

MODIFICATIONS OF CHAPTER 13 PLANS UNDER BAPCPA

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I. THE DISPOSABLE INCOME TEST UNDER BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005 (“BAPCPA”)

A. The “Means Test”

1. Since the effective date of BAPCPA, some courts have concluded that, when the Form B22C “means test” calculation now incorporated in section 1325(b) of the Bankruptcy Code shows that above-median debtors have no disposable income, “debtors with no ‘disposable income’ have no ‘projected income’.” In re Kagenveama, 541 F.3d 868, 875 (9th Cir. 2008). To determine the amount owed to unsecured creditors, the “court is simply to take a debtor’s “disposable income” and multiply that amount by the number of months of the debtor’s payment plan.” In re Roberts, 2008 U.S. Dist. LEXIS 108640 (D.Nev. 2008). Under this reasoning, a debtor that “does not have disposable income under Section 1325(b) [will have his plan] confirmed even though the plan does not provide for payment to unsecured creditors.” In re Barr, 341 B.R. 181, 186 (Bankr. M.D.N.C. 2006).
2. To the contrary, other courts have held that “[t]he statutorily defined ‘disposable income’ is the starting point.” In re Nowlin, 576 F.3d 258, 263 (5th Cir. 2009). Further, the “bankruptcy court’s calculation of a debtor’s projected disposable income can take into account changes in the debtor’s financial circumstances that are reasonably certain to occur during the term of the debtor’s proposed plan.” In re Lasowski, 575 F.3d 815, 819 (BAP 8th Cir. 2009).

B. New Section 521(f)

1. BAPCPA, however, added not only the “means test”, but also new Section 521(f), which provides that, at the request of the court, the United States Trustee, or any party in interest (including an unsecured creditor), a Chapter 13 debtor shall file annually with the court a copy of each filed Federal income tax return while the case is pending and also “a statement, under penalty of perjury, of the income and expenditures of the debtor during the tax year of the debtor most recently concluded before such statement is filed.”
2. As noted by more than one court, this provision “may open the door for trustees and unsecured creditors to propose modifications when there may be a substantial and unanticipated change in the debtor’s post-confirmation financial condition, i.e. an unanticipated large salary increase.” In re Musselman, 379 B.R. 583, 594 (Bankr. E.D.N.C. 2007); accord, In re Kagenveama, 527 F.3d 990, 997, 999 (9th Cir. 2008) and In re Rotunda, 349 B.R. 324, 331 (Bankr. N.D.N.Y. 2006).

II. THE REQUIREMENTS OF SECTION 1329

- A. Motion to Modify Must Be Filed Before Completion of Payments Required by the Confirmed Plan.
- B. Motion to Modify May Be Filed by Debtor, Chapter 13 Trustee, or Holder of Allowed Unsecured Claim.

- C. Modified Plan May Increase or Reduce Amount of Payments on Claims of a Particular Class Provided for by the Plan.
- D. Modified Plan May Extend or Reduce Time for Plan Payments.
- E. Modified Plan May Alter in Amount the Distribution to a Creditor to Account for Any Payment Received by That Creditor Outside the Plan.

III. ADDITIONAL REQUIREMENTS IN THE FOURTH CIRCUIT

A. Unanticipated, Substantial Changes in the Debtor's Financial Condition.

1. The “doctrine of *res judicata* bars an increase in the amount of the monthly payments” pursuant to a proposed modified plan “where there have been no unanticipated, substantial changes in the debtor’s financial condition.” In re Arnold, 869 F.2d 240, 243 (4th Cir. 1989).
2. In the Arnold case, the debtor’s annual income had increased by \$120,000 (from \$80,000 to \$200,000) in the two years since the plan was confirmed. Undoubtedly, this increase of 150% was “substantial”. The Fourth Circuit also found that, “Although it was reasonable to expect Arnold’s income to fluctuate from year to year because it relied so heavily on sales commissions, Weast [the unsecured creditor that filed the motion to modify] should not be expected to have anticipated a \$120,000 jump in his income in only two years.” Arnold, 869 F.2d at 243. Accordingly, the Fourth Circuit upheld the granting of the creditor’s motion to modify.

B. Sale or Refinance of Debtor's Real Estate.

1. Sale. In the case of In re Murphy, 474 F.3d 143 (4th Cir. 2007), the Court found that a 51.6 percent increase in the value of the debtor's real property in only 11 months was "substantial". "Murphy, by selling his condominium, received a substantial amount of readily available cash without any debt." Id. at 152. Noting that the increase in the Housing Price Index in the relevant geographic region for the two years preceding plan confirmation had ranged from ten to thirteen percent per year, the Court also found that "a 51.6 percent increase certainly is an unanticipated change given the current market trends." Id. The Fourth Circuit affirmed the granting of the Trustee's motion to modify Mr. Murphy's plan.
2. Refinance. In the same reported decision, the Fourth Circuit also considered the case of Mr. and Mrs. Goralski, who cashed out over \$64,000 from a refinance loan secured by their real property, which also had "appreciated significantly in value" since the time of confirmation. Murphy, 474 F.3d at 146. Here, however, Mr. Goralski had suffered an approximate 50% reduction in income and "[a]ll the Goralskis did was to eliminate a portion of their equity in the property for cash in exchange for a corresponding amount of debt." Id. at 150. The Court found, therefore, that there had been "no substantial change to the Goralskis' financial condition" and that "the cash-out refinancing cannot provide a basis for modifying the Goralskis' confirmed plan." Id.

3. Res Judicata. In the Murphy decision, the Fourth Circuit reaffirmed the *res judicata* principle first articulated in Arnold, stating, “This doctrine, . . . , ensures that confirmation orders will be accorded the necessary degree of finality, preventing parties from seeking to modify plans when minor and anticipated changes in the debtor’s financial condition take place.” Murphy, at 149. As the Court explained further, “If the change in the debtor’s financial condition was either insubstantial or anticipated, or both, the doctrine of *res judicata* will prevent the modification of the confirmed plan.” Id. at 150.

C. Decisions in Other Circuits.

1. Other decisions that also require at least some change in circumstances, even if that change is not “substantial”, as a prerequisite to filing a motion to modify include In re Hoggle, 12 F.3d 1008 (11th Cir. 1994) and In re Furgeson, 263 B.R. 28 (Bankr. N.D.N.Y. 2001) (stating therein that this is the view throughout the Second Circuit and citing the decisions of other bankruptcy courts within that Circuit).
2. Some courts in other Circuits, however, disagree expressly with the Fourth Circuit, holding that “Congress did not intend the common law doctrine of *res judicata* to apply to Section 1329 modifications.” In re Witkowski, 16 F.3d 739, 745 (7th Cir. 1994). Accord, Barbosa v. Soloman, 235 F.3d 31, 41 (1st Cir. 2000), In re Meza, 467 F.3d 874, 878 (5th Cir. 2006), In re Brown, 219 B.R. 191 (BAP 6th Cir. 1998) and In re Than, 215 B.R. 430 (BAP 9th Cir. 1997). Presumably, in these Circuits, it will be easier for the

Chapter 13 Trustee or unsecured creditors to seek and obtain a plan modification.

IV. CIRCUMSTANCES THAT MAY JUSTIFY MODIFICATION

A. Increase in Value of Real Estate.

1. A Chapter 13 Trustee did not prevail on her motion to modify, seeking to increase the Plan base to yield a 100% payout to unsecured creditors by retaining \$23,155 of the \$80,369 cash-out proceeds from a post-confirmation refinancing (even though the new refinance loan was in the amount of \$120,000 when the order approving the refinance transaction had approved a \$78,000 loan). In re Fiddler, 2007 WL 4510308 (Bankr. N.D.W.Va. 2007).
2. The Fiddler Court noted that the Chapter 13 Trustee had not met her burden to show that the 82% increase in value of the debtors' real property over 32 months (approximately 25% per year) was unanticipated. Based upon independent research undertaken by the Court, including a review of the House Price Index available at the web site of the Office of Federal Housing Enterprise Oversight, the Court determined that real property values in the applicable geographic region had increased by 24.01% in the one-year period preceding the petition date. Before referring to this independent research, the Court stated "it is generally known" that "from 2003-2005 real estate prices were sharply rising in the Eastern Panhandle of West Virginia".

B. Change in Debtors' Income (BAPCPA Cases).

1. Debtors who suffered a post-confirmation decrease in net monthly income of 18.6% were allowed to modify their plan to decrease the payout to unsecured creditors from 100% to 19%. In re Ireland, 366 B.R. 27 (Bankr. W.D. Ark. 2007).
2. The Ireland Court rejected the Chapter 13 Trustee's contention that "the Debtors are bound by the results of the calculation of Form B22C as a minimum payment to unsecured creditors regardless of any change in actual income after the Debtors filed their petition." Id. at 29. The Court stated that there was no "clear statutory command that 1325(b) applies to modifications". Id. at 34.
3. The Ireland Court also noted, "To avoid the preclusive effect of the principle of res judicata, the modification should be necessitated by an unanticipated substantial change in circumstances affecting the debtors' ability to pay." Id. at 33. Although the Court noted that the decrease in income was "substantial", it did not discuss how the decrease was "unanticipated".
4. The Ireland case was cited with approval by In re White, 411 B.R. 268 (Bankr. W.D.N.C. 2008). In the White case, the court allowed the debtor to modify the Plan term to fewer than 60 months even though the debtor's post-confirmation change in financial circumstances did not change his status as an above-median income debtor. The White Court noted that Section 1329 does not make reference to the applicable commitment period

of Section 1325(b). Id. at 272. Significantly, although the debtor sought through the modification to remove both the secured claim of his mortgage lender, which had obtained relief from the stay post-confirmation, and the claim of his automobile lender, which had received the insurance proceeds after the debtor's vehicle was totaled in an accident, he was not seeking to reduce the dividend that his unsecured creditors were receiving under the original confirmed plan. Id. at 272, 275.

C. Change in Debtors' Income (Pre-BAPCPA Case).

1. Although the Debtor "made a threshold showing of a substantial and unanticipated decrease in income sufficient to justify the filing of a modified plan based on changed financial circumstances", the court denied the motion to modify. In re Van Dyke, 2007 WL 1094369 (Bankr. E.D. Va. 2007).
2. The Amended Schedules I and J filed with the proposed modified plan showed a 66% reduction in surplus disposable income. That reduction, however, did not justify reducing the plan term from 60 months to 54 months. It also did not justify proposing a new plan payment that was \$283 per month less than the monthly surplus shown on the Amended Schedules I and J. "The modified plan, in short, fails to reflect a serious effort by the debtor to repay creditors to the best of his ability in light of his current reduced financial circumstances."

D. Change in Expenses.

1. Although the Court found that Section 1329 does not incorporate Section 1325(b), it denied the debtor's proposed plan modification that was based primarily upon a purported change in a domestic support obligation expense. In re Hill, 386 B.R. 670 (Bankr. S.D.Ohio 2008).
2. The Hill Court found that the Debtor had provided the Court with insufficient facts to support the modification request. The Court noted, "if a debtor could always modify his plan to incorporate his actual income and expenses post-confirmation, regardless of the narrowness of the reason asserted, the means test formula would have limited effect in Chapter 13." Id. at 677.

E. Retirement.

1. Chapter 13 debtors who both "retired from their jobs not long after their plan was confirmed" were permitted to modify their plan to reduce the plan term from 60 to 36 months, to reduce the amount of their monthly plan payments, and to reduce the amount paid to general unsecured creditors. In re Ewers, 366 B.R. 139, 140 (Bankr. D.Nev. 2007).
2. In so ruling, the Ewers Court cited In re Sunahara, 326 B.R. 768 (BAP 9th Cir. 2005), which held that Section 1325(b) does not apply to modified plans.

F. Divorce

1. An above-median debtor was permitted to modify her confirmed plan to reduce the monthly plan payment and to reduce the term from 60 months to 36 months after she became divorced and her income as a single person put her below the median income. In re Hall, 2008 WL 2388628 (Bankr. N.D. Ohio 2008).
2. The Hall Court held that Section 1329 permits the Debtor to “reduce the time for her payments unimpeded by the applicable commitment period calculations” of Section 1325(b)(4).

G. Early Payoff.

1. The Ninth Circuit Bankruptcy Appellate Panel affirmed the bankruptcy court’s decision to deny the debtors’ motion for entry of discharge when the debtors sought to prepay their 36-month Plan in month 14. In re Fridley, 380 B.R. 538 (BAP 9th Cir. 2007).
2. The BAP held that the “applicable commitment period” of Section 1325(b)(1) operates as a “temporal requirement”. Id. at 544. The Court also ruled that a “debtor desiring to prepay a chapter 13 plan and obtain an early discharge without paying allowed unsecured claims in full” must comply with Section 1329 of the Bankruptcy Code and Bankruptcy Rule 3015(g). Id. As the Court explained, “part of the statutory bargain inherent in chapter 13 is that the debtors, must, for the prescribed life of the plan, run the gauntlet of exposure to trustee or creditor requests to increase payments.” Id.