By Elizabeth L. Gunn[1]

With Notice Comes Responsibility

Direct Payments to Creditors Are Payments "Under the Plan" and Required for Debtor to Be Granted § 1328(a) Discharge

Chapter 13 provides debtors with many powerful remedies, and one of the most often utilized remedies is the right to cure and maintain payments on a secured (or unsecured) claim on which the last payment is due after the final date of the debtor's plan pursuant to § 1322(b)(5). In practice, the curing of a debtor's pre-petition mortgage arrears, without the incurrence of ongoing late fees, attorneys' fees or default interest, while protected from other collection efforts by the automatic stay, is one of the great benefits to a debtor utilizing chapter 13.

Unlike chapter 11 cases, in chapter 13, the debtor is the only party permitted to propose a plan, and unless they file a timely objection, creditors do not vote or otherwise have any ability to weigh in on the debtor's proposed terms. If the plan meets the requirements for confirmation found in § 1325, the plan becomes a new contract with creditors, binding such creditors for the duration of its term. If the debtor is able to complete the 36-60 month chapter 13 "marathon" and make all their payments under their plan, their reward for "crossing the finish line" is not a medal, but the so-called chapter 13 "super discharge." The chapter 13 trustee is required to maintain and monitor the debtor's payments into the estate during the case for those payments where the trustee serves as the disbursing agent. However, what happens where the debtor is also a disbursing agent?

In 1982, the Fifth Circuit Court of Appeals considered the question as to whether a chapter 13 debtor could pay its mortgage payments directly as the disbursing agent, as opposed to a chapter 13 trustee.[2] Thirty-six years later, the right of a debtor to propose a plan that includes direct payments is commonplace and/or taken for granted in most jurisdictions. Debtors are given, within the context of their jurisdiction's required plan format, the ability to propose the terms of their plan, including the treatment of various classes, and the option to serve as the disbursing agent on specific claims.[3] A debtor's ability to propose direct payments is a clear example that as the law evolves, so does the practice of chapter 13. Therefore, where the debtor is also a disbursing agent, completing all payments under a chapter 13 plan is not as simple as merely making all required payments to the chapter 13 trustee.

When the debtor acts as the disbursing agent, they are "opting out" of having the trustee disburse the funds (and having to pay the trustee's statutory commission on the same), but the payments are still set forth in and part of, the debtor's overall proposed plan. In other words, although the trustee is not involved with ongoing payments, the payments themselves are included in and are part of the entire scope of payments included in the plan. Therefore, to make all payments in the plan, the debtor must make not only the payments to the trustee, but also all direct payments for which it serves as disbursing agent.

Absent the completion of all payments, the debtor has not completed the terms of the "new contract" that he/she proposed to all of his/her creditors and that was confirmed by the bankruptcy court. A debtor who does not complete all payments has not completed all payments under the plan and is not entitled to a discharge, as set forth in § 1328(a).

The chapter 13 discharge is a significant privilege for a debtor who completes the Bankruptcy Code's requirements, specifically § 1328. Obtaining the discharge involves, in most cases, three to five years of fiscal responsibility by individuals who have previously had issues with this same practice. The vast majority of amounts to be paid to a chapter 13 trustee in plans are based on the analysis of the debtor's budget, as set out in Schedules I and J, which include line items for payments to be made directly to creditors under the plan.

Admittedly, many debtors have a shoestring budget, which can be difficult to maintain for years at a time, but is nevertheless what they are committing to pay under their plan in order to obtain the privilege of a discharge. If the debtors cannot maintain the budget, perhaps they really cannot afford to keep the property for which they are utilizing chapter 13 in an attempt to preserve. These are hard discussions that counsel needs to have

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1 The opinions expressed herein are provided as a result of the author's own experiences and not as a representative of the Attorney General or the Division of Child Support Enforcement, and some may have been adopted for the purposes of the debate in this Consumer Point/Counterpoint.

2 *See In re Foster*, 670 F.2d 478, 486 (5th Cir. 1982).

3 Many jurisdictions and trustees have adopted a default requirement for debtors to make all payments through the trustee, including ongoing mortgage payments. In these so-called "conduit payment" jurisdictions, debtors still have the opportunity to propose and seek confirmation of a plan that opts out of the default. Notably, the national form plan (Form 113) allows for outside-the-plan payments.

with debtors at the outset of a case, particularly in light of the requirement to pay all payments under the plan to obtain a discharge.

Notwithstanding the legal arguments as to the definition of "payments under the plan," there is a further equitable issue as to whether a debtor is proceeding in good faith when that debtor fails to pay thousands of dollars of direct payments to a lender, despite the fact that such payments were included in their budget for plan calculation and confirmation purposes. The question is this: If the money was not paid on the debt as provided for, where did the thousands of dollars go during the case?

In 2011, Rule 3002.1 became effective and required chapter 13 trustees to issue to secured creditors a notice of final cure payment in chapter 13 cases. This amendment was designed to help debtors by having a formal process to provide notice for the completion of cure payments and avoid the issues of misapplication of payment(s) or other issues with creditors whose arrears were cured within the chapter 13 plan. However, an unforeseen consequence of the requirement of the trustee's notice of the completion of cure payments is the reporting by secured creditors to the court, trustee and parties-in-interest of what previously may have been undisclosed post-petition payment defaults to direct-payment recipients.

While no court has imposed a duty on chapter 13 trustees to make independent inquiries to direct-pay creditors at the end of a case, at least one court has acknowledged that when a creditor responds to a notice of final cure with disclosure of a post-petition payment default, the chapter 13 trustee has a duty to address the payment default and, if necessary, bring the matter to the court in order to determine whether the debtor is eligible for discharge.[4] Prior to the addition of Rule 3002.1, many cases likely passed through completion of payments to the trustee and discharge without any consideration of post-petition default or the debtor's eligibility for a discharge due to failure to make post-petition direct payments.

If the debtor (or his/her counsel) is not confident of the debtor's ability to avoid the temptation to divert funds from budgeted purposes to other areas, a conduit payment plan can be utilized and the ongoing payments can be made by the trustee. By utilizing the option to make direct payments, a debtor is committing to parties-in-interest that he/she will comply with all payment terms of his/her plan — not just the payment to the trustee.

At the same time, a best practice for creditors is not to sit on their rights for years, or even for the duration of the plan, which happened in the *Gibson* case.[5] While purportedly rejecting the "absolutist" view that the Bankruptcy Code requires all post-petition direct payments to be completed for a debtor to be entitled to a chapter 13 discharge, the facts in *Gibson* show that the creditor neither objected to confirmation nor filed a motion for relief from stay for the entirety of the debtors' case, despite receiving no post-petition direct payments. Equity might provide for a debtor to receive the discharge despite failing to make direct payments to a creditor, particularly a creditor that took no action for the entire period of the case, but in the vast majority of cases, a direct application of the Bankruptcy Code requires denial of the discharge.

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The judge in the *Gibson* case reflected that in all of his years on the bench, the court had never dismissed a case and denied a discharge to a debtor for not making direct payments to a creditor. This statement proves one point: Until Rule 3002.1 was put into place, very few post-petition defaults were brought to the court's attention at a time where the debtor could not modify the plan to provide for such defaults (or choose to convert or dismiss). However, § 1328 requires payment of all payments under the plan, not just the payments that the debtor "thought" he/she was required to pay. The denial of discharge has only become an issue in recent years because the disclosure comes at a point in a chapter 13 case where there is no authority for a modified plan to provide for a cure of the post-petition arrearages to be filed.

Now, with the notice requirements for cure payments, there is more opportunity for the disclosure of post-petition defaults by debtors who could have previously passed through to receive a discharge. The denial of discharge for failure to make direct payments under the plan is one more example of the growth and change in chapter 13 practice, but the vast majority of the authority is clear: Direct payments are payments "under a plan" for § 1328(a) purposes.[6] abi

4 *In re Gonzales*, 532 B.R. 828, 833 (Bankr. D. Colo. 2015).

5 *See In re Gibson*, 2018 Bankr. LEXIS 609 (Bankr. C.D. Ill. March 5, 2018).

6 *See, e.g.*, *In re Evans*, 543 B.R. 213, 221 (Bankr. E.D. Va. 2016); *In re Gonzales*, 532 B.R. 828, 834 (Bankr. D. Colo. 2015); *In re Heinzle*, 511 B.R. 69, 75 (Bankr. W.D. Tex. 2014).