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You've Made Your Bed, Now Lie in It: The Case Against Post-Confirmation Surrendering of Collateral

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Most debtors who file for relief under chapter 13 do so to "save" their homes, automobiles or both. Chapter 13 is designed to let debtors propose plans that allow them to cure prepetition arrears over three to five years while making ongoing payments to their secured creditors.[1] But chapter 13 is a long process, and sometimes job loss or other financial hardship results in the debtors' payments on their secured debts becoming too much to manage. Some courts permit debtors to amend their plans to surrender secured collateral to their creditors and reclassify any deficiency claims as unsecured even years after confirmation, but this approach is contrary to both the plain text of the Bankruptcy Code and congressional intent.

The analysis starts with the confirmation process itself. A debtor must provide all creditors and parties in interest with at least 28 days' notice of the hearing to consider confirmation of a chapter 13 plan.[2] Section 1325(a) of the Code establishes the minimum requirements for confirmation in a chapter 13, including, but not limited to, good faith, liquidation, feasibility and, with respect to secured claims, acceptance of the plan, surrender of the secured collateral or, under § 1325(a)(5)(B), that:

- the plan provides that—
  1. the holder of such claim retain the lien securing such claim until the earlier of —
     a. the payment of the underlying debt determined under non-bankruptcy law; or
     b. discharge under section 1328; and
  2. if the case under this chapter is dismissed or converted without completion of the plan, such lien shall also be retained;
- 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; and
- if –
  1. (I) property to be distributed pursuant to this subsection is in the form of periodic payments, such payments shall be in equal monthly amounts; and
  2. the holder of the claim is secured by personal property, the amount of such payments shall not be less than an amount sufficient to provide to the holder of such claim adequate protection during the period of the plan....

Given the number of "ifs" and contingent clauses, it should come as no surprise that a high volume of plan-related litigation arises out of § 1325(a)(5)(B). Secured creditors routinely object to confirmation of a plan in which debtors fail to propose to pay an appropriate interest rate under *Till*,[3] accurately value an automobile, or provide sufficient adequate protection to the creditor. Since many debtors finance automobiles for little to no money down and with interest rates over 20%, interest rate objections are the most prevalent. However, for debtors who propose to retain an automobile purchased more than 910 days pre-petition, the Code allows them to both reduce the interest rate *and* "cram down" the balance of the loan to the value of the automobile at the time of filing. While there may be brief kerfuffle between the parties, the creditor will likely be forced to accept a reduced secured debt at a reduced interest rate and treatment of the remaining balance as unsecured.

A plan that reduced the secured claim of a car lender was the center of an opinion by the Sixth Circuit pre-BAPCPA in *Chrysler Financial Corp. v. Nolan (In re Nolan)*.[4] In that case, the debtor obtained confirmation of a plan valuing her automobile at $8,200 and treating the remaining loan balance (approximately $4,100) as unsecured. Arguing that the automobile was no longer reliable approximately a year later, the debtor attempted to modify her confirmed plan to surrender the automobile and reclassify the entire loan deficiency as an unsecured claim.[5] The secured creditor objected on the basis that § 1329 did not permit reclassification of a secured claim "absent a good

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1 The position adopted herein is solely for this publication and does not necessarily represent, nor should it be cited back to, the authors.

2 Fed R. Bankr. P. 2002(b)(3).

3 *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004).

4 *Chrysler Fin. Corp. v. Nolan (In re Nolan)*, 232 F.3d 528, 529 (6th Cir. 2000).

5 *Id.* at 529–30.

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faith showing of unanticipated substantial change in circumstances."[6]

At the time *Nolan* was issued, the language of § 1329(a) provided three bases for post-confirmation modification:

- increase or reduce the amount of payments on claims of a particular class provided for by the plan;
- extend or reduce the time for such payments; or
- alter the amount of distribution to a creditor whose claim is provided for by the plan to the extent necessary to take account of any payment of such claim other than under the plan.[7]

On appeal, the Sixth Circuit held that the language of § 1329 does not authorize alteration, reduction or reclassification of allowed secured claims and only "affords the debtor a right to request alteration of the amount or timing of specific payments."[8] The court found that the debtor's proposal would violate the requirement of § 1325(a)(5)(B) to pay an allowed secured claim in full and even render § 1325(a)(5)(B)(ii) meaningless.[9] Further, the court noted that allowing the debtor to reclassify the claim post-confirmation would contravene § 1327(a), which provides that confirmation of the plan is binding upon a debtor and each of their creditors[10] — a point that the Supreme Court underscored almost a decade later in *Espinosa*.[11]

Much of the focus in *Nolan* is on congressional intent — or rather, the lack thereof. Congress did not, the Sixth Circuit wrote, intend "to give debtors the option to shift the burden of depreciation to a secured creditor by reclassifying the claim and surrendering the collateral when the debtor no longer has any use for the devalued asset."[12] Since the creditor has already been forced to accept a reduction of the loan balance at confirmation, post-confirmation modification and reclassification of the claim would result in an unintended "windfall … that unfairly shifts away depreciation, deficiency, and risk voluntarily assumed by the debtor."[13] Cases that have followed *Nolan* post-BAPCPA have highlighted Congress's choice to include the word "surrender" only in § 1325(a)(5) but not § 1329(a).[14]

Returning to the example above – and assuming for the moment that the debtor is an honest but unfortunate one – the logic in *Nolan* quickly becomes clear.[15] The debtor has been able to cram down the automobile loan by thousands of dollars and has paid an interest rate far lower than the usurious numbers often seen in bankruptcy courts. The creditor is bound by these terms and cannot contest the rate at which the pre-petition arrears are being brought current.

Given the length of some chapter 13 plans, the pre-petition arrearage may still exist by the time the debtor is ready to trade in the automobile for a newer, shinier (or operable) model. To force the creditor to accept an even further-reduced unsecured deficiency claim — particularly when it is not permitted to seek a higher valuation in the rare event that the automobile value actually appreciates, as occurred during the COVID-19 pandemic — is wholly inequitable. As a side note, although the focus of this article is on an automobile scenario, at least one court has touched on the possibility of an interminable "modification war" as a result of fluctuating real estate value.[16]

The reality of chapter 13 is that it comes with both benefits and bargains. Although one of those benefits is the chance to cure a default and retain secured collateral, debtors should give serious thought at the outset of their cases as to whether retention or pre-confirmation surrender is truly in their best interests and will remain in their best interests for the next three to five years. After confirmation, depending on their circuit, a decision to retain secured collateral may be final and binding upon both the debtor and the creditor — in accordance with both Supreme Court precedent on § 1327(a) as well as longstanding congressional intent. Debtors who find themselves unable to maintain secured payments a year or two into bankruptcy are not entirely without recourse, however: They can either work out consensual terms with the secured creditor, or, if not possible, avail themselves of the right to dismiss (and likely refile) their chapter 13 case. abi

6 *Id.* at 530.

7 What we now know as § 1329(a)(4), which provides for post-confirmation modification to account for a debtor's health insurance payment, was added by Congress as part of BAPCPA. *See generally* Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005).

8 *Nolan*, 232 F.3d at 532.

9 *Id.* at 532–33 ("For section 1325(a)(5)(B)(ii) to provide any protection to the creditor when the debtor chooses to retain her collateral, the secured claim must not be subject to modification throughout the life of the plan.").

10 *Id.* at 533.

11 *United Student Aid Funds Inc. v. Espinosa*, 559 U.S. 260, 275–78 (2010) (finding that order confirming chapter 13 plan is binding on creditor with actual notice notwithstanding legal error in the plan).

12 *Nolan*, 232 F.3d at 533.

13 *Id.* at 534.

14 *In re Ramos*, 540 B.R. 580, 593–94 (Bankr. N.D. Tex. 2015) ("As is often stated, we are to presume that Congress means to use the words that it uses. Congress knew when to use the word surrender when it wanted to."). *See generally In re Belcher*, 369 B.R. 465 (Bankr. E.D. Ark. 2007).

15 For a dishonest debtor who intentionally engages in what *Nolan* calls a "subterfuge," the impact on the creditor is far worse.

16 *In re Chiapetta*, No. 07-10166, 2009 Bankr. LEXIS 2656, at *4 (Bankr. N.D. Cal. June 8, 2009) (following *Nolan*).