Postconfirmation Mortgage Issues Affecting Discharge

Materials Prepared by

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The materials generally reflect my interpretation of the provisions of the Bankruptcy Code (as amended by BAPCPA), of local rules and forms, and of case decisions relating to chapter 13 practice.

As the trustee in the EDKY, I reserve the right to take a contrary position in any particular case depending on the facts of that case, and I reserve the right to argue an interpretation of the law that may differ from that set forth in these handouts.

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POSTCONFIRMATION MORTGAGE ISSUES AFFECTING DISCHARGE IN CHAPTER 13 CASES

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I. THE § 1322(B)(5) EXCEPTION TO DISCHARGE

If the debtor defaults in mortgage payments after confirmation and the creditor subsequently gets relief from stay and/or the debtor modifies the plan to surrender the collateral, is any resulting deficiency claim discharged upon completion of the plan?[1]

Consider the following fact scenario:

> Debtors propose a plan to cure mortgage arrearages through the plan while making ongoing postpetition mortgage payments directly to the creditor per 11 U.S.C. § 1322(b)(5). Plan is confirmed.
>
> Two years into the case, the debtors' financial condition changes, and they get behind on their mortgage. They file a motion to modify the plan to surrender their home and to lower their plan payments. The motion to modify the plan is sustained.
>
> Because the debtors are postpetition delinquent in their mortgage payments, creditor requests and obtains relief from stay. Debtors relocate.
>
> The debtors continue making all plan payments and after 60 months, they complete their plan payments to the trustee and get a discharge.
>
> After discharge, the mortgage creditor starts sending the debtors written notices that they are delinquent in their mortgage payments. The creditor also begins calling the debtors attempting to collect the debt.

[1] Even in instances where the foreclosing creditor "credit bids," a deficiency claim may still arise. *See U.S. National Bank Assoc. v. American General Home Equity, Inc.*, 387 S.W. 3d 345 (Ky. Ct. App. 2012). Furthermore, if property is surrendered postconfirmation, the impact on any claims of junior mortgage holders needs to be considered as well.

The debtors and their attorney repeatedly instruct the creditor to stop collection efforts on the basis that the debt had been discharged.

Ultimately, the debtors, by counsel, reopen the chapter 13 case and file a motion for sanctions against the creditor for violating the discharge injunction.

The creditor's response? That the claim was provided for in the confirmed plan as a section 1322(b)(5) claim, and as such, the debt was not discharged under section 1328(a)(1).

ISSUE: Does the debtors' discharge bar the mortgage creditor from collection efforts against the debtors personally?

Before addressing the myriad of nuanced issues raised in the above fact scenario, let's look at a paraphrased summary of relevant Code provisions:

- A plan may modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence. 11 U.S.C. § 1322(b)(2).
- A plan may provide for the curing of defaults and maintenance of payments while the case is pending on any claim that matures after the last plan payment would be due (even if the claim is secured by the debtor's residence and not subject to modification). 11 U.S.C. § 1322(b)(5).
- The provisions of a confirmed plan bind the debtor and creditors. 11 U.S.C. § 1327(a).
- After confirmation, the debtor may modify the plan to:
    - Increase or reduce the amount of payments on claims of a particular class provided for by the plan;
    - Extend or reduce the time for such payments; or
    - Alter the amount to be paid to a creditor to account for any payment of the claim other than under the plan. 11 U.S.C. § 1329(a).

- Upon completion of all payments under the plan, the court shall grant the debtor a discharge of all debts provided for by the plan, except any debt provided for under section 1322(b)(5). 11 U.S.C. § 1328(a)(1).

ANALYSIS:

Did the plan provide for the creditor's debt? A claim is "provided for by the plan" when the plan "makes a provision" for, "deals with," or even "refers to" the claim. *Rake v. Wade*, 508 U.S. 464, 474 (1993); *see also In re Holman*, 2013 WL 1100705 (Bankr. E.D. Ky. 2013) (Case No. 12-50023, Memorandum Opinion and Order entered March 15, 2013, Doc. #34) (Wise, J.) (claim is provided for under a plan whereby debtor cures arrearages through the plan while maintaining payments directly to creditor). *But see In re Huyck*, 252 B.R. 509 (Bankr. D. Colo. 2000) (to the extent the plan calls for the debtors to make direct payments to the creditor, the claim is not provided for under the plan; thus, the debt is not discharged because a discharge under § 1328(a) only discharges debts provided for by the plan); *accord In re Dukes*, 2015 WL 3856335 (Bankr. M.D. Fla. 2015) (*appeal pending*, Case No. 2:15-cv-00420-UA (M.D. Fla.)).

Did the plan provide for the debt under section 1322(b)(5)? *Compare In re Rogers*, 494 B.R. 664 (Bankr. E.D.N.C. 2013) (section 1322(b)(5), which says cure AND maintain, is not implicated where there is no prepetition default or arrearages for the debtor to cure; thus, claim can be discharged if debtor was not in default at the time of the petition); *with In re Hunt*, 2015 WL 128048 (Bankr. E.D.N.C. 2015) (any long-term debt provided for by a plan is a 1322(b)(5) claim excepted from discharge).

Did the granting of stay relief to the creditor after confirmation change the nature of the claim? In the case of *In re Holman*, 2013 WL 1100705 (Bankr. E.D. Ky. 2013) (Case No. 12-50023, Memorandum Opinion and Order entered March 15, 2013, Doc. #34) (Wise, J.), the court

held that the provisions of Bankruptcy Rule 3002.1, which is applicable to claims secured by the debtor's residence and provided for under section 1322(b)(5), continue to apply even after a creditor is granted relief from stay. In rejecting the creditor's and the trustee's arguments that upon the granting of relief from stay, the claim was no longer a claim provided for under § 1322(b)(5), the Court stated:

> PNC argues that once stay relief is granted, Rule 3002.1 no longer applies to a creditor because the debt is no longer "provided for" under the cure and maintain provision of § 1322(b)(5) of the plan as required by Rule 3002.1(a)(2). The Court disagrees. While it is true, the debt is no longer <u>being paid</u> as part of the cure and maintain provision, this does not alter that the claim remains <u>provided for</u> under that section of the plan.
> . . . .
> The Court discerns no reason why a different interpretation of the phrase "provided for" should be used in the context of Rule 3002.1 and concludes that a "cure and maintain" claim remains "provided for" in a plan after stay relief. Relief from the stay does not change the essential fact that a plan was confirmed as a cure and maintain plan pursuant to § 1322(b)(5). A conclusion that Rule 3002.1 is no longer effective after stay relief seems to require a determination that the plan as confirmed is not the same plan after relief from the stay. This logic ignores the lack of any court-approved modification of the confirmed plan as would be required by § 1329. 11 U.S.C. § 1329.

Holman, 2013 WL 1100705 at *3, Memorandum Opinion at pages 4-5 (underlined words original; emphasis added in italics).

In the *Holman* case, the court focused on the purpose of Rule 3002.1 and sought to protect debtors' need for information from the creditor after relief from stay is granted.[2] The greater issue of whether the debt would continue to be excepted from discharge as a section 1322(b)(5) claim

[2] Interestingly, Rule 3002.1 is slated for amendment to specify that continued notices are not required after a creditor gets relief from stay, unless the court orders otherwise. The court in *Holman* suggested that perhaps continued Rule 3002.1 notices are more important in judicial foreclosure states where the delay between stay relief and the actual foreclosure sale is longer than in a nonjudicial foreclosure state, so the court might still apply Rule 3002.1 to cases after stay relief is granted.

was not before the court. In describing why debtors need to have the information provided by Rule 3002.1 even after stay relief is granted, the court stated:

> It is easy to contemplate the need for the information required by Rule 3002.1 after stay relief is granted. Stay relief does not prevent a debtor from attempting to keep his home. Following stay relief, a debtor may seek to defend a foreclosure action, enter into a loan modification, propose further plan amendments, or sell the residence by private sale. Required Rule 3002.1 disclosures, such as changes in rates, late fees and penalties, will assist a debtor in any of these post-stay relief options and thus serve the Code's policy of a fresh start. Requiring continued disclosure may further benefit the debtor and chapter 13 trustee in their review of a creditor's post-foreclosure deficiency claim.

Holman, 2013 WL 1100705 at *3, Memorandum Opinion at page 5 (emphasis added).

The holding in *Holman* has the (perhaps) unintended consequence of binding a chapter 13 debtor to personal liability on a deficiency claim on the debtor's residential mortgages even though the creditor obtained relief from stay during the case, and that personal liability would survive discharge.

Does the outcome change if the debtors modified their confirmed plan to surrender the property? This is a hard one to answer. In *Holman*, the Court found that the plan as confirmed was the same plan after relief from stay was granted, and that to hold otherwise would ignore the lack of a court-approved modification under section 1329. If there is a court-approved plan modification under section 1329, it would seem that the plan as confirmed is no longer the same as the plan that was modified. So, is the modification to surrender the property sufficient to support a determination that the mortgage creditor's claim is no longer a section 1322(b)(5) claim and is not excepted from discharge under 11 U.S.C. § 1328(a)(1)?

Not necessarily. In the recent opinion of *In re Spata*, Case No. 09-52154 (Order Entered April 22, 2016, Doc. #122) (Bankr. E.D. Ky. 2016) (Wise, J.), the court held that the debtors' modification, which merely said "the real property at [address] shall be surrendered," did nothing

to change the nature of the claim. "In this modified plan, 'surrender' does not mean payment. No provision of the modified plan limits payment to Chase via the foreclosure action." *Id.* at page 4. Continuing, the court stated: "There is no provision that surrenders the property in full satisfaction of the debt. Upon stay modification, the plan expressly provides for the filing of a deficiency claim. The Court need go no further in its analysis." The creditor's collection efforts did not violate the discharge injunction.

In *Spata*, the mortgage creditor had not yet commenced a foreclosure sale, even though it had obtained relief from stay (and the debtors had surrendered possession of their home) about 2-1/2 years before the debtors received their discharge. While this may be grounds to distinguish *Spata* and argue that a deficiency claim arising while the case is still open would be discharged, the court's opinion doesn't make that distinction. Moreover, the court's suggestion that the modified plan could have (and should have?) surrendered the property in full satisfaction of the claim is enigmatic. The issue should not be whether the creditor is allowed to file a deficiency claim; instead, the issue should be whether the deficiency claim is (a) unsecured; and (b) discharged upon completion of the plan.[3] *See In re Long*, 519 F.3d 288, 291 (6th Cir. 2009) ("Wiping out the deficiency altogether undermines reasonable obligations created by the contract between the parties."); *In re Ramos*, 540 B.R. 580 (Bankr. N.D. Tex. 2015) (mortgage creditor must not be prevented from asserting an unsecured deficiency claim against the debtor after stay

[3] The EDKY form plan at the time the case was filed included the following provision:

> D. Orders Granting Relief From Stay. If at any time during the life of the plan an order terminating the stay is entered, no further distributions shall be made to the Creditor until such time as an amended claim for any deficiency is filed and allowed. Any allowed claim for a deficiency shall be treated as a general unsecured claim.

The form plan has since been amended to delete the sentence that a deficiency claim shall be treated as unsecured.

relief and foreclosure, or else its rights have been modified in contravention of 11 U.S.C. § 1322(b)(2)).

The *Spata* and *Holman* opinions read together indicate that a section 1322(b)(5) long-term debt is not altered either by postconfirmation stay relief or surrender, and that the debtors' personal liability on the debt continues after discharge.

Can the original confirmed plan provide a contingency provision that any deficiency claim arising from any postpetition surrender will be discharged? Maybe. In the case of *In re Ratliff*, Case No. 14-21064, Order entered Nov. 10, 2014, Doc. #43 (Bankr. E.D. Ky. 2014) (Wise, J.), the court confirmed a plan with the following special provision:

> In the event that relief from stay is granted to any creditor addressed in Section II, or in the event that the Debtor surrenders the collateral to the creditor after confirmation, any resulting deficiency, after liquidation of the collateral, shall be classified and paid only as a general unsecured claim, but only up to the amount of said deficiency. Any amount unpaid on said deficiency claim shall be discharged upon completion of the plan. This special provision is intended to cover any and all secured claims, whether payment on the claims are to be made through the plan by the Trustee or to be made directly by the Debtor.

Ratliff, Case No. 14-21064, Doc. #43. The court held that such a provision does not violate the Sixth Circuit's *Nolan/Adkins*[4] doctrine.

> Nolan and Adkins involved post-confirmation attempts to reclassify and pay claims that varied from the terms of a confirmed plan in violation of §§ 1329 and 1327, not whether the treatment of a secured claim is permissible when the creditor is deemed to have accepted the plan.
> . . . .
> Here, unlike either Nolan or Adkins, the bifurcation of the claim and the potential change in the claim's classification, is set forth as part of the original plan confirmation process. Thus, absent an objection from a

[4] *See In re Nolan (Chrysler Financial Corp. v. Nolan)*, 232 F.3d 528 (6th Cir. 2000) and *In re Adkins (Ruskin v. DaimlerChrysler Services North America, LLC)*, 425 F.3d 296 (2005) (Section 1329 does not authorize the "reclassification" of a claim from secured to unsecured after a debtor surrenders collateral or the creditor obtains relief from stay).

> secured creditor, each has accepted the chapter 13 plan and this treatment of its claim.

In re Ratliff, Case No. 14-21064, Order entered Nov. 10, 2014, Doc. #43 (Bankr. E.D. Ky. 2014) (Wise, J.). *Compare In re Kurtz*, 502 B.R. 238, 244 (Bankr. D. Colo. 2013) ("It is not the surrender of collateral postconfirmation which is prohibited by sections 1327 or 1329 of the Code. What a debtor cannot do postconfirmation is, as *Nolan* holds, recalculate the amount of the "allowed secured claim" . . . after surrender and sale of the collateral."); *In re Bell*, 2013 WL 6898251 (Bankr. S.D. Tex. 2013) (postconfirmation plan modification to surrender residence not permitted; modification would alter creditor's rights in contravention of section 1322(b)(2)); and *In re Ramos*, 540 B.R. 580 (Bankr. N.D. Tex. 2015) (mortgage creditor must not, in a plan modification, be prevented from asserting an unsecured deficiency claim against the debtor after stay relief and foreclosure, or else its rights have been modified; however, if the creditor had sought relief from stay upon postpetition default and the debtor had modified the plan sooner than at the end of the case so that the unsecured deficiency claim could have been addressed in the modified plan, the debtors would have been able to receive a discharge).

Debtors' attorneys may need to be more attentive to this issue in drafting plans and filing motions to modify plans to surrender property after a "cure and maintain" plan has been confirmed. At a minimum, attorneys need to counsel their clients that if they change their mind after confirmation and decide to surrender their home, their discharge might not protect them from future collection efforts. A dismissal and re-file, a conversion to chapter 7, a "reverse chapter 20" (a discharged chapter 13 followed by a chapter 7 to the extent allowed by 11 U.S.C. § 727(a)(9)), or a "chapter 26" (a discharged chapter 13 followed by another chapter 13 case at least two years after the petition date of the first chapter 13) need to be considered as alternatives.

II. CHAPTER 13 DISCHARGE: COMPLETION OF "ALL PAYMENTS UNDER THE PLAN" AND A DEBTOR'S DIRECT-PAY MORTGAGE PAYMENTS

Is a debtor's direct payment of a mortgage (what we often call making payments *outside the plan*) a "payment under the plan" that must be completed in order for the debtor to get a discharge under 11 U.S.C. § 1328(a)?

Consider this fact scenario:

> Debtors propose a plan to cure mortgage arrearages through the plan while making ongoing postpetition mortgage payments directly to the creditor per 11 U.S.C. § 1322(b)(5). Plan is confirmed.
>
> Two years into the case, the debtors' financial condition changes, and they get behind on their mortgage payments. The mortgage creditor does not seek stay relief.
>
> The debtors continue making all plan payments and after 60 months, they complete their plan payments to the trustee.
>
> The trustee files the Rule 3002.1 "Notice of Final Cure" and asserts that all prepetition defaults have been cured.
>
> The creditor files the required response and agrees that prepetition defaults have been cured but sets forth the postpetition arrearage that arose during the chapter 13 case.
>
> The trustee (or the court, sua sponte), seeks to deny the debtors' discharge on the grounds that the debtors have not completed all payments under the plan because they did not complete the postpetition mortgage payments that came due during the time the debtors were in chapter 13.

Regardless of whether a direct-pay mortgage claim is excepted from discharge as a section 1322(b)(5) claim, there remains a broader issue of whether the debtor may get a discharge of ***any*** debts if the debtor is delinquent in postpetition mortgage payments at the time s/he completes payments to the trustee under the plan.

Section 1328(a) says in essence: "As soon as practicable after completion by the debtor ***of all payments under the plan***, the court shall grant the debtor a discharge of all debts provided for by the plan . . . ."

Courts seem to be equating "payments under the plan" with payments on "debts provided for by the plan" to conclude that if the debtor has not made all payments on claims "provided for

by the plan," including direct-pay mortgage claims, the debtor has not completed "all payments under the plan" and thus is not entitled to receive a discharge.

The seminal case on this issue is the case of *In re Heinzle*, 500 B.R. 69 (Bankr. W.D. Tex. 2014) (Gargotta, J.). The *Heinzle* decision has been followed by the following courts (listed by state):

- Texas: *See In re Ramos*, 540 B.R. 580 (Bankr. N.D. Tex. 2015) (Jernigan, J.); *In re Kessler*, 2015 WL 4726794 (Bankr. N.D. Tex. 2015) (Jones, J.), *aff'd sub nom Kessler v. Wilson*, Civil Action No. 6:15-cv-040-C (N.D. Tex. November 19, 2015); *appeal pending In re Kessler (Kessler v. Wilson)*, Case No. 15-11252 (5th Cir. December 18, 2015);
- Colorado: *See In re Gonzales*, 532 B.R. 828 (Bankr. D. Colo. 2015) (Tallman, J.); *In re Formaneck*, 534 B.R. 29 (Bankr. D. Colo. 2015) (Romero, J.); *In re Doggett*, 2015 WL 4099806 (Bankr. D. Colo. 2015)(Tallman, J.), and *In re Hoyt-Kieckhaben*, 2016 WL 1089383 (Bankr. D. Colo. 2016) (Brown, J.);
- Virginia: *See In re Evans*, 543 B.R. 213 (Bankr. E.D. Va. 2015) (St. John, J.));
- Oklahoma: *See In re Tumblson*, 2016 WL 889772 (Bankr. E.D. Okla. 2016) (Veith, J.).

The *Kessler* case has made its way to the Fifth Circuit Court of Appeals, where briefing was completed April 27, 2016.

So far courts and trustees have been looking only at mortgage claims, even though there may be other direct-pay claims in a case such as long-term car loans or student loan debts. Why only mortgage claims? Because the evidence is there, compliments of Bankruptcy Rule 3002.1.

Bankruptcy Rule 3002.1 "applies in a chapter 13 case to claims that are (1) secured by a security interest in the debtor's principal residence and (2) provided for under § 1322(b)(5) of the Code in the debtor's plan." Fed. R. Bankr. P. 3002.1(a).

Rule 3002.1(f) requires the trustee, "within 30 days after the debtor completes all payments under the plan," to file a Notice of Final Cure Payment stating that the debtor has paid in full the amount required to cure the default.

Rule 3002.1(g) requires the creditor to file a response to the notice of final cure, stating (1) whether the creditor agrees that the debtor has cured defaults, and (2) "whether the debtor is otherwise current on all payments consistent with § 1322(b)(5) of the Code." The creditor must itemize the amounts the creditor contends remain unpaid.

It is the evidence of a debtor's postpetition mortgage arrearage set forth in the creditor's response filed pursuant to Rule 3002.1(g) which triggers the trustee's or the court's action to deny the debtor a discharge for failure to complete all payments under the plan. There is no evidence in the record as to whether the debtor completed all other long-term debt payments under the plan.

The conclusion that "completion of all payments under the plan" includes payments on direct-pay claims raises some interesting questions. In most jurisdictions, the trustee files something in the record to tell the court that the debtor has completed plan payments (a Notice of Plan Completion, Plan Completion Report, or something similar). If the confirmed plan provides for the direct payment by the debtor of other section 1322(b)(5) long-term claims (like student loans or the seven- or eight-year car loans that seem so prevalent these days), must the trustee undertake some additional inquiry to determine whether the debtor is current on those other claims before filing the notice of plan completion? *See* Fed. R. Bankr. P. 9011(b)(3) – by presenting a paper to the court, the party is certifying that to the best of the party's knowledge, formed after an inquiry reasonable under the circumstances, the factual contentions have evidentiary support. Can the trustee state to the court that the debtor has completed all payments under the plan without making a reasonable inquiry to determine whether the debtor has completed payments on all direct-pay claims?

And in those jurisdictions where the debtor must file a certification that s/he has completed plan payments (either in addition to the trustee's notice or in lieu thereof), can any debtor who is

a penny behind in any direct-pay obligation properly certify to the court that s/he has completed all payments under the plan? If the debtor makes such a certification when in fact s/he has accrued some late fees or has missed a payment, should the debtor's discharge be denied or revoked for fraud?

There is a legitimate argument that a debtor who has not complied with all obligations under a confirmed plan should not receive a discharge, but that goal could be accomplished by seeking a dismissal of the case under 11 U.S.C. § 1307. The difference is that under section 1307, the court may dismiss a case for cause, including a material default by the debtor with respect to a term of a confirmed plan. The denial of a discharge (whether by dismissing the case or by closing the case without a discharge) for failure to complete all payments under the plan creates a *per se* rule: if the debtor is delinquent on a direct-pay claim by any amount, s/he may not receive a discharge of any debts. There is no consideration of materiality. There is no required showing of cause for dismissal.

The *Heinzle* case and its progeny constitute the strongest argument in favor of conduit payments through the trustee of all long-term claims, particularly for debtors who are unlikely to keep their attorney informed when they fall behind in payments on direct-pay claims.