THE TREATMENT OF CLAIMS IN CONSUMER BANKRUPTCIES

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I. Introduction.

The treatment of claims in consumer bankruptcies has generated confusion and conflicting case law since the inception of the Bankruptcy Code. The primary reason for the confusion is unclear drafting, both of the Code and the bankruptcy rules. The Bankruptcy Reform Act of 1994 attempted to resolve some of the ambiguities, but it produced interpretative problems of its own, and several provisions of the bankruptcy legislation considered by Congress in 1998 addressed continuing areas of controversy. This outline sets forth a road map of the general principles for treatment of claims under Chapters 7 and 13, and applies these principles to several continuing areas of controversy, with particular emphasis on recent developments. All statutory references are to the Bankruptcy Code, Title 11, U.S.C., unless otherwise indicated.

II. Definition of "claim".

"Claim" is defined in § 101(5) of the Code, as

> (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured, or
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> (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured.

This definition was intended to be very broad. *See In re M. Frenville Co.*, 744 F.2d 332, 334, 336 (3d Cir. 1984) (quoting H.R.Rep No. 595, 95th Cong., 2d Sess. 309, to the effect that the definition "permits the broadest possible relief in the bankruptcy court."). A broad definition of "claim" provides for expansive bankruptcy relief in two different respects: first, its stops collection activities (through § 362(a)(6)) and discharges a wide range of obligations, thus promoting a fresh start for the debtor following bankruptcy; and second, it allows a wide range of claimants the opportunity to share in the debtor's estate. *See Ohio v. Kovacs,* 469 U.S. 274, 281-3, 105 S.Ct. 705, 709-10 (majority opinion, noting link between definition of claim and fresh start), 712 (O'Connor, J., concurring, noting link between definition of claim and entitlement to estate distribution). The definition of claim applies, of course, to all chapters of the Bankruptcy Code; the definitions of § 101 of the Code apply "in this title." Nevertheless, it was in a pair of consumer bankruptcy cases that the Supreme Court most emphasized the breadth of the definition of claim.

A. *Pennsylvania Dept. of Public Welfare v. Davenport.*

Pennsylvania Dept. of Public Welfare v. Davenport, 495 U.S. 552, 110 S.Ct. 2126 (1990) involved the prepetition obligation of Chapter 13 debtors to make criminal restitution payments as a condition of their probation. In an earlier case, *Kelly v. Robinson*, 479 U.S. 36, 50, 107 S.Ct. 353, 361 (1986), the Supreme Court had held that such payments were excepted from discharge in a Chapter 7 case under § 523(a)(7) of the Code, but had also expressed "serious doubts whether Congress intended to make criminal penalties 'debts'" under the Code. Acting on the basis of this dictum, the district court in *Davenport* held that the restitution obligations of the debtors were not "debts" subject to discharge in Chapter 13. The Supreme Court upheld a decision of the Third Circuit reversing this determination. The Court reasoned as follows:

(1) "Debt" is defined by § 101(12) [then § 101(11)] as "liability on a claim," and hence that the meanings of "debt" and "claim" are "coextensive." 459 U.S. at 558, 110 S.Ct. at 2130.

(2) The phrase "right to payment," as used in the Code's definition of "claim" means "nothing more nor less than an enforceable obligation," regardless of either the creditor's interests in imposing the obligation (rehabilitation and punishment as opposed to reimbursement) or the creditor's method of enforcing the obligation (imprisonment as opposed to judgment liens on property). 459 U.S. at 559, 110 S.Ct. at 2131.

(3) This ruling is not inconsistent with the holding of *Kelly v. Robinson,* but is actually made necessary by that holding, since unless restitution obligations were "claims" there would have been no reason to exclude them from discharge through § 523(a)(7). 110 S.Ct. at 2132-33.

0. *Johnson v. Home State Bank*.

In *Johnson v. Home State Bank*, 501 U.S. 78, 111 S.Ct. 2150 (1991), the Supreme Court emphatically affirmed the holding of *Davenport* in the context of a mortgage claim. The Chapter 13 debtor in *Johnson*, having defaulted on his mortgage, had obtained a discharge of all of his personal indebtedness—including any personal liability on the mortgage—in a prior Chapter 7 case, and sought, in his Chapter 13 case, to retain the mortgaged property by paying the foreclosure judgment through his plan. The mortgagee's principal objection was that there was no "claim" that could be treated under Chapter 13 in the absence of personal liability. The court rejected this contention summarily:

> Applying the teachings of *Davenport*, we have no trouble concluding that a mortgage interest that survives the discharge of a debtor's personal liability is a "claim" with the terms of § 101(5). Even after the debtor's personal obligations have been extinguished, the mortgage holder still retains a "right to payment" in the form of its right to the proceeds from the sale of the debtor's property. Alternatively, the creditor's surviving right to foreclose on the mortgage can be viewed as a "right to an equitable remedy" for the debtor's default on the underlying obligation. Either way, there can be no doubt that the surviving mortgage interest corresponds to an "enforceable obligation" of the debtor.

501 U.S. at 84, 111 S.Ct. at 2154.[1] The court found support for its conclusion in other sections of the Code, and in its legislative history, 501 U.S. at 85-6, 111 S.Ct. 2154-55, and rejected the policy arguments advanced by the mortgagee, finding that Congress had enacted other specific protections against improper serial filings, so as not to require a restricted definition of claim in the context of Chapter 13 cases preceded by Chapter 7 discharges. 501 U.S. at 87-8, 111 S.Ct. at 2156.

III. Treatment of claims in Chapter 7.

To understand the way in which claims are treated in consumer bankruptcies, it is helpful to trace initially the Code provisions relating to claims in Chapter 7, for two reasons: first, many of the provisions applicable to Chapter 7 also apply to Chapter 13; and second, the provisions for Chapter 7 claims create a norm against which treatment in Chapter 13 can be measured. *See* § 1325(a)(4), providing that a Chapter 13 plan must provide for distributions on account of each allowed unsecured claim in an amount not less than the payment that would have been made on the claim in Chapter 7.

0. Secured claims.

The Code does not expressly define "secured claim." However, § 506(a)—which, as discussed below, bifurcates secured claims—deals with any claim "secured by a lien on property in which the estate has an interest, or that is subject to setoff under section 553." "Lien," in turn, is defined by § 101(37) as a "charge against or interest in property to secure payment of a debt or performance of an obligation." Thus, a "secured claim" is a right to payment that can be enforced either against property in which the debtor has an interest or against a claim of the debtor that is subject to setoff. Consistent with this understanding, a creditor does not have a secured claim if the property securing the claim has been transferred out of the debtor's estate. *General Motors Acceptance Corp. v. Dotson*, 155 B.R. 389, 393 (W.Va. 1993) (automobile taken from debtor, the location of which is unknown to debtor, cannot be the basis of a secured claim).

The most important point about secured claims in Chapter 7 is the limited extent to which these claims can be affected by the bankruptcy. Chapter 7 debtors frequently seek to "strip down" secured debts, that is, to keep the collateral securing the debt while paying the secured creditor only the value of the collateral, which may be much less than the debt. In this way, any postpetition appreciation in the property would inure to the benefit of the debtor. However, this "stripping down" of liens is generally unavailable in Chapter 7. Unless a secured creditor in a Chapter 7 case agrees to different treatment, it is likely either that the trustee will be required to pay the creditor in full, or that the creditor will be allowed to pursue claims against the collateral outside of bankruptcy. Thus, the creditor can require more than the value of the collateral in exchange for allowing the debtor to retain

[1]The Court noted that Congress had amended § 1328(a) of the Code to except criminal restitution awards from discharge under Chapter 13, but observed that this did not disturb *Davenport's* "general conclusions of the breadth of the definition of 'claim' under the Code." 501 U.S. at 83, 111 S.Ct. at 2154 n.4.

it. This situation is the result of the interplay of several different Code sections and the Supreme Court's decision in *Dewsnup v. Timm*, 502 U.S. 410, 112 S.Ct. 773 (1992).

(0) Sales under § 363(f).

If the estate has equity in property subject to a creditor's lien, then, under § 363(f)(3), a Chapter 7 trustee may sell the property, with the creditor's lien attaching to the proceeds. H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 344-46 (1977).[2] The effect of such a sale would be to pay the creditor's claim in full. Indeed, where the estate has equity in the property, the creditor is entitled to the payment of interest on its claim, pursuant to § 506(b). However, if the estate does not have equity in the property, then, unless the lien is in bona fide dispute or the lienholder consents, the trustee will likely be prohibited from selling the property. See *In re Terrace Chalet Apartments, Ltd.*, 159 B.R. 821, 825-29 (N.D.Ill. 1993), for a discussion of the limitations imposed on sales of liened property by § 363(f).[3]

(0) Relief from the automatic stay.

Similarly, under § 362(d)(2), if the estate has no equity in the property, the creditor has a right to relief from the automatic stay so as to allow immediate foreclosure. *In re Rosemond*, 105 B.R. 8, 10 (Bankr.W.D.Pa. 1989) (if no equity in property, relief from stay must be granted in Chapter 7, because it involves liquidation rather than reorganization).

(0) Required election under § 521(2).

A secured creditor's right in Chapter 7 to obtain either payment of its claim or possession of the property seems to be enforced by § 521(2) of the Code. This section makes it a duty of a Chapter 7 debtor to make an election with respect to all property of the estate which serves as collateral for consumer debts. The debtor must either surrender the property, or, if the debtor chooses to retain

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[2]At such a sale, the secured creditor may be a purchaser, and may have a substantial advantage over other potential purchasers, since the creditor may bid in the amount of its claim, pursuant to § 363(k) of the Code.

[3]This issue is not, however, without question. § 363(f)(3) allows a trustee to sell property, free of liens, if the sale price "is greater than the aggregate value of all liens on such property." Most courts have construed "the aggregate value of all liens" to mean the face value of the liens, so that if the amount of the liens exceed the proposed sales price, that section would be inapplicable. *In re Perroncello*, 170 B.R. 189, 190-91 (Bankr.D.Mass. 1994) (and cases cited therein). However, some courts hold that the "aggregate value of all liens" is the value of the collateral that supports the liens, so that any sale for fair value would be permissible under § 363(f)(3). *See generally In re Collins*, 180 B.R. 447 (Bankr.E.D.Va. 1995) (and cases cited therein). Moreover, some courts have generally permitted sales of property in which the estate has no equity under § 363(f)(5), which allows sales free and clear of liens if the lienholder "could be compelled, in a legal or equitable proceeding, to accept a money satisfaction" of its lien. These courts argue that a Chapter 11 cramdown is a proceeding in which lienholders can be required to accept the value of their collateral rather than the face amount of their claim, and that the existence of such a procedure allows a sale even in Chapter 7 cases. *In re Healthco Int'l, Inc.*, 174 B.R. 174, 176-77 (Bankr.D.Mass. 1994).

the property, the debtor must choose either to reaffirm the debt or to redeem the property. *In re Burr*, 160 F.3d 843, 849 (1st Cir. 1998); *In re Johnson*, 89 F.3d 249, 250 (5th Cir. 1996); *In re Taylor*, 3 F.3d 1512, 1516 (11th Cir. 1993); *In re Edwards*, 901 F.2d 1383, 1385 (7th Cir. 1990).[4] But reaffirmation requires a voluntary agreement with the creditor, *In re Turner*, 156 F.3d 713, 718-21 (7th Cir. 1998), and so the effect of § 521(1) is to require the Chapter 7 debtor, if the creditor insists, either to give up the property or else to redeem it. [5]

(0) Lien stripping under § 506(d): *Dewsnup v. Timm*.

Finally, under *Dewsnup v. Timm*, 502 U.S. 410, 112 S.Ct. 773 (1992), an undersecured creditor cannot be "stripped down" to the value of the property securing its lien. The possibility of such a strip down was presented by § 506 of the Code. Under § 506(a), a creditor with an allowed claim that is less than fully secured by property of the estate is given a bifurcated claim: first, "a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property," and second, an unsecured claim "to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim." Under § 506(d), the creditor's lien in such a case is generally void "to the extent that [the] lien secures a claim against the debtor that is not an allowed secured claim." Thus, if the "allowed secured claim" referred to in § 506(d) is the same "secured claim" that was defined by § 506(a), an undersecured creditor, in gaining an unsecured claim for the deficiency of its interest in the estate's property, would lose its lien to the extent of that deficiency, and thus would not enjoy the benefit of any increase in the value of the collateral after it was valued for purposes of bifurcation under § 506(a). Acknowledging that this reading might be the most reasonable had the court been "writing on a clean slate," 502 U.S. at 417, 112 S.Ct. at 778, the Supreme Court in *Dewsnup* adopted a different reading of § 506(d), stating that the "allowed secured claim" it refers to is *not* the secured claim that exists after bifurcation under § 506(a), but rather is any allowed claim that is also secured, *before* the bifurcation. 502 U.S. at 415, 112 S.Ct. at 777. In this way, the Court was able to continue what it found to be a longstanding policy that "a lien on real property passe[s] through bankruptcy unaffected," so that "the creditor's lien stays with the real property until the foreclosure." 502 U.S. at 417, 112 S.Ct. at 778. The court acknowledged that the

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[4] However, a number of other courts have held that debtors have the option of retaining collateral that has no equity for the estate if they remain current on the payments required by their loan agreements, even in the absence of a reaffirmation agreement. *E.g., In re Parker*, 139 F.3d 668, 672-73 (9th Cir.), *cert. Denied sub nom. McClellan Fed. Credit Union v. Parker*, 119 S.Ct. 592(1998); *In re Boodrow*, 126 F.3d 43, 53 (2d Cir. 1997), *cert. Denied sub nom. Capital Communications Fed. Credit Union v. Boodrow*, 118 S.Ct. 1005 (1998); *In re Belanger*, 962 F.2d 345, 347 (4th Cir. 1992); *Lowry Federal Credit Union v. West*, 882 F.2d 1543, 1547 (10th Cir. 1989). Even under these decision, however, there would not be a "strip down" of the debt, since the debtor would be required to comply with the contract terms in order to retain the collateral.

[5]*In re Greer*, 189 B.R. 219 (Bankr.S.D.Fla. 1995), and *In re Thomas*, 186 B.R. 470 (Bankr.W.D.Mo. 1995), disagree with *Turner* to some extent, stating that if a debtor offers to reaffirm a debt on the original contract terms, the creditor may not force surrender of the collateral. These rulings have the same effect as those cases (cited in the preceding footnote) that recognize a right in debtors to retain collateral without reaffirmation if payments on the loan are current.

creditor would have been given an unsecured claim in exchange for the strip down, but stated that the unsecured claim "does not strike us a proper recompense for . . . elimination of the remainder of the lien." 502 U.S. at 419, 112 S.Ct at 778. Despite the Court's language, nothing in its opinion limits the interpretation of § 506(d) to claims supported by at least some equity, and thus, it would appear that even creditors whose secured claims are completely without equity still may retain their liens without stripdown under § 506(d). *Laskin v. First National Bank (In re Laskin)*, 222 B.R. 872, 876 (9th Cir. BAP 1998); *but see In re Yi*, 219 B.R. 394, 397-401 (E.D.Va. 1998), and *In re Howard*, 184 B.R. 644 (Bankr.E.D.N.Y. 1995), each limiting *Dewsnup* to its facts: a consensual lien on real estate with equity to support the lien.

(0) Other methods of lien stripping in Chapter 7.

Despite*Dewsnup*, it is still possible for Chapter 7 debtors or trustees to avoid the liens of certain secured creditors in certain situations. In the first place, secured claims in Chapter 7 are subject to attack under the "strong arm" provisions of § 544, and as preferences and fraudulent conveyances, under §§ 547 and 548. And finally, there are two Code provisions, albeit of limited applicability, under which a Chapter 7 debtor is able to strip down a secured claim.

) Redemption under § 722.

Under § 722, a debtor may redeem certain personal property that has been exempted by "paying the holder of such lien the amount of its allowed secured claim." It is generally recognized that "allowed secured claim" in this context is the claim resulting from bifurcation under § 506(a). *See In re Maitland*, 61 B.R. 130, 133-34 (Bankr.E.D.Va. 1986) (stating in dicta that "§ 506(a) may be used by the debtor to determine the amount he must pay to a secured creditor to redeem personal property under 11 U.S.C. § 722"); *In re Williams*, 224 B.R. 873, 876 (Bankr. S.D. Ohio 1998); *In re Donley*, 217 B.R. 1004, 1007 (Bankr. S.D. Ohio 1998) (discussing the proper measure of value under § 506(a) for purposes of a § 722 redemption). Redemption, however, is not an option that most debtors will be able to exercise. It is generally recognized that redemption must be by a lump sum payment, rather than in installments. *In re Edwards*, 901 F.2d 1383, 1386 (7th Cir. 1990); *In re Bell*, 700 F.2d 1053, 1058 (6th Cir. 1983); *In re Cushman*, 217 B.R. 470, 478 (Bankr. E.D.Va. 1998).[6] And the courts are divided on the question of whether, in a case converted from Chapter 13 to Chapter 7, the debtor may redeem collateral by paying the balance of a secured claim that was bifurcated and paid in the Chapter 13 case. *See generally In re Burba*, 42 F.3d 1388, 1994 WL 709314 (6th Cir. 1994) (unpublished disposition, holding that new valuation of the secured claim is required after conversion); *In re Cooke*, 169 B.R. 662 (Bankr.W.D.Mo. 1994) (holding that payment of previously bifurcated claim is sufficient to redeem) (both decisions collecting authorities). This

[6]There is authority, however, for the position that a debtor may reaffirm one debt secured by particular collateral, while redeeming the collateral from another debt. *In re Lombardi*, 195 B.R. 585, 587 (Bankr. W.D.N.Y. 1996) (allowing redemption from second lien where debtor had reaffirmed agreement with first lender); *Altenberg v. General Finance Corp. (In re Altenberg)*, 1 Collier Bank. Cas. 2d (MB) 807 (Bankr. S.D. Fla. 1980). In both cases, the courts allowed redemption for a nominal payment, tied to the cost of obtaining a release of lien.

dispute parallels the debate (discussed below in Section IV.A.3.b.) on the question of whether Chapter 13 plans may provide for release of liens prior to completion of the plan.

) Lien avoidance under § 522(f).

The other means available to a Chapter 7 debtor for stripping liens is § 522(f)(1) of the Code, which allows the "fixing" of a lien to be avoided "to the extent that such lien impairs an exemption to which the debtor would have been entitled." However, this section is also of limited application, in three different respects.

a) Limited to particular liens.

First, not all liens are encompassed by the section. Only "judicial" liens (under § 522(f)(1)(A)) and "nonpossessory, nonpurchase-money" security interests (under § 522(f)(1)(B)). Furthermore, the judicial liens that may be avoided do not include liens enforcing family support awards.[7] And the non-possessory, non-purchase money security interests include liens only on prescribed items, such as household furnishings, tools of the trade, and health aids. *In re Reid*, 121 B.R. 875, 876-78 (Bankr.D.N.M. 1990) (motor vehicles not included in categories of exemptions included in § 522(f)) (collecting authorities).

a) Limited to extent of impairment of exemptions.

a) The formula of the 1994 Reform Act.

Where § 522(f)(1) does apply, for example, with respect to judgment liens on property that is covered by a homestead exemption, the lien is only avoided to the extent that it "impairs" the exemption. Prior to the 1994 Reform Act this limitation had been interpreted by some courts to allow avoiding of the lien only to the extent necessary to assure that the debtor was paid his or her statutory exemption, allowing the judgment creditor to obtain the benefit of appreciation in the property after the bankruptcy, while other courts found impairment whenever there was insufficient non-exempt equity to pay the judgment lien in full. The first approach was exemplified by *In re Chabot*, 992 F.2d 891 (9th Cir. 1993), the second by *In re Henderson*, 18 F.3d 1305 (5th Cir.), *cert. denied sub nom. Belknap v. Henderson*, 115 S.Ct. 573 (1994). *Chabot* illustrates the problem: the debtors owned a home worth about $400,000; there were mortgages against the home in the amount of about $125,000, and a judgment lien of about $242,000; the debtors' homestead exemption was $45,000.

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[7]The exclusion of family support awards from the lien avoidance provisions of § 522(f) was part of the Bankruptcy Reform Act of 1994. Unfortunately, there is an apparent drafting error, in what is now § 522(f)(1)A)(ii)(II), providing that liens securing family support awards are excepted from avoidance "to the extent" that the award "includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance or support." The drafters presumably *meant* to exclude from the exception liabilities designated as support that were actually *not* in the nature of support. This apparent error has not yet been addressed by the courts.

Thus, there was sufficient non-exempt equity in the home to support some, but not all, of the judgment lien. The Ninth Circuit held that, under California law, the judgment lien would never be effective against the homestead exemption, and so did not impair the exemption. The result was that the lien was not avoided at all under § 522(f). Therefore, the debtors left bankruptcy owning property with a value, net of their mortgages and homestead exemption of $230,000 [$400,000 - ($125,000 + $45,000)]; to the extent that they increased this value by paying down their mortgage, the increased value would benefit the judgment creditor, until the entire judgment claim was satisfied. The court expressly approved this result. 992 F.2d at 985.

The 1994 Reform Act rejected this approach by adding to the Code a new provision, § 522(f)(2)(A), which defines "impairment" so as to preserve for the debtors any postpetition increase in the value of their property, consistent with the *Henderson* opinion. The formula requires the court to add the value of the lien subject to being avoided to the value of all other liens on the property and to the amount of the debtor's exemptions. To the extent that this sum exceeds the value of the debtor's interest in the property in the absence of liens, there is impairment. Thus, in the *Chabot* situation, the court would add mortgages ($125,000) to the judgment lien ($242,000) and the homestead exemption ($45,000), arriving at the sum of $412,000. Since this exceeds the value of the property ($400,000) by $12,000, the judgment lien impairs the exemption by that amount, and is to that extent avoided. The debtors would therefore leave bankruptcy with their home subject to a judgment lien fixed at $230,000 ($242,000 - $12,000), and any increase in the value of the property postpetition would be to their benefit. Similarly, where there is no nonexempt equity for the benefit of a judgment creditor, that creditor's lien would be entirely avoided by application of the formula. To see how this result comes about, consider the *Chabot* situation again, but with property worth only $150,000. The mortgages ($125,000) plus the judgment liens ($242,000) plus the homestead exemption ($45,000) again equal $412,000. But if the property is only worth $150,000, the exemption is impaired to the extent of $262,000 ($412,000 - $150,000). Since $262,000 exceeds the amount of the judgment lien, the lien is entirely avoided. This new formula was recently applied by circuit courts in *In re Holland*, 151 F.3d 547, 549-50 (6th Cir. 1998), and *In re Silveira*, 141 F.3d 34, 38 (1st Cir. 1998).

a) Problem: Jointly owned property; single debtor.

The Reform Act formula, applied literally, can produce dubious results when a single debtor asserts the right to avoid a judicial lien on jointly owned property. The problem is that the formula (in § 522(f)(2)(A)(ii)) requires that "all" other liens on the property be deducted from the debtor's interest in the property. Thus, literally, the portion of a mortgage lien attributable to the co-owner of the property would be deducted from the debtor's individual interest in the property, allowing the debtor a much larger avoidance that would otherwise be the case. For example, suppose that the debtor with a homestead exemption of $10,000 sought to avoid a $15,000 judgment lien on jointly-owned property worth $100,000 that was encumbered by a lien of $50,000. One might think that there is no impairment of exemption. The debtor's share of the equity in the property is $25,000, from which a $10,000 homestead exemption may be subtracted, still leaving $15,000 to pay the judgment lien. But if "all other liens"—that is, the full amount of the joint mortgage—are subtracted from the debtor's individual interest in the property then the debtor has no equity (the $50,000 interest is exhausted by the $50,000 mortgage), and the entire judgment lien is avoided. The decisions are in dispute on the application of the formula in this context. Among the decisions applying the formula literally are *Zeigler Engineering Sales, Inc. v. Cozad (In re Cozad),* 208 B.R. 495 (10th Cir. BAP 1997), and *In re Pascucci,* 225 B.R. 25, 27 (Bankr. D.Mass. 1998). Decisions holding that literal application of the formula produces an absurd result include *FDIC v. Finn (In re Finn),* 211 B.R. 780 (1st Cir. BAP 1997) and *In re Lehman*, 223 B.R. 32, 34 (Bankr. N.D.Ga. 1998).

a) Limited to avoiding the "fixing" of liens.

As noted above, § 522(f)(1) allows the avoidance of the "fixing" of liens. Thus, if a lien never "fixes" to property that the debtor claims as exempt, it cannot be avoided. *Farrey v. Sanderfoot,* 500 U.S. 291, 296, 111 S.Ct. 1825, 1829 (1991). Therefore, if state law holds that a judgment lien never fixes on homestead property, there may still be no avoidance under § 522(f)(1), despite the intent reflected in the new definition of impairment. *See In re Harrison,* 164 B.R. 611, 615 (Bankr.N.D.Ill. 1994) (holding that because a judicial lien did not attach to the debtor's homestead estate under Illinois law, the lien could not be avoided under 522(f)). However, in light of the purpose of the 1994 amendment, discussed in the preceding section, it is unlikely that this analysis has continued viability. *See In re Allard*, 196 B.R. 402, 411 (Bankr. N.D.Ill.) (stating that the court will no longer follow its *Harrison* decision)., *aff'd sub nom. Great Southern Co. v. Allard*, 202 B.R. 938 (N.D.Ill. 1996)

a) Not applicable to mortgage foreclosure judgments.

Finally, the definition of impairment under the 1994 Reform Act itself contains a provision (§ 522(f)(2)(C)) stating that the definition does not apply "with respect to a judgment arising out of a mortgage foreclosure." This provision is remarkably unclear. It may merely mean that when a foreclosure court orders property sold, with the creditor's lien to attach to the proceeds of the sale, this court order is not a "judicial lien" subject to avoidance. Such an interpretation would merely restate existing law. *In re Sinnard*, 91 B.R. 850, 853-54 (Bankr.N.D.Iowa 1988). However, the provision might be interpreted to apply to a situation in which a creditor obtains a deficiency judgment from the foreclosure of non-homestead property, and then seeks to enforce that judgment by obtaining a judgment lien on the debtor's homestead. This interpretation would be problematic in two respects. First, giving any protection to such a creditor would appear to contradict the congressional intent that debtors be given the benefit of postpetition increases in the value of their homesteads. Second, removing the statutory definition of impairment in such cases, would merely reinstate the conflicting case law that existed prior to the Reform Act. These considerations led the court in *In re Pascucci*, 225 B.R. 25, 28-29 (Bankr. D.Mass. 1998), to reject such an interpretation.

(0) The need for filing proof of a secured claim.

As noted above, a secured creditor in Chapter 7 is likely either to be paid the amount of its claim or else retain its right to proceed against the property. Nothing in the Bankruptcy Code or the Federal Rules of Bankruptcy Procedure makes these results depend on the filing of proof of the secured claim. See Fed.R.Bankr.P. 3002. requiring that only "[a]n unsecured creditor or an equity security holder must file a proof of claim or interest." Thus, the principal reason for any creditor filing proof of a secured claim would be for the creditor to obtain the benefit of an unsecured claim in the amount of any deficiency in the collateral, pursuant to § 506(a).

0. Unsecured claims.

There are basically three steps in treating unsecured claims in Chapter 7: allowance, prioritization/payment, and discharge.

(0) Allowance; late-filed claims.

The mechanism for allowance of claims in Chapter 7 is set forth in §§ 501 and 502 of the Code. Section 501 provides for the filing of proofs of claim by various parties, and § 502 provides for allowance and disallowance of claims for which proofs are filed pursuant to § 501. The 1994 Reform Actaddressed one of the major unresolved issues regarding allowance of claims in Chapter 7: whether late-filed claims are allowed. Many decisions under the pre-amendment Code had simply assumed that late filed claims were disallowed. *See, e.g., In re Davis*, 936 F.2d 771, 772-73 (4th Cir. 1991). However, a number of more recent decisions concluded that the late filing of a claim in Chapter 7 did *not* result in disallowance of the claim. *See, e.g., In re McLaughlin*, 157 B.R. 873, 876 (Bankr.N.D.Iowa 1993). The source of the dispute among these decisions was the text of Fed.R.Bank.P. 3002, which sets forth the time limitations for the filing of proofs of claims by creditors and states that "[a]n unsecured creditor . . . must file a proof of claim . . . in accordance with this rule for the claim . . . to be allowed."[8] However, nothing in the express language of §§ 501 or

[8]Under Fed.R.Civ.P. 3002(c) the deadline for a creditor's filing proof of an unsecured claim is generally 90 days after the first date set for the meeting of creditors called pursuant to § 341(a) of the Code. This deadline is subject to a few very specific grounds for extension, not generally available, and, pursuant to Fed.R.Civ.P. 9006(b)(3), these

502 required timely filing as a basis for allowance of a claim, and, as noted below, § 726 expressly provides for payment of untimely filed claims.

The 1994 Reform Act addressed this issue by creating a new ground for objection to claims, § 502(b)(9), which generally provides for disallowance where a "proof of . . . claim is not timely filed." However, the new ground is expressly inapplicable to claims "tardily filed as permitted under paragraph (1), (2), or (3) of section 726(a) of this title or under the Federal Rules of Bankruptcy Procedure." As discussed in the next section of this outline, § 726(a) makes provision for payment of both late-filed priority claims and late-filed general unsecured claims. None of these claims, therefore, are subject to disallowance under the new § 502(b)(9).[9] The only Chapter 7 claims subject to disallowance under § 502(b)(9) would appear to be late-filed claims for noncompensatory fines and penalties, dealt with by § 726(a)(4).

(0) Prioritization/Payment.

Why does it matter whether a claim in Chapter 7 is allowed? The answer is provided by § 726(a) of the Code, which sets forth a complete scheme of payment priority for unsecured claims in Chapter 7 cases: only *allowed* unsecured claims are specified for payment, with the balance paid to the debtor. Thus claims that are not allowed are paid nothing. (As noted earlier, there is no requirement that secured claims be allowed in order for the creditor to proceed outside of bankruptcy against the property securing the claim or to retain its lien against the proceeds of any sale of the property by the trustee.) Although § 726 does not explicitly address the question, it is apparent that payment of unsecured claims in Chapter 7 is made by the trustee, who must account for the administration of the estate under § 704(9). The prioritization of payments under § 726(a) is as follows:

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grounds are the only ones that can be employed by the court. In contrast, the deadline for filing of claims, on behalf of a creditor, by the debtor or trustee — set by Fed.R.Civ.P. 3004 at 30 days after the expiration of the creditor's deadline — is not subject to the extension limitation of Fed.R.Civ.P. 9006(b)(3), but rather to the excusable neglect standard of Fed.R.Civ.P. 9006(b)(1). That standard is fairly flexible, as indicated by the Supreme Court's decision in *Pioneer Inv. Services Co. v. Brunswick Assocs. Ltd. Partnership*, 507 U.S. 380, 113 S.Ct. 1489 (1993). However, mere inattention may not be sufficient to constitute excusable neglect for a debtor's late filing of a claim on behalf of a creditor. *In re Ford*, 205 B.R. 960 (Bankr.N.D.Ala.1996).

[9]Moreover, any "claim of a governmental unit" is excepted by new § 502(b)(9) from the otherwise applicable rules regarding timely filing, so that a governmental claim "shall be timely filed if it is filed before 180 days after the date of the order for relief or such later time as the Federal Rules of Bankruptcy Procedure may provide."

) Priority claims under § 726(a)(1); family support claims.

Under § 726(a)(1), priority claims ("claims of the kind specified in, and in the order specified in, section 507") are paid before all other claims. This group of claims includes, most significantly, "administrative expenses allowed under section 503(b)" (§ 507(a)(1)); various tax claims (now § 507(a)(8)); and, under the 1994 Reform Act, a new priority for family support claims ("claims for debts to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child.") (§ 507(a)(8)).

Late-filed priority claims — including the new family support priority claims — are still entitled to first priority payment as long as they are "filed before the date on which the trustee commences distribution" under § 726. This last provision, added by the Bankruptcy Reform Act, resolved a conflict in the case law between cases that accorded late-filed priority claims treatment under § 722(a)(1), such as *In re Vecchio*, 20 F.3d 555 (2d Cir. 1994) and *In re Pacific Atlantic Trading Co.*, 33 F.3d 1064 (9th Cir. 1994), and those that had subordinated the claims, such as *In re Waindel*, 65 F.3d 1307 (5th Cir. 1995), and *In re Mantz*, 151 B.R. 928 (9th Cir. BAP 1993), *rev'd*, 33 F.3d 59 (9th Cir. 1994).

There are two principal questions left open by the new language. The first question is whether it is possible for a late-filed priority claim to be equitably subordinated under § 510(c), as suggested by *Vecchio*, 20 F.3d at 560. Nothing in the language added to § 726(a)(1) indicates that equitable subordination is not possible, and courts have in fact considered such subordination. *See In re M.A.P. Restaurant, Inc.*, 191 B.R. 519, 520 (Bankr. D.R.I. 1996) (considering the possibility of equitable subordination of late-filed IRS claim accorded priority status, but finding no grounds for subordination); *In re Hohenberg*, 191 B.R. 694, 704-05 (Bankr. W.D.Tenn. 1996) (holding that if a late-filing creditor's claims were allowed, they would be equitably subordinated to the claims of all other creditors).

The second question is the point at which a trustee "commences distribution" under § 726, so as to cut off the right of a late-filing priority creditor to treatment under § 726(a)(1). The most reasonable interpretation of this provision would put the cut-off on the date that the trustee makes a general distribution to unsecured creditors. At this point, the estate is likely to have been depleted of funds necessary to pay priority claims in full, even if a reserve has been withheld to pay contingent claims or pay for continuing expenses of administration. On the other hand, when a trustee simply makes early distributions to secured creditors or to other priority claimants, without substantially exhausting the assets of the estate, a distribution under § 726 should not be found. *See In re Wilson*, 190 B.R. 860, 862 (Bankr. E.D.Mo. 1996) (holding that the date of the United States Trustee's approval of a trustee's final report should be viewed as the commencement of distribution); *contra*, *In re Hohenberg*, 191 B.R. 694, 699 (Bankr. W.D. Tenn. 1996) (payment of administrative expenses consituted commencement of distribution).

) General unsecured claims under § 726(a)(2).

The second priority of distribution is accorded by § 726(a)(2) to two different types of non-priority ("general") allowed unsecured claims: first, under paragraph (A) and (B), timely filed claims, regardless of whether filed by the creditor or another party; and, second, under paragraph (C), claims tardily filed by a creditor, if the creditor did not have notice or actual knowledge of the case in time for timely filing, and if the claim is nevertheless filed "in time to permit payment of such claim." The only question likely to be raised by these provisions is the point at which there is no longer time to permit payment of the claim. This is a different standard than the "commence distribution" rule of § 726(a)(1) for cutting off payment of priority claims. Presumably, as long as the trustee has sufficient funds to pay a late-filed claim under § 726(a)(2)(C), without exhausting the funds necessary for payment of priority claims, the trustee should make the payment, even though a general distribution has already been made to unsecured creditors. There may be situations in which a debtor wishes to have a claim paid from the estate even though the creditor filed it too late to share in the distribution of the estate—for instance, where the claim is nondischargeable.

) General unsecured claims under § 726(a)(3).

The third priority of distribution, under § 726(a)(3), is for payment of tardily filed allowed unsecured claims other than those specified in § 726(a)(2)(C). This provision essentially deals with surplus cases. If the estate has sufficient funds to pay all of the claims under the first two priorities, then other late- filed claims may be paid. It is likely that if a priority claim is filed after the date on which the trustee commences distribution under § 726, that claim would fall within this category, since it would be "an allowed unsecured claim, proof of which is tardily filed . . ., other than a claim under paragraph (2)(C) of this subsection."

) Lower priorities.

Although they are not often encountered in practice, § 726(a) does provide three lower priorities: a fourth, under § 726(a)(4), for noncompensatory fines, penalties, and forfeitures, and for punitive damages; a fifth, under § 726(a)(5), for postpetition interest on the claims specified in the prior paragraphs; and finally, a sixth, under § 726(a)(6), for any residue of the estate to be paid to the debtor.

(0) Discharge.

) Grant or denial of discharge; scope of discharge.

Discharge of indebtedness in Chapter 7 is governed by § 727 of the Code. Section 727(a) deals with the issue of whether the debtor should be given a discharge, and sets out the grounds on which discharge can be denied, including fraudulent conduct in connection with the bankruptcy case, such as concealing assets, making false oaths or accounts, presenting false claims, and failing to explain loss of assets. Section 727(b) sets out the scope of the Chapter 7 discharge. Critically, it "discharges the debtor from all debts that arose before the date of the order for relief . . . whether or not a proof of claim based on any such debt . . . is filed under section 501 . . . and whether or not a claim based on any such debt . . . is allowed under section 502."

) The effect on discharge of failing to schedule creditors.

The only exceptions from the discharge defined by § 727 are set forth in § 523 of the Code. Thus, even if a particular claim is not scheduled, and hence the creditor lacks notice of the bankruptcy, the claim will be discharged unless it fits within one of the exceptions of § 523. *Judd v. Wolfe*, 78 F.3d 110, 113-16 (3d Cir. 1996); *In re Beezley*, 994 F.2d 1433, 1434 (9th Cir. 1993); *In re Thibodeau*, 136 B.R. 7, 10 (Bankr.D.Mass. 1992); *In re Mendiola*, 99 B.R. 864, 865 (Bankr.N.D.Ill. 1989) (each holding that no purpose would be served by reopening a case to add omitted creditors to the schedules); *cf. In re McKinnon*, 165 B.R. 55, 57 (Bankr.D.Me. 1994) (acknowledging that dischargeability is not immediately affected by adding omitted creditors, but holding that it might be affected in the event that additional assets are discovered).[10]

) Particular exceptions from discharge.

The list of claims excepted from discharge in Chapter 7 includes some that are also nondischargeable in Chapter 13 (such as family support obligations and most student loans) as well as some that are not excepted from dischargeable in Chapter 13 (such as claims for fraud, breach of fiduciary duty, and willful and malicious injury). Compare § 523(a)(2), (4), (5), (6), and (8) with § 1328(a). For any debt that may be nondischargeable, it will usually be in the debtor's interest that as much of the debt as possible be paid from the estate. Therefore, if a creditor holding a nondischargeable debt fails to file a claim, the debtor should consider filing on that creditor's behalf. Although a creditor cannot seek a retroactive extension of time to file a complaint, the debtor can seek such an extension for filing a claim on the creditor's behalf. See n.8, above. Four of the exceptions from discharge are have raised significant questions in Chapter 7 cases.

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[10] The exception from discharge that is based on a lack of notice to the creditor, § 523(a)(3), makes a claim nondischargeable under two circumstances: first, if the creditor did not get notice or have actual knowledge of the bankruptcy in time to file a timely proof of claim, and second, if the creditor had a claim under 523(a)(2), (4), or (6) — claims which can only be found nondischargeable in a bankruptcy proceeding filed within a specified time — and the creditor did not get notice or have actual knowledge in time to file the proceeding. In a no asset case, creditors are usually informed that they need not file claims unless they receive further notice (pursuant to Fed.R.Bankr.P. 2002(e)), and hence the failure to schedule creditors in a no-asset case can only result in nondischargeability if the creditor's claim falls within § 523(a)(2), (4), or (6). However, one decision, *In re Raanan*, 181 B.R. 480 (Bankr. C.D.Cal. 1995), holds that equitable estoppel may prevent a debtor from asserting his discharge as to an unscheduled claim in a no-asset Chapter 7 case, even though the claim did not fall within the categories described by § 523(a)(2),(4) and (6). The debtor in that case had litigated the claim pospetition, hoping to collect on a counterclaim without notice to the trustee, and told the plaintiff about the bankruptcy only after losing the litigation.

a) Credit card fraud.

By far the largest controversy in dischargeability law has been in connection with charges of fraud in the use of credit cards, governed by § 523(a)(2)(A) (which excepts debts incurred through "actual fraud") and § 523(a)(2)(C) (which creates a presumption of fraud in certain situations of credit card use shortly before bankruptcy). In *Field v. Mans*, 516 U.S. 59 (1995), the Supreme Court determined (in a case not involving credit card fraud), that common law fraud principles should govern the interpretation of § 523(a)(2)(A), and specifically that a plaintiff must prove "justificable reliance" on a false representation made by the debtor. This understanding of §523(a)(2)(A) has raised three basic questions:

a) Is there an actionable representation?

Several decisions have held that the ordinary use of a credit card is not a representation of any sort. *See, e.g., In re Etto*, 210 B.R. 734 (Bankr. N.D.Ohio 1997); *In re McDaniel*, 202 B.R. 74 (Bankr. N.D.Tex. 1996); *In re Alvi*, 191 B.R. 724 (Bankr. N.D.Ill. 1996). This holding would eliminate the possibility of a successful dischargeability action under § 523(a)(2)(A), but it has not generally been accepted. A related theory is that credit card companies assumes the risk or implicitly consents to all use of credit cards (at least within the credit limits) until the card is revoked. *In re Gilmore*, 221 B.R. 864, 873-77 (Bankr. N.D.Ala. 1998). One difficulty with these holdings is the presumption of § 523(a)(2)(C) that certain use of a credit card within 60 days of the bankruptcy filing is fraudulent under § 523(a)(2)(A). Without an actionable representation in the use of credit cards, this presumption cannot meaningfully apply—how, for example, can the presumption of a fraudulent representation be rebutted if there is no representation?

a) What is the representation?

The majority of courts that find an actionable representation in the use of credit cards hold that a credit card user implicitly represents an intent (although not necessarily an ability) to repay debts incurred through use of the card. Recent decisions so holding include *Rembert v. AT&T Universal Card Serv. Inc. (In re Rembert)*, 141 F.3d 277, 281 (6th Cir.), *cert. Denied*, 119 S.Ct. 438 (1998), and *Anastas v. American Sav. Bank (In re Anastas)*, 94 F.3d 1280, 1285 (9th Cir. 1996). These decisions note that a representation about ability to repay involves the financial condition of the debtor, which can only be the basis for nondischargeability based on fraud if the representation is in writing, pursuant to § 523(a)(2)(B). Various lists of factors have been applied by the coruts in determining whether the debtor's implciit representation of an intent to repay was true or false. *See Anastas*, 94 F.3d at 1284 n.1, for a commonly cited list of twelve factors. *Lousiana Capitol Fed. Credit Union v. Melancon (In re Melancon)*, 223 B.R. 300, 319 (Bankr. M.D.La. 1998), holds that the relevant representation is "I will repay." In effect, this is similar to the "intent to repay" representation found by the majority of courts, since *Melancon* recognizes that the debtor may make the represenation truthfully without having actual ability to repay (as where the debtor is unaware of an impossible financial situation).

a) How can there be justifiable reliance?

Many of the decisions holding that there is no representation in the use of a credit card also hold that a credit card issuer must conduct reasonable investigations into the debtor's ability to pay in order to establish the "justifiable reliance" required by *Field v. Mans*. *See, e.g., In re Etto*, 210 B.R. 734, 739 (Bankr. N.D.Ohio 1997); *In re McDaniel*, 202 B.R. 74 (Bankr. N.D.Tex. 1996); *In re Alvi*, 191 B.R. 724, 730-31 (Bankr. N.D.Ill. 1996). However, the majority of decisions allow "justificable reliance" to be established by a showing that "the account is not in default and any intial investigations into a credit report do not raise red flags that would make reliance unjustifiable." *Anastas*, 94 F.3d at 1286; *Melancon*, 223 B.R. at 331.

a) Debts incurred to pay nondischargeable taxes.

Section 523(a)(14), added by the 1994 Reform Act, makes nondischargeable debts incurred to pay a nondischargeable tax. The difficulty with this provision is that, unless the proceeds of the borrowing are paid directly to the taxing authority, there may be substantial tracing problems. Of the very few reported decisions dealing with §523(a)(14), at least one raises this tracing problem in connection with borrowed funds deposited into a checking account of the debtor, which account the debtor used to pay taxes. *MBNA America v. Chrusz (In re Chrusz)*, 196 B.R. 221, 224 (Bankr. D.N.H. 1996).

(3) Property divisions in divorce cases.

Section 523(a)(15), also added by the 1994 Reform Act, creates an exception to discharge for property divisions in divorce or separation cases. Unlike the exception for family support awards, which can be raised at any time and in any forum, the new exception is like the exceptions for fraud, breach of fiduciary duty, and intentional injury to property (§ 523(a)(2), (4), and (6)) — it can be adjudicated only in bankruptcy proceedings, and only upon a timely filed complaint.[11] Thus, divorce counsel should automatically file complaints to determine the dischargeability of any award that might be characterized as a property divisions when the non-client spouse files a Chapter 7 bankruptcy.

Once the case is properly before the court, there are two factors, either of which may prevent the finding of nondischargeability: (a) that the debtor does not have the ability to pay the debt from

[11]The time limit, pursuant Fed.R.Bankr.P. 4007(c), is 60 days following the first date set for the meeting of creditors under § 341. Unfortunately, lack of notice of the bankruptcy in time to file a complaint under § 523(a)(15) was not made a ground for nondischargeability under § 523(a)(3)(B). Therefore, if a debtor fails to give notice of the bankruptcy to a nondebtor spouse, the right to assert a claim under § 523(a)(15) could be lost through no fault of the nondebtor. *See Fidelity National Title Ins. Co. v. Franklin (in re Franklin)*,, 179 B.R. 913, 923 n.25 (Bankr. E.D.Cal. 1995) (pointing out the anomaly, and suggesting either amendment of the statute or the use of equitable tolling).

disposable income (that is, income not necessary for the support of the debtor, the debtor's dependents or the debtor's necessary business expenses), or (b) discharging the debt would "result in a benefit to the debtor that outweighs the detrimental consequences" to the spouse, former spouse or child who is the beneficiary of the award. The first factor is like the disposable income test of § 1325(b)(2), and so may be illuminated by the case law interpreting that section. The second factor is a new balancing test, that should prevent findings of nondischargeability in situations where the nondebtor spouse is in a better financial situation than the debtor.

The major ambiguity is whether the two factors listed in §523(a)(15) are elements of nondischargeability, the absence of which must be shown by the plaintiff (usually a nondebtor spouse), or whether they are affirmative defenses that must be established by the debtor. The conflicting authorities are collected in *Moeder v. Moeder (In re Moeder)*, 220 B.R. 52, 56 (8th Cir. BAP 1998) (holding, in accordance with what it finds to be the majority of opinions, that the two factors are affirmative defenses).

An additional question is standing. Occasionally, a party other than the debtor's former spouse (or a similarly related party)—most notably the debtor's divorce attorney—will assert that a right to payment under a state court decree is nondischargeable under § 523(a)(15). These attempts are usually unsuccessful. *See In re Wenneman*, 210 B.R. 115, 117-19 (Bankr. N.D. Ohio 1997) (collecting authorities).

a) Condominium association assessments.

Section 523(a)(16), another addition of the 1994 Reform Act, makes nondischargeable in Chapter 7 cases condominium fees and assessments that become due *after* the filing of the bankruptcy case, during a period when the debtor either physically occupied the premises or rented the premises and received payments from the tenant. The importance of this provision is primarily in its resolution of a dispute among the courts as to how condo fees should be treated. One group of decisions, exemplified by *In re Beeter*, 173 B.R. 108 (Bankr.W.D.Tex. 1994), held that condo fees for periods after the filing of a bankruptcy are postpetition debts not subject to discharge. Another group, including *In re Rosteck*, 899 F.2d 694 (7th Cir. 1990), held that, because all condo fees arise from a prepetition agreement between the debtor and the association, even fees that become due after the filing of the bankruptcy are dischargeable prepetition debts. The conflicting authorities are collected in *In re Lamb*, 171 B.R. 52, 54-55 (Bankr.N.D. Ohio 1994).

The new exception to discharge necessarily adopts the second group of decisions: if condo fees were not prepetition claims, they would not be dischargeable, and there would be no reason to except them from discharge. In fact, the legislative history of the Bankruptcy Reform Act expressly approves the *Rosteck* analysis. 140 Cong. Rec. H10, 770 (daily ed. Oct. 4, 1994) (statement of Rep. Brooks). Thus, postpetition condo fees that are not within the scope of the new exception (for example, fees that become due during a period for which the debtor is not in residence and not collecting rent) are dischargeable. Similarly, any postpetition condo fees would be dischargeable in Chapter 13.

There is, however, one ambiguity in the new provision—whether its terms apply to all housing association fees and assessments, or only to the fees and assessments of the specified entities, condominiums and cooperative housing corporations. In the only decision that appears to have addressed this issue to date, a narrow construction was applied, making the new provision inapplicable to "homeowner's association dues." *Old Gride Estates Community Assn. v. Lozada (In re Lozada)*, 214 B.R. 558 (Bankr. E.D.Va. 1997).

IV. Claims in Chapter 13.

The 1994 Reform Act made a substantial change in the eligibility requirements for Chapter 13 debtors. Previously, in order to be eligible for Chapter 13 relief, a debtor was required to have have less than $100,000 in "noncontingent, liquidated, unsecured debts" and $350,000 in "noncontingent, liquidated, secured debts." Those limits were increased to $250,000 for unsecured debts and $750,000 for secured debts. The intent, according to the legislative history was to "encourage individual debtors to elect chapter 13 repayment over chapter 7 liquidation" because "[c]reditors generally benefit when a debtor elects chapter 13." 140 Cong. Rec. H10, 765 (daily ed. Oct. 4, 1994) (statement of Rep. Brooks). As reflected in the following material, there are a number of differences in the treatment of claims between Chapter 7 and Chapter 13, and not all are beneficial to all creditors.

0. Secured Claims.

(0) Relief from the automatic stay.

The difference in the treatment of secured claims between Chapter 7 and Chapter 13 is striking. As an initial matter, a lack of equity in the property is not necessarily a ground for relief from stay. Section 362(d)(2) provides for relief from stay as to property in which the debtor has no equity, but only if the property is "not necessary to an effective reorganization." Most courts have held that Chapter 13 plans involve "reorganization" in the sense implied by § 362(d), and hence that if property is necessary for completion of a Chapter 13 plan, relief from stay is not available under that section. *In re Garner*, 18 B.R. 369, 371 (S.D.N.Y. 1982); *In re Scott*, 121 B.R. 605, 608 (Bankr.E.D.Okla. 1990); *In re Walters*, 188 B.R. 582, 585 (Bankr.E.D.Ark. 1995).[12] And most courts will probably take a generous view of the necessity of the debtor's retaining property such as residences and automobiles. *See, e.g., Garner*, 18 B.R. at 371 ("A stay against foreclosure on residential property

[12]A minority of cases have limited the application of § 362(d)(2) even further, holding that the section simply does not apply in Chapter 13. *E.g., In re Fischer*, 136 B.R. 819, 825 (D.Alaska 1992) ("A Chapter 13 proceeding is not a reorganization of a business entity and therefore should not require the same standards as a Chapter 11 reorganization.") This result is untenable. First, as pointed out by *Scott*, 121 B.R. at 607, § 103(a) of the Code applies all of Chapter 3 of the Code, including § 362(d)(2), to Chapter 13. Second, if a Chapter 13 case were not a "reorganization" under § 362(d)(2), then relief from stay would always have to be granted when a Chapter 13 debtor had no equity in the property, because, as in Chapter 7 liquidations, the property would then not be necessary for a reorganization.

might be lifted where the debtor's present assets or prospects and the plan would not suffer materially. In most circumstances, however . . . such a stay should ordinarily continue in support of the plan of rehabilitation."); *In re Wyatt*, 173 B.R. 698, 703 (Bankr.D.Idaho 1994) (an automobile used by debtor in traveling to his job was necessary to an effective reorganization); *In re Sharon*, 200 B.R. 181, 194 (Bankr.S.D.Ohio 1996) (alleged "luxury" vehicle was necessary for debtor's transportation to employment).

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(0) The need for filing proof of a secured claim.

A second basic difference between Chapter 7 and Chapter 13 is in the need for a secured creditor to file a proof of claim. A secured creditor in Chapter 7 need not file a claim in order to retain its lien and obtain the proceeds of any sale of its collateral, and similarly, a secured creditor whose claim is not dealt with by a Chapter 13 plan will retain its lien on the property. *In re Kuebler*, 172 B.R. 595, 597 (E.D.Ark. 1994) (tax lien, not addressed by plan, remained effective after plan concluded, even though personal liability of debtors was discharged). Furthermore, a secured creditor may receive payment (or a return of collateral) under a Chapter 13 plan even though it has not filed a claim. No provision of Chapter 13 restricts payments under a plan to "allowed" claims, and § 1322(b)(4) expressly permits a plan to provide for payments on "any" secured or unsecured claims. *Cf. In re Pence*, 905 F.2d 1107, 1110 (7th Cir. 1990) (upholding treatment given by Chapter 13 plan to secured creditor which had filed no claim); *In re Babbin*, 156 B.R. 838, 850 (Bankr.D.Colo. 1993) ("[T]he trustee must distribute in accordance with the confirmed plan notwithstanding the lack of a timely filed proof of claim."), *rev'd in part*, 160 B.R. 848 (D.Colo. 1993) (holding that the filing of proof of a *secured* claim is not a prerequisite to payment under a plan but that proof of *unsecured* claims is required); *contra In re Schaffer*, 173 B.R. 393 (Bankr.N.D.Ill. 1994). However, as noted below, the protections offered by § 1325(a)(5) to secured creditors apply only if they are holders of "allowed" secured claims, and claims are allowed under § 502(a) of the Code only if they are filed under § 501.[13] Thus, it is generally advantageous for secured creditors to file proofs of claim in Chapter 13 cases.

(0) Stripdown of secured claims ("cramdown") generally permitted.

The most significant difference between secured claims in Chapter 7 and Chapter 13 may lie in the debtor's ability to strip down a lien: *i.e.*, to eliminate the creditor's security interest by paying the present value of that interest. As noted above, *Dewsnup* rendered strip downs unavailable in Chapter 7, but this decision interpreted only § 506(d) of the Code, and expressly disclaimed any purpose to interpret other sections of the Code with similar language. 502 U.S. at 417, 112 S.Ct. at 778 n.3. Chapter 13 contains specific provisions allowing the satisfaction of secured claims by paying the value

[13] In Chapter 11 (and Chapter 9), claims are deemed filed under § 501 simply by being listed in the debtor's schedule of liabilities (unless scheduled as disputed, contingent, or unliquidated). See 11 U.S.C. §§ 1111(a) and 925. There is no similar provision in Chapter 13, and thus, to be allowed, a proof of claim must be filed. *In re Linkous*, 990 F.2d 160, 165 (4th Cir. 1993) (Chapman, J., dissenting); *contra In re Babbin*, 156 B.R. 838, 847-48 (Bankr.D.Colo.), *rev'd*, 160 B.R. 848 (D. Colo. 1993).

of underlying security interest. First, § 1322(b)(2) provides that a Chapter 13 plan may generally "modify the rights of holders of secured claims," subject to an exception for certain home mortgages, discussed below. Next, § 1325(a)(5)(B) allows a plan to be confirmed if (among other things) (i) the holder of each allowed secured claim retains the lien securing its claim, and (ii) "the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim." The quoted language, referring to the amount of an "allowed secured claim," must be read to apply to the amount *after* bifurcation under § 506(a). To apply the *Dewsnup* interpretation of
§ 506(d) to "allowed secured claim" would result in an absurdity, requiring the debtor to pay the full amount of a claim, with interest, even if the property securing it was virtually worthless, while the creditor would also have an unsecured claim under § 506(a). Moreover, in contrast to
§ 506(d), as to which the legislative history gave no illumination of congressional intent, the legislative history of § 1325(a)(5)(B) does reflect an intent to allow satisfaction of secured claims by payment of the value of the collateral:

> Of course, the secured creditors' lien only secures the value of the collateral and to the extent property is distributed of a present value equal to the allowed amount of the creditor's secured claim the creditor's lien will have been satisfied in full. Thus the lien created under section 1325(a)(5)(B)(i) is effective only to secure deferred payments to the extent of the amount of the allowed secured claim.

124 Cong Rec. H11, 107 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards setting forth results of conference committee), *reprinted in* Appendix 3 Collier on Bankruptcy IX-122 (15th ed. 1993).[14]

Some courts refer to the operation of §§ 1322(b)(2) and 1325(a)(5)(B) as "cram down," possibly because this treatment of secured claims can be "crammed down the throat" of creditors who voice objections to the plan.[15] There is fairly uniform acceptance of the general operation of the "cram down" provisions. *In re Dinsmore*, 141 B.R. 499, 508 (Bankr.W.D.Mich. 1992):

> Since the earliest case law considering § 1325(a)(5), a debtor has been allowed to bifurcate and cram down a claim not secured solely by the debtor's principal residence. The words, "allowed secured claim", have been consistently interpreted to mean the value of the creditor's claim determined by reference to the collateral under § 506(a). Summarizing the treatment under § 1325(a)(5)(B), the Sixth Circuit stated that "[i]n effect the law requires the creditor to make a new loan in the amount of the value of the

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[14]As noted above, the limitation of § 1325(a)(5) to "allowed" claims means that a creditor who does not file proof of a secured claim prior to confirmation may not be entitled to the protection that the section provides.

[15]This etymology is suggested by *In re Schaitz*, 913 F.2d 452, 453 (7th Cir. 1990): "Instead of the trustee's seizing and selling the bankrupt's non-exempt assets, as in a Chapter 7 proceeding, under Chapter 13 . . . the bankrupt proposes a plan for the repayment of his debts out of future income. Sometimes the plan is in the creditors' best interests, but even if they object to it the bankruptcy judge can cram it down their throats. 11 U.S.C. § 1325(a)(5)(B)."

> collateral rather than repossess it, and the creditor is entitled to interest on his loan." *Memphis Bank & Trust v. Whitman*, 692 F.2d 427, 429 (6th Cir. 1982).

See also *In re McDonough*, 166 B.R. 9 (Bankr.D.Mass. 1994) for a particularly clear analysis of lien stripping in Chapter 13. Examples of lien stripping applied to automobile loans include *In re Flowers*, 175 B.R. 698 (Bankr.N.D.Ill. 1994), *aff'd sub nom. Bank One v. Flowers*, 183 F.R. 509 (N.D.Ill.. 1995), and *In re Lee*, 162 B.R. 217 (D.Minn. 1993). The one reported decision that took a contrary position, *In re Hernandez,* 162 B.R. 160 (Bankr.N.D.Ill. 1993), has been reversed, 175 B.R. 962 (N.D. Ill. 1994).[16]

Despite the general acceptance of cram down under § 1325(a)(5)(B), some questions remain unresolved regarding its application, including the period of time over which the secured portion of a claim may be paid, the method of valuing the collateral, and the interest rate that should be applied to provide present value to the creditor.

) Time for payment of secured portion of claim.

The cram down of secured claims under § 1325(a)(5)(B), as noted above, requires a Chapter 13 debtor to pay to a secured creditor the present value of the "allowed secured claim" that results after bifurcation under § 506(a). One question that arises in applying this cram down requirement is how much time the debtor has to pay the value of the secured claim. A conflict exists among bankruptcy decisions on this issue. One view, espoused in *In re Legowski*, 167 B.R. 711, 715-16 (Bankr.D.Mass. 1994), is that the claim must be paid in full during the life of the debtor's plan. The other point of view, reflected in decisions such as *In re McGregor*, 172 B.R. 718 (Bankr.D.Mass. 1994); *In re Brown*, 175 B.R. 129 (Bankr.D.Mass. 1994); and *In re Murphy*, 175 B.R. 134 (Bankr.D.Mass. 1994), is that a long term secured claim (in each of these cases, a mortgage on real estate) may be paid pursuant to the original loan terms — simply reducing the number of payments to account for the reduced value of the claim — with only the unsecured portion of the claim paid during the Chapter 13 plan. Under this analysis, debtors might take much longer than the term of their plans to pay the value of a secured claim; in the *Brown* case, for example, debtors proposed to pay the secured portion of their mortgage over a period of more than nine years.

The argument for allowing extended payment of secured claims is based on § 1322(b)(5). This provision allows for "the curing of any default within a reasonable time and maintenance of payments

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[16]A final provision of Chapter 13, relevant to cram down in light of *Dewsnup,* is § 1325(a)(4), which imposes the "best interests of creditors" test. This subsection requires that a creditor be treated in Chapter 13 at least as well as the creditor would have been in Chapter 7, by requiring that "the value, as of the effective date of the plan, of property to be distributed under the plan . . . is not less than the amount that would have been paid . . . if the estate of the debtor were liquidated under chapter 7 on such date." The critical feature of this provision is that it is applicable only to "allowed unsecured claims." *See In re Sherman*, 157 B.R. 987, 991 (Bankr.E.D.Tex. 1993) (noting the difference between § 1325(a)(4) and the more general "best interests" of § 1129(a)(7), applicable in Chapter 11 cases). Thus, it would appear that a secured creditor would not be allowed to claim the benefit of postpetition appreciation of its collateral, even though that appreciation would have been available in a Chapter 7 case.

while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due." The decisions allowing extended payment reason that there would be "maintenance of payments" under § 1322(b)(5) by "keeping the same [interest] rate and making the same payments of principal and interest called for by the [original loan documentation] during the life of the plan and during such further period of time as is necessary to have the total principal payments equal the amount of the secured claim as valued by [the] court." *McGregor*, 172 B.R. at 721. *Brown* also specifies that any mortgage arrears would have to be paid in full, as a separate component, through the plan. 175 B.R. at 133.

This rationale for extending payment of secured claims beyond the life of the plan has substantial difficulty. Most importantly, as pointed out in *Legowski*, § 1325(a)(5) requires payment of the allowed secured claim to be made through "property to be distributed under the plan," and § 1322(d) [formerly 1322(c)] requires that the plan "not provide for payment over a period that is longer than three years, unless the court . . . approves a longer period . . . not . . . longer than five years." 167 B.R. at 716. Second, it is not clear how the unsecured portion of the lien is avoided under this approach. *Dewsnup* makes clear that liens are not avoided merely by bifurcating a secured claim under § 506. Rather, it appears that liens can only be avoided in Chapter 13 by modifying the secured claim holders' rights under § 1322(b)(2), pursuant to a plan, and hence (although there is some dispute on the point) that lien avoidance "could not occur until the debtors have fully performed their plan." *In re Gibbons*, 164 B.R. 207, 208 (Bankr. D.N.H. 1993); *In re Scheierl*, 176 B.R. 498, 501-02 (Bankr. D.Minn. 1995) (collecting authorities). Yet under the extended payment approach, the debtor apparently enjoys an immediate lien avoidance that would continue after the Chapter 13 case concludes, even though the debtor has not fully performed it obligation to pay the stripped down claim, and may thereafter default. Finally, the extended payment approach appears to misconstrue § 1322(b)(5). This section implies a "cure" of default followed by full repayment of the long term debt involved. Thus, it applies to long term homestead only mortgages, which, as discussed below, cannot be modified under § 1322(b)(2). And when unsecured debt is "cured" and repaid under § 1322(b)(5), it is not discharged at the conclusion of the plan, so that any balance left unpaid at plan conclusion would remain payable in full. 11 U.S.C. § 1328(a)(1), (c)(1).[17] Nevertheless, where the extended payment approach is accepted, it provides a substantial benefit to the debtors with long term modifiable debt.

) Release of lien.

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[17] This understanding of "cure" and "maintenance" under § 1322(b)(5) eliminates what is the otherwise difficult issue of how to treat the repayment of arrearages, whether as part of the secured portion of the creditor's claim, as unsecured, or as divided between the two. See *In re Arvelo*, 176 B.R. 349, 356-59 (Bankr.D.N.J. 1995). If § 1322(b)(5) is read to require full payment of the "cured" obligation according to its original terms, there is no bifurcation under § 506(a); the default is simply paid in a reasonable period of time, with or without interest as required by §§ 506(b) and 1322(e), and the obligation paid according to its terms.

There is a dispute among the cases as to whether a Chapter 13 plan can provide for a release of lien upon payment of the secured claim remaining after cram down. Among the most recent decisions on the question are *In re Thompson*, 224 B.R. 360, 365-67 (Bankr. N.D.Tex. 1998) (holding that such a release of lien is improper) and *In re Johnson*, 213 B.R. 552, 554-58 (Bankr. N.D.Ill. 1997) (holding that a Chapter 13 plan may properly provide for release of lien upon payment of the secured claim). One of the issues dividing the courts is the question of whether an avoided lien must be reinstated upon dismissal, pursuant to § 349(b). However, nothing in that section appears to require reinstatement of liens that have been avoided under the modification provisions of §1322(b)(2). In contrast to the decisions clearly taking one side or the other, the court in *In re Zakowski*, 213 B.R. 1003, 1006-08, appears to distinguish situations in which the creditor was clearly on notice of the debtor's intent to seek a release of lien prior to completiion of plan payments from situations in which this intent was not clear.

) Valuing collateral for purposes of cram down.

a) Value determined by the court.

In those situations where the court is required to value a secured claim under § 506(a) for purposes of cram down, a number of questions arise, with creditors usually seeking resolutions that maximize the value of the secured claim, and debtors usually seeking resolutions that result in minimal secured claims.

a) Basis for valuation.

a) The *Rash* decision.

For many years, the courts were divided on the question of what basis should be used for valuing collateral under § 506(a). Creditors argued that value of collateral was what it would cost the debtor to replace it—a retail valuation, with no costs of sale deducted. Debtors argued that the value should be what the creditor would receive after selling it—a wholesale valuation, with costs of sale deducted. These arguments—generally arising in the context of cramdown of vehicle loans in Chapter 13—split the courts of appeal, with some accepting creditors' arugments (*see, e.g., Metrobank v. Trimble (In re Trimble)*, 50 F.3d 530 (8th Cir. 1995), some accepting debtors' arguments (*see, e.g., In re Mitchell*, 954 F.2d 557, 559-60 (9th Cir.), *cert. denied*, 506 U.S. 908 (1992)), and some splitting the difference (*see, e.g., In re Hoskins*, 102 F.3d 311 (7th Cir. 1996)).

It appeared that the Supreme Court would resolve this dispute in *Associates Commercial Corp. v. Rash*, 117 S.Ct. 1879 (1997). In *Rash*, the Supreme Court dealt with the usual situation—valuation of a vehicle for cramdown in Chatper 13. After considering the arguments, the Court announced its holding as follows: After resolving all of the arguments as set forth above, the Court announced its holding as follows: "[U]nder § 506(a), the value of property retained because the debtor has exercised the . . . 'cram down' option is the cost the debtor would incur to obtain a like asset for the same 'proposed . . . use.'" 117 S.Ct. at 1186. However, this apparent adoption of the creditors' position was undercut by what a footnote attached to the holding:

> Whether replacement value is the equivalent of retail value, wholesale value, or some other value will depend on the type of debtor and the nature of the property. We note, however, that replacement value, in this context, should not include certain items. For example, where the proper measure of the replacement value of a vehicle is its retail value, an adjustment to that value may be necessary: A creditor should not receive portions of the retail price, if any, that reflect the value of items the debtor does not receive when he retains his vehicle, items such as warranties, inventory storage, and reconditioning. Cf. 90 F.3d, at 1051-52.

117 S.Ct. at 1186 n.6. Thus, the Court appeared to modify the usual position of the replacement value proponents, who argue that what is being measured is the actual price that a debtor would have to pay in an available market, rather the value of the collateral itself, shorn of extra elements of value added by a retailer. The Court did not indicate how these items might be measured in a typical valuation situation.

a) Cases applying *Rash*.

The ambiguity in the *Rash* decision has resulted another wide variety of approaches. Cases dealing with the valuatiion of vehicles for purposes of cramdown in Chapter 13 have used the following formulas: retail value (defined by National Association of Automobile Dealers' "Blue Book")—*e.g.*, *In re Russell*, 211 B.R. 12 (Bankr. E.D.N.C. 1997); retail value less 5%—*e.g.*, *In re Renzelman*, 227 B.R. 740 (Bankr.W.D.Mo.1998); midpoint between retail and wholesale— *e.g.*,*In re Lyles*, 226 B.R. 854 (Bankr.W.D.Tenn. 1998); market price available to debtor, less added value—*e.g.*, *In re McElroy*, 210 B.R. 833 (Bankr. D.Or. 1997). There is no consensus on the appropriate approach, and so the state of the law now is not appreciably more settled than than it was prior to the *Rash* decision.

a) Time of valuation.

Another area of judicial disagreement is point in time that the valuation of a secured claim should take place. With depreciating property, like automobiles, it is to the creditor's advantage that the valuation be at the outset of the case rather than at the time of a later valuation or confirmation hearing. *In re Coates*, 180 B.R. 110, 117-18 (Bankr.D.S.C. 1995) (collecting authorities; holding value should be measured as of time of hearing); *In re Johnson*, 145 B.R. 108 (Bankr. S.D.Ga. 1992) (value measured as of confirmation), *rev'd* 165 B.R. 524 (S.D.Ga. 1994) (value as of date of filing).

In re Kennedy, 177 B.R. 967 (Bankr.S.D.Ala. 1995), effectively applies different valuation dates for different purposes: for adequate protection, the claim is valued as of the beginning of the case, to that "[t]here is just compensation for any property value decline, if re other quested by the creditor," 177 B.R. at 973, but the value of the claim to be paid through the plan is measured as of the time of confirmation, 177 B.R. at 974. *Accord, In re Cason*, 1995 WL 764220 (Bankr.N.D.Ala. Dec. 14, 1995) (referring to this approach as "multiple valuation"). *Cf. In re Addison Properties Ltd. Partnership*, 185 B.R. 766 (Bankr.N.D.Ill. 1995) (applying same theory of dual valuation in Chapter 11 case).

a) Relevance of third-party agreements.

One issue that seems resolved is whether the value of a secured creditor's interest in collateral is affected by agreements with third parties to pay particular amounts to the creditor in the event of the debtors' default. This situation exists whenever a mortgage lender has mortgage insurance guaranteeing repayment of the original loan, or when an auto lender has an agreement with the selling dealer to repurchase a financed vehicle at a particular price. In these situations, the courts have held that the value *of the collateral* does not depend on the creditor's agreements with third parties. *In re Fischer*, 136 B.R. 819, 826-28 (D.Alaska 1992) (mortgage insurance); *Grubbs v. National Bank of South Carolina*, 114 B.R. 450, 452 (D.S.C. 1990) (auto repurchase agreement). *Cf. First Fidelity Bank v. McAteer*, 985 F.2d 114, 118 (3d Cir. 1993) (holding that confirmation of a plan does not alter the right of a creditor to collect from third parties, including insurers on policies owned by the debtor).

a) Value determined through the plan.

Chapter 13 cases present debtors with the possibility of avoiding a § 506(a) hearing on the valuation of claims by simply specifying in the plan the value to be accorded particular secured claims. Section 1327(a) provides for a substantial degree of finality with respect to the terms of a confirmed plan, stating that these terms "bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan." This provision has led the courts to deny postconfirmation objections by creditors to the treatment of their claims. *See In re Chappell*, 984 F.2d 775, 782 (7th Cir. 1993) (holding that secured creditor not entitled to interest on claim when interest not provided for by the plan; "the failure to raise an 'objection at the confirmation hearing or to appeal from the order of confirmation should preclude . . . attack on the plan or any provision therein as illegal in a subsequent proceeding,'" quoting *In re Gregory*, 705 F.2d 1118, 1121 (9th Cir. 1983), and collecting authorities); *In re Arkell*, 165 B.R. 432, 434 (Bankr.M.D.Tenn. 1994). Debtors have relied on this rule in arguing that a plan provision which sets the value of a secured claim is binding unless objected to.

This argument has received mixed success in the courts, apparently depending on the degree of notice given to the secured creditor. *In re Howard*, 972 F.2d 639, 641 (5th Cir. 1992) holds that "the general applicability of *res judicata* as to bankruptcy plan confirmations must give way . . . to the interest of the secured creditor . . . in being confident that its lien is secure unless a party in interest objects to it." *Howard* thus requires the debtor to file a claim objection in order "to challenge the amount of a secured claim either by asserting a counterclaim or offset against it or by disputing the amount or validity of the lien." 972 F.2d at 642. The decision distinguishes changes in the terms of payment from challenges to the amount of the lien, and thus would enforce a plan provision that a secured claim be fully satisfied by return of certain property, as was the situation in *In re Pence*, 905 F.2d 1107 (7th Cir. 1990), a decision favorably cited in *Howard*. *Id.*

In re Linkous, 990 F.2d 160, 163 (4th Cir. 1993), takes a position more favorable to the debtor, allowing a plan to determine the value of a secured claim under § 506(a) as long as the notice of confirmation hearing informs the creditor that such a valuation will take place at confirmation: "A debtor should inform the *secured* creditor of an intent to reclassify its claim into partially secured and partially unsecured status." Other relevant decisions are collected in *In re Duke*, 153 B.R. 913, 917 (Bankr.N.D.Ala. 1993) (holding that an objection to a secured claim cannot be reconsidered after confirmation) and *In re Basham*, 167 B.R. 903, 908 (Bankr. W.D.Mo. 1994) (adopting the "middle-of-the-road" approach of *Linkous*).

) The appropriate interest rate for cram down.

The dispute as to interest rates parallels the valuation disputes, and is complicated by the fact that each of several methods of assessing a proper interest rate purport to be determining "market rate."[18] Several courts have agreed with debtors that present value under § 1325(a)(5)(B) is provided to a secured creditor by paying an interest rate equivalent to what the creditor would have to pay to borrow money—the "cost of funds" approach. The theory here is that, absent bankruptcy, the creditor would foreclose and obtain the value of the collateral. Borrowing an amount equal to the value of the collateral would put the creditor in this same position. All that is then required is that debtor pay interest equivalent to that charged on the creditor's loan, and the creditor is made whole. Thus, *In re Hudock*, 124 B.R. 532, 534 (Bankr.N.D.Ill. 1991) found that interest on the value of an automobile retained by a Chapter 13 debtor should be paid at the prime rate, since this best approximates "the rate at which [the secured creditor] borrows the money it then uses to make loans to consumers." *Accord In re Jordan*, 130 B.R. 185, 190 (Bankr. D.N.J. 1991). More recently, the Second Circuit adopted the cost of funds approach in *In re Valenti*, 105 F.3d 55, 63-64 (2nd Cir. 1997) (interest rate should be that of a treasury instrument with a maturity equivalent to the duration of the payout under debtor's plan).

An opposing point of view (adopted by the majority of circuit court opinions) emphasizes that creditors may not be able to borrow the funds lost to them through inability to foreclose; this approach therefore requires that the creditor be paid the profit that would have been obtained had the

[18] *See In re Hardzog*, 901 F.2d 858, 859 (10th Cir. 1990), quoting 5 *Collier on Bankruptcy* § 1225.03 at 1225-21 (1989) ("While the cases considering the issue are fairly uniform in agreeing that a market of interest is appropriate, the cases differ drastically in their interpretation of how a 'market' rate is to be determined.").

creditor been able to make a new loan in the amount of the collateral value of the property retained by the debtor. This "rate of return" approach was applied in *United Carolina Bank v. Hall*, 993 F.2d 1126, 1130 (4th Cir. 1993):

> When it is recognized that every secured creditor has a limited amount of credit on which to draw, then it follows that utilizing some of that borrowing capacity without providing the secured creditor with the usual return on its capital produces a loss for the secured creditor.
>
> * * *
>
> Therefore we conclude that it is fairer to treat the value of the collateral retained by the debtor under the "cram down" provision of Chapter 13 as a new loan and to match its rate of return to the secured creditor with that which the creditor would otherwise be able to obtain in its lending market.

The court in *Hall* did place two caveats on its approach: (1) that the relevant rate of return was what the secured creditor received, which might be less than what a borrower would pay (for example, if the creditor had to pay a fee to a third party for processing or administering the loan), and (2) that the interest rate should never exceed the contract rate, because this would cause an inequitable "windfall." 993 F.2d at 1131. This approach was also employed in *General Motors Acceptance Corp. v. Jones*, 999 F.2d 63, 67-70 (3d Cir. 1993); *In re Hardzog*, 901 F.2d 858, 860 (10th Cir. 1990) (dealing with cram down in the context of Chapter 12); and *In re Smithwick*, 121 F.3d 211, 213-14 (5th Cir.1997), *cert. denied, sub nom. Smithwick v. Green Tree Financial Servicing Corp.*, 118 S.Ct. 1516 (1998).

Still a third approach calculates the appropriate interest rate for cram down by adding a "risk factor" interest rate to some standard measure of "risk-free" lending.. *See, e.g., In re Carson*, 227 B.R. 719 (Bankr.S.D.Ind.1998) (applying the prime rate plus 1-1/2%); *In re Collins,* 167 B.R. 842 (Bankr.E.D.Tex. 1994) (treasury bond rate plus 2%); *United States v. Doud,* 869 F.2d 1144 (8th Cir. 1989) (Chapter 12).

Where courts allow short-term residential mortgages to be stripped down pursuant to § 1322(c)(2)—as discussed at Section IV.A.5.e., below—the same questions of the appropriate cramdown interest rate will arise in that context. *See In re Bagne*, 219 B.R. 272 (Bankr. E.D.Cal. 1998) (§1322(c)(2) allows cramdown of short-term mortgages at market interest); *In re Harko,* 211 B.R. 116 (2d Cir. BAP 1997) (holding that contract rate is only required for cure of arrearages; a market rate should apply to cramdown).

(0) The exception to cram down for homestead-only mortgages; *Nobleman v. American Savings Bank.*

The general permission given by § 1322(b)(2) to modify "the rights of holders of secured claims" is subject to an express exception for any "claim secured only by a security interest in real property that is the debtor's principal residence" (a "homestead-only mortgage"). For some time there was a substantial controversy over the impact of this exception. Several courts had held that the protection against modification provided by the exception applied only to the "allowed secured claims" that resulted after § 506(a) bifurcation. Under this interpretation, a Chapter 13 plan could provide that the terms of a homestead-only mortgage would be kept intact (*i.e.*. not modified), but that these mortgage terms would be applied to a new principal balance, reduced to reflect the value of the collateral. *In re Bellamy*, 962 F.2d 176 (2d Cir. 1992); *In re Hart*, 923 F.2d 1410 (10th Cir. 1991); *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123 (3d Cir. 1990); *In re Hougland*, 886 F.2d 1182 (9th Cir. 1989). This interpretation, however, was rejected by the Supreme Court in *Nobelman v. American Savings Bank*, 508 U.S. 1020, 113 S.Ct. 2106 (1993). In *Nobleman,* the court held that the prohibition against modification did not apply to "secured claims," but rather to the "rights" of the holders of secured claims. 113 S.Ct. at 2109-2110. The rights of a mortgagee, in turn, are defined by state law, and include "the right to repayment of the [original] principal in monthly installment over a fixed term at specified . . . rates of interest." 113 S.Ct. at 2110. The court finally held that the "claim secured only by a security interest in real property" most reasonably refers "to the lienholder's entire claim, including both the secured and unsecured components of the claim." 113 S.Ct. at 2111. The effect of the court's ruling then is to protect from modification the claim of a homestead-only mortgage before that claim is bifurcated under § 506(a).[19]

The anti-modification provision of § 1322(b)(2) applies only to claims secured by a "security interest," which the Code defines as a "lien created by an agreement" (§ 101(51)). Thus, the anti-modification provision is inapplicable to judgment liens. *In re McDonough*, 166 B.R. 9, 13 (Bankr.D.Mass. 1994).

(0) Exceptions to the exception: cram down of home mortgages despite *Nobleman*.

The *Nobleman* decision does not draw any distinction between first mortgages and junior mortgages, or between long term and short term mortgages. Nevertheless, there are several grounds on which Chapter 13 debtors have been able to cram down home mortgages, despite the *Nobleman* opinion. Most of these grounds stem from a very careful parsing of the language of the exception in § 1322(b)(2), which excludes from modification (and hence crammed down lien stripping) only "the rights of holders of secured claims . . . secured only by a security interest in real property that is the debtor's principal residence." Moreover, the 1994 Reform Act may have provided another exception to the *Nobleman* rule.

) Anti-modification clause inapplicable because the creditor is not the "holder of a secured claim."

[19]*In re Pruitte*, 157 B.R. 662, 665 (Bankr.E.D.Mo. 1993), equates "modification" with "impairment" under Chapter 11, and holds that unless "the legal, equitable, and contractual rights" to which the secured creditor is entitled are left unaltered, the creditor's rights have been modified. This holding appears to be entirely consistent with *Nobleman*.

The anti-modification clause of § 1322(b)(2) applies, by its terms, to "the rights of holders of secured claims." *Nobleman* itself can thus be read to exclude from the coverage of the clause any homestead-only mortgage that is not supported by equity. The *Nobleman* court stated at one point that the debtors "were correct in looking to § 506(a) . . . to determine the status of the bank's secured claim," but noted that even with the valuation of the homestead suggested by the debtors, the mortgagee would "still [be] the 'holder' of a 'secured claim'" because, despite the debtors' claimed depreciation, their home still had some value to support the claim. 113 S.Ct. 2110. In light of this observation, a number of courts have held that where there is *no* collateral value to support the creditor's claim, the creditor is not the "holder" of a "secured claim." *Johnson v. Asset Management Group, LLC*, 226 B.R. 364, 366 (D.Md.1998) (collecting authorities); *Lam v. Investors Thrift (In re Lam*, 211 B.R. 36 (9th Cir. BAP 1997); *In re Purdue*, 187 B.R. 188 (S.D.Ohio 1995); *Wright v. Commercial Credit Corp.*, 178 B.R. 703, 706-07 (E.D.Va. 1995). However, other decisions have pointed out that this conclusion appears to be inconsistent with other reasoning used in the *Nobleman* opinion, in that it requires a determination of secured status *after* application of § 506(a). *In re Tanner*, 223 B.R. 379 (Bankr.M.D.Fla.1998); *In re Lewandowski*, 219 B.R. 99 (Bankr.W.D.Pa.1998); *In re Shandrew*, 210 B.R. 829 (Bankr. E.D.Cal. 1997).

) Claim not secured "only" by real property that is the debtor's principal residence.

Another basis for avoiding the exception to cram down focuses on the fact that a home mortgage loan must be secured "only" by the security interest in the debtor's residence in order to be excepted. Thus, additional security for the loan will result in the secured claim being subject to cram down. *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123, 129 (3d Cir. 1990).[20] The question currently active in the courts is whether typical, "boilerplate" provisions of home mortgages, calling for assignment of rents, security interests in fixtures and equipment, rights to insurance proceeds, and so forth, give rise to such additional security. The results of recent opinions are mixed, but tend to find that the boilerplate does not create "additional security." *In re French*, 174 B.R. 1, 7 (Bankr.D.Mass. 1994) ("{T]he test should be whether or not the 'additional collateral' set forth in the subject mortgage is nothing more than an enhancement which is or can, by agreement of the parties, be made a component part of the real property or is of little or no independent value."); *In re Pruitte*, 157 B.R. 662, 664 (Bankr.E.D.Mo. 1993) (reasoning from legislative history that boilerplate in a mortgage should not give rise to a finding of additional security); *In re Ireland*, 137 B.R. 65, 70-71 (Bankr.M.D.Fla. 1992) (boilerplate language generally does not create additional security). A summary of the relevant cases is set forth in *In re Graham*, 144 B.R. 80, 82-83 (Bankr.N.D.Ind. 1992). More particularized discussions are included for the following types of "additional collateral":

[20]Creditors have occasionally released liens on other collateral so as to be secured only by a lien on the debtor's principal residence. If the release was effected prior to the filing of the bankruptcy, in good faith, the creditor will be accorded the benefit of the anti-modification provision of § 1322(b)(2), but postpetition releases have no such effect. *In re Amerson*, 143 B.R. 413, 416-417 (Bankr.S.D.Miss. 1992), applies this rule and collects the authorities. *Accord In re Boisvert*, 156 B.R. 357, 359 (Bankr.D.Mass. 1993).

a) Assignment of rents.

One decision holds that, at least in connection with rental property, an assignment of rents clause in a mortgage does provide additional security, removing the claim from the anti-modification provision of § 1322(b)(2). *In re Jackson*, 136 B.R. 797, 803 (Bankr.N.D.Ill. 1992). However, the majority of cases have reasoned that an assignment of rents is merely a part of the security interest that the creditor has in the debtor's real property, and hence is not additional security. *In re Cervelli*, 213 B.R. 900, 902-04 (Bankr. D.N.J. 1997); *In re Spano*, 161 B.R. 880, 884-90 (Bankr.D.Conn. 1993) (applying Connecticut law); *In re Lee*, 137 B.R. 285, 287 (Bankr.E.D.Wis. 1991) (collecting cases holding that an assignment of rents "does not create additional collateral distinct from that normally considered incidental to ownership of realty"). *In re Davis*, 989 F.2d 208, 213 n.1 (6th Cir. 1993), suggests that *Jackson* and *Lee* can be harmonized by focussing on the question of whether rental property was involved in the mortgage. A similar situation arose in *In re Hernandez*, 149 B.R. 441 (Bankr.E.D.Tex. 1993), where the court found that boilerplate language giving the creditor an interest in "oil, gas or mineral leases" provided no "additional security" in part because there were no such leases.

a) Fixtures.

It is commonly held that a clause in a mortgage extending the security interest of the creditor to "fixtures" does not create any security interest "in addition" to the creditor's interest in real estate because fixtures are considered part of the real estate. *In re Davis*, 989 F.2d 208, 212-13 (6th Cir. 1993) (collecting cases). On the other hand, where the mortgage proposes to give a security interest in items that cannot be considered fixtures, several Third Circuit decisions have found "additional security" so as to remove the mortgage from the anti-modification provision. *In re Johns*, 37 F.3d 1021 (3d Cir. 1994); *In re Hammond*, 27 F.3d 52 (3d Cir. 1994); *Sapos v. Provident Institution of Savings*, 967 F.2d 918, 920 (3d Cir. 1992) (wall-to-wall carpeting); *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123, 128-29 (3d Cir. 1990) (appliances, machinery, furniture and equipment); *In re Escue*, 184 B.R. 287, 291 (Bankr. M.D.Tenn. 1995) ("other property . . . to be used about the building"); *cf. In re Guilbert*, 176 B.R. 302, 307-08 (D.R.I. 1995) (additional security interest in personalty intended by parties, so that more than "boilerplate" language is involved). *But see In re Hirsch*, 166 B.R. 248, 254-55 (E.D.Pa. 1994) (finding no additional security interest conveyed by boilerplate language regarding "appliances, machinery, and furniture" where no such security interests were taken in fact).

a) Insurance.

In *In re Washington*, 967 F.2d 173 (5th Cir. 1992), the court surveyed recent decisions bearing on the question of whether credit life and disability insurance constituted additional security under § 1322(b)(2), and concluded that it generally did not, first, because the policies "are merely contingent interests—interests that are illusory until the occurrence of some triggering event"; second, because optional credit life and disability insurance have "become a standard accompaniment for mortgage loans" and hence to count the insurance as additional security would defeat the congressional purpose of protecting creditors; and third, because, unlike a security interest, the mortgagor can terminate the insurance at will, without the lender's approval. 967 F.2d at 175-76. *Accord In re Amerson*, 143 B.R. 413 (Bankr.S.D.Miss. 1992).[21] With ordinary hazard insurance, there is even less likelihood that additional security will be found, because the insurance is necessary to protect the creditor's interest in the collateral itself. *In re Davis*, 989 F.2d 208, 210-212 (6th Cir. 1993); *In re Jackson*, 136 B.R. 797, 802 (Bankr.N.D.Ill. 1992); *In re Wright*, 128 B.R. 838, 844 (Bankr.N.D.Ga. 1991). However, language that "goes beyond the traditional right to use proceeds to pay off the obligation"—such as an assignment of unearned or returned premiums—may constitute additional security. *Davis*, 989 F.2d at 212 (reserving the issue "for another day"); *Jackson*, 136 B.R. at 802. *But see In re Surber*, 211 B.R. 17, 19 (Bankr. N.D. Ohio 1997) ("The boilerplate language included in the security agreement's cancellation of insurance provisions is insufficient to create a lien.").

a) Cross-collateralization.

Where a debtor with a home mortgage also has other secured loans with the same lender, there is a potential for "other security" to support the mortgage claim if any of the security agreements contain cross-collateralization or "dragnet" clauses. *In re Graham*, 144 B.R. 80, 84 (Bankr. N.D.Ind. 1992) holds that if these clauses are recognized by state law they do provide "additional security," even if that other security has no value, considering the lien that attaches to it, to support the mortgage loan.

) Claim not secured by real property that "is" the debtor's principal residence.

In re Glenn, 760 F.2d 1428 (6th Cir. 1985), *cert. denied sub nom. Miller v. First Fed.*, 474 U.S. 849 (1985), presents a variant on the argument that a claim is secured by something other than a mortgage on the debtor's principal residence. Here, the debtors argued that the anti-modification provision was inapplicable because their home was located on 50 acres of farmland. The court disposed of this argument on the ground that the debtors did not use the land for farming. 760 F.2d at 1441. A more general reason for rejecting the argument is that § 1322(b)(2) excludes from modification claims secured by a lien "in real property that is the debtor's principal residence," rather than "in real property that is principally the debtor's residence." Thus, the fact that the real property on which the debtor lives is used for some other purpose would not alter the application of the exclusion. *In re Guilbert*, 165 B.R. 88, 89 (Bankr.R.I. 1994), *rev'd on other grounds*, 176 B.R. 302 (D.R.I. 1995). *Cf. GMAC Mortgage Corp. v. Marenaro (In re Marenaro)*, 217 B.R. 358 (1st Cir. BAP 1998) (mortgage extending to lots contiguous to the lot on which the debtor's home was built was not excluded from the protection of § 1322(b)(2); potential for other use is irrelevant). Nevertheless, many cases have held that the phrase "real property that *is* the debtor's residence" was intended by Congress to exclude from the anti-modification provision any real property used for a purpose other than the debtor's residence, since otherwise the phrase would have been "real property that

[21] There is authority, however, to the effect that credit life insurance is additional security for a mortgage. *In re Selman*, 120 B.R. 576 (Bankr.D.N.M. 1990) (collecting authorities).

contains the debtor's residence. *Loman Mortgage, Inc. v. Louis*, 184 B.R. 630 (D.Mass. 1995); *In re Del Valle*, 186 B.R. 347 (Bankr.D.Conn. 1995); *In re McGregor*, 172 B.R. 718, 720-21 (Bankr.D.Mass. 1994)(collecting authorities); *In re Ramirez*, 62 B.R. 668, 670 (Bankr.S.D.Cal. 1986) (security interest extending to rental property on which the debtor resides is subject to modification). The legislative history of the 1994 Reform Act contains a favorable citation to *Ramirez.* 140 Cong. Rec. H10, 767 (daily ed. Oct. 4, 1994) (statement of Rep. Brooks).

) Claim not secured by an "enabling" mortgage.

A particular problem for Chapter 13 debtors are short term, non-purchase money, "home equity" loans. These loans, secured by junior mortgages, often carry very high rates of interest. Thus, debtors would like to be able to cram them down to a lower interest on whatever collateral value secures the creditors' claims. Section 1322(b)(2)'s exclusion of home mortgages from cram down was designed to promote purchase money mortgages, the "enabling" home mortgages that encourage production of homes and home ownership. See *In re Glenn*, 760 F.2d 1428, 1434 (6th Cir.), *cert. denied*, 474 U.S. 849 (1985). Thus it has been argued that home equity loans, since they do not serve this end, should not be protected by the exclusion. *In re Shaffer*, 84 B.R. 63, 65-67 (Bankr.W.D.Va.), *aff'd in relevant part sub. nom. Capital Credit Plan of Tennessee, Inc. v. Shaffer*, 116 B.R. 60, 61-62 (W.D.Va. 1988). However, most decisions have read § 1322(b)(2) according to its terms, excluding from modification *any* claim secured only by a lien on the debtor's principal residence, including short term, high interest, home equity loans. *In re Davis*, 989 F.2d 208, 210, 213 (6th Cir. 1993) (collecting authorities holding that "the language of § 1322(b)(2) is clear and unambiguous on its face and does not permit the interpretation that the statute has application only to 'enabling' loans," and stating that an interest rate that it believes to be exorbitant "does not constitute a reason to remove [the lender] from the protection to which Congress has entitled it"); *In re French*, 174 B.R. 1, 4 (Bankr.D.Mass. 1994); *In re Boisvert*, 156 B.R. 357, 359 (Bankr.D.Mass. 1993). *Cf. In re Lumsden*, 112 B.R. 978, 979 (Bankr. W.D.Mo. 1990) (denying confirmation of a plan that proposed modification of a high interest second mortgage with the observation that "it sometimes becomes the unhappy lot of a Bankruptcy Judge to quit interpreting the law and start applying it").

) Short term mortgages: § 1322(c)(2).

As noted in the preceding paragraph, courts have generally rejected the notion that a home mortgage is subject to strip down simply because it was not a purchase money or "enabling" loan. Nevertheless, most "home equity" loans may be subject to strip down under § 1322(c)(2) of the Code. This provision, added by the 1994 Reform Act, deals with home mortgages that would otherwise be subject to the anti-modification clause of § 1322(b)(2), and states that if "the last payment on the original payment schedule . . . is due before the date on which the final payment under the plan is due," then "the plan may provide for the payment of the claim as modified pursuant to § 1325(a)(5)." Section 1325(a)(5), as noted above, is the provision that allows for lien stripping in Chapter 13, and the new section expressly permits its application "[n]otwithstanding subsection (b)(2) and applicable nonbankruptcy law." Since most home equity loans are short term, new § 1322(c)(2) has the effect of allowing them to be stripped down. Indeed, the reach of the new section is apparently even larger, applying to any mortgage that is due, by its original terms, before the end of a Chapter 13 plan (a maximum of five years under § 1322(d)). Thus, balloon mortgages would be within the new section's coverage, conventional mortgages near the end of their term, and even expired mortgages, since in all of these circumstances, the last payment on the original schedule for the loan would have come due prior to the last plan payment.[22]

This interpretation of §1322(c)(2) is persuasively advanced in *Eubanks v. First Union Mortgage Corp. (In re Eubanks)*, 219 B.R. 468 (6th Cir. BAP 1998), and has been accepted by most courts that have considered the issue, most recently *In re Reeves*, 221 B.R. 756 (Bankr.C.D.Ill. 1998). Nevertheless, the Fourth Circuit, in *Witt v. United Companies Lending Corp.*, 113 F.3d 508 (4th Cir. 1997), declined to apply what it acknowledged to be the most natural reading of § 1322(c)(2), instead holding that, in light of the policies underlying *Nobelman* and the inconclusive legislative history, § 1322(c)(2) should be interpreted only to affect the manner in which a mortgage was paid during a plan, and not the extent of the lien.

(0) The alternative to cram down: curing of default under § 1322(b)(5).

For those home mortgages that cannot be excepted from the anti-modification clause of § 1322(b)(2), as interpreted by *Nobleman*, the only option offered by the Code is the "curing of default," under § 1322(b)(5). As the Supreme Court pointed out in *Nobleman*, "[Section] 1322(b)(5) permits the debtor to cure prepetition defaults on a home mortgage by paying off arrearages over the life of the plan 'notwithstanding' the exception in § 1322(b)(2)." 113 S.Ct. at 2110. Actually, the operation of a "cure" under § 1322(b) is not this simple. First, § 1322(b)(5) does not allow *any* cure of a mortgage default. It requires cure of default within a "reasonable time," which may be less than the life of the plan. It requires that regular mortgage payments be maintained while the default is being cured. And it applies only to long-term mortgages (those whose final payment is due after the last plan payment). Second, § 1322(b)(5) is only one of two provisions for "cure" of default in Chapter 13. Section 1322(b)(3) states simply that a plan may "provide for the curing or waiving of *any* default" (emphasis added). With this statutory scheme, a number of questions have arisen regarding the "cure" of secured claims.

) Reasonable period of cure.

Nothing in the language of the Code assists a court in determining what a "reasonable time" would be for the cure of a default under § 1322(b)(5). Some courts have held that some time less than the term of the plan would be required. *See , e.g., In re Brooks*, 51 B.R. 741 (Bankr. S.D.Fla.

[22]For example, with an expired loan, it would be possible to modify the claim by paying its value over the term of the plan, with interest as determined by the court. *In re Sarkese*, 189 B.R. 531, 535 (M.D.Fla. 1995); *In re Lobue*, 189 B.R. 216, 219 (Bankr.S.D.Fla. 1995) (warning, however, that the court might not be willing to apply § 1322(c) "blindly" where unfairness to the secured creditor might result); *In re Chang*, 185 B.R. 50 (Bankr. N.D.Ill. 1995). *Contra*, *In re Haman*, 190 B.R. 358, 361 (Bankr. E.D.Mo. 1995) (holding that a mortgage which has matured prepetition may not be modified under new § 1322(c)(2)).

1985), in which the judge stated that ”[w]hile each case must be judged upon its merits, I have yet to see any case where it would be reasonable to permit a mortgagor without the lender’s consent to take over a year to cure a default.” Similarly, one court has adopted a rule that cures under § 1322(b)(5) should be effectuated within twelve months unless the debtor can make a showing that a longer period is reasonable. *In re Newton*, 161 B.R. 207, 211-12 (Bankr.D.Minn. 1993). However, most recent decisions reflect a trend toward allowing debtors as much time as they need, within the term of their plans, for the cure of arrearages. *In re Masterson*, 147 B.R. 295, 296-97 (Bankr.D.N.H. 1992) (approving a 56 month cure period); *In re Randolph*, 102 B.R. 902, 903-04 (Bankr.S.D.Ga. 1989) (approving a 35 month cure and stating that “[n]othing in the legislative history of § 1322(b)(5) suggests that the cure of the default is restricted to a time less than the period of the plan”). A thorough survey of the authorities is set forth in *In re Sidelinger*, 175 B.R. 115 (Bankr.D.Me. 1994) (finding that a 36 month cure is not per se unreasonable). Of course, the cure may not exceed the duration of the plan itself. *In re Sapos*, 967 F.2d 918, 928 (3d Cir. 1992); *In re Bellamy*, 962 F.2d 176, 185 (2d Cir. 1992).

) Cure of mortgages accelerated because of default.

Even though a homestead-only mortgage is subject to the anti-modification clause of § 1322(b)(2), the courts have uniformly held that a "cure" of the mortgage may involve its reinstatement, even though the mortgage was accelerated under its terms because of the debtor's default. The first circuit court decision to deal with this question was *In re Taddeo*, 685 F.2d 24 (2d Cir. 1982). Based on a reading of legislative history, *Taddeo* concluded that "[w]hen Congress empowered Chapter 13 debtors to 'cure defaults' . . . Congress intended to allow mortgagors to 'deaccelerate' their mortgage and reinstate its original payment schedule." 685 F.2d at 26. *Taddeo* was followed in *Grubbs v. Houston First American Savings Association*, 730 F.2d 236, 242 (5th Cir. 1984) (en banc) ("We believe *Taddeo* to be correctly decided."); *In re Clark*, 738 F.2d 869, 872, 874 (7th Cir. 1984) ("[T]he plain meaning of 'cure' . . . is to remedy or rectify the default and restore matters to the *status quo ante*." "[T]he power to 'cure' a default provided by § 1322(b)(5) permits a debtor to de-accelerate the payments under a note secured by a residential property mortgage."); *In re Terry*, 780 F.2d 894, 896 (11th Cir. 1985) ("[R]esidential mortgages that would otherwise permit the lender to declare the entire debt presently due, may be modified by the plan to cure the default and reinstate regular installment payments."); *In re Metz*, 820 F.2d 1495, 1499 (9th Cir. 1987) ("Congress intended the bankruptcy code to permit debtors to 'rescue the benefit of their respective bargains' and to reinstate 'the underlying expectations of the parties,'" quoting *In re Nelson*, 59 B.R. 417, 419 (9th Cir. BAP 1985).); *In re Roach*, 824 F.2d 1370, 1376-77 (3d Cir. 1987) ("[W]e construe § 1322(b)(5) to authorize post-acceleration cure of long-term home mortgages."); *In re Thompson*, 894 F.2d 1227, 1230 (10th Cir. 1990) (holding that accelerated mortgages can be cured until foreclosure sale). *Cf. Justice v. Valley National Bank,* 849 F.2d 1078, 1083-1086 (8th Cir. 1988) (Chapter 12 case, approving decisions allowing deacceleration of defaulted mortgages but holding that they are inapplicable after foreclosure sale).

) Cure of mortgages after judgment of foreclosure; new § 1322(c)(1).

Since a defaulted mortgaged can be cured even though it has been accelerated, the question arises at what point in a mortgage foreclosure this right is cut off. This question produced some conflict in judicial decisions, with most decisions outside of the Third Circuit holding that mortgage defaults could be cured until a foreclosure sale had taken place.[23] The 1994 Reform Act codifies the

[23]*See In re Hurt*, 158 B.R. 154, 156-58 (9th Cir. BAP 1993) (collecting authorities). Other significant decisions setting foreclosure sale as the cut-off include: *In re Glenn*, 760 F.2d 1428, 1435 (6th Cir. 1985) (basing its decision on pragmatic considerations); *In re Clark*, 738 F.2d 869, 871 (7th Cir. 1984) (reading applicable state law to preserve homeowners' interest in mortgaged property after judgment of foreclosure but before sale); *In re Tynan*, 773 F.2d 177, 178, 179 n.2 (7th Cir. 1985) (denying right to cure after foreclosure sale, based on state law); *Justice v. Valley National Bank,* 849 F.2d 1078, 1083-1086 (8th Cir. 1988) (denying right to cure after foreclosure sale in Chapter 12, based on state law considerations); *In re Thompson*, 894 F.2d 1227, 1230 (10th Cir. 1990) (holding that accelerated mortgages can be cured until foreclosure sale, based on an understanding of property of the estate and practical considerations). There are two exceptions to this set of holdings. First, *In re Roach*, 824 F.2d 1370, 1376-77 (3d Cir. 1987) and *First National Fidelity Corp. v. Perry*, 945 F.2d 61, 63, 65 (3d Cir. 1991), construing New Jersey law, found that, once a foreclosure judgment is entered, there is no contractual relationship left to cure. *Roach* was also applied within the Third Circuit to mortgages not governed by New Jersey law. *In re Epps*, 110 B.R. 691, 708-09 (E.D.Pa. 1990)

majority rule, by enacting a new § 1322(c)(1): "a default with respect to, or that gave rise to, a lien on the debtor's principal residence may be cured . . . until such residence is sold at a foreclosure sale that is conducted in accordance with state law." This new provision does not indicate at what point a residence is "sold" at a foreclosure sale, and sharp divisions have arisen in the case law about whether the "sale" referred to is defined by the provision itself, or whether state law on the finality of sales is incorporated. *See In re Jones*, 219 B.R. 1013 (Bankr. N.D.Ill. 1998) (discussing conflicting intra-district decisions and holding that a sale is complete for purposes of cure only after judicial confirmation under Illinois law); *In re Johnson*, 213 B.R. 134 (Bankr. W.D.Tenn. 1997) (discussing conflicting intra-district decisions and holding that a sale is complete for purposes of cure only upon execution of a deed under Tennessee law); *McCarn v. WyHy Fed. Credit Union*, 218 B.R. 154, 159-62 (10th Cir. BAP 1998) (holding that the "actual" auction sale is the federally-defined cut-off for cure under § 13322(c)(1) and collecting authorities). Similarly, it is not clear whether, in a jurisdiction that allowed cure after the conclusion of a foreclosure sale, the new provision would require a change, since the new text does not say that the default may *not* be cured *after* the residence is sold.

) Cure of short term mortgages.

Although the issue was once in some doubt, the cases are now in fairly clear agreement that short term mortgages can be cured under § 1322(b)(3).[24] However, because new § 1322(c)(2)— as

(foreclosure of mortgage to HUD, foreclosure governed by federal law). Second, *In re Ragsdale*, 155 B.R. 578, 585 (Bankr.N.D.Ala. 1993), after an exhaustive survey of the cases, held that a cure may be effectuated any time prior to the expiration of the debtors' right to redemption under state law, even though this is after a foreclosure sale.

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The problem arose from the complicated relationship between "modification" and "cure" in § 1322(b). Subsection (b)(2) allows modification of all claims except homestead-only mortgages; subsection (b)(3) allows "cure" of all claims; and subsection (b)(5) allows "cure" of long-term debt, "notwithstanding" the homestead-only exception. There must be surplusage somewhere here. It may be that curing a default is simply one way of "modifying" a claim. If this is true, then subsection (b)(3) is surplusage, conveying a power that was already accorded by subsection (b)(2). Otherwise — if curing a default is not a kind of modification — then the "notwithstanding" clause of subsection (b)(5) is surplusage, since the anti-modification provision of subsection (b)(2) would not have prohibited the cure of default in any event. At first, it appeared that the courts would split on this question, with one circuit court reading the anti-modification provision of subsection (b)(2) to prohibit all cures of homestead-only mortgages except those covered by subsection (b)(5). *Grubbs v. Houston First American Savings Association*, 718 F.2d 694, 696-97 (1983), *rev'd on reh'g en banc*, 730 F.2d 236, 238 (5th Cir. 1984) (Section 1322(b)(3) is not applicable to homestead-only mortgages, and "[t]he only situation in which the rights of a holder of a claim secured by an interest in real property that is the debtor's principal residence may be modified is one which satisfies § 1322(b)(5)."). However, the *Grubbs* panel decision was reversed by the 5th Circuit in en banc rehearing, and now, all of the courts of appeal that have addressed the question have agreed that any claim—even short-term homestead-only mortgages—can be cured. *In re Taddeo*, 685 F.2d 24, 27 (2d Cir. 1982) ("[W]e believe that the power to 'cure any default' granted in § 1322(b)(3) and (b)(5) is not limited by the ban against 'modifying' home mortgages in § 1322(b)(2) because we do not read 'curing defaults and maintaining payments' under (b)(5) to be *modifications* of claims."); *Grubbs v. Houston First American Savings Association*, 730 F.2d 236 (5th Cir. 1984) (en banc); *In re Clark*, 738 F.2d 869, 872 ("[I]t is clear that Congress intended 'cure' to mean something different from 'modify'' otherwise, interpreted by courts other than the Fourth Circuit—allows modification of short term mortgages, this question will likely no longer be relevant: in a situation where a cure would previously have been required, the debtor will now be able to stretch out payments on the allowed amount of the secured claim over the term of the plan.

) Cure of mortgages expired under their original payment schedules.

Another issue that troubled the courts for some time was whether a homestead-only mortgage could be "cured" if it had expired, by its terms, prior to the filing of the bankruptcy. Most, but not all courts, had held that this was a prohibited modification.[25] Under § 1322(c)(2), as interpreted by most courts, this issue is also moot. The last payment on an expired mortgage will have come due prior to the last payment due under the plan, and so modification is now expressly allowed. A fully matured mortgage may thus be stripped to value of the collateral that supports it, and may be paid at an appropriate interest rate over the term of the plan, pursuant to § 1325(a)(5). *Contra, In re Haman*, 190 B.R. 358, 361 (Bankr. E.D.Mo. 1995) (holding that a mortgage which has matured prepetition may not be modified under new § 1322(c)(2), but may be cured under § 1322(c)(1)).

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in light of (b)(2), (b)(3) would be superfluous."); *In re Roach*, 824 F.2d 1370, 1376 (3d Cir. 1987); *cf. In re Entz-White Lumber & Supply, Inc.*, 850 F.2d 1338, 1341-42 (9th Cir. 1988) (in Chapter 11 context, "cure" of a default does not "impair" a creditor's claim). *But see In re Baxter*, 155 B.R. 285, 287 (Bankr.D.Mass. 1993) ("Although the language of § 1322(b)(3) authorizes a debtor to cure a default on a secured claim by repayment under a Chapter 13 plan, this right is qualified by §§ 1322(b)(2) and (5).")

[25] The majority position was first set out in *In re Seidel*, 752 F.2d 1382, 1386 (9th Cir. 1985), which refused to allow a Chapter 13 debtor to pay through a plan the amount in default on a mortgage that had "naturally matured, without acceleration, prior to the filing of the Chapter 13 petition" (emphasis omitted). The court reasoned that "modification" means "'the alteration . . . of [any] provisions of the secured creditors' contract,'" 752 F.2d at 1384 (quoting Bankruptcy Laws Commissions's Report, H.R.Doc. No. 137, pt. 2, 93rd Cong., 1st Sess. 205 (1973)), and thus, "by postponing payment of the debt beyond the time originally contemplated by the parties to the contract, [debtor's] plan clearly amounts to a unilateral 'modification' of the original debt contract." *Id.* The result of *Seidel* has been reached in numerous bankruptcy court decisions. *In re Leach*, 171 B.R. 58, 60 (W.D.Ark. 1994); *In re Pruitte*, 157 B.R. 662, 665 (Bankr.E.D.Mo. 1993); *In re Manocchia*, 157 B.R. 45 (Bankr.D.R.I. 1993); *In re Baxter*, 155 B.R. 285, 287-88 (Bankr.D.Mass. 1993). Similarly, in cases in which a note matured during the term of a plan, the courts have required that any cure pursuant to § 1322(b)(3) provide that the note be paid in full prior to the maturity. *In re Rubottom*, 134 B.R. 641, 644-45 (Bankr. 9th Cir. 1991); *In re Harris*, 147 B.R. 17, 19 (Bankr.N.D.Ohio 1992). There is a minority position, however, reflected in *In re East*, 172 B.R. 861, 866-67 (Bankr.S.D.Tex. 1994), and *In re Dixon*, 151 B.R. 388 (Bankr.S.D.Miss. 1993). These decisions draw on *Grubbs v. Houston First American Savings Association*, 730 F.2d 236, 237 (5th Cir. 1984) (en banc), which allowed the cure of a mortgage that had been accelerated prepetition. Although it is unclear whether the mortgage would have matured by its terms prior to the completion of the debtor's plan, see 730 F.2d at 237, the language used by the court appears to contemplate cure of a default *after* maturity of the loan: "Section 1322(b) . . . evinces no legislative intent that a home-mortgagor debtor is barred . . . from proposing (in his Chapter 13 plan for consideration by the bankruptcy court) that all past due *or matured amounts* secured by his home mortgage be paid during the term of the plan."

) Interest on arrearages: *Rake v. Wade* and § 1322(e).

Another issue that arose in connection with the application of § 1322(b)(5) was resolved first by the Supreme Court and then by the 1994 Reform Act. Section 506(b) of the Code, as interpreted by the Supreme Court in *United States v. Ron Pair Enterprises, Inc.,* 489 U.S. 235, 109 S.Ct. 1026 (1989), generally requires the payment of interest on oversecured claims. Several courts of appeals had held this requirement inapplicable to mortgage arrearages being cured pursuant to § 1322(b)(5). Thus, if the mortgage documents or applicable nonbankruptcy law did not provide for the payment of interest on arrearages, the courts would not require the Chapter 13 debtor to pay such interest. *In re Laguna,* 944 F.2d 542 (9th Cir. 1991), *cert. denied*, 112 S.Ct. 1577 (1992); *Landmark Financial Services v. Hall,* 918 F.2d 1150 (4th Cir. 1990); *In re Capps*, 836 F.2d 773 (3d Cir. 1987); *In re Terry,* 780 F.2d 894 (11th Cir. 1985). In *Rake v. Wade,* 113 S.Ct. 2187 (1993), the Supreme Court ruled to the contrary, holding that the requirement of interest payment was fully applicable to arrearages on oversecured mortgages being cured under § 1322(b)(5), and presumably under § 1322(b)(3), both before and after confirmation.[26]

Rake, however, has been statutorily overruled by the 1994 Reform Act. Section 1322(e) provides that notwithstanding § 506(b), "the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law." Thus, even with oversecured homestead only mortgages, there will again be interest payable on arrearages only to the extent that the loan documents, and nonbankruptcy law provide. The only caveat is that § 1322(e) is applicable only to agreements entered into after October 22, 1994, the date of its enactment. Thus, *Rake* will continue to apply to Chapter 13 cases until these new agreements go into default, as noted in *In re Hardware,* 189 B.R. 273, 276 n.3 (Bankr.E.D.N.Y. 1995).

0. Unsecured Claims.

The treatment of unsecured claims in Chapter 13 can be understood by looking at the same three steps of allowance, prioritization/payment, and discharge that are involved in Chapter 7. There are, however, very significant differences in the way Chapter 13 operates.

[26]Rake raises the question of the appropriate interest rate to be applied to the arrearages, a question similar to determining the interest rate necessary for cramdown. *See In re Callahan,* 158 B.R. 898 (Bankr.W.D.N.Y. 1993), in which the court held that the appropriate interest rate would be the state judgment rate. Another issue that has been raised under *Rake* is the question of whether interest must be paid on arrearages when the mortgage is undersecured. *In re Morgan*, 225 B.R. 309 (Bankr.E.D.Pa. 1998), collects the conflicting authorities and holds that interest is not payable on undersecured mortgages.

(0) Allowance.

) Prepetition claims; the impact of late-filing.

a) Background.

The Code sections and rules that bear on allowance of claims in Chapter 7 apply in the same way to Chapter 13: filing of claims is governed by § 501, allowance is governed by § 502, and filing deadlines are set out by Rules 3002 (for creditors), 3004 (for the debtor or trustee), and 3005 (for codebtors). In Chapter 13, as in Chapter 7, the most significant unresolved issue regarding claim allowance had been whether claims filed after the deadlines established by the rules are disallowed. Numerous bankruptcy court decisions sharply divided on this issue, with two "en banc" bankruptcy decisions taking opposite positions. The 1994 Reform Act, by making late-filing a statutory ground for disallowance in § 502(b)(9), largely eliminates the confusion. However, to understand the way the new provision operates, it is helpful to review the basis of the judicial disagreement.

In re Hausladen, 146 B.R. 557 (Bankr.D.Minn. 1992), was the leading case for the rule that late filing does not result in disallowance. The decision, rendered en banc by the bankruptcy judges of Minnesota, made three major points: first, § 501 does not impose any time limits for filing claims, and its legislative history states that the rules will determine whether claims are timely or tardily filed. 146 B.R. at 559. Second, prior to the 1994 amendments, § 502 set out eight specific grounds for disallowance of claims filed under § 501, none of which included late filing, and § 502 directed the court to allow any claim to the extent that these specific grounds were inapplicable. 146 B.R. at 559-60. Third, § 726, which governs distribution in Chapter 7, provided for payment of allowed claims that are tardily filed, indicating that "while treatment of a claim may be dependent on its timeliness, allowance is not." 146 B.R. at 560. Grounded in these considerations, the decision held that to the extent Rule 3002 is inconsistent with the allowance of late-filed claims, the rule "must fall," 146 B.R. 560 n.5, and that the rights of tardily filing claim holders "are not defined by the Code but rather are controlled by the Chapter 13 plan," which could contain any provision not inconsistent with the Code under § 1322(b)(10). 146 B.R. at 560. The judges went on to illustrate possible plan provisions:

> The plan may treat [late-filed] claims in several different ways. The plan may provide that tardily filed claims be paid after timely filed claims are paid in full or for no payment at all. The plan may provide identical treatment for all allowed unsecured claims, regardless of timeliness or for payment at a different percentage than timely filed claims.

The leading case for the rule that late filing did result in disallowance was *In re Zimmerman*, 156 B.R. 192 (Bankr.W.D.Mich. 1993), another en banc decision. *Zimmerman* did not dispute *Hausladen's* observation that § 502(b) of the Code excluded late filing as a ground for disallowance. However, *Zimmerman* contended that "[t]he merits of a claim will be analyzed under § 502 only if the claim meets § 501's requirements," and that timeliness of filing is a "procedural requirement" contemplated by § 501. 156 B.R. at 195. In this context, *Zimmerman* viewed the disallowance of claims imposed by Rule 3002 merely as a procedural penalty, rather than the substantive disallowance set forth by § 502(b). 156 B.R. at 192. "[T]he effect of Fed.R.Bankr.P. 3002 is to prevent the claim from moving forward in the process toward treatment under § 502."

a) Section 502(b)(9); the need for objection.

New § 502(b)(9) resolved this conflict over late-filed claims by reaching the result of *Zimmerman* (late-filed claims disallowed) using the reasoning of *Hausladen* (disallowance must be based on a ground enumerated in § 502(b)). Thus, the amendment rejects the *Zimmerman* position that a requirement of timeliness is inherent in § 501. Late-filed claims are still claims, and will be allowed unless an objection is filed under § 502(b)(9). On the other hand, with a claim objection, any unsecured claim, priority or general unsecured, may be disallowed on the ground of late-filing.[27]

a) Claims filed late because of a lack of notice.

Nothing in new § 502(b)(9) creates an exception to disallowance for claims filed late because the creditor did not receive notice of the bankruptcy in time to permit timely filing. This creates a potential problem of due process. Most claims that are disallowed under § 502(b) are discharged under § 1328(a) and (c). Thus, a creditor who was not given notice might be denied the opportunity of being paid under the plan, and then have the claim discharged when the plan was completed. Even courts that, prior to the new law, disallowed late claims found it necessary to grant allowance of claims late-filed without notice. *See In re Cole*, 146 B.R. 837, 840-41 (D.Colo. 1992) (relying on due process concerns to allow a late filed IRS claim). Courts faced with an objection to a claim filed late because of a lack of notice should create an exception to § 502(b)(9) based on due process, either allowing the claim, or holding that it is simply not provided for by the plan (hence excepting the claim from discharge under § 1328(a) and (c)). *In re Gardenshire*, 220 B.R. 376 (9th Cir. BAP 1998), accomplished this result by use of a "tolling doctrine," allowing a trial court considerable discretion to extend retroactively the filing deadlines imposed by the bankruptcy rules.

[27]It should be noted, however, that claims of governmental units are given an extended filing time by § 502(b)(9): 180 days after the date of the order for relief.

a) Amendments to timely filed claims.

With untimeliness an explicit ground for disallowance, a creditor who files late may argue that the late-filed claim should be considered an amendment to a claim that was timely filed. Courts have sometimes accepted such arguments, even where the late-filed claim would not have been allowed as an amendment under Fed.R.Civ.P.15. *In re Unroe*, 937 F.2d 346 (7th Cir. 1991); *In re Barton*, 151 B.R. 110, 115-16 (Bankr.W.D.Mich. 1993). To determine when to allow the late-filed claim as an amendment these courts have employed a multifactor test announced in *In re Miss Glamour Coat Co.*, 80-2 U.S.T.C. (CCH) ¶ 9737, 1980 WL 1668 (S.D.N.Y. 1980).

) Postpetition claims.

Section 1305 permits certain creditors to have their postpetition claims allowed against the debtor's estate and, thereby, provided for in the debtor's Chapter 13 plan. However, three preconditions must be met in order for such postpetition claims to be allowed:

• A proof of claim must be filed *by the creditor* ("an entity that holds a claim against the debtor") for the postpetition claim.

• The claim must be for: (1) taxes owed to a governmental unit that became payable during the pendency of the Chapter 13 case; or (2) a consumer debt that arose after the date of the order for relief under Chapter 13 and is for property or services necessary for the debtor's performance under the plan.

• The debtor must show that the Chapter 13 trustee approved of the postpetition indebtedness before it was incurred by the debtor, or alternatively that such approval was impractical.

In re Sorge, 149 B.R. 197, 203-04 (Bankr.W.D.Okla. 1993); *In re Trentham*, 145 B.R. 564, 566-69 (Bankr.E.D.Tenn. 1992); *In re Goodman*, 136 B.R. 167, 169-71 (Bankr.W.D.Tenn. 1992); *In re Benson*, 116 B.R. 606, 607-09 (Bankr.S.D. Ohio 1990).[28]

If a valid postpetition claim is not permitted to be paid through a Chapter 13 plan (because, for example, it is not for necessary property or services), the claim plainly is not discharged under § 1328. See Section IV.B.3.c., below. One court has held further that the creditor holding such a postpetition claim is not prevented by the automatic stay from enforcing the claim against wages of the debtor not needed to fund the plan. *In re Leavell*, 190 B.R. 536 (Bankr. E.D.Va. 1995), but this question is very much in controversy. *See In re Kolenda*, 212 B.R. 851, 853 (W.D.Mich. 1997) (finding a violation of the automatic stay under these circumstances and discussing the authorities).

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[28] Many postpetition tax claims and claims for "property or services necessary for the debtor's performance under the plan" might be "administrative expenses" under § 503(b)(1). In such situations, the creditors would be well advised to file administrative claims under that section (and so be entitled to full payment under § 1322(a)(2)), rather than postpetition claims under § 1305.

(0) Prioritization/payment.

There is no equivalent in Chapter 13 to § 726(a)—no single provision of the Code specifies the priority in which all unsecured creditors should be paid from the debtor's plan contributions. Instead, *the debtor's plan* fixes the priority of payments, within broad guidelines established by a number of sections of the Code. *See In re Gullatt*, 164 B.R. 279, 281 n.6 (Bankr. M.D.Tenn. 1994) ("The lack of an analog to § 726 in other chapters [of the Code] reflects that distributions under those chapters are governed by plans."); *rev'd on other grounds*, 169 B.R. 385 (M.D.Tenn. 1994). Perhaps most significantly, as with secured claims, nothing in the Code limits payments under Chapter 13 to unsecured creditors whose claims are allowed.[29] If only allowed claims are to receive payment (as would be the situation in Chapter 7), the plan should so provide. Of course, it would be foolish for an unsecured creditor to rely on the absence of such a provision as eliminating the need for filing a timely proof of claim. Moreover, as is the situation with secured claims, certain creditor protections in Chapter 13, discussed below, apply only to holders of "allowed" unsecured claims.

) Priority claims, including family support claims.

Chapter 13, like Chapter 7, was affected by the new priority under the 1994 Reform Act for "claims for debts to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, codified as new § 507(a)(8). However, the treatment of priority claims under the two chapters is quite different. In Chapter 7, all priority claims are paid before general unsecured claims, pursuant to § 726(a)(1). In contrast, the relevant provisions of Chapter 13 require no such priority; the only requirement is that priority claims be paid in full, not that they be paid first.

a) Priority claims in general.

Section 1322(a)(2) requires that a Chapter 13 plan "provide for the full payment, in deferred cash payments" of all priority claims, unless the holder agrees to different treatment. *In re Ferguson*, 134 B.R. 689, 696 (Bankr.S.D.Fla. 1991), an en banc decision, holds that the deferred payments required by § 1322(a)(2) are not required to be equal monthly payments over the life of the plan, but "may be paid in periodic intervals over the life of the plan as determined by the individual debtor." *Ferguson* presents a thorough analysis, and has not been questioned. *See In re Volle Elec., Inc.*, 139 B.R. 451 (C.D.Ill. 1992) (following *Ferguson* in Chapter 11 context). Thus, a Chapter 13 plan may provide for payments on a priority tax claim, or family support arrearage, to commence after the cure of mortgage arrearages. This could be a substantial benefit to debtors, since postpetition interest might have to be paid on mortgage arrears if the mortgage is oversecured, pursuant to *Rake v. Wade*, 113 S.Ct. 2187 (1993), but postpetition interest need not be paid on priority claims, *In re Hageman*, 108 B.R. 1016, 1018 (Bankr.N.D.Iowa 1989).

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[29] However, Fed.R.Bank.P. 3021 does state that "[a]fter confirmation of a plan, distribution shall be made to creditors whose claims have been allowed . . . ."

The courts appear to be in disagreement about how to treat Chapter 13 plans that do not provide for full payment of priority claims in the absence of an objection from the affected creditor. The failure to object might be construed as an agreement to less than full payment, as in *In re Hebert*, 61 B.R. 44, 46-47 (Bankr.W.D.La. 1986). However, *In re Northrup*, 141 B.R. 171 (N.D.Iowa 1991), holds that such an agreement must be express, so that the failure of a priority creditor to object does not render confirmable a plan that does not provide for full payment of a priority claim. *Northrup* also holds that if a plan providing for less than full payment of priority claims is confirmed (albeit erroneously) without express consent, the priority creditor will nevertheless be bound. "A creditor has a great incentive to object prior to confirmation of the plan in order to place the bankruptcy court on notice of any potential risk that the bankruptcy court will not discover the defect in the exercise of its independent review and will confirm the plan. In other words, failure to object prior to confirmation will operate as a waiver of the objection after confirmation." 141 B.R. at 173. This conclusion, however, was flatly rejected by the Seventh Circuit in *In re Escobedo,* 28 F.3d 34 (7th Cir. 1994), which holds that a plan providing for less than full payment of priority claims is void, so that it lacks res judicata effect on the priority claimant. *But see In re Ivory*, 70 F.3d 73, 75 (9th Cir. 1995) (even jurisdictional errors in confirmation order are res judicata). The *Escobedo* holding has been flatly rejected in at least two subsequent decisions, which continue to hold that the terms of a confirmed plan bind even the holder of a priority claim not given full payment. *Great Lakes Higher Education Corp. v. Pardee (In re Pardee),* 218 B.R. 916, 926 (9th Cir. BAP 1998); *In re Joseph*, 1998 WL 939694 (Bankr. E.D.Va. Nov 04, 1998). Finally, even without such a rule of invalidity, there is authority for the proposition that a court may revoke confimation of a Chapter 13 plan, on the ground that the debtor acted in bad faith, where the debtor attempts to discharge a priority claim without full payment or the express consent of the creditor. *In re Ekeke*, 133 B.R. 450 (S.D.Ill. 1991).

a) Administrative claims.

Section 1326(b) provides that "[b]efore or at the time of each payment to creditors under the plan, there shall be paid—(1) any unpaid claim of the kind specified in section 507(a)(1)." Section 507(a)(1) provides priority status for administrative claims. The most common administrative claims in Chapter 13 are the fees awarded to debtors' attorneys. The decisions applying this provision have again required no priority of payments— as long as administrative claimants are paid concurrently with other creditors, § 1326(b)(1) is complied with. *In re Palombo*, 144 B.R. 516, 519 (Bankr.D.Colo. 1992) (construing identical language in § 1226(b) to allow a Chapter 12 plan "to spread out payment of administrative claims, even over the life of the plan"); *In re Lanigan*, 101 B.R. 530, 532 (Bankr.N.D.Ill. 1986) (court orders fees for Chapter 13 debtors attorneys' paid in small monthly installments); *In re Parker*, 21 B.R. 692, 694 (E.D.Tenn. 1982).

) General unsecured claims.

Once a plan provides for full payment of priority claims (with the timing discretion described above), the remaining unsecured claims may be treated in a variety of ways.

a) Classification.

There is no requirement that claims be classified by a Chapter 13 plan; a plan may provide for claims to be paid generally, as was the situation under Chapter XIII of the Bankruptcy Act of 1898. Without classification, all unsecured claims are given the same treatment.[30] However, unlike Chapter XIII of the Act, Chapter 13 of the Code does *permit* a debtor to classify unsecured claims. Under § 1322(b)(1), the plan may designate either a single class or multiple classes of claims, as provided by § 1122. Section 1122, in turn, has two provisions, (a) that all the claims in a particular class must be substantially similar, and (b) that there can be a class of unsecured claims that are less than (or reduced to) an amount that the court approves as reasonable and necessary for administrative convenience. If a plan does classify unsecured claims, it must, under § 1322(a)(3) "provide the same treatment for each claim within a particular class."

a) Prioritization; unfair discrimination.

Although the claims in each class must be similar, and all claims in a class treated alike, there is no requirement that all similar claims be in the same class or that all classes be treated alike. *In re Chapman*, 146 B.R. 411, 417 (Bankr.N.D.Ill. 1992).[31] Thus, a plan may provide for its own scheme of priorities, establishing multiple classes of claims and treating the classes differently, subject only to the general requirement of § 1322(b)(1) that the plan "not discriminate unfairly against any class." *Chapman*, 146 B.R. at 417; *In re Leser*, 939 F.2d 669, 671-72 (8th.Cir. 1991). The Code does not define "unfair discrimination," and a substantial controversy has arisen over its meaning, as Chapter 13 debtors seek preferential classification of certain debts.[32]

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[30]*See In re Lawson*, 93 B.R. 979, 983 (Bankr.N.D.Ill. 1988): "Pursuant to Section 646(1) of the Bankruptcy Act, 11 U.S.C. § 1046(1), a Chapter XIII plan was required to 'include provisions dealing with unsecured debts generally.' This was interpreted to mean that '*all* unsecured debts must be dealt with, and they must be dealt with in the *same* way.' 9 Collier on Bankruptcy ¶ 28.02 (14th ed. 1974) (emphasis in original); *In re Bailey*, 188 F. Supp. 47, 49 (N.D.Ala. 1960); *In re Heger*, 180 F.Supp. 147, 148 (D.Minn. 1959)."

[31] In Chapter 11, the separate classification of similar claims can be seen as "gerrymandering" for purposes of creating an impaired class that approves the plan, as required for cram down under § 1129(a)(10) and (b)(1). This has led some courts to require that all "substantially similar claims"—i.e., "those which share common priority and rights against the debtor's estate"— should ordinarily be placed in the same class. *E.g., In re Greystone III Joint Venture*, 995 F.2d 1275, 1278 (5th Cir. 1991), *cert. denied sub nom. Greystone III Joint Venture v. Phoenix Mut. Life Ins. Co.*,, 113 S.Ct. 72 (1992); *contra In re ZRM-Oklahoma Partnership*, 156 B.R. 67, 70 (Bankr.W.D.Okla. 1993). This "gerrymandering" concern has no application in Chapter 13, and it appears not to have given rise to any cases denying the authority of the debtor to place claims of similar nature in different classes.

[32]However, at the very least, it would appear that debtors would be permitted to track the provisions of § 726 by subordinating noncompensatory penalties. *Cf. In re Virtual Network Services Corp.*, 902 F.2d 1246 (7th Cir. 1990) (approving equitable subordination of tax penalty in Chapter 11 case).

The test most commonly applied to measure the fairness of any difference in treatment of unsecured claims under a Chapter 13 plan has four parts, and was set forth in *Leser*, 939 F.2d at 672, as follows:

> Lacking more explicit direction from Congress, courts have developed a four-part test to determine whether a proposed separate classification of unsecured claims is fair by inquiring: (1) whether the discrimination has a reasonable basis; (2) whether the debtor can carry out a plan without the discrimination; (3) whether the discrimination is proposed in good faith; and (4) whether the degree of discrimination is directly related to the basis or rationale for the discrimination.

This test has been frequently criticized. *See In re Brown*, 152 B.R. 232, 235-37 (Bankr.N.D.Ill.) (collecting authorities), *rev'd on other grounds sub nom. McCullough v. Brown*, 162 B.R. 506 (N.D.Ill. 1993). The problems with the test are (1) that it does not identify what interests may properly be advanced by different treatment of claims, (2) that it does not specify whether a difference in treatment must be essential for carrying out the debtor's plan in order to be fair, and (3) it incorporates the separate requirement of good faith (§ 1325(a)(3)) into the test of fairness. These features make the test unpredictable in application.

Brown suggests that the test ought to be whether the proposed priority scheme of a Chapter 13 plan "rationally furthers an articulated, legitimate interest of the debtor." 152 B.R. at 238. *Accord, In re Willis*, 189 B.R. 203 (Bankr.N.D.Okla. 1995). This test focuses on the debtor's interest because the right to prioritize is given to the debtor, as part of the incentives encouraging use of Chapter 13, but limits the debtor's right to establish priorities by eliminating schemes that advance interests that are found improper—such as distinguishing among creditors on the basis of personal affection, or for purposes of obtaining larger amounts of postpetition credit. 152 B.R. at 239-40. On appeal, the district court rejected this test, 162 B.R. 511-16, and suggested that "there is much to be said for a position that the *only* perspective from which the unfairness of a proposed differential in treatment should be evaluated is that of the disfavored class or classes of unsecured claimants," 162 B.R. at 512. However, the district court did not state any test of its own, "cheerfully reject[ing] any temptation to formulate a universal standard." 162 B.R. at 516.

Yet another approach to unfair discrimination was applied in *In re Bird*, No. 94-01012,1994 WL 738644 (Bankr.D.Idaho Dec. 23, 1994), where the court analyzed all the prior case law to arrive at eight non-definitive factors, to be used on a "qualitative case-by-case basis."

The question of what constitutes "unfair discrimination" remains very unsettled. Depending on the test applied, the courts are likely to reach varying results as different types of priority schemes are proposed by debtors. Issues of the fairness of preferring landlords, medical professionals providing current treatment, creditors with cosigned debt, claims that could give rise to criminal conviction if not paid in full, are some of those on which courts have disagreed. However, the following areas illustrate the different approaches taken by the courts.

a) Particular unsecured claims.

a) Dischargeable claims in Chapter 13 that would be nondischargeable in Chapter 7.

Among the claims that may be discharged in Chapter 13, pursuant to § 1328(a), are claims for fraud, breach of fiduciary duty, and intentional and malicious injury. These claims include heinous criminal offenses. At one time, it appeared that a Chapter 13 debtor might be required to give preferential treatment to such claims. *In re Smith*, 848 F.2d 813 (7th Cir. 1988) reversed on good faith grounds the confirmation of a Chapter 13 plan that provided for payment of a fraud claim to the State of Indiana (nondischargeable in Chapter 7 under § 523(a)(2)), in part because the plan would have paid this claim on the same level of priority as other unsecured claims that did not involve fraud. The court commented that "[t]he appropriate solution may be to make the State into a separate class and to allow it a higher recovery." This suggestion has generally not been adopted. Instead of suggesting preferential classification, courts that have found that Chapter 13 debtors are paying too little on claims that would be dischargeable in Chapter 7 have simply denied confirmation, leaving the debtor with little prospect for relief in bankruptcy. *See, e.g., In re Carsrud*, 161 B.R. 246 (Bankr.D.S.D. 1993) (plan proposing to pay 2.4% on claim arising from rape of debtor's sister). On the contrary, where the courts have found a good faith effort to deal with creditors, even though some of the debt would be nondischargeable in Chapter 7, the plans have been confirmed despite the lack of preferential treatment for the nondischargeable debt. *See, e.g., In re Short*, 176 B.R. 886 (Bankr. S.D.Ind. 1995) (confirming plan of joint debtor convicted of criminal embezzlement; 24% paid to unsecured creditors). *See also In re Lawson*, 93 B.R. 979, 88-90 (Bankr.N.D.Ill. 1988) (denying confirmation of a plan that preferentially classified student loans at a time when such loans were dischargeable in Chapter 13); *In re Vent*, 188 B.R. 396 (Bankr.E.D.Ark. 1995) (enforcing confirmation order providing minuscule payment on intentional tort claim, where claimant did not object to confirmation) .

a) Nondischargeable claims in Chapter 13.

a) Student loans.

Under the Code as originally enacted, student loan debt was generally nondischargeable in Chapter 7 cases, but was fully dischargeable in Chapter 13. See § 523(a)(8). But in 1990, the Code was amended to provide that student loan claims are nondischargeable in Chapter 13 on the same basis as in Chapter 7. Since then, the courts have arrived at four somewhat conflicting positions regarding the treatment of student loan debt in Chapter 13.

By far the largest group of cases, illustrated by *In re Chapman*, 146 B.R. 411, 418 (Bankr. N.D.Ill. 1992), holds that no preferential treatment of student loans is permissible, arguing in part that this would effect an "equitable subordination" contrary to the principles developed under § 510(c). *Cf. In re Lackey,* 148 B.R. 626, 633 (Bankr.N.D.Ala. 1992) (citing *Chapman* in support of the proposition that "[t]he priority of payments established by Congress in the Bankruptcy Code must be followed"). The difficulty with this argument is that there are no priorities established for unsecured claims in Chapter 13, other than those established by the debtor's plan. Thus the debtor's plan does not change the priorities, it creates them. Equitable subordination would only be raised by a party other than the debtor to change the priorities established by the plan. Other recent cases generally prohibiting preferential treatment of student loan claims include: *In re Groves*, 39 F.3d 212 (8th Cir. 1994); *McCullough v. Brown*, 162 B.R. 506 (N.D.Ill. 1993); *In re Sperna*, 173 B.R. 654 (9th Cir.BAP 1994); *In re Eiland*, 170 B.R. 370 (Bankr.N.D.Ill. 1994); *In re Anderson*, 173 B.R. 226 (Bankr.D.Colo. 1993). *Cf. In re Ponce*, 218 B.R. 571, 575 (Bankr.E.D.Wash. 1998) (applying the *Chapman* rationale to criminal fines nondischargeable in Chapter 13).

A second group of cases, including most recently, *In re Chandler,* 210 B.R. 898, 903-04 (Bankr. D.N.H. 1997), holds that student loans may be paid preferentially, but only pursuant to § 1322(b)(5), *i.e.*, curing arrearages and maintaining current payments. By similar reasoning, § 1322(b)(3) could be used to cure a default on a debt that becomes due during the term of the plan. Thus, if the debtors have a large default on their student loans, they will be able to obtain a substantial preference over other creditors, but if their loan is current, and the regular payments small, the extent of the preference would be minimal. Other decisions employing this rationale include: *In re Cox*, 186 B.R. 744 (N.D.Fla. 1994); *In re Benner*, 156 B.R. 631 (Bankr.D.Minn. 1993); *In re Christophe*, 151 B.R. 475 (Bankr.N.D.Ill. 1993) (denying confirmation of plan, but noting § 1322(b)(5) as a permissible type of discrimination); *In re Saulter*, 133 B.R. 148, 149-50 (Bankr.W.D.Mo. 1991); *cf. In re Dodds*, 140 B.R. 542, 543-44 (Bankr.D.Mont. 1992) (approving a preference for student loans under § 1322(b)(5), but holding that it is not the only permissible preferential classification). However, this approach has also been rejected by at least one recent decision. *In re Coonce,* 213

B.R. 344, 348 (Bankr. S.D.Ill. 1997) (rejecting treatment of long-term student loans under §1322(b)(5) as an "end run" around the unfair discrimination test).

Third, some courts have recognized the debtor's interest in a fresh start as a sufficient rationale to allow preferential classification of student loans, just as with family support obligations. *In re Willis*, 189 B.R. 203 (Bankr.N.D.Okla. 1995); *In re Brown*, 152 B.R. 232, 241 (Bankr.N.D.Ill. 1993), *rev'd sub nom McCullough v. Brown*, 162 B.R. 506 (N.D.Ill. 1993); *In re Boggan*, 125 B.R. 533, 534 (Bankr.N.D.Ill. 1991); *cf. In re Husted*, 142 B.R. 72, 75 (Bankr. W.D.N.Y. 1992) (generally holding that preferential classification of nondischargeable Chapter 13 claims is permissible, holding applied to child support).

Finally, *Andersen v. Higher Education Assistance Foundation (In re Andersen)*, 215 B.R. 793, 796 (10th Cir. BAP 1998), enforces a plan provision stating that the balance of a student loan, unpaid after the completion of the plan, will be discharged as an undue hardship, pursuant to § 523(a)(8)(B); the court's ruling was based on the binding effect of confirmed plans under § 1327(a). The binding effect of plan confirmation has also been used to enforce a plan provision waiving interest on a student loan. *Great Lakes Highter Education Corp. V. Pardee (In re Pardee)*, 218 B.R. 916 (9th Cir. BAP 1998).

a) Family support.

a) Preferential classification.

Family support claims (alimony, maintenance, and child support) are excepted from discharge both in Chapter 7 (§ 523(a)(5)) and in Chapter 13 (by § 1328(a)(2), which incorporates the exceptions of § 523(a)(5)). However, unlike the student loans, preferential classification of support claims has been approved by most courts. *In re Leser*, 939 F.2d 669 (8th Cir. 1991); *In re Gonzales*, 172 B.R. 320, 327 (E.D.Wash. 1994); *In re Benner*, 146 B.R. 265 (Bankr.D.Mont. 1992); *In re Husted*, 142 B.R. 72 (Bankr.W.D.N.Y. 1992); *In re Harris*, 132 B.R. 166 (Bankr. S.D.Iowa 1989)(denying confirmation on good faith grounds); *In re Whittaker*, 113 B.R. 531 (Bankr. D.Minn. 1990); *In re Storberg*, 94 B.R. 144 (Bankr.D.Minn. 1988); *In re Davidson*, 72 B.R. 384 (Bankr.D.Colo. 1987)(denying confirmation on feasibility grounds). *Contra In re Warner*, 115 B.R. 233 (Bankr.C.D.Cal. 1989); *In re Lackey*, 148 B.R. 626, 631-32 (Bankr. N.D.Ala. 1992).

The principal reason given by these decisions for permitting a higher priority to be given family support claims is the debtor's interest in a fresh start. *E.g., Whittaker*, 113 B.R. at 534:

> Payment in full of the nondischargeable child support arrearage obligation is reasonably related to the Debtor's legitimate interest in not being burdened with a substantial debt at the completion of his Chapter 13 plan, and thus the different treatment of the child support arrearage claim does not discriminate unfairly against the nonpriority unsecured claims. . . .

Although these cases remain useful for understanding the approach of the courts to unfair discrimination, their practical importance was largely eliminated by the 1994 inclusion of family support claims as a priority in § 507(a)(7). As noted above, this provision not only allows but requires payment of support arrearages to spouses, former spouses, and children of Chapter 13 debtors. However, the priority does not apply to support arrearages payable to governmental agencies, even though such support obligations are nondischargeable under § 523(a)(5)(A). Thus, *In re Leser,* 939 F.2d 669 (8th Cir. 1991), which allows preferential classification of such support arrearages continues to have practical application.

b) Automatic stay.

The application of the automatic stay to family support claims in Chapter 13 has been clarified by a number of recent decisions. These decisions first make clear that there is a distinction between *current* support payments, due during the pendency of the Chapter 13 case, and *past due* support payments, the right to which arose prepetition. *In re Heflin*, 145 B.R. 560 (Bankr.S.D.Ohio 1992), dealt with current support payments, holding that the debtor's former wife technically violated the automatic stay by obtaining a deduction order against the debtor's current wages, but that the court would have granted relief from stay had it been sought. The court's rational was that "chapter 13 does not relieve chapter 13 debtors of their legal and moral obligations to provide current support to their children." 145 B.R. at 560. This ruling appears well grounded in the statute. As noted in *In re Brown*, 152 B.R. 232, 241 (Bankr.N.D.Ill. 1993), *rev'd on other grounds sub nom. McCullough v. Brown*, 162 B.R. 506 (N.D.Ill. 1993), "Current support payments are not governed by a Chapter 13 plan; the disposable income that is contributed to the plan is calculated by deducting all payments required for "maintenance or support of . . . a dependent of the debtor." 11 U.S.C. § 1325(b)(2). The need to support the current needs of the debtor's dependents can therefore quite reasonably be seen as "cause" to modify the automatic stay, pursuant to § 362(d)(1). However, an alternative to this result, which might well cause the plan to fail would be to amend the plan to reduce payments in light of the debtor's increased expenses, and to treat any postpetition support arrearage as a postpetition claim under § 1305.

Past due support payments, by contrast, are prepetition claims, and any doubt that the bankruptcy court may properly exercise jurisdiction over such claims should be completely eliminated by the inclusion of past due support as a priority payable in bankruptcy, in § 507(a)(7). Further support for bankruptcy treatment of support arrearages is found in *Ankenbrandt v. Richards,* 504 U.S. 689, 701-7, 112 S.Ct. 2206, 2214-16 (1992), which holds that federal courts should only abstain from hearing matters involving the issuance of a divorce, alimony, or child custody decree.[33] The enforcement of a support decree, previously issued by a state court, is therefore not within the domestic relations exception to federal jurisdiction. As prepetition claims, moreover, past due family support payments would be within the basic coverage of the automatic stay, which (among other applicable provisions) prohibits the commencement or continuation of any judicial or administrative action "to recover a claim against the debtor that arose before the commencement of the [bankruptcy] case." 11 U.S.C. § 362(a)(1).

Section 362(b)(2) creates an exception to the provisions of the automatic stay for "collection of alimony, maintenance, or support from property that is not property of the estate," and was amended by the 1994 Reform Act to also exclude from the stay proceedings to establish paternity and establish or modify support awards. In *In re Walter*, 153 B.R. 38, 40 (Bankr.N.D.Ohio 1993); and *In re Lackey*, 148 B.R. 626, 629 (Bankr.N.D.Ala. 1992), the courts found the exception from the stay for enforcement of support awards from non-estate property inapplicable in Chapter 13, because all of the debtor's property and postpetition earnings become property of the estate, under §§ 541 and 1306. *Lackey* notes that § 1327(b) provides that all property of the estate vests in the debtor at confirmation, but this provision is subject to contrary provisions in the plan or order of confirmation. 148 B.R. at 626. Thus, the result in *In re Engel*, 151 B.R. 542 (Bankr.D.Idaho 1993), which relied on § 1327(b) to except support enforcement actions from the automatic stay, could have been reversed by a plan providing that the property would not vest in the debtor until discharge.

In re Raboin, 135 B.R. 682 (Bankr.D.Kan. 1991) deals with both past due and current family support payments, and, consistent with the view of the law outlined above, denies relief from stay as to past due payments, while allowing current payments to be deducted from the debtor's wages pending confirmation.

a) Cosigned debts.

Under § 1322(b)(1), a debtor is expressly authorized to treat differently (*e.g.*, pay preferentially) a consumer debt for which another individual is liable. This situation would most often arise in the context of a cosigned note. *In re Chapman*, 146 B.R. 411, 416 (Bankr.N.D.Ill. 1992) ("[A] debtor can pay more to a consumer creditor who could look to any individual codebtor for payment, and may even unfairly discriminate in favor of such a creditor in order to protect the codebtor from being pressured by the creditor . . . .); *In re Dornon*, 103 B.R. 61, 64 (Bankr. N.D.N.Y. 1989). However, a majority of recent decisions have held that, despite the statutory permission, preferential payment of cosigned debt is still subject to the unfair discrimination test. *In re Jannsen*, 220 B.R. 639, 643-44 (Bankr. N.D.Iowa 1998) (applying the four-part test for unfair discrimination); *In re Gonzales*, 172 B.R. 320, 328-30 (E.D.Wash. 1994) (holding that the debtor must be the principal obligor in order to give preferential treatment to the cosigned debt); *In re Cheak*, 171 B.R. 55, 58 (Bankr.S.D.Ill. 1994); *In re Lewman*, 157 B.R. 134, 137 (Bankr. S.D.Ind. 1992) (interpreting the

[33] *Ankenbrandt* and § 507(a)(7) may thus be seen as removing the theoretical support for the major bankruptcy decision calling for such abstention, *Caswell v. Lang*, 757 F.2d 608 (4th Cir. 1985).

statutory language as "simply mean[ing] that separate classification and treatment on the sole basis of codebtor liability is not *per se* unfair discrimination" so that "[d]ebtors still bear the burden of showing that separate classification and treatment of unsecured claims does not unfairly discriminate").

a) Installment debt subject to cure.

Under §§ 1322(b)(3) and (5), the debtor may treat an *unsecured* debt for which periodic payments are due in the same way as secured debt: curing any default over a reasonable time, and maintaining current payments. *Cf. In re Delauder*, 1995 WL 726919 (Bankr.E.D.Va. 1995) (installment auto loan, unsecured portion paid according to contract terms). However, several decisions have rejected this approach in connection with long-term student loans, as discussed above in Section IV.B.2.b.(3).(b).i).

a) Postpetition claims.

Under § 1322(b)(6), the plan may provide for payment of "all or part of" any postpetition claim allowed under § 1305. This provision should allow preferential treatment of postpetition debt.

a) General limitations on treatment of claims.

No matter how a debtor's plan classifies general unsecured claims, four requirements limit the permissible payment provisions.

• Section 1322(d) provides that the plan may not call for payments to be made for a period in excess of three years unless the court, for cause, approves a longer period, but even then, the period for payments may not exceed five years.

• Section 1325(a)(4) imposes a "best interest of creditors test": the plan must provide for property to be distributed on account of each allowed unsecured claim that has a value, as of the effective date of the plan, "not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 . . . on such date." The application of this provision is explained and applied in *In re Dixon*, 140 B.R. 945 (Bankr.W.D.N.Y. 1992) (amounts that would be distributed in Chapter 7 liquidation are calculated with consideration of all costs of liquidation).

• Section 1325(b) provides that, if the trustee or the holder of an allowed unsecured claim objects, the plan must either pay the allowed unsecured claim(s) in full or provide that all of the debtor's disposable income for a three-year period "will be applied to make payments under the plan." *In re Cordes*, 147 B.R. 498, 502 (Bankr.D.Minn. 1992), explains this provision and applies it to a plan providing for debtor's retention of a recreational boat, holding that even payments for luxury items are "payments under the plan," and hence do not require denial of confirmation under §

1325(b). Section 1325(b)(2) has been substantially impacted, however, by the enactment of the Religious Liberty and Charitable Donation Protection Act of 1998, Pub. L. 105-183, which added new language to the section, excluding from disposable income "charitable contribution . . . in an amount not to exceed 15 percent of the gross income of the debtor for the year in which the contributions are made." This new language would appear to give Chapter 13 debtors an absolute right to make the defined contributions. However, in *In re Buxton*, 1999 WL 16255 (Bankr. W.D.La., Jan 13, 1999), the court held that any charitable contributions would still be required to satisfy the reasonableness requirement otherwise applicable to debtors' expenditures, and on that basis, declined to confirm a plan that called for debtors to make charitable contributions at a substantially higher level than they had done prior to their bankruptcy filing.

• Section 1325(a)(3) requires that all plans be "proposed in good faith and not by any means forbidden by law." Bankruptcy courts have been accorded broad discretion in applying this provision under a "totality of circumstances" or "fundamental fairness" test. *In re Love*, 957 F.2d 1350, 1357 (7th Cir. 1992), (acknowledging that "the standard of fundamental fairness does not provide a great deal of needed guidance"); *In re Cordes*, 147 B.R. 498, 503 (Bankr.D.Minn. 1992) (applying the "totality of circumstances" test to deny confirmation of a plan involving retention of an encumbered recreational boat).

) Payment

Contrary to the situation in Chapter 7, where it is assumed that the trustee must be responsible for all payments to creditors from the estate, it has been uniformly held that, in Chapter 13, the plan may provide for the debtor to serve as disbursing agent to certain secured creditors, usually mortgagees, and the court may confirm (or reject) such a payment scheme in its discretion. *In re Aberegg*, 961 F.2d 1307 (7th Cir. 1992); *In re Foster*, 670 F.2d 478, 487 (5th Cir. 1982); *In re Jutila*, 111 B.R. 621, 624-25 (W.D.Mich. 1989); *In re Burkhart*, 94 B.R. 724 (Bankr.N.D.Fla. 1988). This result follows from § 1326(c), which provides that the trustee shall make payments to creditors "[e]xcept as otherwise provided in the plan or in the order confirming the plan."

(0) Discharge.

) Generally.

In Chapter 7, as noted above, claims are discharged under § 727(b) (unless excepted by § 523(a)), if they arose prepetition. In Chapter 13, claims are discharged under section 1328(a) if they are "provided for by the plan or disallowed under section 502," and if the debtor completes all payments under the plan.[34] Instead of the full list of nondischargeable debts set forth in § 523, § 1328(a) excludes from discharge only five types of debt:

[34]Section 1328(a) provides that the discharge will not be granted if the court approves a written waiver of discharge executed by the debtor. In Chapter 7 cases, a debtor may execute a waiver of discharge to avoid litigation over an objection to discharge under § 727(a). In Chapter 13, there is no provision for an objection to discharge, and hence little apparent reason for a debtor to execute a waiver.

• long term debt treated under the “cure and maintenance” provisions of § 1322(b)(5);

• family support obligations, defined by § 523(a)(5);

• student loan debts defined by § 523(a)(8);

• death or personal injury debts due to driving while intoxicated, as defined by § 523(a)(9);

• restitution or a criminal fine included in a sentence on the debtor’s conviction of a crime.

Section 1328(b) provides for a hardship discharge to debtors who are not able to make complete all payments under the plan due to circumstances for which they should not be held accountable, but only if each allowed unsecured claim has been paid as much as it would have received in a Chapter 7 liquidation, and only if modification of the plan would not be practicable. The scope of the hardship discharge is restricted under § 1328(c) to exclude not only long term debt treated under § 1322(b)(5), but also all of the debts excepted from discharge under § 523(a). Again, the debts discharged are limited to those “provided for by the plan or disallowed under section 502.”

The language of § 1328 makes it clear that *any* discharge under Chapter 13 will apply only to debts “provided for” by the plan or disallowed under § 502. This situation is in contrast with § 727(b), which provides for a discharge of all prepetition debt. The case law has construed “provided for” fairly broadly, to require only that the plan “make a provision” for the claim involved, “i.e., deal with it or refer to it.” *In re Gregory*, 705 F.2d 1118, 1122 (9th Cir. 1983); *In re Tomlan*, 102 B.R. 790, 796 (E.D.Wash. 1989), *aff’d*, 907 F.2d 114 (9th Cir. 1990); *In re Leber*, 134 B.R. 911, 914-16 (Bankr.N.D.Ill. 1991); *In re Border*, 116 B.R. 588, 593-94 (Bankr.S.D.Ohio 1990).

) Claims for which proof is not filed.

In order for a full discharge to be effected, the plan should “make provision for” claims for which a proof of claim is never filed, since these claims will neither be allowed nor disallowed under § 502. It is fairly well accepted that a plan may specifically provide for no payment on a particular claim, and the claim will nevertheless be discharged, as long as the creditor had notice of the plan in time to object to the proposed treatment. Thus, *In re Gregory*, 705 F.2d 1118, 1122 (9th Cir. 1983), adopted the reasoning of the BAP decision it was reviewing that “there is a significant difference between a plan which does not acknowledge an unsecured claim and a plan which proposes to pay nothing on a claim. In the former case, the unsecured creditor has no ability to object, in a meaningful way, to confirmation of the debtor’s plan.” A closer case is presented by a plan that deals with a class of claims that would include claims of an unscheduled creditor. *In re Leber*, 134 B.R. 911, 915-16 (Bankr.N.D.Ill. 1991), holds that such claims are “provided for” if the creditor receives actual notice of the bankruptcy case.

Implicit in all of these cases is a determination that claims of creditors who do not receive notice of the case or have actual knowledge of it in time to file a timely claim are *not* discharged.

This result would be in conformity with the exception from discharge that would apply in Chapter 7 cases under § 523(a)(3)(B).

) Postpetition claims.

The one area in which courts are inclined to deny discharge on the ground that a claim is not provided for in a plan is in connection with postpetition debts. *See United States v. Wilson*, 1992 U.S. Dist. LEXIS 17319 at *16–*21 (D.Kan. 1992) (discussing a largely postpetition claim not treated by the plan because not acknowledged by the debtors). *Accord In re Sorge*, 149 B.R. 197, 203 (Bankr.W.D.Okla. 1993) ("Since a claim may not be allowed under § 502 unless a proof of the claim has been filed, a § 1305 claim as to which no claim has been filed may not be allowed and, under § 1322(b)(6), may not be provided for by the Chapter 13 plan or, under § 1328(a), discharged at the completion of payments under the plan.") However, a § 1305 claim that is *disallowed* under § 502 would be subject to discharge.