Things Don't Always Go as Planned: Post-Confirmation Modifications and Appealing an Order Denying Confirmation

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11 USC §1325 provides a comprehensive list of requirements which need to be met in order for a chapter 13 plan to be confirmed by the court. Conversely, 11 USC §1329 gives a far looser framework for post-confirmation plan modification. The reading material below examines some hot topics and open questions concerning §1329 worthy of examination.

Whose Motion is it Anyway? Post Confirmation Increases in Chapter 13 Debtor's Income Should Be Monitored by the Chapter 13 Trustee

Chapter 13 debt reorganization plans are designed to last between 36 and 60 months[1] and debtors in a chapter 13 are required to have regular income[2]. Three to five years can be a significant amount of time and much can change for an individual with regular income during this span. The ebbs and flows of life can create significant changes in circumstances, both positive and negative, which in turn can have large effects on a debtor's ability to perform under a confirmed plan. Understanding this reality, §1329 has long provided for post confirmation plan modifications.[3]

Section 1329 motions are commonly used to defer defaults in plan payments or lower monthly payments when a debtor goes through a hard time. The task of identifying the need for a §1329 motion where the debtor has had a change for the worse is not difficult. The debtor typically will fall behind in plan payments and the chapter 13 trustee files a motion to dismiss pursuant to §1307(c)(6). Once the motion to dismiss is filed the court will hold a hearing to determine if the plan can be salvaged or if the case must be dismissed. But the alternative scenario, where a debtor experiences a stroke of good luck, finding the

[1] 11 U.S.C. §1325(b)(4)(A)(i), 11 U.S.C. §1325(b)(4)(A)(ii)
[2] 11 U.S.C. §109(e)
[3] The current language of §1329 was implemented over thirty years ago on July 10, 1984. The text of the Bankruptcy Amendments and Federal Judgeship Act of 1983 is available at https://www.govtrack.us/congress/bills/98/hr5174/text/enr

need for the motion creates a more significant challenge. An increase in income does not have the same automatic safeguard as a material default does to get the court's attention. Also, it is not a foregone conclusion that an increase in income automatically equals a higher trustee payment and an increase in the plan base. So, how does one know if plan modification is necessary?

It has been held that a significant change in circumstances is not a prerequisite for a plan modification[4], so at first blush it may appear that any increase in income should lead to plan modification. But whether plan modification is appropriate is far less straightforward and mathematical proposition than determining the amount which goes to unsecured creditors at the time of confirmation, which is navigated by the enumerated confines of §1325.

A majority of courts have held that the disposable income provisions of §1325(b) do not apply to §1329 motions since the express language of §1325(b) limits its application solely to plan confirmation.[5] Section 1329(b)(1) explicitly lists four code sections, leaving §1325(b) out of the equation and putting §1325(a) in. This omission leaves the good faith requirement component in place, along with feasibility and best interests of creditors, but dispenses with the mathematical analysis of §1325(b).

Once §1325(b) is removed, the standard effectively becomes good faith and feasibility. Considering the only issue in a motion of this sort is whether unsecured creditors with allowed claims receive a higher payout, the results of a best interest test are self-evident. Feasibility, or the debtor's ability to make the plan payments, can be determined by a review of schedules I and J.

But unlike feasibility or pre-confirmation determination of disposable income, good faith is not math. "Every bankruptcy statute since 1898 has incorporated… a standard of good faith for the commencement, prosecution, and confirmation of bankruptcy proceedings."[6] But in stark contrast to its central place in bankruptcy jurisprudence, the code does not grant practitioners the favor of providing a definition. Even searching legislative history will not "shed any light on its intended meaning."[7] Still, absent a definition in the code, courts have found that good faith incorporates equitable principles akin to "clean hands" and "fundamental fairness."[8] In our context, good faith means if a debtor enjoys a significant positive change in circumstance post confirmation, it is unfair to general unsecured creditors for the debtor to carry on to plan completion acting like nothing has changed when in reality a higher dividend can be paid.

What this patchwork of requirements all boils down to is that in some cases the increase in income means the plan payments needs to increase and in some cases they do not. Given the Code's opacity, the only manner to determine whether plan modification is necessary is to bring the facts before the court.

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[4] See *In Re Perkins*, 111 B.R. 671, (Bankr. M.D. Tenn. 1990)
[5] e.g. *In Re Grutsch*, 453 B.R. 420 (Bankr. D. Kan. 2011); *In re Powers*, 507 B.R. 262, (Bankr. C.D. Ill. 2014)*, In Re Davis* 439 B.R. 863 (Bankr. N.D. Ill. 2010)
[6] *In re Jensen,* 369 B.R. 210, 231 (Bankr. Court, ED Pennsylvania 2007) (quoting *Little Creek Dev. Co. v. Commonwealth Mortgage Corp.,* 779 F.2d 1068, 1071 (5th Cir. 1986))
[7] Id. at 232
[8] Id. at 231, 233

Additionally, the issue of which party bears the responsibility to monitor the debtor's post-petition income and file the appropriate motion to modify the plan is offered little guidance by §1329. The statute plainly states that "the plan may be modified, upon request of the debtor, the trustee, or the holder of an allowed unsecured claim."[9] This language gives equal latitude to three enumerated parties. Forcing general unsecured creditors, particularly those that are already bound to receive a fraction of their allowed claim, to monitor a debtor's post-confirmation income over a three to five year period is unreasonable and leads to potentially absurd results. Accordingly, that class should not be burdened with an affirmative duty to monitor post confirmation income. That being said, if an unsecured creditor is so inclined it does have the statutory right to take this burden on and bring such a motion.

Left with a decision between the debtor and the chapter 13 trustee, the unique role of a chapter 13 likely tips the balance the charge the trustee with the duty to monitor the post confirmation income of a debtor and where appropriate request plan modifications based on increases in income.

"Chapter 13 trustees wear many hats and perform several functions."[10] Chapter 13 trustees accept monthly payments and make disbursements according to confirmed plans, but the job of the trustee extends beyond overseeing plan confirmation and subsequent administration. "The chapter 13 trustee may not become a mere disinterested bystander once the plan is confirmed."[11]

Section 1302 bestows the chapter 13 trustee with an array of powers and responsibilities. The trustee has a statutory duty to assist the debtor.[12] But this duty to assist the debtor should not be conflated with a duty to make the debtor's life as easy as possible. Rather, a more appropriate interpretation is to ensure that the debtor can carry out the plan to completion while still remaining in compliance with §1325 and §1326. Accordingly, at other times the trustee takes on a more adversarial role, such as seeking dismissal. Courts have also identified a "statutory duty to investigate a debtor's financial affairs."[13]

The debtor, with or without the aid of counsel, is a vastly different entity from a chapter 13 trustee. A pro se debtor cannot be expected to grasp the nuances of how life's vicissitudes affect compliance with the code. Similarly, counsel for the debtor is tasked with providing legal advice and representing the debtor before the court. But a debtor's attorney cannot be expected to have an operation of similar magnitude as an office of a chapter 13 trustee, who administers, monitors and audits untold volumes of active cases. To impose a duty on debtor and debtor's counsel to perform ongoing analysis of debtor's situation is impracticable, and absent the debtor making the affirmative step of notifying counsel, it is unduly burdensome for a debtor's attorney to make this ongoing analysis, essentially performing annual audits on each active chapter 13.

Whether or not a chapter 13 trustee will make this inquiry and ultimately make it a requirement for plan completion should be within the discretion of the chapter 13 trustee. Considering the variety of tasks

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[9] 11 U.S.C. §1329(a)
[10] *In re Harwood*, 519 B.R. 535, 542 (Bankr. N.D. Cal. 2014)
[11] *Morgan v. Goldman (In Re Morgan)*, 353 B.R. 599, 604 (Bankr. E.D. Ark. 2006) (quoting 8 Collier On Bankruptcy ¶ 1302.03[1][j] (15th ed.1993)).
[12] 11 U.S.C. 1302(b)(4)
[13] Id. at 867

involved and general practices in local courts, it is not surprising for standards to differ greatly between different chapter 13 trustees.[14] Therefore, where chapter 13 trustees wish to engage in ongoing investigations of the debtor's financial affairs the trustee can impose a duty on the debtor to turnover tax returns.[15] The trustee would then be in a position to monitor the debtor's income annually, and if the return shows an increase the trustee can file the appropriate motion. By making the income disclosure annual and not ongoing, which is how it may be when the debtor communicates directly to counsel, situations where a debtor obtains a better job and shortly thereafter loses it, or doesn't receive the boost in income it promised, can be largely avoided. By relying on tax returns the trustee is able to determine if the change in income is longstanding and not temporary.

Post-petition earnings are property of the bankruptcy estate under §1306. By monitoring post-petition income, the trustee is fulfilling the duty to investigate the affairs and the duty to make sure the debtor is in compliance with code. Furthermore, failure to turnover tax returns or refusal by the debtor to modify a plan in these instances could constitute bad faith and lead to a motion to dismiss.

After the trustee has taken note of a debtor's increase in income and filed a motion to modify plan to increase the monthly payment, the debtor's attorney is charged with providing counsel to the debtor. Essentially, the debtor's attorney must re-examine the debtor's budget and determine if a good faith basis exists for not increasing the monthly trustee payment. Perhaps the debtor has had a concomitant increase in expenses due to additional transportation, or the increase in income enabled the debtor to move to a safer but more expensive neighborhood, maybe the debtor has a larger household size and now has a new child care expense. Assuming §1325(b) no longer applies, the debtor would need to demonstrate that the dividend to unsecured creditors provided for in the confirmed plan is still all the debtor needs to pay.

It is becoming apparent that this area of chapter 13 practice requires statutory extrapolation and it may be ripe for congressional development. But until then, the chapter 13 trustee has both the posture and the statutory duties to make these inquiries, and debtors' counselors must be at the ready to defend against any unnecessary increases in plan payments.

[14] For one example of how policies differ between different offices of chapter 13 trustees across the nation see the article by Ariane Holtschlag, "Income Tax Refunds and Chapter 13: Plan Confirmation Confusion" ABI Journal, December, 2013).
[15] 11 U.S.C. §521(f)

An issue for the discussion of Post-Confirmation Modification: Can the debtor switch from paying a car loan to surrendering the car?

The relevant Code provision, § 1329(a):

At any time after confirmation of the plan but before the completion of payments under such plan, the plan may be modified, upon request of the debtor, the trustee, or the holder of an allowed unsecured claim, to—
(1) increase or reduce the amount of payments on claims of a particular class provided for by the plan;
(2) extend or reduce the time for such payments;
(3) alter the amount of the distribution to a creditor whose claim is provided for by the plan to the extent necessary to take account of any payment of such claim other than under the plan; or
(4) reduce amounts to be paid under the plan by the actual amount expended by the debtor to purchase health insurance for the debtor [under specified circumstances].

The "no" rationale

The leading case denying this a payment to surrender modification is *Chrysler Financial Corporation v. Nolan (In re Nolan)*, 232 F.3d 528 (6th Cir. 2000). *In re Ramos*, 540 B.R. 580, 591-92 (Bankr. N.D.Tex. 2015), summarizes Nolan as follows:

[S]ection 1329(a) of the Bankruptcy Code only permits modification of the amount or timing of payment. [T]he court also focused on the inherent unfairness of a debtor promising payments based on the value of a vehicle at the outset of the case, the vehicle depreciating after use, and then passing the car off to the lender after the decline in value. [T]he Sixth Circuit concluded that debtors can never modify a plan under section 1329(a) of the Bankruptcy Code by surrendering collateral and having a deficiency treated as an unsecured claim.

The "yes" rationale

One of the leading cases rejecting Nolan's approach is *Bank One, N.A. v. Leuellen (In re Leuellen)*, 322 B.R. 648, 657, 660 (S.D. Ind. 2005), written by David Hamilton, now a member of the Seventh Circuit Court of Appeals:

The modification proposed by the debtors is expressly permitted by the terms of section 1329(a)(1). The debtors' modification, though it affected the creditor's secured claim, did so by "reducing the amount of payments" on the creditor's secured claim from the amount stated in the original plan down to zero, after surrender of the collateral.

. . .

Preventing Chapter 13 debtors from modifying their plans to surrender collateral . . . amounts to granting secured creditors a windfall in the form of insulation from a significant portion of a risk, after they have already had ample opportunity to protect themselves against it.

Lower court decisions in the Seventh Circuit

Accepting Nolan:

• *In re Arguin*, 345 B.R. 876 (Bankr. N.D. Ill. 2006) (Squires, J.)

• *In re Adams*, 275 B.R. 274 (Bankr. N.D. Ill. 2002) (Schmetterer, J.)

Rejecting Nolan (in addition to Leuellen):

• *In re Brown*, 463 B.R. 134 (Bankr. S.D. Ind. 2011) (Metz, J.)

Treating as an open question:

• *In re Moncree,* 511 B.R. 922 (Bankr. E.D. Wis. 2014) (Kelley, J.)

After Germeraad v. Powers – Greedy Debtor or Greedy Trustee? Let's work together and be neither.

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SUMMARY OF CASE

On June 23, 2016, the 7th Circuit Court of Appeals rendered its decision in *Germeraad v. Powers*, an appeal from the United States District Court of Central District of Illinois. The issue was whether a Chapter 13 Trustee could move to modify a confirmed plan under 11 U.S.C. §1329 based on a post confirmation increase in the Debtors' income.

Trustee contended that the bankruptcy court has the discretion to grant a motion to modify where the Trustee shows that because of an increase in income, the Debtor can afford to pay more to the unsecured creditors than the original plan requires.

Debtors argued that the modification based on increased income was allowed only if the Trustee showed that "good faith" required the increase.

While the circuit court did not address the issue of whether or not 11 USC §1325(b) does not apply to modifications under §1329, the Court concluded that the district court and bankruptcy courts erred in concluding that the Bankruptcy Code did not authorize the trustee's modification, vacated the judgment of the district court and remanded to the district court for further proceedings.

ARTICLE

Whenever a circuit court renders a decision in a Chapter 13 case, there are "winners" and "losers" and the tension between the Trustee, Debtors and Creditors rises until the local bankruptcy courts determine the effect of the new decision. Trustees, in seeking to increase the dividend to unsecured creditors, are seen as "greedy Trustees" seeking to take more money from the Debtors. Debtors, in seeking to retain the fruits of their hard work and increase in income, are seen as "greedy Debtors" not willing to pay a dime more to their creditors.

Such is the case in the *Germeraad v. Powers* decision rendered in June 2016. It is not so much what the circuit court decided- but instead what the court said in dicta that will cause questions in interpretation. The question is one that arises in many chapter 13 bankruptcies- if the Debtor has a substantial increase in income after filing, should the dividend to the unsecured creditors in the confirmed plan be increased? And if the answer is yes- then what limits are there to modifications under 11 U.S.C. §1329?

In *Germeraad v. Powers*, the 7th Circuit clarified three key points on motions for post-confirmation modification of a Plan for Chapter 13 practitioners. (1) Is an order denying a motion for post-confirmation modification a final order that is appealable or is it analogous to an order denying confirmation that is not appealable? (2) Is an Order on Plan Modification retroactive to the date the modification was filed or is the Plan modified only upon the date the Court orders the modification? (3) Can a Plan be modified on the grounds that a Debtor has increased income?

The facts of the *Powers* case are likely familiar with all Chapter 13 practitioners. The case begins normally enough with the Debtors filing their Chapter 13 Plan in May 2010, which was confirmed in March 2011. The Plan provided for monthly payments to the Trustee of $670.00 which was going to result in an approximate dividend to the general unsecured creditors of $22,000.00.

As is typically required by Chapter 13 Trustees, the Debtors provided their income tax returns. Upon review by the Trustee's office, it was determined that the Debtors' income had increased by $50,000.00 in the 2012 taxes. The question at this point is, can the Trustee file a Motion for Post-Confirmation Modification to increase the Debtors' monthly Plan payments?

The first issue the 7th Circuit addresses is whether the Bankruptcy Court's order denying the Trustee's Motion to Modify is a final appealable order. The 7th Circuit holds that yes it is, and almost always will be. They write, "In the bankruptcy context, 'finality' is understood somewhat differently than it is in the context or ordinary civil litigation. *See e.g., Bullard v. Blue Hills Bank*, ___ U.S. ___, ___, 135 S.Ct. 1686, 1692 (2015). A bankruptcy case involves an aggregation of individual controversies, many of which would exist as stand-alone lawsuits but for the bankrupt status of the debtor. Id. An order in a bankruptcy case is considered final when it resolves one of the individual controversies that might exist as

a stand-alone suit outside of bankruptcy." *See Schaumburg Bank & Trust Co. v. Alsterda*, 815 F.3d 306 at 312-13 (7th Cir. 2016)

The Court goes on to differentiate between an order denying Confirmation, which we know from *Bullard* is not a final appealable order, and an order on Plan modification. The Court differentiates the two as a difference in finality, in looking at the "larger proceeding." For example, an order denying confirmation is not a final appealable order because a new Plan can still be proposed and the denial of confirmation does not end the "larger proceeding" of the confirmation of a Plan. If, hypothetically speaking, an Order denying confirmation at the same time dismissed the case, that would be a final appealable order because the order would be final and bring resolution to the confirmation process.

Analogously, the Order on Plan Modification is final because if the Court denies the modification, that resolves that "larger proceeding." The Trustee cannot again seek modification on those same grounds. In other words, if the Trustee files for a modification due to the increase in income based upon the tax returns and loses at the trial court level, the Trustee cannot refile her motion for modification due to the increase in income based upon the tax returns due to the res judicata effect of the Order denying the motion.

As mentioned above, there is one caveat. If the Court denies the Trustee's Motion for Modification on the basis of some defect or on some other basis that an amended motion could cure, the Court's Order in that limited situation would not be a final appealable order, because a revised motion could be submitted.

The second question is, decided in *Powers*, when does a plan modification go into effect? This question stems from the Debtor contending the appeal is moot. Debtor argued the appeal is moot because the relief the Trustee granted can no longer occur because five years had elapsed since her Plan term began. As the Court points out in rejecting Debtor's argument that the case is moot, if it vacated the bankruptcy Court's order, then "the trustee's modified plan would become the plan." Once the modification is filed, the Plan is modified. Period - regardless of objections that are later filed. The Court writes, "the plan is modified, on the date the party requests modification of the plan, unless the court later disapproves it."

If a Modification is filed, the Plan is immediately modified. If no objections are filed by the objection deadline, the Court will approve the modification and it is effective (either the payment increase or payment decrease) from the date the modification was filed. If an objection is filed two possible outcomes exist. After litigation, the modification is ultimately approved, the modification is effective back to the date the modification was approved, just as if the modification was never objected to. However, if after litigation the modification is ultimately denied, it is as if the modification was never filed, and the Plan never changed.

This is an important point for Trustees and Debtors' Counsel to remember. If you are the Trustee and are objecting to and litigating a Debtors' Motion to reduce plan payments, you should only disburse according to the lower Plan payments in the motion and hold all other sums on hand. Likewise, if you are the Debtors' Counsel, it is imperative to make sure your clients are aware that despite any litigation that is ongoing, any successful plan modification will relate back to the modification date. Thus it is always best to err on the side of making the extra payment. If, as in the present case, the modification is ultimately

granted 24 months after it was originally filed, the modification relates back to the date the modification was filed. In the Powers case, the Trustee requested an extra $746.00 monthly in payments. As modification was ultimately granted after 24 months of litigation, an additional $17,904.00 was due to the estate. It is unlikely the Debtor has these funds on hand, or could obtain these monies through other means. Alternatively, if the modification was denied, these funds would ultimately be refunded back to the Debtor.

Finally, the Court answers the meat of the question, whether a Trustee can modify a Plan due solely to a Debtor's increased income. The Court holds a Trustee can modify a Plan on the sole basis of a Debtor's increased income. Section 1329 begins by providing that "any time after confirmation of the plan but before the completion of payments under such plan, the plan may be modified, upon request of the debtor, the trustee, or the holder of an allowed unsecured claim, to…" So it is first clear that (1) a Trustee; (2) can move to modify a Plan; (3) if the request is made during the Plan term.

Next, Section 1329 provides four allowable modifications. They are: (1) increase or reduce payments to a particular class of creditors; (2) increase or reduce the Plan term; (3) alter the distribution a creditor will receive to account for money already received outside the Trustee conduit; and (4) reduce the Plan payments based upon the purchase of health insurance.

Finally, Section 1329 requires the modification to comport with Sections 1322(a), 1322(b), 1323(c), and Section 1325(a).

As the Court noted, "courts routinely deem modification appropriate when there has been a post-confirmation change in the debtor's financial circumstances that affects his or her ability to make plan payments." Several rationales exist for this overwhelming line of case law. The purpose of Chapter 13 is to allow the Debtors the fresh start of a Chapter 7 without liquidating their assets by ensuring the Debtors devotes all disposable income to the Plan. Additionally, support for this case law is drawn from the amendments to the Bankruptcy Code in 1984, when Section 1329 was amended to add that Trustees and unsecured creditors (not just debtors) could file plan modifications. Finally, Bankruptcy Courts, as the saying goes, are courts of equity, and it is only equitable to the Debtors creditors to increase the Plan payment to pay the unsecured creditors extra if the Debtor has increased income.

Now that this is settled 7th Circuit case law, what does the practitioner need to know? Make sure your attorney-client retainers contain language requiring your clients to inform you of increased income and to always provide you with their tax returns at the same time they file them each year. Your file should contain side-by-side spaces to insert the Debtor's Adjusted Gross Income from their tax returns all 5 years of the bankruptcy and the 2 years prior to filing. Having a method as simple as this will allow your staff to input this number and determine if the income has increased a substantial amount. If you notice the Debtor's income has increased substantially, that should trigger a case file review in your office and perhaps a meeting with the Debtor.

While not discussed in *Powers*, the Code already has a provision for the reporting of this increased income. 11 U.S.C. § 521(f). Most know Section 521 as the authority requiring tax returns to be remitted to the Trustee upon request each year to verify income. But Section 521(f)(4)(B) also includes a

provision for Debtors to annually submit new statements of the income and expenditures, i.e. annual Schedules I and J to be submitted to the Trustee. Again, as a tip for the Debtor practitioner, it is likely best practices to do this with your client as this could even lead to filing motions to reduce their Plan payments. But, you don't want to be the Debtor Attorney who only files Motions to reduce Plan payments. Filing a motion to increase the Plan payment when justified for increased income- in the amount calculated by the Debtor identifying and using the increased expenses that have arisen due to the increased income.

It is always better to file the modification than to object to the modification. As a practical matter, if Debtor's Counsel files a modification to increase the Plan payments along with submitting amended Schedules I and J, the Trustee is not likely to object. Have your client in to your office and determine what their increased expenses are and inform them they need to complete Amended Schedules I and J and modify the Plan. It is difficult to imagine a scenario where the Trustee objects that the Debtor's modification to increase the Plan payment does not increase the Plan payment enough! This is the Debtors' chance to be on offense and amend their budget to show exactly what the increased payment should be.

If the Debtor allows the Trustee to file a Post-Confirmation Modification to increase the payment, the Debtor is now on defense and the Debtor is now likely objecting to a Motion that increases the payment far more than the Debtor would have. Furthermore, the optics are bad for the Debtor in the eyes of the Judge.

Would you rather be the Debtor fighting the Trustee's modification that you can't afford the new payment despite your extra $50,000.00 in annual income, or would you rather be the Debtor filing the modification after you amended your budget and either not fighting the Trustee, or fighting her objection that you did not increase your Plan payment enough?

The optics of the latter are "Greedy Trustee." The optics of the former when the Trustee files the modification because you did not disclose your increased income are "Greedy Debtor."

Instead, if we all work together, if Debtor's Counsel spot these issues before getting to the Trustee, we can all work together and ensure neither the Debtor nor the Trustee is viewed as "greedy" and truly make Bankruptcy Courts the Courts of Equity that have always been.