By Michelle H. Bass

Fail to Make Direct Payments to Secured Creditors? No Discharge

If you are a rule-follower, debtor clients can be disorganized, forgetful, careless, perhaps even reckless and desperately in need of structure. Rules are not made to be broken, and when approached by clients for leniency after breaking the rules, just remember the following: Strict adherence to the rules will set you free — free of all debts provided for by the plan.

It might surprise a rule-follower to learn that language contained in the discharge provision of 11 U.S.C. § 1328(a) has recently come under fire.[1] Bankruptcy courts around the nation are being asked to evaluate a debtor's right to discharge after they fail to make, in some cases, years' worth of mortgage payments. These debtors are challenging the secured creditors' and chapter 13 trustees' objections to their discharges despite their own shortcomings during the course of their cases. These debtors assume that the rules do not apply to them, and that the terms of the plan that they sought approval of can be amended in their favor after plan expiration.

The debtors raising these challenges are in need of a serious reality check. The statutory language is clear that chapter 13 debtors are eligible for a discharge as soon as possible after completion of all payments under the plan, so long as they make all payments provided for by the plan. Therefore, debtors who fail to make all payments provided by the plan after the time for completion of payments are presumably ineligible under § 1328(a).

Much like enjoying dessert after dinner, the benefit of the discharge is premised on the debtor completing *all* required payments under the terms of a plan. Why should a debtor expect to receive such significant relief for doing anything less than what is required by statute? The debtors' argument is rooted in the perceived difference between payments made "by the plan" (payments disbursed by the chapter 13 trustee) and payments made "under the plan" (payments identified in the plan that the debtor has proposed to make directly). Turning to the language in the statute itself, 11 U.S.C. § 1328(a) provides:

> Subject to subsection (d), 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 or disallowed under section 502 of this title.[2]

For some, this statutory language opens the door to an argument that a debtor can receive a discharge of all pre-petition debts if they simply make all required trustee payments. But what about payments provided for by the plan that the debtor forgot to make, or *chose* not to make? What good is a discharge if it excludes debts associated with payments that the debtor specifically omitted during the life of the plan?

This nuanced language might appear to be insignificant, but the disagreements that have emerged between the affected parties are great. The difference of opinion on this subject has led to a variety of outcomes for consumer debtors upon plan expiration, ranging from the loss of one's home *and* discharge, to receipt of a discharge with the retention of secured property despite the debtor's failure to make secured mortgage payments.

While different interpretations of the discharge provision have in large part been opined over the last decade,[3] the majority of bankruptcy courts ruling on this issue agree that "payments under the plan" in 11 U.S.C. § 1328(a) refer to any payment made pursuant to a chapter 13 plan. This is regardless of whether such payment is made by a debtor directly to the creditor or through the trustee.[4] Therefore, if the phrase "payments under the plan" refers to *any* payment prescribed by the plan, failure to make a payment or otherwise account for it prior to plan expiration subjects a debtor to loss of their discharge. Any other interpretation for this term of art would serve to ignore, or even contradict, the statute.

The Majority View: Reality Check

A recent case from the Southern District of Illinois highlights the majority view — or rather, the harsh reality — that payments under the plan include all payments referenced by the plan. In *Simon v. Finley (In re Finley)*,[5] the debtors filed a motion for entry of discharge after expiration of

continued on page 56

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1 *In re Gibson*, 582 B.R. 15, 18.

2 11 U.S.C. § 1328(a).
3 *In re Gibson*, 582 B.R. 15, 18.
4 *Simon v. Finley (In re Finley)*, 2018 Bankr. LEXIS 2585.
5 *Id.*

from page 28

their plan. In their motion, the debtors stated they had made all payments provided for by their confirmed plan. As it turns out, the debtors were post-petition delinquent on their mortgage by more than $70,000 — a fact they did not dispute but failed to disclose in their discharge request. Without moving to surrender the collateral that they neglected to pay for prior to plan expiration, the debtors brazenly asked the court to grant them a discharge of all debts.

The mortgage company in *Finley* filed a response to the trustee's notice of completion of payments noting the significant delinquency. That creditor failed, however, to respond to the debtors' motion for entry of discharge. The trustee likewise failed to take any action following the mortgage company's response until after the discharge was granted. Although the trustee sought revocation of discharge pursuant to § 1328(e), this relief was denied.

Despite the inapplicability of § 1328(e), the court did except the unpaid mortgage payments from the debtors' discharge. The *Finley* court reasoned that a standard discharge under § 1328(a) requires completion of all "payments under the plan," as that language plainly embraces that payments that a plan provides to be made directly by the debtor to a creditor.[6] The outcome in this case demonstrates that debtors are not entitled to a full discharge when they fail to make direct post-petition payments provided for by the plan.

In yet another majority opinion, the court in *In re Thornton*[7] took an equally harsh stance against a debtor who fraudulently attempted to obtain a discharge in a similar fashion. In this case, the debtor failed to make post-petition direct mortgage payments as required by § 1328(a). The chapter 13 trustee filed its notice of final cure payment, to which the mortgage company filed a response indicating more than $35,000 in arrears. The trustee objected to the debtor's discharge request for failure to make all payments under the plan, and also cited the debtor's failure to remit all disposable income.

Since the debtor's motion indicated that she made post-petition mortgage payments when in fact she had not, there was an additional $691 in disposable monthly income that could have — and should have — been remitted for the benefit of creditors. In this case, the debtor fraudulently attempted to obtain a discharge after failing to make direct payments under the plan *and* failing to remit all disposable income as required under § 1325(b)(1)(B)(2). The *Thornton* court took a holistic approach in denying the debtor's § 1328(a) discharge by requiring that the case be dismissed or converted to chapter 7.

As *Finley* and *Thornton* demonstrated, debtors are not permitted to have their cake and eat it, too. However, what about the breadth of debtors seeking a chapter 13 discharge who *do* disclose their failure or inability to maintain secured payments during the life of their plan?

Failure to Make All Payments Under the Plan in Good Faith

In *In re Diggins*,[8] the U.S. Bankruptcy Court for the District of Colorado suggests that perhaps there is room to make concessions within this strict rule. In this case, the court did not deny the debtor her discharge despite failing to make all payments owed to her mortgage company. The debtor's plan included a "cure and maintain" provision, with arrearages paid through the plan by the trustee and ongoing payments made directly to the mortgage company.

The debtor was in the process of completing a loan modification when her plan expired. She made all required plan payments curing the pre-petition delinquency, but ceased making direct post-petition payments during the final year of her plan. The *Diggins* court ruled that it would be inequitable to deny her a discharge in this unique situation.[9] The court reasoned that the debtor had made continuing payments for four years, seeking immediate modification upon experiencing a negative change in financial circumstances.

Cure-and-Maintain Provisions Support a Denial of a Discharge

It is apparent from *Diggins* that a debtor's good-faith attempts to mitigate missed payments provided for by the plan might make the difference between a receipt or loss of a § 1328(a) discharge. Although the debtor in this case received a full discharge, the fact that *Diggins* involved a cure-and-maintain mortgage claim only serves to bolster the majority view.

A cure-and-maintain mortgage provision requires payments to be made on two different parts of the same claim pursuant to § 1322(b)(5).[10] Notwithstanding that § 1328(a) expressly excepts cure-and-maintain mortgage payments from discharge, courts are uniform in concluding that when a plan contains such a provision, the mortgage claim as a whole is considered to be "provided for by the plan," and the post-petition mortgage payments are made "under the plan."

In this light, all post-petition mortgage payments are considered to be made "under the plan" regardless of whether they are made directly to the mortgage-holder or by the trustee.[11] Therefore, in a cure-and-maintain situation where a debtor defaults on any payment toward the ongoing mortgage claim, that failure to pay renders the debtor ineligible for a chapter 13 discharge.

In *Kessler v. Wilson (In re Kessler)*,[12] the Fifth Circuit reaffirmed the bankruptcy court's decision that all payments provided for in the plan are likened to payments "under the plan," denying the debtors a discharge.[13] In doing so, the Fifth Circuit reasoned that under § 1322(b)(5), both the pre-petition arrears and the ongoing maintenance are payments

6 *Id.*
7 572 B.R. 738 (W.D. Mo. 2017).
8 561 B.R. 782.
9 *Id.*
10 *In re Thornton*, 572 B.R. 738, 740.
11 *Id.*
12 655 Fed. App'x. 242.
13 *Id.* at 244.

on the *same* claim to satisfy the *same* debt. The debtors were estopped from asserting that their post-petition mortgage payments were not considered under the plan on account of being made separately from the trustee's disbursements.

Although typically arrearage and ongoing maintenance portions of the same claim are required to be paid by the trustee through the plan, there are situations in which courts have allowed debtors to make ongoing maintenance directly. The presence of a cure-and-maintain provision in a plan prevents debtors from asserting that ongoing direct-pay maintenance is "outside of the plan." The logic embedded in *Kessler* with regard to post-petition ongoing maintenance being properly considered as being "under the plan" contributes to the weight of authority in favor of a strict statutory construction.

Shortcomings of the Minority View

Proponents of the more lenient minority view oppose the majority's uncompromising stance based on a number of theories. The minority recognizes a general policy resolving ambiguities in the Code in favor of debtors, particularly where the provision at issue affects a debtor's right to a discharge.[14]

In *Gibson*, the court's analysis of the language in § 1328(a) ignored the clear literal meaning of the words. This minority opinion cited Congress's use of different terminology for payments made "under the plan" vs. "by the plan" as implying an intended distinction.[15] The minority view even makes excuses for debtors, going so far as to credit the 2011 amendments to the Federal Rules of Bankruptcy Procedure with triggering the majority's so-called "theory of dismissal without discharge."[16]

More specifically, the minority opinion in *Gibson* characterizes the recent majority trend favoring dismissal without discharge as "a punitive remedy for a debtor's failure to make direct payments."[17] The *Gibson* opinion identifies the enactment of Bankruptcy Rule 3002.1 as giving rise to the disproportionate number of chapter 13 dismissals after plan expiration. Rule 3002.1 provides formal notice requirements for mortgage companies holding claims secured by a security interest in the debtor's principal residence in chapter 13 cases. It requires that the chapter 13 trustee file a *notice of a final cure payment* to be served on the debtor and the holder of such a claim, providing the holder of the claim an opportunity to file a response either agreeing or disagreeing with whether the debtor is current on the obligation at the end of their case. These "final cure payment" notices under subsections (f) and (g) of the rule all take place *after* completion of payments under the plan.

The minority argues that this so-called "debtor-friendly" rule was adopted to ensure a fresh start for those who complete payments under the plan. However, it is worth noting that in both *Finley* and *Thornton*, the trustees discovered the debtors' post-petition mortgage delinquencies as a result of direct responses filed pursuant to Rule 3002.1. Thus, to proponents of the minority, the following questions must be asked: Does this rule not have the unintended consequence of bringing debtors' failures during the life of their plan to the surface? If Rule 3002.1 is viewed as benefiting debtors by mediating disputes over the status of mortgage payments, how does this discovery at the end of a plan serve to promote judicial efficiency, especially where cases that could have been dismissed well before plan expiration remain on the docket?

This view clearly contains significant flaws as it fails to take into account numerous general policy considerations. Whereas the minority praises the enactment of this rule for playing a supportive role, ushering debtors into the discharge phase of their case, those in the majority view Rule 3002.1 through an entirely different lens. Proponents of the plain meaning of § 1328(a) counter that Rule 3002.1 was created to lessen the impact on lenders seeking to collect post-confirmation fees and costs from debtors who included a cure-and-maintain provision in their plan.[18]

For those in the majority, this rule does not change the requirements under § 1328 for a discharge premised on completion of payments made under the plan. Instead, it has the effect of waving an ultraviolet light over a debtor's transgressions during the case, innocent or not, which has ultimately led to a greater number of chapter 13 dismissals.

Conclusion

While these two theories regarding the language in § 1328(a) remain at odds, only one emerges as a prominent policy in current chapter 13 practice. The liberal minority view disregards the meaning of the language in the statute. Those who promote the minority view do not presume to hold debtors accountable for the terms they chose to include in their plan. This radical view believes that debtors should receive a discharge, even if they fail to make post-petition mortgage payments. This view includes those true language artists who interpret "payments under the plan" to mean, quite simply, payments disbursed by the chapter 13 trustee. Those who support this view believe that only claims being paid out of the funds the debtor remits to the trustee are those payments that actually fall "under the plan."

On the opposite side are the realists, the majority-view-holders, those who adhere to and defend the plain meaning of the statute, the purveyors of justice under the Bankruptcy Code to whom financial freedom is granted for upholding one's responsibilities. Proponents of the majority acknowledge that debtors are not entitled to a § 1328(a) discharge if they fail to make post-petition payments to secured creditors provided by the plan. The cases that have shaped this view are grounded in sound logic, where granting a discharge to a debtor who has not paid substantial sums dedicated to post-petition mortgage payments is considered contrary to the chapter 13 process.[19]

The majority view is also supported by neighboring Code sections. Pursuant to § 1307(c)(6), a material default by the debtor with respect to a term of a confirmed plan constitutes potential grounds for conversion or dismissal. Courts upholding the majority view acknowledge and celebrate the sacrifices that honest, law-abiding debtors make in pursuit of their discharge. The receipt of a chapter 13 discharge following five long years gives many debtors the chance to finally breathe a sigh of relief. It also serves as a sweet reward for a job well done. abi

14 *In re Gibson*, 582 B.R. 15, 16.
15 *Id.*
16 *Id.* at 18.
17 *Id.* at 19.
18 "Rethinking Chapter 13," 59 *Ariz. L. Rev.* 1, 20 (2017).
19 "Note: Living Mortgage And Interest Free? The Unwarranted Discharge for Debtors Who Fail to Make Direct Post-Petition Mortgage Payments," 82 *Alb. L. Rev.* 643, 654.