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THE PROBLEM WITH LOCAL FORMS FOR THE CHAPTER 13 PLAN

*By Travis Sasser**

In *United Student Aid Funds, Inc. v. Espinosa*,¹ the Supreme Court declined to provide a creditor relief from a Chapter 13 plan provision that discharged a student loan obligation that normally would have required the filing of an adversary proceeding. In that case, the Supreme Court stated—perhaps, in dicta—that bankruptcy courts have an obligation, even in the absence of an objection to confirmation, to direct debtors to conform their plans to the statutory requirements. As a response to the *Espinosa* ruling, many bankruptcy judges supported the creation of an official form for the Chapter 13 plan that would be mandatory and uniform and would make it easier to identify improper provisions.² A significant faction of bankruptcy judges opposed this national plan form, claiming that a national plan could not accommodate state law differences or circuit court differences.³ The result was Bankruptcy Rule 3015.1 which allows districts to opt-out of the national plan form subject to certain formatting and disclosure requirements intended to “promote consistency among Local Forms and clarity of content of Chapter 13 plans.”⁴ Only about nine districts out of 94 use the national plan.⁵ Most districts opted out.

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A review of the local forms for the Chapter 13 plan that have resulted from the widespread opt-out reflects the preferences of judges as opposed to any discernable pattern based on state law or circuit law. At best the local form plans merely reflect pointless provincialism; at worst, the local form plans abridge the substantive rights of debtors and/or are contrary to provisions of the Code. A few examples make the point:

- S.D. Ala. provision 12.3. “To the extent that debtor(s)’ asset values exceed allowable exemption limits, the non-exempt portions are property of the estate and subject to distribution by the trustee.”
- E.D. Mich. provision V (CC). “Debtor and the Chapter 13 Trustee shall have

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concurrent standing to prosecute all Pre-and Post-Petition causes of action. . . . Any proceeds or damages recovered by or on behalf of the debtor shall be retained pending Order of the Bankruptcy Court.”

- E.D. Tex. provision 9.3. “No settlement of any litigation prosecuted by the Debtor during the Plan Term shall be consummated without the consent of the Chapter 13 Trustee and, except as otherwise authorized by the Trustee, all funds received by the Debtor, or any attorney for the Debtor, shall be immediately tendered to the Chapter 13 Trustee for satisfaction of any authorized exemption claim of the Debtor, with the remainder of the funds dedicated as an additional component of the plan base.”
- C.D. Ill. provision 8. “Upon confirmation, all property of the estate shall vest in the Debtor. Notwithstanding this provision, the Trustee retains the right to assert a claim to any additional property of the estate that the Debtor acquires post-petition pursuant to 11 U.S.C.A. § 1306.”⁶
- S.D. Ill. provision 14. “Property acquired by the Debtor post-petition shall vest in the Trustee and become property of the estate as contemplated by 11 U.S.C.A. § 1306.”
- S.D. Ohio provision 9.2. “The Debtor shall keep the Trustee informed as to any claim for or receipt of money or property regarding personal injury, workers compensation, bonuses, buy-out, severance package, lottery winning, inheritance, or any other fund to which the Debtor may be entitled to

receive. Before the matter can be settled and any funds distributed, the Debtor shall comply with all requirements for filing applications or motions for settlement with the Court as may be required by the Bankruptcy Code, the Bankruptcy Rules, or the Local Bankruptcy Rules. Unless otherwise ordered by the Court, these funds shall be distributed by the Trustee for the benefit of creditors.”

- W.D. Pa. provision 8.1. “This is the voluntary chapter 13 reorganization plan of the debtor(s). The debtor(s) understand(s) and agree(s) that the chapter 13 plan may be extended as necessary by the trustee (up to the period permitted by applicable law) to insure that the goals of the plan have been achieved.”
- E.D. Mo. provision 4.6. “Debtor is not to incur further credit or debt without the consent of the Court unless necessary for the protection of life, health or property and consent cannot be obtained readily.”

These provisions are, in various ways, inconsistent with §§ 1303, 1306(b) and 1327, but the overriding problem is that they violate the debtor’s “valuable exclusive” right to propose a plan under § 1321.⁷ Some bankruptcy courts have become the drafters and enforcers of adhesion contracts in which the fine print in the mandatory local form for the Chapter 13 plan always favors the trustee and unsecured claim holders.

Two local plan provisions have recently been invalidated by circuit courts. The United States Court of Appeals for the Ninth Circuit ruled that a mandatory plan provision requiring a fixed payment term

was not required by the Code—in the absence of an objection to confirmation such that Chapter 13 debtors are permitted to propose and confirm plans with estimated durations.⁸ The *Sisk* holding points out that nothing prevents a party from objecting to confirmation of a particular plan as it relates to plan duration or seeking to modify a plan post-confirmation. The *Sisk* decision rejected policy arguments, reminding the bankruptcy courts that there is no license for bankruptcy judges to use local forms to judicially amend the requirements of Chapter 13.

Similarly, the United States Court of Appeals for the Fifth Circuit invalidated a mandatory plan provision requiring all tax refunds above \$2,000 to be paid to the trustee as additional disposable income, absent a motion and contest by the debtor.⁹ The *Diaz* court found the categorical rule and mandatory plan provision abridged the rights of Chapter 13 debtors to use their future income for reasonable and necessary expenses and that local plan provisions must be procedural not substantive.

Both *Sisk* and *Diaz* reject policy as a rationale for imposing non-Code substantive plan provisions on debtors. *Diaz* emphatically rejects efficiency as a basis for using a mandatory plan provision as a pathway to deciding substantive issues. The takeaway from these two circuit decisions is that Chapter 13 debtors should be able to seek confirmation of plans in which the debtor dictates the substantive provisions. The courts’ role is to provide a uniform procedural format for the plan that is clear and predictable. Trustees and creditors can object to confirmation. Judges then apply the provisions of § 1325 to determine if the plan should be confirmed.

PROPERTY SALES AS A PARTICULAR CASE IN POINT

The sale of property during a Chapter 13 case is an area frequently warped by local form plan provisions.

THE BANKRUPTCY CODE APPROACH

In Chapter 13 cases, sales of bankruptcy estate property outside the ordinary course of business are governed by § 363(b). A debtor is not required to sell estate property. A debtor has the option of proposing to sell property to help fund a plan pursuant to § 1322(b)(8). A sale of property is not one of the enumerated permissible provisions of a post-confirmation modification of a plan under § 1329. There are no restrictions in the Bankruptcy Code with regards to a debtor selling property that is not property of the bankruptcy estate. Pursuant to § 1303, a debtor has, exclusive of the trustee, the rights and powers of a trustee under § 363(b). The process for selling estate property outside the ordinary course is for the Chapter 13 debtor to file a notice of proposed sale pursuant to Bankruptcy Rule 6004(a). A 21-day notice is required pursuant to Bankruptcy Rule 2002(a)(2). An objection to the proposed sale under Bankruptcy Rule 6004(b) is a contested matter pursuant to Bankruptcy Rule 9014. If no objection is filed under Bankruptcy Rule 6004(b), no court order is required for a Chapter 13 debtor to sell estate property outside the ordinary course. If an objection is filed under Bankruptcy Rule 6004(b), the court must decide if the proposed sale is an appropriate exercise of the debtor's business judgment. A § 363(b) sale is not a vehicle to modify a plan post-confirmation. However, the facts surrounding a § 363(b)

sale may result in a plan modification filed pursuant to § 1329 and Bankruptcy Rule 3015(h) which the court may choose to allow or not pursuant to § 1329(b)(2).

PRE-CODE APPROACH

Under the Bankruptcy Act, the sale of estate property required a court order and it was said that a bankruptcy sale was a sale by the court itself, with the trustee or other officer acting merely as the court's agent.¹⁰ Under Chapter XIII of the Bankruptcy Act, it was clear that post confirmation, vested property was solely controlled by the debtor.¹¹

FROM THE ACT TO THE CODE

The Code removed the judge from bankruptcy estate administrative functions. Rather, the judge became an arbiter of disputes that arise in bankruptcy cases.¹² This concept, embodied in the phrase "after notice and a hearing," was intended to free the judge from ruling on the many undisputed administrative decisions that must be made in a case and to only involve the judge when there is an actual dispute to be resolved.¹³ This change is reflected in Bankruptcy Rule 6004 such that no court order is necessary to sell estate property outside the ordinary course if the proposed sale is uncontested.

ERRONEOUS APPROACHES IN LOCAL FORM PLANS

Many local form plans have blanket requirements that estate property does not vest in the debtor until discharge or dismissal as opposed to at confirmation. Such provisions abridge the rights of debtors under § 1322(b)(9) to propose plans in which

estate property vests at confirmation or at some date other than discharge.

Some local form plans assign limited, ambiguous or no relevance to the effect of asset vesting in the debtor at confirmation.¹⁴ Once an asset vests in the debtor, there is no statutory role for the bankruptcy court with regards to a sale of the former estate property.

One problematic local form plan provision is E.D.N.C. provision 7.2. Although 7.1 provides the debtor with the various vesting options, provision 7.2 provides:

Possession and Use of Property of the Bankruptcy Estate: Except as otherwise provided or ordered by the Court, regardless of when property of the estate vests in the Debtor(s), property not surrendered or delivered to the Trustee (such as payments made to the Trustee under the Plan) shall remain in the possession and control of the Debtor(s), and the Trustee shall have no liability arising out of, from, or related to such property or its retention or use by the Debtor(s). The use of property by the Debtor(s) remains subject to the requirements of 11 U.S.C. § 363, all other provisions of the Bankruptcy Code, Bankruptcy Rules, and Local Rules.

The E.D.N.C. provision purports to nullify the impact of vesting in the debtor as it relates to the debtor's use of property.¹⁵ Provision 7.2 empowers the bankruptcy court to exercise oversight of sale proceeds of vested property.¹⁶ The *Taylor* court observed that the debtor had failed to appeal the confirmation order arising from the plan with the mandated standard provision. The *Taylor* holding reflects a court using a plan provision to write its own jurisdictional ticket.

Some local form plans require a court order for a debtor to sell property outside the ordinary course.¹⁷ A court order is not

required for an uncontested § 363(b) sale. Requiring a court order for a sale inappropriately flips the burden of proof and persuasion to the debtor as opposed to an objecting party.

Some districts require trustee approval prior to the sale of property.¹⁸ This is inconsistent with § 1303 which gives the Chapter 13 debtor the *exclusive* rights and powers of a trustee under § 363(b). Although a trustee has standing to oppose a sale pursuant to Bankruptcy Rule 6004(b), the trustee should not have veto power over a sale.

Some local form plans dictate what must happen to sale proceeds.¹⁹ This abridges a debtor's right to propose a plan in which sale proceeds are not applied to the plan. The funding of a plan through an asset sale is optional under § 1322(b)(8).

A POSSIBLE SOLUTION FOR THE DEBTOR

The Advisory Committee Note to Rule 3015.1 explains that nonstandard provisions under 3015.1(e) "gives the opportunity to propose provisions that are not otherwise in, or that deviate from, the Local Form." As such, it is appropriate to provide in a nonstandard provision that a standard provision(s) will not apply.

CONCLUSION

The national form plan is a content neutral form and respects that only a debtor has the right to propose a plan. Unfortunately, some local form plan provisions reflect judges who are not content to merely call balls and strikes.²⁰ As a result, an effort motivated in part to prevent gamesmanship by debtors has instead resulted in gamesmanship of a different sort.

ENDNOTES:

¹*United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 130 S. Ct. 1367, 176 L. Ed. 2d 158 (2010).

²See Hon. Eugene Wedoff, John Gustafson & Henry Hildebrand, National Plan Form—Q & A (Jan. 5, 2013), available at <https://considerchapter13.org/2013/01/05/national-plan-form-q-a/>. See also Hon. Rebecca B. Connelly, Official Form Chapter 13 Plan Draft Published for Comment, ABI Consumer Bankr. Comm. Newsletter (Nov. 2014), available at <https://www.abi.org/committee-post/official-form-chapter-13-plan-draft-published-for-comment>.

³See letter submitted to the Bankruptcy Rules Committee by the “Committee of Concerned Bankruptcy Judges” dated November 18, 2014, available at http://ncbankruptcyexpert.com/wp/wp-content/uploads/2018/11/144_judges_comment-1.pdf.

⁴Advisory Committee Note to Rule 3015.1.

⁵The District of Utah uses the national plan form but requires certain nonstandard plan provisions under its local rule 2083-2(f).

⁶“Claim” is a defined term (11 U.S.C.A. § 101(5)) being misused in this provision.

⁷“Valuable exclusive” is how a debtor’s § 1321 right is referred to in *Bullard v. Blue Hills Bank*, 575 U.S. 496, 505, 135 S. Ct. 1686, 1694, 191 L. Ed. 2d 621 (2015).

⁸*In re Sisk*, 962 F.3d 1133 (9th Cir. 2020).

⁹*Diaz v. Viegelahn (In re Diaz)*, 972 F.3d 713 (5th Cir. 2020).

¹⁰*Governor’s Island v. Eways (In re Governor’s Island)*, 45 B.R. 247 (Bankr. E.D.N.C. 1984).

¹¹See §§ 21(h) and 70(i) of the Bankruptcy Act.

¹²Report on the Committee of the Judiciary, House of Representatives, to accompany H.R. 8200, H.R. Rep. No. 95-595, App. Pt. 4(d) (1977).

¹³Report on the Committee of the Judiciary, House of Representatives, to accompany H.R. 8200, H.R. Rep. No. 95-595, App. Pt. 4(d) (1977).

¹⁴M.D. Ala. plan provision 16(b); E.D. Cal. plan provision 6.2 & LBR 3015-1(b)(1); D. Guam plan provision 11.1(j); S.D. Ind. plan provision 14; E.D. La. plan provision I and confirmation order paragraph 5; E.D. Mich. plan provision O; W.D. Mich. plan provision IV(B)&(C); D. Nev. plan provision 8.1(a); E.D.N.C. LBR 4002-1(g)(4) and plan provision 7.2; D. Haw. plan provision 11(j); D. Or. plan provision 11; E.D. Va. plan provision 10; W.D. Wash. plan provision VIII.

¹⁵Instead of tracking the § 363(b) verbiage of “use, sell or lease,” this provision only refers to “use.” It is unclear if this was poor drafting or a meaningful distinction.

¹⁶*Taylor v. Logan*, No. 5:20-CV-663-BO, 2021 U.S. Dist. LEXIS 103282 (E.D.N.C. June 1, 2021), available at <https://casetext.com/case/taylor-v-logan-2>.

¹⁷C.D. Cal. plan provision V; E.D. Cal. plan provision 6.02 & LBR 3015-1(b)(1); S.D. Cal. plan provision 8; D. Guam plan provision 11.1; D. Nev. plan provision 8.1(a); D.N.H. plan provision 11(c); S.D.N.Y. Chapter 13 Instructions to Comply with the Bankruptcy Code and Rules paragraph 12; E.D.N.C. LBR 4002-1(g)(4) and form order confirming plan; E.D. Mich. plan provision O; W.D. Mich. plan provision IV(c); W.D. Penn. provision 8.3; N.D. Tex. plan provision T; W.D. Wash. plan provision VIII; N.D. W. Va. plan provision 3.7; S.D. W. Va. plan provision 3.7;

¹⁸N.D. Cal. plan provision 6.01; E.D.N.C. LBR 4002-1(g)(4).

¹⁹S.D. Tex. plan provision 19; N.D. W. Va. plan provision 3.7; S.D. W. Va. plan provision 3.7.

²⁰“Judges and Justices are servants of the law, not the other way around. Judges are like umpires. Umpires don’t make the rules, they apply them. The role of an umpire and a judge is critical. They make sure everybody plays by the rules, but it is a limited role . . . I will remember that it’s my job to call balls and strikes, not to pitch or bat.” See Chief Justice Roberts Statement-Nomination Process, available at <https://www.uscourts.gov/educational-resources/educational-activities/chief-justice-roberts-statement-nomination-process>.