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CHAPTER 13 AFTER BAPCPA

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THE REMAINING PROVISIONS OF THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005 TAKE EFFECT ON OCTOBER 17, 2005. THE NEW LAW IS INTERNALLY INCONSISTENT, POORLY ORGANIZED AND COMPLEX. THESE MATERIALS OFFER SOME PRELIMINARY THOUGHTS AND OBSERVATIONS ON THE FUTURE OF CHAPTER 13 PRACTICE IN MAINE AFTER BAPCPA. THEY ARE OFFERED TO STIMULATE DISCUSSION. THE TRUSTEE'S MIND REMAINS OPEN TO INSTRUCTION FROM THE BENCH AND PERSUASION FROM THE BAR.

1. Chapter 13 under BAPCPA is an attractive and viable option for many debtors.

All is not lost. Most of the reasons why Chapter 13 was useful before BAPCPA remain. The following is a partial list. (All citations are to the Bankruptcy Code as amended by BAPCPA.)

- **"Any default" – including mortgage defaults – can be cured through Chapter 13. § 1322(b)(2), §1322(b)(5) and § 1322(b)(3).** Approximately 65% of current Chapter 13 cases are filed to save the debtor's home from foreclosure or to rescue property from repossession. There is no change in these provisions of the law.

- **Stripoff is unchanged. § 506.** A wholly unsecured junior lien – including a wholly unsecured junior mortgage against the debtor's home – can be stripped off under current law. The claim will be paid as unsecured and the lien discharged. *In re Mann*, 249 B.R. 831 (1st Cir. 2000). The only change wrought by BAPCPA is that the lien will be discharged only upon completion of the plan, not upon confirmation. In all other respects, debtors can avoid wholly unsecured junior liens in Chapter 13 while *Dewsnup* continues to prohibit such treatment in Chapter 7.

- **Cramdown still exists. § 1322(b)(2), § 1325(9) and § 506.** Except for a home mortgage that secures no other property, current law permits payment of the value of a secured creditor's collateral in full satisfaction of its secured claim. Current law also permits the modification of the interest rate charged by the creditor. BAPCPA retains the same protection for home mortgages. It also prevents the cramdown of debt to value (i) of a purchase money security interest (ii) where the debt was incurred within the 910 days (roughly 30 months or 2 ½ years) before the bankruptcy filing, and (iii) the collateral is a motor vehicle acquired for the debtor's personal use, or the collateral is 'any other thing of value" acquired within one year of the date of bankruptcy filing. Non-PMSI vehicle loans, loans on vehicles not for the debtor's personal use and loans outside these time periods remain subject to cramdown. In addition, there is no change in the ability of a Chapter 13 plan to modify the interest rate on a secured debt, whether or not the debt is being crammed down to the value of the collateral. *See, Till v. SCS Credit Corp.*, 124 S.Ct. 1951 (2004).

- **Non-exempt property can still be protected in Chapter 13. § 1325(a)(4).** So long as the plan provides for payment to unsecured creditors of at least what they would receive in a hypothetical Chapter 7 case, a Chapter 13 debtor may retain non-exempt property that would have to be surrendered to the Chapter 7 trustee.

- **More debts are dischargeable through Chapter 13 than through Chapter 7. § 1328(a).** Current law grants Chapter 13 debtors a "superdischarge" under which all debts other than (i) criminal fines, forfeitures and restitution, (ii) alimony and child support, (iii) most student loans, (iv) drunk driving liability, and (v) long term [usually mortgage] debts that the plan provides will survive. BAPCPA increases the number of nondischargeable debts under Chapter 7 and adds seven categories of debt to the nondischargeable list under Chapter 13, leaving us with a not-quite-super discharge. Nonetheless, important debts that are wholly nondischargeable in Chapter 7 are still dischargeable in Chapter 13, including income tax debts for which timely non-fraudulent returns were filed, debts incurred to pay taxes, willful and malicious damage to property (although not to individuals) and property division debts in domestic relations cases. (Domestic relations property divisions are entirely nondischargeable in Chapter 7 under BAPCPA. § 523(a)(15). They remain wholly dischargeable in Chapter 13.)

- **Chapter 13 relief is available 4 years after a prior Chapter 7 discharge and 2 years after a prior Chapter 13 discharge. § 1328(f).** The new law prohibits a Chapter 7 discharge in a case filed within eight years of a prior Chapter 7 discharge. § 727(a)(8). Chapter 13 relief is available after four years from a prior Chapter 7 and two years from a prior Chapter 13 case. § 1328(f).

- **The co-debtor stay is unaffected. § 1301.** Although the automatic stay has been constricted by BAPCPA under certain circumstances, the co-debtor stay is unaffected.

- **Control of the case.** Under § 707(a), a debtor may dismiss a Chapter 7 case only with permission of the court after notice and hearing. BAPCPA does not change the rule that a Chapter 13 debtor has a near-absolute right to dismiss his or her case at any time, provided that it has not been converted to Chapter 13 from another chapter. (There are emerging erosions or the debtor's power to dismiss a Chapter 13 case unrelated to BAPCPA.)

2. Lower income debtors may use a three year plan. Higher income debtors must propose a five-year plan.

Current law requires that a plan must run for at least three years (unless it proposes to pay all creditors if full over a shorter period) but no more than five years. BAPCPA now provides that debtors with current monthly income above the median for their household must provide for an applicable commitment period of five years. § 1322(d)(1) and § 1325(b)(4)(A)(ii). Debtors with income below the median will be permitted to propose plans as short as three years if a partial dividend is to be paid. § 1322(d)(2) and § 1325(b)(4)(A)(i). Payment in full to all allowed creditors will permit any debtor to propose a shorter plan, as is the case under current law. § 1325(b)(4)(B).

3. The starting point to determine a debtor's available disposable income is "current monthly income" – which is not necessarily current or monthly or income.

Historically, a debtor's plan was based, at least in part, on the debtor's Schedules I and J: actual, reasonable expenses were subtracted from projected future income to determine his or her available disposable income to be paid to creditors. Both projected future income and actual, reasonable expenses are no longer key.

The starting point now is the debtor's "current monthly income" as defined by § 101(10A).

> The term 'current monthly income' means -
> (A) the average monthly income from all sources that the debtor receives (or in a joint case the debtor and the debtor's spouse receive) without regard to whether such income is taxable income, derived during the 6-month period ending on –
> (i) the last day of the calendar month immediately preceding the date of the commencement of the case if the debtor files the schedule of current income required by § 521(a)(1)(B)(ii); or
> (ii) the date on which current income is determined by the court for purposes of this title if the debtor does not file the schedule of current income required by § 521(a)(1)(B)(ii); and

(B) includes any amount paid by any entity other than the debtor (or in a joint case the debtor and the debtor's spouse), on a regular basis for the household expenses of the debtor or the debtor's dependents (and in a joint case the debtor's spouse if not otherwise a dependent), but excludes benefits received under the Social Security Act [and certain other payments].

This figure is based on all funds (subject to SSA exclusion) that the debtor received during the last six calendar months prior to filing. Taken together, § 521(a)(1) and § 101(10A) require the debtor to document all receipts received during those months (e.g., if the debtor filed on July 15, the applicable period would be January 1 through June 30). The new law assumes that whatever existed over the past six months will continue into the future; hence, "current monthly income" is not necessarily current. "Current monthly income" is determined by dividing the number of months (6) into total receipts for that period. A single large payment or a lengthy dry spell will skew the result. Hence, it is not necessarily monthly. Finally, gifts, inheritances or the proceeds of the sale of an asset are hardly "income" in most common parlance, yet they would factor into the retrospective prediction of future receipts.

4. **The "means test" does not apply to lower income debtors in Chapter 13, but does apply to higher income debtors. Do higher income debtors get an advantage as a result?**

Debtors whose income is below the state median are not subject to the means test in the determination of available disposable income. The term "disposable income" means current monthly income (other than child support payments, foster care payments or disability payments for a dependent child) *less* (i) amounts reasonably necessary to be expended for the maintenance of the debtor, for a dependent of the debtor, or for a domestic support obligation that first becomes payable after the bankruptcy is filed, (ii) for qualified charitable contributions, and (iii) if applicable, for reasonably necessary business expenses. § 1325(b)(2). Except for the starting point of 'current monthly income,' this is the same test as applies across the board under the current law. The "means test" does not apply.

Higher income debtors who are above the state median are analyzed under a wholly different rubric. The means test described in § 707(b)(2) provides the parameters within which to determine the amount that higher income debtors are required to contribute. The intricacies of the means test are beyond the time limits of this program. In overly-simple summary, it is computed as follows:

Current monthly income [§ 101(10A)]
Less
(IRS national and local expense standards)
Less
(Actual monthly expenses for IRS Other Necessary Expenses)
Less
(Allowance up to 5% of food and clothing if special need shown)
Less
(Allowance for disabled family members if special need shown)
Less
(Chapter 13 trustee administrative expenses)

Less

(Private school tuition up to $1,500 per year per child if special need shown)

Less

(Actual excess housing and utility allowance if special need shown)

Less

(Average monthly secured debt payments over 60 months)

Less

(Average monthly payment to cure defaults over 60 months)

Less

(All debts entitled to priority divided by 60 months)

Equals:

Balance available to unsecured creditors

It is becoming apparent that the means test does not provide a pot of gold for unsecured creditors in Chapter 13, just as it will force relatively few debtors out of Chapter 7. In some cases, higher income debtors who choose Chapter 13 for reasons other than the requirements of § 707(b)(2) will end up with a 'zero' balance at the end of the means test. There is an argument that the plain language of § 1325(b)(1)(B) permits those individuals to propose a 'zero percent' plan to general unsecured creditors – especially if there are priority unsecured creditors who are being paid in full pursuant to § 1322(a)(2) – even if there is significant actual available disposable income based on the debtor's actual income and reasonable expenses.

BAPCPA preserves the indexing provisions of § 104. Numbers will change in the future. However, the existing numbers were developed in 1994 when BAPCPA was first drafted. Congress did not re-examine the practical application of the means test it wrote in 1994 when it finally enacted the law in 2005. Lower income debtors are stuck with the traditional balance sheet analysis when crafting their Chapter 13 plans. Higher income debtors may well be able to laugh up their sleeves at the (unintended?) consequence of the statute and walk away with hundreds or thousands of surplus dollars.

By way of caveat to aggressive debtor's counsel, there is the judicial doctrine that plain language should not be followed if it would produce an absurd result plainly at odds with the intent of Congress. Large institutional creditors engender scant sympathy. Maine, however, has tens of thousands of small creditors who are entitled to the full protection of the law. The bankruptcy system should hoist them with any glee on the petard meant for the credit card companies. The Chapter 13 trustee's office in Maine has traditionally been solicitous of unsecured creditors. We are still undecided as to which side of the debate we will support.

5. Adequate protection will be provided through the plan under § 1326 rather than through duplicated payments.

Section 1326(a)(1) requires the debtor to make *both* the plan payment and payment to secured creditors to provide adequate protection pending confirmation. Since the plan would otherwise provide for payment to many secured creditors, the effect of the new section is to create a double payment obligation for the debtor. In most cases, this would be an impossible burden to meet.

BAPCPA provides a loophole in the introductory clause to § 1326(a)(1) by permitting some other arrangement if the court orders otherwise.

Although the precise mechanism has yet to be determined, payment of only the Chapter 13 plan obligation will begin immediately or within 15 days of the filing of the case. Some states are adopting a local rule to this effect, others have a standing order that will likely morph later into a rule, others will adopt summary confirmation procedures, and still others will use "first day motions" akin to those used in Chapter 11 cases. Practitioners should explore the several options and provide feedback to the Local Rules Committee chaired by AUSA Rick Emery. Whatever the form, the result will be to provide prompt adequate protection to secured creditors without creating an insurmountable obstacle to reorganization.

Section 1326(a)(2) alters the disposition of funds held by the trustee if the case is not confirmed and is thereafter dismissed. Funds are no longer returned to the debtor. Rather, they are to be distributed to creditors according to the terms of the debtor's plan, after payment of any allowed claim for administrative expenses. This new approach will provide comfort to counsel, since fees may be paid in full after dismissal to the extent of available funds, upon application to and allowance by the court. The balance would be paid to creditors according to the terms of the debtor's proposed, but not confirmed, plan.

6. Starting on October 17, on-going mortgage payments must be made through the trustee's office if arrearages are being cured through the plan.

In order to provide tighter control, decrease the number of motions for relief from stay, save money for debtors in the long run, and increase the return to unsecured creditors, for all cases filed on and after October 17, current on-going mortgage payments will be made through the trustee's office in all cases where the plan provides for curing mortgage arrearages to save the debtor's home, except as the court orders otherwise. The same approach will also be taken with lease payments. In those rare situations where secured personal property loan defaults are to be cured but the debt stretches out beyond the term of the plan, those payments made during the plan would also be administered by the trustee. To ensure that payments are actually made, payroll orders will be sought in all such cases.

Although the burden will fall chiefly on unsecured creditors, there may be a short term impact on debtors for the first few months until the additional revenue to the trustee's office drives down the trustee's statutory commission. Once there is stability with a lower percentage, plans can be computed on a lower imputed fee. Debtors will benefit from the decrease in motions for relief from stay that have generated high fees for debtor's and creditor's counsel. Unsecured creditors will receive a higher proportion of the funds administered by the trustee's office. Secured creditors will have greater assurance of prompt and full payment without the administrative hassle of monitoring a debtor's plan performance.

7. Resources.

The United States Trustee program has internet links to census data and the IRS standards in order to determine official median income levels and expense allowances, respectively. It is expected that the information obtained from those links will be "official" in the determination of the means test under § 707(b)(2) and § 1325(b)(3). The information can be found at:

http://www.usdoj.gov/ust

From the United States Trustee Program home page, click on "Means Testing Information" to reach the Census Bureau Data links for median income and to reach the IRS Data links for national and local expense standards.

The Maine State Bar Association is offering a full-day CLE program on Tuesday, October 17, in on BAPCPA. Announcements are expected out within a week.

There are at least two commercial CLE programs in the works on BAPCPA, one scheduled in November and one in December.

The MSBA will present a two-day national quality CLE program in October 2006 to mark the first anniversary of BAPCPA. It will feature Henry E. Hildebrand, Chapter 13 trustee from Memphis, Hon. Keith M. Lundin from Tennessee, and Barbara May, Esq., NACBA board member from Minnesota, as well as the Maine bench and local practitioners.

Neil Shankman, Esq., of Lewiston, is the NACBA representative in Maine. He can provide materials on how to join the National Association of Consumer Bankruptcy Attorneys. NACBA offers a panoply of materials and resources to debtor's counsel.

The National Consumer Law Center has not yet issued a BAPCPA update to its excellent CONSUMER BANKRUPTCY LAW AND PRACTICE volume. NCLC's address is 77 Summer Street, Boston 02110; www.consumerlaw.org .