection against the risk of excess accumulations in the hands of trustees by seeking to have a Chapter 13 plan include a schedule for regular disbursement of collected funds. Pp. 1839 – 1840.

757 F.3d 468, reversed and remanded.

GINSBURG, J., delivered the opinion for a unanimous Court.

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Opinion

Justice GINSBURG delivered the opinion of the Court.

This case concerns the disposition of wages earned by a debtor *after* he petitions for bankruptcy. The treatment of postpetition wages generally depends on whether the debtor is proceeding under Chapter 13 of the Bankruptcy Code (in which the debtor retains assets, often his home, during bankruptcy subject to a court-approved plan for the payment of his debts) or Chapter 7 (in which the debtor's assets are immediately liquidated and the proceeds distributed to creditors). In a Chapter 13 proceeding, postpetition wages are "[p]roperty of the estate," 11 U.S.C. § 1306(a), and may be collected by the Chapter 13 trustee for distribution to creditors, § 1322(a)(1). In a Chapter 7 proceeding, those earnings are not estate property; instead, they belong to the debtor. See § 541(a)(1). The Code permits the debtor to convert a Chapter 13 proceeding to one under Chapter 7 "at any time," § 1307(a); upon such conversion, the service of the Chapter 13 trustee terminates, § 348(e).

When a debtor initially filing under Chapter 13 exercises his right to convert to Chapter 7, who is entitled to postpetition *1835 wages still in the hands of the Chapter 13 trustee? Not the Chapter 7 estate when the conversion is in good faith, all agree. May the trustee distribute the accumulated wage payments to creditors as the Chapter 13 plan required, or must she remit them to the debtor? That is the question this case presents. We hold that, under the governing provisions of the Bankruptcy Code, a debtor who converts to Chapter 7 is entitled to return of any postpetition wages not yet distributed by the Chapter 13 trustee.

I

A

[1] The Bankruptcy Code provides diverse courses overburdened debtors may pursue to gain discharge of their financial obligations, and thereby a "fresh start." *Marrama v. Citizens Bank of Mass.,* 549 U.S. 365, 367, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007) (quoting *Grogan v. Garner,* 498 U.S. 279, 286, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991)). Two roads individual debtors may take are relevant here: Chapter 7 and Chapter 13 bankruptcy proceedings.

[2] [3] [4] [5] [6] Chapter 7 allows a debtor to make a clean break from his financial past, but at a steep price: prompt liquidation of the debtor's assets. When a debtor files a Chapter 7 petition, his assets, with specified exemptions, are immediately transferred to a bankruptcy estate. § 541(a)(1). A Chapter 7 trustee is then charged with selling the property in the estate, § 704(a)(1), and distributing the proceeds to the debtor's creditors, § 726. Crucially, however, a Chapter 7 estate does not include the wages a debtor earns or the assets he acquires *after* the bankruptcy filing. § 541(a)(1). Thus, while a Chapter 7 debtor must forfeit virtually all his prepetition property, he is able to make a "fresh start" by shielding from creditors his postpetition earnings and acquisitions.

[7] [8] [9] Chapter 13 works differently. A wholly voluntary alternative to Chapter 7, Chapter 13 allows a debtor to retain his property if he proposes, and gains court confirmation of, a plan to repay his debts over a three- to five-year period. § 1306(b), § 1322, § 1327(b). Payments under a Chapter 13 plan are usually made from a debtor's "future earnings or other future income." § 1322(a)(1); see 8 Collier on Bankruptcy ¶ 1322.02 [1] (A. Resnick & H. Sommer eds., 16th ed. 2014). Accordingly, the Chapter 13 estate from which creditors may be paid includes both the debtor's property at the time of his bankruptcy petition, and any wages and property acquired after filing. § 1306(a). A Chapter 13 trustee is often charged with collecting a portion of a debtor's wages through payroll deduction, and with distributing the withheld wages to creditors.

Proceedings under Chapter 13 can benefit debtors and creditors alike. Debtors are allowed to retain their assets, commonly their home or car. And creditors, entitled to a Chapter 13 debtor's "disposable" postpetition income, §

1325(b)(1), usually collect more under a Chapter 13 plan than they would have received under a Chapter 7 liquidation.

[10] [11] Many debtors, however, fail to complete a Chapter 13 plan successfully. See Porter, The Pretend Solution: An Empirical Study of Bankruptcy Outcomes, 90 Texas L.Rev. 103, 107–111 (2011) (only one in three cases filed under Chapter 13 ends in discharge). Recognizing that reality, Congress accorded debtors a nonwaivable right to convert a Chapter 13 case to one under Chapter 7 "at any time." § 1307(a). To effectuate a conversion, a debtor need only file a notice with the bankruptcy court. Fed. Rule Bkrtcy. Proc. 1017(f)(3). No motion or court order *1836 is needed to render the conversion effective. See *ibid.*

[12] [13] Conversion from Chapter 13 to Chapter 7 does not commence a new bankruptcy case. The existing case continues along another track, Chapter 7 instead of Chapter 13, without "effect[ing] a change in the date of the filing of the petition." § 348(a). Conversion, however, immediately "terminates the service" of the Chapter 13 trustee, replacing her with a Chapter 7 trustee. § 348(e).

B

In February 2010, petitioner Charles Harris III filed a Chapter 13 bankruptcy petition. At the time of filing, Harris was indebted to multiple creditors, and had fallen $3,700 behind on payments to Chase Manhattan, his home mortgage lender.

Harris' court-confirmed Chapter 13 plan provided that he would immediately resume making monthly mortgage payments to Chase. The plan further provided that $530 per month would be withheld from Harris' postpetition wages and remitted to the Chapter 13 trustee, respondent Mary Viegelahn. Viegelahn, in turn, would distribute $352 per month to Chase to pay down Harris' outstanding mortgage debt. She would also distribute $75.34 per month to Harris' only other secured lender, a consumer-electronics store. Once those secured creditors were paid in full, Viegelahn was to begin distributing funds to Harris' unsecured creditors.

Implementation of the plan was short lived. Harris again fell behind on his mortgage payments, and in November 2010, Chase received permission from the Bankruptcy Court to foreclose on Harris' home. Following the foreclosure, Viegelahn continued to receive $530 per month from Harris' wages, but stopped making the payments earmarked for Chase. As a result, funds formerly reserved for Chase accumulated in Viegelahn's possession.

On November 22, 2011, Harris exercised his statutory right to convert his Chapter 13 case to one under Chapter 7. By that time, Harris' postpetition wages accumulated by Viegelahn amounted to $5,519.22. On December 1, 2011—ten days after Harris' conversion—Viegelahn disposed of those funds by giving $1,200 to Harris' counsel, paying herself a $267.79 fee, and distributing the remaining money to the consumer-electronics store and six of Harris' unsecured creditors.

Asserting that Viegelahn lacked authority to disburse funds to creditors once the case was converted to Chapter 7, Harris moved the Bankruptcy Court for an order directing refund of the accumulated wages Viegelahn had given to his creditors. The Bankruptcy Court granted Harris' motion, and the District Court affirmed.

The Fifth Circuit reversed. *In re Harris*, 757 F.3d 468 (2014). Finding "little guidance in the Bankruptcy Code," *id.*, at 478, the Fifth Circuit concluded that "considerations of equity and policy" rendered "the creditors' claim to the undistributed funds ... superior to that of the debtor," *id.*, at 478, 481. Notwithstanding a Chapter 13 debtor's conversion to Chapter 7, the Fifth Circuit held, a former Chapter 13 trustee must distribute a debtor's accumulated postpetition wages to his creditors.

The Fifth Circuit acknowledged that its decision conflicted with the Third Circuit's decision in *In re Michael,* 699 F.3d 305 (2012), which held that a debtor's undistributed postpetition wages "are to be returned to the debtor at the time of conversion [from Chapter 13 to Chapter 7]." *Id.*, at 307. We granted certiorari to resolve this conflict, 574 U.S. ––––, 135 S.Ct. 782, 190 L.Ed.2d 649 (2014), and now reverse the Fifth Circuit's judgment.

*1837 II

A

Prior to the Bankruptcy Reform Act of 1994, courts divided three ways on the disposition of a debtor's undistributed postpetition wages following conversion of a proceeding from Chapter 13 to Chapter 7. Some courts concluded that undistributed postpetition wages reverted to the debtor. *E.g., In re Boggs,* 137 B.R. 408, 411 (Bkrtcy.Ct.W.D.Wash.1992). Others ordered a debtor's undistributed postpetition earnings disbursed to creditors pursuant to the terms of the confirmed (albeit terminated) Chapter 13 plan. *E.g., In re Waugh,* 82 B.R. 394, 400 (Bkrtcy.Ct.W.D.Pa.1988). Still other courts, including several Courts of Appeals, held that, upon conversion, all postpetition earnings and acquisitions became part of the new Chapter 7 estate, thus augmenting the property available for liquidation and distribution to creditors. *E.g., In re Calder,* 973 F.2d 862, 865–866 (C.A.10 1992); *In re Lybrook,* 951 F.2d 136, 137 (C.A.7 1991).

[14] Congress addressed the matter in 1994 by adding § 348(f) to the Bankruptcy Code. Rejecting the rulings of several Courts of Appeals, § 348(f)(1)(A) provides that in a case converted from Chapter 13, a debtor's postpetition earnings and acquisitions do not become part of the new Chapter 7 estate:

> "[P]roperty of the [Chapter 7] estate in the converted case shall consist of property of the estate, as of the date of filing of the [initial Chapter 13] petition, that remains in the possession of or is under the control of the debtor on the date of conversion."

In § 348(f)(2), Congress added an exception for debtors who convert in bad faith:

> "If the debtor converts a case [initially filed] under chapter 13 ... in bad faith, the property of the estate in the converted case shall consist of the property of the estate as of the date of the conversion."

[15] Section 348(f), all agree, makes one thing clear: A debtor's postpetition wages, including undisbursed funds in the hands of a trustee, ordinarily do not become part of the Chapter 7 estate created by conversion. Absent a bad-faith conversion, § 348(f) limits a converted Chapter 7 estate to property belonging to the debtor "as of the date" the original Chapter 13 petition was filed. Postpetition wages, by definition, do not fit that bill.

B

[16] With this background, we turn to the question presented: What happens to postpetition wages held by a Chapter 13 trustee at the time the case is converted to Chapter 7? Does the Code require return of the funds to the debtor, or does it require their distribution to creditors? We conclude that postpetition wages must be returned to the debtor.

[17] By excluding postpetition wages from the converted Chapter 7 estate, § 348(f)(1)(A) removes those earnings from the pool of assets that may be liquidated and distributed to creditors. Allowing a terminated Chapter 13 trustee to disburse the very same earnings to the very same creditors is incompatible with that statutory design. We resist attributing to Congress, after explicitly exempting from Chapter 7's liquidation-and-distribution process a debtor's postpetition wages, a plan to place those wages in creditors' hands another way.

[18] [19] [20] [21] Section 348(f)(2)'s exception for bad-faith conversions is instructive in this regard. If a debtor converts in bad faith—for example, by concealing assets in "unfair manipulation of the bankruptcy system," *1838 *In re Siegfried,* 219 B.R. 581, 586 (Bkrtcy.Ct.Colo.1998)—the converted Chapter 7 estate "consist[s] of the property of the [Chapter 13] estate *as of the date of conversion*." § 348(f)(2) (emphasis added). Section 348(f)(2) thus penalizes bad-faith debtors by making their postpetition wages available for liquidation and distribution to creditors. Conversely, when the conversion to Chapter 7 is made in *good* faith, no penalty is exacted. Shielding a Chapter 7 debtor's postpetition earnings from creditors enables the "honest but unfortunate debtor" to make the "fresh start" the Bankruptcy Code aims to facilitate. *Marrama,* 549 U.S., at 367, 127 S.Ct. 1105 (internal quotation marks omitted). Bad-faith conversions apart, we find nothing in the Code denying debtors funds that would have been theirs had the case proceeded under Chapter 7 from the start. In sum, § 348(f) does not say, expressly: On conversion, accumulated wages go to the debtor. But that is the most sensible reading of what Congress did provide.

[22] [23] Section 348(e) also informs our ruling that undistributed postpetition wages must be returned to

the debtor. That section provides: "Conversion [from Chapter 13 to Chapter 7] terminates the service of [the Chapter 13] trustee." A core service provided by a Chapter 13 trustee is the disbursement of "payments *to creditors*." § 1326(c) (emphasis added). The moment a case is converted from Chapter 13 to Chapter 7, however, the Chapter 13 trustee is stripped of authority to provide that "service." § 348(e).

[24] Section 348(e), of course, does not require a terminated trustee to hold accumulated funds in perpetuity; she must (as we hold today) return undistributed postpetition wages to the debtor. Returning funds to a debtor, however, is not a Chapter 13 trustee service as is making "paymen[t] to creditors." § 1326(c). In this case, illustratively, Chapter 13 trustee Viegelahn continued to act in that capacity after her tenure ended. Eight days after the case was converted to Chapter 7, she filed with the Bankruptcy Court a document titled "Trustee's Recommendations Concerning Claims," recommending distribution of the funds originally earmarked for Chase to the remaining secured creditor and six of the 13 unsecured creditors. No. 10–50655 (Bkrtcy. Ct. WD Tex., Nov. 30, 2011), Doc. 34. She then acted on that recommendation. She thus provided a Chapter 13 trustee "service," although barred from doing so by § 348(e). Returning undistributed wages to the debtor, in contrast, renders no Chapter 13–authorized "service."

C

[25] Viegelahn cites two Chapter 13 provisions in support of her argument that the Bankruptcy Code *requires* a terminated Chapter 13 trustee "to distribute undisbursed funds to creditors." Brief for Respondent 21. The first, § 1327(a), provides that a confirmed Chapter 13 plan "bind[s] the debtor and each creditor." The second, § 1326(a)(2), instructs a trustee to distribute "payment[s] in accordance with the plan," and that, Viegelahn observes, is just what she did. But the cited provisions had no force here, for they ceased to apply once the case was converted to Chapter 7.

[26] [27] When a debtor exercises his statutory right to convert, the case is placed under Chapter 7's governance, and no Chapter 13 provision holds sway. § 103(i) ("Chapter 13 ... applies only in a case under [that] chapter."). Harris having converted the case, the Chapter 13 plan was no longer "bind[ing]." § 1327(a). And Viegelahn, by then the *former* Chapter 13 trustee, lacked authority to distribute "payment[s] in accordance with the plan." § 1326(a)(2); see § 348(e).

*1839 [28] Nor can we credit the suggestion that a confirmed Chapter 13 plan gives creditors a vested right to funds held by a trustee. "[N]o provision in the Bankrupty Code classifies any property, including post-petition wages, as belonging to creditors." *Michael,* 699 F.3d, at 312–313.

[29] [30] Viegelahn alternatively urges that a terminated Chapter 13 trustee's "duty" to distribute funds to creditors is a facet of the trustee's obligation to "wind up" the affairs of the Chapter 13 estate following conversion. Brief for Respondent 25 (internal quotation marks omitted). The Federal Rules of Bankruptcy Procedure, however, specify what a terminated Chapter 13 trustee must do postconversion: (1) she must turn over records and assets to the Chapter 7 trustee, Rule 1019(4); and (2) she must file a report with the United States bankruptcy trustee, Rule 1019(5)(B)(ii). Continuing to distribute funds to creditors pursuant to the defunct Chapter 13 plan is not an authorized "wind-up" task.

[31] [32] Finally, Viegelahn homes in on a particular feature of this case. Section 1327(b) states that "[e]xcept as otherwise provided in the [Chapter 13] plan ... the confirmation of a plan vests all of the property of the estate in the debtor." Harris' plan "otherwise provided": It stated that "[u]pon confirmation of the plan, all property of the estate shall not vest in the Debto[r], but shall remain as property *of the estate*." App. 31 (emphasis added). That plan language does not change the outcome here. Harris' wages may have been "property of the estate" while his case proceeded under Chapter 13, but estate property does not become property of creditors until it is distributed to them. See *Michael,* 699 F.3d, at 313. Moreover, the order confirming Harris' plan provided that upon conversion to Chapter 7, "[s]uch property as may revest in the

debtor shall so revest." App. 48. Pursuant to that provision, property formerly in the Chapter 13 estate that did not become part of the Chapter 7 estate revested in Harris; here, Harris' postpetition wages so revested.

D

The Fifth Circuit expressed concern that debtors would receive a "windfall" if they could reclaim accumulated wages from a terminated Chapter 13 trustee. 757 F.3d, at 478–481. As explained, however, see *supra* at 1835 – 1836, Chapter 13 is a voluntary proceeding in which debtors endeavor to discharge their obligations using postpetition earnings that are off-limits to creditors in a Chapter 7 proceeding. We do not regard as a "windfall" a debtor's receipt of a fraction of the wages he earned and would have kept had he filed under Chapter 7 in the first place.

[33] We acknowledge the "fortuit[y]," as the Fifth Circuit called it, that a "debtor's chance of having funds returned" is "dependent on the trustee's speed in distributing the payments" to creditors. 757 F.3d, at 479, and n. 10. A trustee who distributes payments regularly may have little or no accumulated wages to return. When a trustee distributes payments infrequently, on the other hand, a debtor who converts to Chapter 7 may be entitled to a sizable refund. These outcomes, however, follow directly from Congress' decisions to shield postpetition wages from creditors in a converted Chapter 7 case, § 348(f)(1)(A), and to give Chapter 13 debtors a right to convert to Chapter 7 "at any time," § 1307(a). Moreover, creditors may gain protection against the risk of excess accumulations in the hands of Chapter 13 trustees by seeking to include in a Chapter 13 *1840 plan a schedule for regular disbursement of funds the trustee collects.

* * *

For the reasons stated, the judgment of the United States Court of Appeals for the Fifth Circuit is reversed, and the case is remanded for further proceedings consistent with this opinion.

It is so ordered.

All Citations

135 S.Ct. 1829, 83 USLW 4293, 61 Bankr.Ct.Dec. 11, Bankr. L. Rep. P 82,799, 15 Cal. Daily Op. Serv. 4830, 2015 Daily Journal D.A.R. 5323, 25 Fla. L. Weekly Fed. S 251

Footnotes

* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

Dischargeability of Student Loans: The Devil is in the Details

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At first glance, 11 U.S.C. §523(a)(8) seems pretty clear – student loans are not dischargeable in bankruptcy unless the debtor can show an undue hardship. Specifically, §523(a)(8) states:

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt–

(8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for--

(A) (I) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or

(ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or

(B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual;

In some cases, practitioners may make the mistake of simply assuming that all student loans made or insured by a government unit are automatically non-dischargeable. However, a very careful reading of the statute can expose some loopholes that can be utilized to discharge a student loan debt.

While it may sound obvious, in order for a student loan to deemed non-dischargeable, the debtor has to have actually received funds from the for-profit creditor. In the recent Cristoff decision, the 9th Circuit BAP found that the issuance of tuition credit does not equate to receiving actual funds[2]. The Court's analysis of §523(a)(8)(A)(ii), which was added when BAPCPA was enacted, requires there have been "funds received". In Christoff, the debtor merely acquired tuition credits, not actual funds[3]. In In re Corbin[4] cited by Christoff,

> the bankruptcy court explained that, post-BAPCPA, this Code provision protects four categories of educational claims from discharge: (1) loans made, insured, or guaranteed by a governmental unit; (2) loans made under any program partially or fully funded by a governmental unit or nonprofit institution; (3) claims for funds received as an educational benefit, scholarship, or stipend; and (4) any "qualified educational loan" as that term is defined in the Internal Revenue Code.

So, a loan from a for-profit agency where no funds actually changed hands, was discharged under §523(a)(8)(A)(ii).

Another issue to keep your eye out for is whether or not the debt is a "qualified education loan" as required by §523(a)(8)(B). As defined by the Internal Revenue Code,

[T]he term "qualified education loan" means any indebtedness incurred by the taxpayer solely to pay qualified higher education expenses:

(A) which are incurred on behalf of the taxpayer, the taxpayer's spouse or any dependent of the taxpayer as of the time the indebtedness was incurred,

(B) which are paid or incurred within a reasonable period of time before or after the indebtedness is incurred, and

© which are attributable to education furnished during a period of time during which the recipient was an eligible student[5].

There are multiple terms in that paragraph that demand definition. What is a "qualified higher education expense[6]"? What is an "eligible student[7]"? Who qualifies as a "dependent of the debtor[8]"? Look out for loans where the debtor guaranteed the student loan debt for a niece/nephew, grandchild, friend, fiancé, etc. that was not a dependent of the debtor *at the time the loan was taken*. Any person who is not the debtor, the debtor's spouse or a dependant of the debtor may be able to get their obligation on the student loan discharged. Make sure the loan was given at a time when the recipient was actually an eligible student. Eligibility issues center around the level of education (elementary, secondary or post-secondary) being pursued and is the student taking the minimum required number of credits? These are all important questions to research to see if the debt can be discharged.

Take the time to dissect §523(a)(8) and to discover the dirty details surrounding the debtor's student loan obligation. You may find that it is dischargeable with little effort.

1. Ms. Krohn has been a licensed bankruptcy attorney in the District of Nevada for 22 years and a Chapter 7 panel trustee for 4 years.

2. In re Christoff, 527 B.R. 624 (9th Cir. BAP 2015).

3. In re Christoff, 527 B.R. 624, 626 (9th Cir. BAP 2015).

4. 506 B.R. at 291 (citing Rumer v. Am. Educ. Servs. (In re Rumer) , 469 B.R. 553 (Bankr.M.D.Pa.2012)) In re Christoff, 527 B.R. 624, 632 (B.A.P. 9th Cir. 2015).

5. 26 U.S.C. 221(d)(1).

6. 26 U.S.C. 221(d)(2) and 20 U.S.C. 1087.

7. 26 U.S.C. 221(d)(3), 26 U.S.C. 25A(b)(3) and 20 U.S.C. 1091(a).

8. 26 U.S.C. 221(d)(4) and 26 U.S.C. 152.

527 B.R. 624
United States Bankruptcy Appellate Panel
of the Ninth Circuit.

In re Tarra Nichole CHRISTOFF, Debtor.

Institute of Imaginal Studies dba Meridian University, Appellant,
v.
Tarra Nichole Christoff, Appellee.
BAP No. NC–14–1336–PaJuTa. | Bankruptcy No. 13–10808. | Adversary No. 13–3186. | Argued and Submitted on Feb. 19, 2015. | Filed March 27, 2015.

Synopsis
Background: University that Chapter 7 debtor attended using tuition credits provided by university sued for determination that debtor's obligation to repay university was excepted from discharge, except on showing of "undue hardship," as debt for "funds received as an educational benefit, scholarship, or stipend." The United States Bankruptcy Court for the Northern District of California, Dennis Montali, J., 510 B.R. 876, entered summary judgment in favor of debtor, and university appealed.

[Holding:] The Bankruptcy Appellate Panel, Pappas, J., held that, as matter of first impression, debtor's obligation to university was not "obligation to repay funds received as an educational benefit, scholarship, or stipend."

Affirmed.

West Headnotes (9)

[1] Bankruptcy
Conclusions of law; de novo review

Bankruptcy Appellate Panel (BAP) reviews bankruptcy court's grant of summary judgment de novo.

Cases that cite this headnote

[2] Bankruptcy
Conclusions of law; de novo review

Bankruptcy Appellate Panel (BAP) would review de novo bankruptcy court's application of legal standard in determining whether debt was excepted from discharge, except on showing of "undue hardship," as debt for "funds received as an educational benefit, scholarship, or stipend." 11 U.S.C.A. § 523(a)(8)(A)(ii).

Cases that cite this headnote

[3] Bankruptcy
Construction and Operation

Any analysis of the Bankruptcy Code begins with statutory text.

Cases that cite this headnote

[4] Statutes
Context
Statutes
Statutory scheme in general

Words of statute must be read in their context and with view to their place in overall statutory scheme.

Cases that cite this headnote

[5] Statutes
Absence of Ambiguity; Application of Clear or Unambiguous Statute or Language
Statutes
Statutory scheme in general

If statutory language is unambiguous and statutory scheme is coherent and consistent, judicial inquiry must cease.

Cases that cite this headnote

[6] Bankruptcy
Debts and Liabilities Discharged

Dischargeability exceptions must be limited to those plainly expressed in the Bankruptcy Code. 11 U.S.C.A. § 523(a).

Cases that cite this headnote

[7] Bankruptcy
Educational Loans

While Chapter 7 debtor's obligation to pay a for-profit university back for tuition credits that it extended to her to allow her to take classes at university by paying less than her full tuition upfront was obligation to repay university for educational benefits that it had extended to her, this was not enough to trigger dischargeability exception for debtor's "obligation to repay funds received as an educational benefit, scholarship, or stipend," which did not apply to debtor's obligation to repay any educational benefit, scholarship, or stipend, but only educational benefits, scholarships, or stipend that took the form of "funds received" by debtor. 11 U.S.C.A. § 523(a)(8)(A)(ii).

Cases that cite this headnote

[8] Bankruptcy
Educational Loans

Debtor must receive actual funds in order for debt to be excepted from discharge as one for "funds received as an educational benefit, scholarship, or stipend." 11 U.S.C.A. § 523(a)(8)(A)(ii).

Cases that cite this headnote

[9] Bankruptcy
Educational Loans

Dischargeability exception recognized by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) amendments to the Bankruptcy Code for debtor's "obligation to repay funds received as an educational benefit, scholarship, or stipend" is separate education-related dischargeability exception, that is delinked from the phrases "educational benefit or loan" and "any other educational loan" in separate provisions of same statute. 11 U.S.C.A. § 523(a)(8)(A)(i, ii), (a)(8)(B).

Cases that cite this headnote

Attorneys and Law Firms

*625 Scott D. Schwartz of Rust, Armenis & Schwartz, P.C., San Francisco, CA, argued for Appellant Institute of Imaginal Studies d/b/a Meridian University.

Lindsay R. Torgerson of Wine Country Family Law & Bankruptcy Office, Cloverdale, CA, argued for Appellee Tarra Nichole Christoff.
Before: PAPPAS, JURY, and TAYLOR, Bankruptcy Judges.

OPINION

PAPPAS, Bankruptcy Judge.

This appeal raises an important issue of first impression concerning the scope of the exception to discharge for student debts in bankruptcy. Creditor Institute of Imaginal Studies d/b/a Meridian University ("Meridian") appeals the summary judgment of the bankruptcy court determining that the debt owed to Meridian by chapter *626 7[1] debtor Tarra Nichole Christoff ("Debtor") was not excepted from discharge pursuant to § 523(a)(8)(A)(ii). Based upon the plain language of the Bankruptcy Code, we AFFIRM.

I. FACTS[2]

A. *Relationship of the Parties.*

Meridian is a for-profit California corporation which operates a private university licensed under California's Private Post Secondary Education Act of 2009, Cal. Educ.Code § 94800, *et seq.* If a graduate of Meridian fulfills other post-graduate requirements, the graduate may obtain a license from California to practice as an independent, unsupervised psychologist.

Debtor applied for admission to Meridian in 2002. Meridian agreed to admit Debtor and offered her $6,000 in financial aid to pay a portion of the tuition for that school year. Under this arrangement, Debtor did not receive any actual funds from Meridian, but instead she received a tuition credit. Debtor signed an enrollment agreement acknowledging Meridian's offer to "finance" $6,000 of the tuition, and she signed a promissory note in favor of Meridian evidencing her obligation. The promissory note provided that the debt for the tuition credit was to be paid by Debtor in installments of $350 per month after Debtor completed her course work or withdrew from Meridian. Interest accrued on the unpaid balance of the note at nine percent per annum, compounded monthly.

In 2003, Debtor submitted a similar application, and Meridian granted her a financial aid award of $5,000 for that school year. As before, Debtor signed a promissory note for $5,000. Again, Debtor did not receive any funds but instead received a tuition credit. The promissory note contained payment terms identical to those in the prior note.

Debtor completed her course work at Meridian, and Debtor's note payments began in October 2005. After making several payments on the notes, in 2009, Debtor sought a deferral of her payments for a period of one year. Meridian granted the extension. Also in 2009, Debtor withdrew from Meridian without completing her dissertation, a requirement for obtaining her degree.

After the extension expired, Debtor did not pay the amounts due under the two promissory notes. Thereafter, Meridian unsuccessfully attempted to collect the balance due from Debtor. Eventually, Meridian and Debtor agreed to submit Meridian's claims to arbitration under a provision in the enrollment agreement. In July 2012, an arbitrator ordered Debtor to pay Meridian the unpaid balance due on the promissory notes, $5,950, plus accrued interest.

B. *The Bankruptcy Case and Adversary Proceeding.*
Debtor filed a chapter 7 bankruptcy petition on August 19, 2013. Debtor listed Meridian in schedule F as an unsecured, nonpriority creditor. Meridian commenced an adversary proceeding against Debtor seeking a determination by the bankruptcy court that the debt owed by *627 Debtor to Meridian was excepted from discharge pursuant to § 523(a)(8).

On April 30, 2014, Meridian filed a motion for summary judgment. In its motion, Meridian conceded that Debtor's debt did not qualify for an exception to discharge under either § 523(a)(8)(A)(i) or (a)(8)(B).[3] However, it argued that the debt was excepted from discharge under § 523(a)(8)(A)(ii). Debtor disputed that this Code provision applied to her debt to Meridian.[4] The parties appeared at a motion hearing on May 30, 2014, presented their arguments, and the bankruptcy court took the issues under advisement.

On June 11, 2014, the bankruptcy court entered a Memorandum Decision in which it held that Debtor's debt to Meridian did not qualify for an exception to discharge under § 523(a)(8)(A)(ii). *Inst. of Imaginal Studies dba Meridian Univ. v. Christoff (In re Christoff),* 510 B.R. 876, 884 (Bankr.N.D.Cal.2014). In making this ruling, the bankruptcy court noted that the question raised by the motion was an issue of first impression in the Ninth Circuit following enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA).[5] After a thorough review of amended § 523(a)(8) and the cases addressing the issue, the bankruptcy court concluded:

[b]ecause Debtor's obligations under applicable documents were to pay the amount under the [p]romissory [n]otes, and thereafter the arbitration award, but did not flow from 'funds received' either by her as the student or by Meridian from any other source, the debt is not covered by [§ 523(a)(8)(A)(ii)] and is therefore eligible for discharge in Debtor's discharge. *In re Christoff,* 510 B.R. at 884.

Interpreting the "funds received" requirement in § 523(a)(8)(A)(ii), the bankruptcy court explained that "Meridian simply agreed to be paid the tuition later ... [i]t did not receive any funds, such as from a third party financing source." *Id.* at 879. The bankruptcy court therefore concluded that, while the transactions between Debtor and Meridian were clearly loans, § 523(a)(8)(A)(ii) does not extend to loans but, instead, grants an exception to discharge for "an obligation to repay funds received." *Id.* at 879. The bankruptcy court observed that BAPCPA had amended the prior version of § 523(a)(8) and had created a "newly separated [§ 523(a)(8)(A)(ii), which] refers to an 'obligation to repay funds received as an educational benefit, scholarship[,] or stipend,' without reference to educational loans or any other kind of loan." *Id.*

Meridian filed a notice of appeal concerning the Memorandum Decision on June 26, 2014. The bankruptcy court, on July 2, 2014, entered an order granting summary judgment in favor of Debtor and denying Meridian's motion for summary judgment; it also entered a judgment incorporating these rulings. On July 11, 2014, Meridian filed an amended notice of *628 appeal to include the order and judgment entered by the bankruptcy court.

II. JURISDICTION

The bankruptcy court had jurisdiction under 28 U.S.C. §§ 1334 and 157(b)(2)(I). We have jurisdiction under 28 U.S.C. § 158.

III. ISSUE

Whether the bankruptcy court erred in holding that the Meridian debt was not excepted from discharge under § 523(a)(8)(A)(ii) because it was not an obligation for "funds received."

IV. STANDARDS OF REVIEW

[1] We review a bankruptcy court's grant of summary judgment de novo. *The President & Bd. of Ohio Univ. v. Hawkins (In re Hawkins),* 317 B.R. 104, 108 (9th Cir. BAP 2004), *aff'd,* 469 F.3d 1316 (9th Cir.2006); *Thorson v. Cal. Student Aid Comm'n (In re Thorson),* 195 B.R. 101, 103 (9th Cir. BAP 1996) (citing *Jones v. Union Pac. R.R. Co.,* 968 F.2d 937, 940 (9th Cir.1992)). According to Civil Rule 56, made applicable to adversary proceedings in Rule 7056, summary judgment is appropriate if there is a showing "that there is no genuine dispute as to any material fact and the movant is entitled to judgment as a matter of law." Civil Rule 56(a); *Celotex Corp. v. Catrett,* 477 U.S. 317, 322, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986). A trial court, in the exercise of its discretion, may grant a summary judgment for a nonmovant pursuant to Civil Rule 56(f)(1).

[2] "We review de novo the bankruptcy court's application of the legal standard in determining whether a student loan debt is dischargeable." *Educ. Credit Mgmt. Corp. v. Jorgensen (In re Jorgensen),* 479 B.R. 79, 85 (9th Cir. BAP 2012) (citing *Rifino v. United States (In re Rifino),* 245 F.3d 1083, 1087 (9th Cir.2001)). "To the extent the bankruptcy court interpreted statutory law, we review the issues of law de novo." *In re Thorson,* 195 B.R. at 103.

V. DISCUSSION

A. *Arguments of the Parties.*

Meridian argues that the bankruptcy court erred when it interpreted § 523(a)(8)(A)(ii) to require that actual funds be received by a debtor in order for a debt to qualify for an exception to discharge under that provision. According to Meridian, "funds received," as that language is used in § 523(a)(8)(A)(ii), is the equivalent to "loans" received by the debtor, as described in the other provisions of § 523(a)(8). To support this argument, Meridian cites to *McKay v. Ingleson,* 558 F.3d 888 (9th Cir.2009), and to *Johnson v. Mo. Baptist Coll. (In re Johnson),* 218 B.R. 449 (8th Cir. BAP 1998), a decision cited and relied upon by the Ninth Circuit in *McKay.* Meridian argues that the bankruptcy court erred in distinguishing these cases because those decisions determined that a "loan" under § 523(a)(8) required no funds to be transferred to a debtor. Meridian argues that since the terms "loan" and "funds received" are synonymous as used in § 523(a)(8), *McKay* and *In re Johnson* control the outcome in this case.

Debtor points to the difference in the language employed by Congress to delineate what types of student debts are excepted from discharge under § 523(a)(8). While § 523(a)(8)(A)(i) and (B) indeed make "loans" nondischargeable in bankruptcy, absent undue hardship, § 523(a)(8)(A)(ii) applies to a different type of debt: a debtor's "obligation to repay funds received as an educational benefit, scholarship, or stipend [.]" Because Congress *629 did not refer to "loans" in this subsection of the Code, Debtor urges that it was intended to apply to a distinctly different type of debt, an obligation to repay the creditor for "funds received." Therefore, Debtor argues, it is inappropriate to borrow from the logic of the cases construing the "loan" language used in the other student debt exceptions to construe the meaning of "funds received" in § 523(a)(8)(A)(ii).

We agree with Debtor.

B. *Statutory Interpretation and Exceptions to Discharge.*
[3] [4] [5] Any analysis of the Bankruptcy Code begins with the text of the statute. *Ransom v. FIA Card Servs., N.A.,* 562 U.S. 61, 69, 131 S.Ct. 716, 178 L.Ed.2d 603 (2011); *Danielson v. Flores (In re Flores),* 735 F.3d 855, 859 (9th Cir.2013) (en banc) (citing *Miranda v. Anchondo,* 684 F.3d 844, 849 (9th Cir.2012)). "Furthermore, 'the words of [the Code] must be read in their context and with a view to their place in the overall statutory scheme.' " *In re Flores,* 735 F.3d at 859 (quoting *Gale v. First Franklin Loan Servs.,* 701 F.3d 1240, 1244 (9th Cir.2012)). "If the statutory language is unambiguous and the statutory scheme is coherent and consistent, judicial inquiry must cease." *Fireman's Fund Ins. Co. v. Plant Insulation Co. (In re Plant Insulation Co.),* 734 F.3d 900, 910 (9th Cir.2013) (citations and internal quotation marks omitted).

[6] Courts must limit the provisions granting exceptions to discharge to those plainly expressed in § 523(a). *Bullock v. BankChampaign, N.A.,* ––– U.S. ––––, 133 S.Ct. 1754, 1760, 185 L.Ed.2d 922 (2013) (noting the "long-standing principle that exceptions to discharge should be confined to those plainly expressed") (internal quotations marks and citations omitted); *Hawkins v. Franchise Tax Bd. of Cal.,* 769 F.3d 662, 666 (9th Cir.2014) (reminding that "the Supreme Court has interpreted exceptions to the broad presumption of discharge narrowly"); *Sachan v. Huh (In re Huh),* 506 B.R. 257, 263 (9th Cir. BAP 2014) (en banc) (stating "the exception to discharge provisions of the Bankruptcy Code are interpreted strictly in favor of debtors"); *Benson v. Corbin (In re Corbin),* 506 B.R. 287, 291 (Bankr.W.D.Wa.2014) (observing, in a § 523(a)(8) case, that "[c]ourts construe exceptions to discharge strictly against a creditor and liberally in favor of the debtor").

C. *The Pre–BAPCPA § 523(a)(8).*
The student debt exception to discharge, embodied in § 523(a)(8), has been amended several times over the years, most recently by BAPCPA in 2005.

Prior to BAPCPA, § 523(a)(8) provided that a bankruptcy discharge would not apply to a debt for:

> an educational benefit overpayment or loan made, insured or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit, or nonprofit institution, or for an obligation to repay funds received as an educational benefit, scholarship, or stipend, unless excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents.

In re Hawkins, 317 B.R. at 108 (quoting § 523(a)(8)).

Interpreting this version of § 523(a)(8), the Panel stated,

> [g]enerally speaking, debts that are potentially nondischargeable under § 523(a)(8) fall into two categories: 1) debts for educational benefit overpayments or loans made, insured, or guaranteed by a governmental unit or nonprofit institution; or 2) debts for *630 obligations to repay funds received as an educational benefit, scholarship[,] or stipend.

Id. at 109 (citing *Mehlman v. N.Y. City Bd. of Educ. (In re Mehlman),* 268 B.R. 379, 383 (Bankr.S.D.N.Y.2001)).

In *In re Hawkins,* the Panel examined an agreement between the debtor and Ohio University wherein the debtor agreed, in exchange for admission to the

University's medical school, that when she completed her studies she would practice medicine in Ohio for at least five years after licensure. 317 B.R. at 107. If she failed to do this, the agreement provided that she would pay liquidated damages to the University. *Id.* The debtor graduated but promptly moved to a different state. *Id.* The University sued the debtor in state court and obtained a money judgment for the liquidated damages specified in the agreement. *Id.* The debtor filed for chapter 7 relief, and the University sought a determination from the bankruptcy court that the judgment debt was excepted from discharge under § 523(a)(8). *Id.* at 108. Applying § 523(a)(8) to these facts, the Panel addressed both categories of debt covered by the discharge exception.*Id.* at 110–11.

First, the Panel concluded that the agreement between the debtor and the University was not an "educational loan" because "while an educational loan need not include an actual transfer of money ... to [the d]ebtor, in order for it to fall within the definition of ... § 523(a)(8), the loan instrument must sufficiently articulate definite repayment terms and the repayment obligation must reflect the value of the benefit actually received [by the debtor], rather than some other ill defined measure of damages or penalty." *Id.* at 110 (emphasis deleted).

Next, the Panel considered whether the agreement created a debt for "an obligation to repay funds received as an educational benefit." *Id.* at 112. The Panel quickly concluded that it did not, "because the plain language of this prong of the statute requires that a debtor receive actual funds in order to obtain a nondischargeable educational benefit." *Id.* (citing *Cazenovia Coll. v. Renshaw (In re Renshaw),* 229 B.R. 552, 555 n. 5 (2d Cir. BAP 1999), *aff'd,* 222 F.3d 82 (2d Cir.2000)). The University appealed the BAP's decision and the Ninth Circuit affirmed, adopting the opinion of the BAP as its own. *See Ohio Univ. v. Hawkins (In re Hawkins),* 469 F.3d 1316, 1317 (9th Cir.2006) ("We adopt the opinion of the BAP, which is reported at 317 B.R. 104, and affirm its judgment.").

A few years later, the Ninth Circuit again addressed whether an agreement between a student and a college constituted a "loan" for purposes of the pre-BAPCPA version of § 523(a)(8). In *McKay v. Ingleson,* 558 F.3d 888, 889 (9th Cir.2009), the court reviewed an agreement between the debtor and Vanderbilt University that deferred payment of the debtor's tuition and costs of other "educational services" to monthly bills to be sent to the debtor. *Id.* If the debtor did not pay the bills as they became due, a late fee would be assessed. *Id.* The debtor did not pay the bills as agreed and later filed for bankruptcy relief. A couple of years after the debtor received her discharge, the University sued the debtor in state court to recover the amounts owed under the agreement. In response, the debtor commenced an adversary proceeding against the University in the bankruptcy court claiming that the University violated the discharge injunction of § 524(a) by prosecuting the state court action. *Id.* The bankruptcy court, and later the district court on appeal, concluded that no violation of the discharge injunction occurred because the debt at issue was excepted from discharge *631 under § 523(a)(8). *Id.* The Ninth Circuit affirmed, reasoning that the agreement between the parties was a nondischargeable "loan" under § 523(a)(8), and that it did not matter that no actual money had changed hands between the parties under their arrangement. *Id.* at 890. In explaining its decision, the court cited to *In re Johnson,* 218 B.R. 449 (8th Cir. BAP 1998). *Id.* The court also cited to the BAP's opinion in *In re Hawkins* for the proposition that the amount of the loan must be based on the amount of benefit the debtor received; the court concluded that the "loan" in *McKay* complied with that requirement. *Id.* at 891.

In re Johnson, the decision relied upon by the Ninth Circuit in *McKay,* addressed what constituted a "loan" under the pre-BAPCPA version of § 523(a)(8): "Since the parties stipulate that the [c]ollege is a non-profit institution and that the credit was extended for educational purposes ... the only issue presently on appeal is whether the [c]ollege's extension of credit was a loan."*In re Johnson,* 218 B.R. at 450–51. *In re Johnson* focused on a debt represented by a promissory note, executed to evidence the debtor's obligation to a college to pay for tuition, books, and other expenses. *Id.* at 450. The debtor defaulted on the note and filed a chapter 13 case. *Id.* The college filed an adversary proceeding in the debtor's bankruptcy case asking the bankruptcy court to declare that the debt represented by debtor's note was excepted from discharge. *Id.* The bankruptcy court concluded that the debt was a "loan" for purposes of § 523(a)(8), and the Eighth Circuit BAP agreed. *Id.* The panel rejected the debtor's argument that the note was not a "loan" because no funds had ever been given to him by the college:

> [W]e conclude[ ] that the arrangement between [the debtor] and the [c]ollege constitutes a loan.... [B]y allowing [the debtor] to attend classes without prepayment, the [c]ollege was, in effect, 'advancing' funds ... to [the debtor] ... [and i]t is immaterial that no money actually changed hands.

Id. at 457.

It is important to note that the BAP in *In re Johnson,* as relied upon by the Ninth Circuit in *McKay,* acknowledged that another avenue may have existed for the college to obtain an exception to discharge under § 523(a)(8), characterizing the note as "an obligation to repay funds received as an educational benefit"; however, the panel determined it need not venture down that path because the debt arising from the agreement with the debtor was determined to be an educational benefit "loan" made by a nonprofit or a governmental unit.[6] 218 B.R. at 450. By contrast, in *In re Hawkins,* the Panel was required to decide whether the agreement before it created "an obligation to repay funds received as an educational benefit" because it had concluded the agreement was not a "loan" under the statute. 317 B.R. at 112. In addressing this issue, the Panel stated "the plain language of this prong of the statute requires that a debtor *receive actual funds* in order to obtain a nondischargeable benefit." *Id.* (citations omitted; emphasis added). The Panel found this requirement was not satisfied because no "actual funds" were received by the debtor in consideration of her admission and education at the medical school. *Id.*

D. *Enter BAPCPA.*

As a result of the Code amendments in BAPCPA, since 2005, § 523(a)(8) has provided *632 that a debtor may not discharge a debt:

unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for—

(A)(i) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit or nonprofit institution; or

(ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or

(B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual.[7]

As can be seen, many of the statute's former attributes survived BAPCPA's revisions. On the other hand, there were some additions to its text, and there was also a clear restructuring of the statute.

Since enactment of BAPCPA, neither the Ninth Circuit nor this Panel has published decisions interpreting § 523(a)(8)(A)(ii). And only one published decision, other than the bankruptcy court's decision at issue in this appeal, was located from bankruptcy courts in the Ninth Circuit interpreting § 523(a)(8)(A)(ii). *Benson v. Corbin (In re Corbin),* 506 B.R. 287 (Bankr.W.D.Wa.2014).[8] In *In re Corbin,* the bankruptcy court explained that, post-BAPCPA, this Code provision:

> protects four categories of educational claims from discharge: (1) loans made, insured, or guaranteed by a governmental unit; (2) loans made under any program partially or fully funded by a governmental unit or nonprofit institution; (3) claims for funds received as an educational benefit, scholarship, or stipend; and (4) any "qualified educational loan" as that term is defined in the Internal Revenue Code.

506 B.R. at 291 (citing *Rumer v. Am. Educ. Servs. (In re Rumer),* 469 B.R. 553 (Bankr.M.D.Pa.2012)). The bankruptcy court explained that § 523(a)(8)(A)(ii) "was added, covering loans made by nongovernmental and profit-making organizations...." *Id.* at 296. Canvassing the out-of-circuit bankruptcy court decisions, the court noted that they "pay no attention to who the lender is, but focus instead [under § 523(a)(8)(A)(ii)] on whether, in the plain language of the subsection, the

obligation is 'to repay funds received as an educational benefit' as reflected by the debtor's agreement and intent to use the funds at the time the obligation arose." *Id.* at 296–97 (citing *Roy v. Sallie Mae (In re Roy),* 2010 WL 1523996 (Bankr.D.N.J. Apr. 15, 2010); *Carow v. Chase Student Loan Serv. (In re Carow),* 2011 WL 802847 (Bankr.D.N.D. Mar. 2, 2011); *Skipworth v. Citibank Student Loan Corp. (In re Skipworth), *633* 2010 WL 1417964 (Bankr.N.D.Ala. Apr. 1, 2010)).

Given the lack of case law, the bankruptcy court set out to apply post-BAPCPA § 523(a)(8)(A)(ii) to the facts before it. *In re Corbin* involved cash advances from a third-party lender to the debtor to attend college made, in part, because the debtor's coworker had agreed to co-sign the loan. 506 B.R. at 290. The lender later notified the co-signer that the debtor was not paying the loan. *Id.* The co-signer paid the loans and sued the debtor in state court to recover the amounts he had paid the lender. *Id.* The debtor then filed a bankruptcy case, and the co-signer commenced an adversary proceeding against the debtor arguing that the debt owed by the debtor to the co-signer was excepted from discharge under both § 523(a)(8)(A)(i) and (a)(8)(A)(ii). *Id.* The bankruptcy court declined to hold that this arrangement qualified for an exception from discharge under § 523(a)(8)(A)(i) based upon Ninth Circuit authority on subrogated claims. *Id.* at 295–96 (citing *Nat'l Collection Agency v. Trahan,* 624 F.2d 906 (9th Cir.1980)). However, the bankruptcy court concluded that the debt was excepted from discharge under § 523(a)(8)(A)(ii), reasoning that because the debtor

> intended to and did use the funds she received to pay for educational expenses ... this [c]ourt concludes that the provisions of an accommodation, in order to secure for a student funds for the purpose of paying educational expenses, gives rise to an obligation on the part of the debtor to repay funds received as an educational benefit once the co-signer is required to honor its obligation to pay the debt.

Id. at 297–98.

Of course, the *In re Corbin* debtor actually received funds from the lender to pay for her education; the facts here are different.

E. *Application of § 523(a)(8)(A)(ii) to Meridian's Debt*

[7] We agree with the bankruptcy court that the language of § 523(a)(8) is plain and that it must be read in context with a view to the overall statutory scheme. Moreover, as instructed by the Supreme Court and Ninth Circuit, we must construe § 523(a) narrowly, limiting this discharge exception to those debts described in the statute.*Bullock,* 133 S.Ct. at 1760; *Hawkins,* 769 F.3d at 666; *In re Huh,* 506 B.R. at 263. Finally, we must construe the provisions of § 523(a)(8) that were found in the pre-BAPCPA version of that statute in accord with the Ninth Circuit authorities interpreting them. Doing all this, we conclude that the debt represented by Meridian's arbitration award against Debtor is not excepted from discharge under § 523(a)(8)(A)(ii). As a result, the bankruptcy court did not err in granting summary judgment to Debtor, and denying Meridian's motion for summary judgment.

[8] Section 523(a)(8)(A)(ii) plainly provides that a bankruptcy discharge will not impact "an obligation to repay funds received as an educational benefit, scholarship, or stipend." It is undisputed that the agreements between Meridian and Debtor constitute an "obligation to repay" "educational benefits" provided by Meridian to Debtor. However, § 523(a)(8)(A)(ii) requires more. To except a debt from discharge under this subsection, the creditor must demonstrate that the debtor is obliged to repay a debt for "funds received" for the educational benefits. The phrase "funds received" has been interpreted by the BAP, in an opinion which was as adopted by the Ninth Circuit as its own, to require "that a debtor *receive actual *634 funds* in order to obtain a nondischargeable benefit." *In re Hawkins,* 317 B.R. at 112 (emphasis added); *accord In re Oliver,* 499 B.R. 617, 625 (Bankr.S.D.Ind.2013) (holding under § 523(a)(8)(A)(ii), "[i]n order to be obligated to *repay* funds received, [the] [d]ebtor had to have received funds in the first place.") (emphasis in original). Because the *In re Hawkins* decision construed the very same language of the statute implicated here, we conclude that *In re Hawkins* controls the outcome in this case notwithstanding that BAPCPA later amended § 523(a)(8). *See Ball v. Payco–General Am. Credits, Inc. (In re Ball),* 185 B.R. 595, 597 (9th Cir. BAP 1995) ("We will not overrule our prior rulings unless a Ninth Circuit

Court of Appeals decision, Supreme Court decision or subsequent legislation has undermined those rulings."). That the arrangement between the parties in *In re Hawkins* was dissimilar to the agreement in this case is of no consequence, and renders that decision no less binding, concerning the proper construction of § 523(a)(8)(A)(ii). This is so because *In re Hawkins* construed the very same statutory language implicated here, and because the Panel and the Circuit have concluded that this language requires that "a debtor receive actual funds." *Id.* at 112.

[9] This result is bolstered by the changes made to § 523(a)(8) by Congress in BAPCPA. As noted above, the exact wording used in amended § 523(a)(8)(A)(ii) was formerly a part of § 523(a)(8). However, BAPCPA set off the "obligation to repay funds received" language from the other provisions of § 523(a)(8) in a new subsection. We agree with the bankruptcy court, that in restructuring the discharge exception in this fashion, Congress created "a separate category delinked from the phrases 'educational benefit or loan' in § 523(a)(8)(A)(i) and 'any other educational loan' in § 523(a)(8)(B)." *In re Christoff,* 510 B.R. at 882. Put another way, "new" § 523(a)(8)(A)(ii), now standing alone, excepts from discharge only those debts that arise from "an obligation to repay funds received as an educational benefit," and must therefore be read as a separate exception to discharge as compared to that provided in § 523(a)(8)(A)(i) for a debt for an "educational overpayment or loan" made by a governmental unit or nonprofit institution or, in § 523(a)(8)(B), for a "qualified education loan."

Meridian's arguments conflating "loan" as used in § 523(a)(8)(A)(i) and (a)(8)(B), and as interpreted by *McKay* and *In re Johnson* with "an obligation to repay funds received" as provided in § 523(a)(8)(A)(ii), are unconvincing. According to Meridian, "[t]here is no reason why the word 'funds' should not be interpreted in the same light that 'loans' has been interpreted in prior cases in the Ninth Circuit...." Appellant's Op. Br. at 14. In effect, Meridian argues that we should read § 523(a)(8)(A)(ii) to say "loans received" as opposed to "funds received." But this we must not do. *See* *Conn. Nat'l Bank v. Germain,* 503 U.S. 249, 253–54, 112 S.Ct. 1146, 117 L.Ed.2d 391 (1992) ("[I]n interpreting a statute a court should always turn first to one, cardinal canon before all others. We have stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there.") (citations omitted). Instead, we must presume that, in organizing the provisions of § 523(a)(8) as it did in BAPCPA, Congress intended each subsection to have a distinct function and to target different kinds of debts.[9]

*635 We are also unpersuaded by Meridian's reliance on those bankruptcy cases that, perhaps inadvertently, imprecisely quote the provisions of the discharge exception statute as applying to "loans received," as opposed to the "obligation to repay funds received" dealt with by § 523(a)(8)(A)(ii). *See, e.g.,* *In re Rumer,* 469 B.R. at 561 (stating "loans received as an educational benefit, scholarship, or stipend" are excepted from discharge); *see also Beesley v. Royal Bank of Canada (In re Beesley),* 2013 WL 5134404 (Bankr.W.D.Pa. Sept. 13, 2013) (quoting *Rumer* and its misstatement of the law); *Liberty Bay Credit Union v. Belforte (In re Belforte),* 2012 WL 4620987 (Bankr.D.Mass.2012) (same). In addition, as observed by the bankruptcy court, the other cases relied upon by Meridian are distinguishable because they all dealt with cases where the debtor actually received funds. *See, e.g.,* *In re Corbin,* 506 B.R. at 287; *Brown v. Rust (In re Rust),* 510 B.R. 562 (Bankr.E.D.Ky.2014); *Maas v. Northstar Educ. Fin., Inc. (In re Mass),* 497 B.R. 863 (Bankr.W.D.Mich.2013); *In re Beesley,* 2013 WL 5134404; *In re Belforte,* 2012 WL 4620987; *In re Carow,* 2011 WL 802847; *Sensient Techs. Corp. v. Baiocchi (In re Baiocchi),* 389 B.R. 828 (Bankr.E.D.Wis.2008). Finally, while we have reviewed the other decisions cited by Meridian that, arguably, reach a different conclusion than we do here, because the courts' analysis and reasoning in those cases is not fully developed, we find them unpersuasive. *See* *In re Roy,* 2010 WL 1523996; *The Rabbi Harry H. Epstein School, Inc. v. Goldstein (In re Goldstein),* 2012 WL 7009707 (Bankr.N.D.Ga. Nov. 25, 2012).

Simply put, because Debtor did not actually receive any funds, Meridian's debt is not excepted from discharge under § 523(a)(8)(A)(ii).

VI. CONCLUSION

The bankruptcy court did not err in granting summary judgment to Debtor. We therefore AFFIRM the decision of the bankruptcy court.

All Citations

527 B.R. 624, 315 Ed. Law Rep. 900, Bankr. L. Rep. P 82,795, 15 Cal. Daily Op. Serv. 3688, 2015 Daily Journal D.A.R. 3591

Footnotes

1 Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101–1532, and to the Federal Rules of Bankruptcy Procedure, Rules 1001–9037. "Civil Rule" references are to the Federal Rules of Civil Procedure 1–86.

2 This recitation of the undisputed facts is taken primarily from the bankruptcy court's decision, which neither of the parties has challenged.

3 We agree that Meridian cannot take advantage of these discharge exceptions because it was neither a governmental unit nor a nonprofit institution as required for an exception under § 523(a)(8)(A)(i), nor was the debt in this case a "qualified education loan" as defined by the Internal Revenue Code, a condition for an exception to discharge under § 523(a)(8)(B).

4 The parties agreed that if the bankruptcy court determined that the Meridian debt qualified for an exception to discharge under § 523(a)(8)(A)(ii), Debtor would be allowed to amend her answer and plead that she could not repay the debt without an "undue hardship".

5 Pub.L. No. 109–8, 119 Stat. 23.

6 Of course, the college/creditor in *In re Johnson* was a nonprofit organization. *See In re Johnson,* 218 B.R. at 450. (stating the "parties stipulate that the [c]ollege is a non-profit institution"). Similarly, Vanderbilt University is a nonprofit institution.

7 Under § 523(a)(8)(B) to be a "qualified education loan" under 26 U.S.C. § 221(d)(1), it must, among other things, be a debt for a "qualified higher education expense," as defined by 26 U.S.C. § 221(d)(2), which is the "costs of attendance ... at an eligible educational institution." An "eligible educational institution" is one as defined by 26 U.S.C. § 25A(f)(2), which provides an " 'eligible educational institution' means an institution—(A) which is described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088) ... (B) which is eligible to participate in a program under title IV of such Act." An "eligible program" is further defined at 20 U.S.C. § 1088(b).

8 In addition, only one unpublished decision in this circuit has tackled this chore. In a case that involved Meridian, relying heavily upon the bankruptcy court's decision here, the bankruptcy court declined to grant an exception to discharge. *Inst. of Imaginal Servs. v. Coelho (In re Coelho),* No. 13–10975, 2014 WL 3858514 (Bankr.N.D.Ca. Aug. 4, 2014).

9 On this point, we agree with Debtor's counsel's statement at oral argument that § 523(a)(8)(A)(ii) is not a "catch-all" provision designed to include every type of credit transaction that bestows an educational benefit on a debtor. Instead, this subsection includes a condition, distinct from those in the other subsections of § 523(a)(8), that must be fulfilled. *In re Hawkins* held that this unique requirement, that "funds [be] received" by the debtor, mandates that cash be advanced to or on behalf of the debtor. In light of the many programs available to students which provide cash benefits to students, like veteran's educational benefits, stipends for teaching assignments, and cash scholarships, it is not absurd to assume that Congress intended the scope of § 523(a)(8)(A)(ii) to target obligations other than those arising from traditional student loans.

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Hot Consumer Bankruptcy Topics: Determining Household Size[1]

With the decline of the nuclear family and the rise of the more variable postmodern family, it is unsurprising that multiple definitions of "household" size have emerged. Post-BAPCPA, household size became an essential element in determining a debtor's eligibility for Chapter 7 as well as in determining how much and for how long a debtor must pay in Chapter 13. Summarized below are recent cases illustrating the three primary methods for determining household size applied in common scenarios practitioners are likely to encounter.

I. **Heads on Beds**: follows the Census Bureau's broad definition of a household as all the people who occupy a housing unit without regard to relationship, financial contributions, or financial dependency.

A. *In re Ellringer*, 370 B.R. 905 (Bankr.D.Minn. 2007). Prior to filing for Chapter 7 bankruptcy, the Debtor lived together with a non-filing individual with whom she co-owned their home, a vehicle and shared living expenses. *Id*. at 907. Pre-petition the individual contributed $600 per month to the household expenses, post-petition the non-filing individual moved out of their home. *Id*. In resolving a motion to dismiss this case for abuse under § 707(b), the Court found that in the absence of a definition of "household" in the Bankruptcy Code itself, the definition provided by the Census Bureau "provides the most appropriate definition of 'household' for use in the means test because it ensures that a household in the means test will have the same number of members as the calculation of median family income." *Id*. 910-911.

B. *In re Smith*, (Bankr.W.D.Mich. 2008). When the Debtors commenced their case under Chapter 13 they had three adult children who each resided with them to varying degrees.

[1] Prepared by Ariane Holtschlag, associate attorney with the law firm of FactorLaw in Chicago, Illinois. The views expressed herein do not necessarily reflect those of FactorLaw or its clients.

One daughter lived with the Debtors along with the daughter's minor child. The Debtors' son had a room at the Debtors' home and shared some meals with them. The Debtors' third child was a college student who resided at home during the summer. The Debtors argued that their "household" included at least the one daughter and their grandchild. The Court held that a broad definition of household to include all of those who reside under the same roof was warranted under § 1325(b)(4). The term "household" as used in that section, meant all persons, related or not, who resided in the same housing unit as the debtor. The court rejected any requirement that the co-resident be supported by the debtors. Thus it would appear that the daughter and the grandchild could be part of debtors' household under § 1325(b)(4).

II. *In re Epperson*, 409 B.R. 503, 507 (Bankr. D. Ariz. 2009). The debtor and house mate were a cohabitating couple that lived together for several years. The debtor alleged that they maintained separate finances and, until recently, his roommate gave him $ 900 per month for household expenses. The trustee argued that the debtor was receiving an unfair advantage by claiming a household size of two and not including the second household member's income in current monthly income, and that the debtor should either include all of the house mate's income in current monthly income or reduce the household size to one. The court rejected the trustee's argument. In the absence of Congressional guidance, it was unreasonable to conclude that two persons living in the same home were not a part of the same household. Therefore, the debtor household size of two was correct. Only the house mate's monthly contribution to household expenses should be included in the debtor's current monthly income.

III. **Income Tax Dependent**: derived from the Internal Revenue Manual's definition that examines which individuals either are or could be included on the debtor's tax return as dependents.

A. In re Law, 2008 Bankr. LEXIS 1198, 2008 WL 1867971 (Bankr. D. Kan. 2008). In In re Law, 2008 WL 1867971 (Bankr.D.Kan. 2008), it was undisputed that the Debtor was above the median income for a household of one or two – the question was, on the facts, was he allowed to claim the expenses for a household of one or two? (There was a non-dependent adult son living with him, as such, one.) This is persuasive because of the Code's reference to the allowable expenses under the Internal Revenue Guidelines in calculating the projected disposable income figures.

IV. **Economic Unit test**: assesses the number of individuals in the household who act as a single economic unit by including those who are financially dependent on the debtor, those who financially support the debtor , and those who's income and expenses are intermingled with the debtor's.

A. *In re Ford*, 509 B.R. 695 (Bankr. D. Idaho 2014). Debtor claimed that his household size was five, which included himself, his girlfriend, his daughter, his stepson (daughter and stepson being half-siblings, with the same mother, not his current girlfriend), and the girlfriend's son. He had custody of his daughter every other weekend, and often visited during the week, and during those times, he spent time with his stepson as well, and treated the stepson as if he were his natural child. The Court denied confirmation of his plan, finding that the economic unit test was the better analysis (after considering the tests below), finding that "the correct approach is one that determines household members based upon a person's financial dependence upon, and residence with, a debtor." *Ford*, 509 B.R. at 698, quoting *In re Kops*, 2012 W.L. 438623 at *5 (Bankr.D.Idaho 2012). "[S]ome sort of direct financial relationship to the debtor must be present, whether it be financial dependence on a debtor, financial support of a debtor, or the intermingling of income or expenses with a debtor." *Ford*, 509 B.R. at 700, quoting *In re Morrison*, 443 B.R. 378, 386 (Bankr. M.D.N.C. 2011). In this case, the Debtor hadn't shown the financial ties necessary to claim the stepson as part of the household.

V. In re Skiles, 504 B.R. 871 (Bankr. N.D. Ohio 2014). "[A]n adult capable of supporting himself, but who is not working without reasonable cause and lives off the generosity of the debtor, usually should be excluded from the debtor's 'household,' even if the adult would otherwise satisfy the requirements of the 'economic unit' definition… There are obvious, appropriate exceptions to this rule that will be developed on a case-by-case basis." *In re Skiles*, 504 B.R. 871, 882-883 (Bankr. N.D.Ohio 2014).

VI. **Fractional Economic Unit test**: first assesses the number of individuals who's income and expenses are intermingled with the debtors and then calculates how much time any part-time residents are members of the debtor's household to establish a fractional dependent.

A. *Johnson v. Zimmer*, 686 F.3d 224 (4^{th} Cir. 2012). Court of Appeals affirms Bankruptcy Court's denial of a motion for chapter 13 plan confirmation. Debtor argues her household size is seven, but, based on part-time residency, the Court calculates each of the Debtor's sons constitute .56 members of the household (residing with her 204 days out of a possible 365), and each of the Debtor's three step-children constitute .49 members of the household (residing with her 180 days out of 365). The Court concludes, therefore, that the Debtor has 2.59 members in her household, which the Court rounded up to 3, for a total household of 5.

VII. Conclusion. Nationwide, the economic unit test appears to be the majority view and the recent trend appears to be toward the fractional economic unit approach.

Hot Consumer Bankruptcy Topics: Unwanted Collateral[1]

As attorneys representing consumer debtors, we are most often faced with clients desperate to *save* their home or car and there are many tools in our bankruptcy toolbox to help clients *keep* collateral that is *wanted*. But what happens when a client wants to part ways with financially cumbersome or otherwise undesirable collateral? How can we protect our clients from on-going financial liability when the lender is unwilling or unable to take possession of its collateral? Recent cases, summarized below, illustrate the most common scenarios giving rise to this issue and provide examples of some creative bankruptcy solutions being tried.

I. Chapter 7

A. Failure to foreclose as a violation of the discharge injunction? Intent to surrender, alone, is not enough. *Canning v. Beneficial Canning of Maine, Inc*. 706 F.3d 64 (1st Cir. 2013). Debtor claims that lender violated the discharge injunction by failing to foreclose. Debtor demands that the lender either finish its foreclosure or release its lien. The bankruptcy court found that the failure to foreclose, alone, was not a violation of the debtor's discharge injunction. However, the bankruptcy court did suggest that failure to foreclose, taken together with other facts not evidenced in the case at bar, might yield a different result.

II. Chapter 13.

A. *In re Rosa*, 495 B.R. 522 (Bankr.D.Haw 2013). The debtor jointly owned property that was subject to a first and second mortgage. The property was apparently subject to homeowners' association fees. The debtor had no equity in the property and both mortgages were seriously delinquent. To escape liability for association fees, the debtor proposed that title be vested in the

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[1] Prepared by Ariane Holtschlag, associate attorney with the law firm of FactorLaw in Chicago, Illinois. The views expressed herein do not necessarily reflect those of FactorLaw or its clients.

first mortgagee pursuant to § 1322(b)(9). Neither mortgagee objected. The court held that it was reasonable to infer acceptance of the plan from the lack of an objection only if the first mortgagee had received adequate notice of the plan. The court held that the first mortgagee got proper notice of the plan, and its failure to object meant that it had accepted the plan, within the meaning of 11 U.S.C.S. § 1325(a)(5)(A).

B. In re Rose, 512 B.R. 790 (Bankr.W.D.N.C. 2014). The Debtors jointly owned residential real estate in Arcadia, Florida (the "Residence"), that was not their current residence, worth $30,000 and subject to an SBA mortgage with a balance of $78,653.47. *Id*. at 792-3. The Debtors' confirmed plan "provided for the surrender of the Residence to the SBA and granted relief from stay so that the lender might foreclose its mortgage." *Id*. at 793. Approximately one hear into the Debtors' plan, the SBA had not yet commenced a foreclosure or otherwise taken possession of the Residence. *Id*. The Debtors then filed their Motion for Authority to Transfer Real Property to Secured Creditor by Quitclaim Deed seeking permission to quitclaim their Residence to the SBA without its consent. The court declined to read §1322(b)(9) as requiring a lender to accept title to a property. *Id*. at 795. The court also declined to read § 105(a) as permitting a debtor to transfer property to its mortgage lender by fiat. *Id*. Instead, interpreting Florida state law, the Court found that although acceptance of title by the lender cannot be compelled, acceptance can be presumed if not rejected. Therefore, the Court granted the Debtors' motion as follows:

> a. the Debtors may prepare and forward to the SBA, within thirty (30) days of this Order, an executed quitclaim deed to the Residence;
> b. the SBA shall have sixty (60) days from delivery of said quitclaim deed in which to take one of the following steps:
> i. record the deed, and thereby accept ownership of the Residence;

> ii. reject the deed and the proposed conveyance through a written document filed with this Court, and [798] served on the Debtors and their counsel; or
> iii. initiate foreclosure against the Residence, thereby indicating rejection of the proposed conveyance by quitclaim deed.
> Should the SBA fail to take any of the steps outlined in paragraph 2, then at the expiration of the sixty (60) day tender period, the Debtors will be permitted to record the quitclaim deed in the applicable Florida registry and thereby transfer the property to the SBA. In this event, recordation of the deed shall be considered final conveyance of the Residence to the SBA, not subject to later repudiation.

C. In re Sagendorph, 2015 Bankr. LEXIS 2055 (Bankr. D. Mass. June 22, 2015). Debtor's proposed Chapter 13 plan provided for vesting of three (3) investment properties with each's respective lender upon confirmation. *Id* at *3. One lender objected to this treatment. The Court ultimately determined that "[j]ust as Bankruptcy Code § 1123(a)(5)(B) authorizes so-called "dirt for debt plans" in chapter 11, § 1322(b)(9) should permit confirmation of chapter 13 plans calling for the transfer of collateral to a secured creditor in satisfaction of the creditor's debt." *Id*. at 15. Though noting factors not present in this case might support denial of "dirt for debt" plans if there is evidence of bad faith.

D. *Bank of N.Y. Mellon v. Watt*, 2015 U.S. Dist. LEXIS 54041 (D. Or. Apr. 22, 2015). Reverses bankruptcy court order confirming plan providing for the vesting of property with the Debtor's lender upon confirmation, over the lender's objection. Court holds that a secured creditor cannot be forced to accept surrendered property, even where post-petition costs, including those assessed by a HOA, continue to accrue. *Id*. at 17-18.

Lien-Stripping an Undersecured Claim: *Bank of America v. Caulkett*

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I. Relevant Statutes

a. 11 U.S.C. § 506(a): bifurcates a creditor's undersecured claim into: (1) a secured claim in an amount equal to the value of the creditor's collateral; and (2) an unsecured claim for the remainder.

   i. Example: a lender holding a $100,000 mortgage claim secured by real estate worth $40,000 would have a secured claim for $40,000 and an unsecured deficiency claim for $60,000.

   ii. This is known as a "stripping down" a creditor's claim. A debtor is allowed to reduce the creditor's secured portion of its claim to the present value of its collateral.

b. 11 U.S.C. § 506(d): To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void unless: (1) such claim was disallowed only under section 502(b)(5) or 502(e) of this title; or (2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.

   i. This is known as "stripping off" a creditor's claim. It refers to a debtor's ability to completely remove a wholly unsecured, but otherwise valid, lien through the claim valuation process under 11 U.S.C. § 506 (d). *Branigan v. Davis (In re Davis)*, 716 F.3d 331 (4th Cir. 2013).

II. ***Bank of America v. Caulkett/Toledo-Cardona***

a. Supreme Court granted cert on November 17, 2014 for two lien-stripping cases: *Bank of America v. Caulkett*, 566 Fed.Appx. 879 (11th Cir. 2014) and *Bank of America v. Toledo-Cardona*, 556 Fed.Appx. 911 (11th Cir. 2014). In both cases, the bankruptcy court stripped off a wholly underwater second mortgage of a chapter 7 debtor. The 11th circuit, bound by prior panel precedent, concluded a wholly unsecured junior lien is voidable under § 506(d).

b. Arguments:

   i. Petitioner (Bank of America):

      1. *Dewsnup* controls and its statutory holding is both correct and settled. Under *Dewsnup*, a "secured claim" is a claim supported by a security interest in property, regardless of whether the value of that property would be sufficient to cover the claim.

      2. Respondents offered no reason to depart from *Dewsnup.*

   ii. Respondents (Caulkett & Toledo-Cardona):

      1. § 506(a) bifurcates claims into secured and unsecured claims and § 506(d) expressly voids valueless liens. Petitioner's argument contradicts the express terms of the statute because Petitioner's claim is unsecured and valueless.

      2. *Dewsnup* does not extend to completely underwater 2^{nd} mortgages and its policy considerations are largely inapplicable to them.

      3. Before the 1978 Bankruptcy code, the Supreme Court upheld the

power of bankruptcy courts to void valueless junior liens.

iii. Lawless, Markell, & Pottow as amici curiae:

1. Under state law, a wholly underwater lien is valueless.
2. The Code protects junior liens by giving creditors a say in the valuation process.
3. If a court doesn't allow lien-stripping, then it gives junior lienholders hostage value.
4. Courts have misinterpreted *Long v. Bullard,* 117 U.S. 617, 620-21 (1886), - liens do not pass through bankruptcy. For example: trustee's avoiding powers and cram-down provisions
5. The Court should overrule *Dewsnup* because the opinion is deeply flawed and should be abandoned.

c. Supreme Court's Holding and Reasoning

i. A debtor in a Chapter 7 bankruptcy proceeding may not void a junior mortgage lien under 11 U.S.C. § 506(d) when the debt owed on a senior mortgage lien exceeds the current value of the collateral if the creditor's claim is both secured by a lien and allowed under Section 502 of the Bankruptcy Code.

ii. In a 9-0 decision, the Court, with Justice Thomas writing the majority, relied on *Dewsnup's* construction of §506(d)'s term "secured claim." It is a claim supported by a security interest in property, regardless of whether the value of that property would be sufficient to cover the claim. Therefore, a junior mortgage lien is still an allowed secured claim despite being subordinate to a senior mortgage lien which is greater than the value of the home. §506(d) is inapplicable to this case because Bank of America's claim was an "allowed secured claim."

iii. Thomas discusses §506(a)(1)'s bifurcation of claims and appears to disagree with his own final ruling.

1. "If the value of a creditor's interest in the property is zero - as is the case here - his claim cannot be a "secured claim" within the meaning of §506(a). And given that these identical words are later used in the same section of the same Act—§506(d)—one would think this presents a classic case for application of the normal rule of statutory construction that identical words used in different parts of the same act are intended to have the same meaning. Under that straightforward reading of the statute, the debtors would be able to void the Bank's claims." *Caulkett* at 56.

iv. The Court ultimately decides to keep *Dewsnup's* construction of §506(d).

1. In *Dewsnup*, rather than apply the statutory definition of "secured claim" in §506(a), the Court reasoned that the term "secured" in §506(d) contained an ambiguity because the self-interested parties before it disagreed over the term's meaning. Relying on policy considerations and its understanding of pre-Code practice, the Court concluded that if a claim has been 'allowed' pursuant to §502 of the Code and is secured by a lien with recourse to the underlying collateral, it does not come

within the scope of §506(d). *Dewsnup* at 415-416; *Caulkett* at 57.

2. The debtor could not strip down the creditors' lien to the value of the property under §506(d) because the claim was secured by a lien and had been fully allowed pursuant to §502. In other words, *Dewsnup* defined the term "secured claim" in §506(d) to mean a claim supported by a security interest in property, regardless of whether the value of that property would be sufficient to cover the claim. Under this definition, §506(d)'s function is reduced to "voiding a lien whenever a claim secured by the lien itself has not been allowed." *Dewsnup* at 416; *Caulkett* at 57.

III. <u>History</u>

a. Using these statutes, homeowners in bankruptcy asked courts to value their homes at less than the full amount owed on the mortgage. If the court did so, the homeowner would then ask the court to void the lien to the extent that the lender's claim exceeded that court-determined value – i.e. "strip down" the lien. If the court had undervalued the property or the property later appreciated in value, the debtor, not the lender, benefited from the additional value.

b. *Dewsnup v. Timm*, 502 U.S. 410 (1992),

   i. Supreme Court decided a chapter 7 debtor couldn't strip-down a creditor's lien on real property to the value of the collateral, as judicially determined, when that value was less than the amount of the claim secured by the lien.

ii. The Court held "§ 506(d) does not allow petitioner to strip down respondents' lien, because respondents' claim is secured by a lien and has been fully allowed pursuant to § 502. Were we writing on a clean slate, we might be inclined to agree with petitioner that the words 'allowed secured claim' must take the same meaning in § 506(d) as in § 506(a). But, given the ambiguity in the text, we are not convinced that Congress intended to depart from the pre-Code rule that liens pass through bankruptcy unaffected." *Id.* at 417. Secured claims were defined by state-law before the Code, so the Court defined "secured claim" in § 506(d) as a valid state law lien rather than "secured to the extent of the value of the property," as defined in § 506(a).

iii. The lien would therefore survive the bankruptcy, and the lender could foreclose it even after the Chapter 7 debtor received a discharge of his or her debts. The discharge prevented the lender from collecting a deficiency from the former debtor, but now the lender would benefit from any increase in the value of the real estate itself, whether by appreciation or as a result of the court's low-ball valuation.

c. Response to *Dewsnup*:

i. An Amici Brief characterizes *Dewsnup* as "a short and thinly-theorized precedent that almost no bankruptcy scholar defends. The principal problem is one of statutory interpretation. The opinion is almost completely irreconcilable with the plain language of the Code and effectively concedes as much." Brief of Bankruptcy Law Professors Robert M. Lawless, Bruce A. Markell, and John A. Pottow as Amici Curiae in Support of Affirmance. 21-

22. Feb. 24, 2015.

ii. In a concurrence in *Bank of America Nat. Trust and Sav. Ass'n v. 203 North LaSalle Street Partnership*, 526 U.S. 434, 461-62 (1999), Justice Thomas said: "The Court justified its reliance on such practice by finding the provision ambiguous. *Id*., at 416, 112 S.Ct. 773. Section 506 was ambiguous, in the Court's view, simply because the litigants and amici had offered competing interpretations of the statute. *Ibid*. This is a remarkable and untenable methodology for interpreting any statute. If litigants' differing positions demonstrate statutory ambiguity, it is hard to imagine how any provision of the Code—or any other statute—would escape *Dewsnup's* broad sweep. A mere disagreement among litigants over the meaning of a statute does not prove ambiguity; it usually means that one of the litigants is simply wrong. *Dewsnup's* approach to statutory interpretation enables litigants to undermine the Code by creating "ambiguous" statutory language and then cramming into the Code any good idea that can be garnered from pre-Code practice or legislative history.

IV. Future Considerations

a. The Supreme Court in *Caulkett* limited its ruling to Chapter 7 cases, but the ruling may allow creditors to challenge lien stripping in Chapter 13 cases when a loan is solely secured by the debtor's principal residence.

i. Under 11 U.S.C. § 1322(b)(2), a reorganization plan may modify the rights of holders of secured claims, unless the claim is secured only by a security interest in real property that is the debtor's principal residence, or if the creditor holds an unsecured claims.

ii. Courts got around this by finding that this protection for lenders only applies if the lien has equity or value supporting it. If there is no equity, then the anti-modification provisions do not apply and the debtor can still strip off the lien as unsecured.

iii. After *Caulkett*, secured creditors can now argue there is no basis to remove a lien that is entitled to the Code's anti-modification provisions as long as the lender's claim is "allowed" and "secured."