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When Things Don't Go According to the Plan

Rule 3002.1: A Case Odyssey[1]

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Federal Rule of Bankruptcy Procedure 3002.1 was intended to address communication problems regarding mortgage companies and Chapter 13 debtors, and the rule furthers its goal of increased transparency in two ways.

First, it allows mortgage companies to convey important information to debtors regarding account status without being sued for violating the automatic stay. Second, it aids in avoiding the unfortunate situation of a debtor being blindsided by mortgage company charges or allegations of default as soon as his case is closed.

As a consequence of accomplishing its goal of increased transparency, however, Rule 3002.1 has also shed light on the perhaps not surprising number of debtors in non-conduit[2] districts who have defaulted on their post-petition mortgage payments. This, in turn, is generating a wave of decisions on the issue of whether those post-petition mortgage payments are payments "under the plan" the complete payment of which is a condition precedent to receipt of a discharge under §1328(a). This article will examine a recent case from my home district, In re Evans, 543 B.R. 213 (Bankr.E.D.Va. 2016), where the court's analysis includes an interesting distinction between cases in which the debtor is curing pre-petition arrearages and maintaining direct mortgage payments ("cure and maintain"), versus those in which the debtor is maintaining direct mortgage payments but is not behind pre-petition ("maintain only").

A Short Re-Cap

Not long ago, the NACTT Academy published a two-part article that I wrote about the near-ubiquitous bad habit of categorizing debts as "inside" or "outside" the plan, and the recent string of cases in which debtors have been denied discharges due to defaulting on post-petition mortgage payments (i.e., debts that are, in many jurisdictions, referred to as "outside the plan").

That article reviewed the case of In re Formaneck, 534 B.R. 29 (Bankr.D.Colo. 2015), which held a debtor's failure to maintain post-petition mortgage payments as required by their Chapter 13 plan constituted a "material default by the debtor with respect to a term of a confirmed plan" under §1307(c)(6), resulting in dismissal of the case. Formaneck, 534 B.R. 29, 33. The article also discussed the case of In re Heinzle, 511 B.R. 69 (Bankr.W.D.Tex. 2014), which held that, even if the debtor's plan requires direct payments by the debtor, post-petition mortgage payments are "payments under the plan" pursuant to §1328(a), and that debtors who fail to make such payments are not eligible to receive a discharge under §1328(a)—notwithstanding their completion of payments to the trustee. Heinzle, 511 B.R. 69, 78. The Heinzle decision followed from the 5th Circuit's decision in In re Foster, 670 F.2d 478 (5th Cir.1982), which held that post-petition mortgage payments made pursuant to §1322(b)(5) are "payments under the plan". Foster, 670 F.2d 478, 490.

Finally, the article asserted that "outside the plan" terminology is a relic of the Bankruptcy Act of 1898 with no place under current practice and no support in the language of the Code. The article concluded that conduit mortgage payments—paying post-petition mortgage payments through the trustee, rather than direct by the debtor—allow for greater certainty with regard to payment of mortgages during Chapter 13 cases and at costs that are at least no greater than what debtors in non-conduit plans already pay.

In re: Evans:

Recently, the bankruptcy court in my home district addressed this issue and offered an interesting analysis. In Evans, the court was alerted to a debtor's post-petition mortgage default by the Trustee's Notice of Final Cure

1 Many thanks to Emily Connor Fort, Esquire, for her excellent editorial contributions to this article.

2 In "non-conduit" jurisdictions, debtors send their regular post-petition mortgage payments directly to their mortgage loan servicer, rather than to the trustee.

Payment and the lender's Response to Notice of Final Cure payment pursuant to Rule 3002.1. The court in Evans reaches the same conclusions as in Formaneck and Heinzle, holding that debtors who utilize §1322(b)(5) to cure defaults and maintain direct postpetition payments must remain current on those mortgage payments until the end of the plan in order to receive their §1328(a) discharge. (In fact, the court said its view was "universal[ly]" held among the courts to have considered the issue. Evans, 543 B.R. 213, 223.) However, what distinguishes Evans from other cases on this issue is how the court reached its decision—including a thorough review of case law on what we might loosely call "inside the plan" and "outside the plan"—and a very interesting suggestion that "outside the plan" may still exist in so-called "maintenance-only" cases.

The debtor in Evans argued that only her arrears were "provided for" by her plan and that her post-petition mortgage payments were "outside the plan"—as debtors in non- conduit districts frequently say. The trustee paid a pre-petition arrearage of $400.00, and the debtor was required to pay her post-petition mortgage payments directly.[3] Rather than dismissing such terminology, however, the court concluded that a debtor might actually provide for her mortgage "outside the plan" if—but only if—she did not also pay mortgage arrears through the trustee. Evans at 227-228, citing In re Kessler, 2015 WL 4726794 (Bankr.N.D.Tex. 2015).

Although the holding is the same as Formaneck, Heinzle, and other cases, Evans' discussion raises the possibility that the same rules do not apply to so-called "maintenance only" cases in which debtors are merely maintaining post-petition payments without curing arrears. Although this position may be surprising to some, it finds support in the Supreme Court precedent cited by the court: "§ 1328(a) unmistakably contemplates that a plan 'provides for' a claim when the plan cures a default and allows for the maintenance of regular payments on that claim, as authorized by § 1322(b)(5)." Evans at 222, quoting Rake v. Wade, 508 U.S. 464, 474 (1993). Because the debtor in Evans chose to cure the seemingly insignificant sum of $400.00 in mortgage arrears through the trustee, this made her entire post-petition mortgage payments a claim provided for by the plan. Evans at 228.

In emphasizing the critical distinction between "cure and maintain" cases, on the one hand, and "maintenance only" cases, Evans extensively cited In re Kessler, 2015 WL 4726794 (Bankr.N.D.Tex. June 9, 2015), aff'd sub nom. Kessler v. Wilson (In re Kessler), Civil Action No. 6:15–CV–040–C (N.D.Tex. Nov. 19, 2015). Like Evans, Kessler involved debtors who cured their prepetition arrears through the trustee but defaulted on their post- petition mortgage payments. Also like Evans, the debtors in Kessler argued their direct payment of post-petition mortgage was "outside the plan". In response, Kessler relied upon the 5th Circuit's Foster decision, which examined the two possible meanings of and continuing use of "outside the plan" treatment in Chapter 13:

"In Foster, the Fifth Circuit discussed the two possible interpretations to the phrase 'outside the plan.' [ ]. Under one interpretation, the debt is treated under the plan

but the debtors act as the 'disbursing agent' and make payments 'directly to the creditors rather than through the standing trustee.' [ ]. The alternative meaning is that 'outside the plan' refers to payments of debts not treated by the terms of the plan. [ ]. The Fifth Circuit in Foster held that payments so made are indeed made under the plan. [ ]. It follows, then, that a payment truly 'outside the plan' refers to a payment on a debt that is not provided for by the terms of a plan. A current, fully secured claim may, for example, be left unaffected and thus excluded from the plan. [ ]. Such claim would then be paid 'outside the plan.' When a debtor chooses to exclude a secured debt from treatment under the plan, 'the lien securing [such debt] merely passes through the bankruptcy case unaffected'; as a consequence, it will not be discharged. [...]

"In the context of residential mortgage debts, a debtor has the option to make his mortgage payments under the plan or outside the plan. But a debtor loses the option to make payments that are truly outside the plan if the plan provides for the curing of a default under the mortgage. [ ]. '[F]or the arrearage on a mortgage claim to be cured under § 1322(b)(5), the current mortgage payments while the case is pending must be provided for in the plan.'"

Kessler, 2015 WL 4726794 at *2-3, quoting Foster v.

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3 The debtor was $6,344.08 behind in post-petition mortgage payments by the end of the case, which she estimated was about 10 months of payments.

Heitkamp (In re Foster), 670 F.2d 478, 485-486, 488-489 (5th Cir. 1982) and In re Harris, 107 B.R. 204, 206 (Bankr.D.Neb. 1989).

After citing this discussion from Kessler, the Evans court concluded, "This Court follows the reasoning set forth in the Foster, Kessler, and Heinzle cases and finds that postpetition payments on a mortgage debt made through direct payments by the debtor to the creditor must be treated as 'payments under the plan' when the plan also provides for the curing of prepetition arrears." Evans at 228. By curing her prepetition arrears through the trustee, Ms. Evans' plan "provided for" the regular post-petition mortgage claim she was supposed to be maintaining under §1322(b)(5). Evans at 222. As such, the plain language of §1328(a) dictated that she be denied her discharge because she had failed to make all payments required "under the plan". Id. at 234.

Despite its consistency with Rake v. Wade and the 5th Circuit's Foster decision, the Evans court's holding that a plan "provides for" post-petition mortgage payments under §1322(b)(5) only where the debtor provides for curing arrears through the trustee is not uniformly accepted. However, the position finds certain support in case law—and it is a wrinkle that could make the difference between discharge and no discharge for certain debtors.

A Different View

There are courts that hold contrary to Evans (i.e., that "maintenance-only" plans are not "outside the plan" but, instead, implicate §1322(b)(5) just like "cure and maintain" plans). Whereas the statutory analysis in Evans focused on § 1328(a), those holding the opposite view have focused on the plain language of §1322(b)(5).[4] The Bankruptcy Court for the Northern District of Illinois has provided perhaps the most detailed statutory analysis supporting the position contrary to the Foster/Evans/ Kessler position on maintenance-only: "Section 1325(a)(5) contains the general provisions that apply to secured claims in chapter 13. It provides that if a secured creditor does not 'accept' the plan, the debtor has two options: (1) pay the full allowed amount of the secured claim by making payments over the course of the plan equaling the value of the collateral plus interest, or (2) surrender the collateral to the creditor. [ ].

"Section 1322(b), however, contains specific provisions that apply to mortgage claims on the debtor's primary residence. [ ].

"[Section] 1322(b)(5) contains a specific grant of authority to debtors with respect to those same mortgage claims on the principal residence... Subsection (b)(5) provides that, notwithstanding the prohibition in subsection (b)(2) [on cram down], the debtor's plan may provide for curing any defaults and maintaining payments on any secured or unsecured debt that would otherwise extend beyond the term of the plan. Because the introductory language of subsection (b) uses the word 'may,' subsection (b) (5) provides two permissible options to debtors: curing pre-petition defaults and maintaining current payments. It does not require debtors to do both in every case.

Section 1322(b)(5) also expressly permits the plan to provide for maintenance of payments on 'any unsecured or secured claim on which the last payment is due after the date on which the final payments under the plan is due.' [ ]. This phrase permits the continuation of monthly payments on 'any' long-term debt, not just long-term debt on which debtors owe pre-petition arrears. Thus, the language of §1325(b)(5) makes it clear that debtors may maintain monthly payments regardless of whether they owe pre-petition arrears.

"Section 1322(b)(5) permits debtors to avoid having to comply with the provisions of § 1325(a)(5), which would otherwise require debtors either to pay the full value of the collateral over the course of the plan or surrender the collateral."

In re Tollios, 491 B.R. 886, 889-890 (Bankr.E.D.Ill. 2013) (internal citations omitted).

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4 See, e.g., In re Hunt, 2015 WL 128048 (Bankr.E.D.N.C. 2015)

The Take-Home Message for Counsel

Evans carries on what appears to be the monolithic rule that debtors who default on post-petition mortgage payments—at least, those who also cure arrears through the trustee—will not receive their §1328(a) discharge.

However, if your local court accepts the possibility of mortgage payments being "outside the plan" (where the debtor is not curing arrears through the plan), a default on post-petition mortgage payments would not also constitute a default under the plan, or a failure to complete all payments under the plan. As such, counsel should become familiar with their court's view on whether maintenance-only plans trigger §1322(b)(5).

In jurisdictions where courts do not view maintenance-only plans as triggering §1322(b)(5), as in Foster, Evans, and Kessler, this should impact counsel's advice to their debtor clients, as well as their drafting of Chapter 13 plans. For example, if the debtor in Evans had merely cured the $400.00 arrearage before filing Chapter 13, she apparently would have received her discharge—despite her default in post-petition mortgage payments. Likewise, post-petition mortgage loan modifications that are common in today's Chapter 13 practice, and a modification which reamortizes all arrears may allow a debtor who began her Chapter 13 with a "cure and maintain" plan to modify her plan and make it "maintenance-only". Debtors' attorneys need to know all of the possible angles in order to successfully defend their clients' right to a discharge.

Counsel everywhere should expect an increase in the number of hearings at the end of Chapter 13 plans in order to evaluate debtors' completion of post-petition mortgage payments and, therefore, their eligibility for discharge. Counsel should also learn their court's view of §1322(b)(5), maintain close communication with their clients regarding mortgage payments, and help clients plan accordingly so that their post-petition mortgage payment status does not prevent them from receiving a discharge.

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