

## CONSUMER BANKRUPTCY

# Chap 13 Debtors Must Be Current at Time of Discharge

By Craig D. Robins

This summer saw two decisions handed down by our judges in the Central Islip Bankruptcy Court that will make it harder for some struggling Chapter 13 debtors with mortgages to obtain their discharges.

Most consumers seek Chapter 13 relief to utilize the Chapter 13 payment plan to cure mortgage arrears over a sixty-month period, stopping any foreclosure proceeding in the process. The plan also enables the debtor to discharge credit card debt by often paying just pennies on the dollar.

The plan requires the debtor to pay

the current monthly mortgage payment “outside the plan” directly to the mortgagee, while satisfying the arrears with monthly plan payments to the trustee.

For years, many debtors entering the home stretch of their plan would find themselves struggling to make all necessary payments including remaining current on their post-petition mortgage payments. Their attorneys would suggest that if they didn’t have enough money, they should just make the trustee plan payments, get their discharge, and then enter into a payment arrangement with



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the mortgagee. However, that approach is now history.

Both Judge Alan S. Trust and Robert E. Grossman have held that if a Chapter 13 debtor is not current with the post-petition mortgage payments when the plan ends, he or she is not entitled to a discharge. *In re Coughlin*, 568 B.R. 461 (Bankr. E.D.N.Y. Case No.11-76202-ast, June 15, 2007, Judge Trust); *In re Hanley* (Bankr. E.D.N.Y. Case No.11-76700-reg, August 11, 2007, Judge Grossman).

What has happened over the past few years to trigger this? The answer has to do with Bankruptcy Rule 3002.1, a rel-

atively new statute that went into effect in 2011. This statute requires mortgagees to make certain disclosures to increase the transparency of mortgage servicing practices in Chapter 13 cases. It is also designed to prevent post-discharge disputes between debtors and mortgagees with regard to pre-discharge defaults. (This statute was discussed at length in the February 2017 installment of this column, *Mortgagee Sanctioned \$375k for Chapter 13 Rule Violation*).

Of importance here, at the end of a Chapter 13 case, the mortgagee must file a “Response to Notice of Final Cure Payment” indicating whether the debtor is cur-

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rent with the mortgage, and if not, specifying the amount of post-petition arrears. This now results in trustees quickly learning, before closing the case, if the debtor is current or not. Previously, Chapter 13 trustees either didn’t know, or perhaps more importantly, didn’t care, as this issue had not been litigated much in the past.

Now, however, trustees feel obligated to bring a debtor’s failure to make post-petition mortgage payments to the attention of the court by way of a motion to dismiss the case without granting a discharge. The legal basis is that a debtor’s failure to make such payments constitutes a default of the plan.

Granting such motions and denying the debtor a discharge is incredibly harsh. As Judge Grossman stated, “While it might seem inequitable or draconian to deny the Hanleys their discharge after making plan payments to the trustee for five years, the equitable powers of the court cannot override the statute or the specific provisions of a confirmed Chapter 13 plan. In their confirmed plan, the Hanleys promised to make not only their plan payments to the trustee but also their post-petition mortgage payments directly to the mortgagee. In exchange, the Hanleys intended to avail themselves of the benefits of the Bankruptcy Code and the Chapter 13 discharge. However, the Hanleys failed to uphold their end of the bargain by failing to comply with the stated terms of the confirmed plan.”

Judge Grossman issued this harsh ruling while at the same time recognizing, in the very first paragraph of his deci-

sion, that “an increasing number of debtors” fail to remain current with their post-petition mortgage payments.

Judge Trust in his analysis, painstakingly analyzed the wording in Bankruptcy Code § 1328(a), which states that a debtor receives his discharge after all “payments under the plan” are made. He determined that post-petition mortgage payments are payments under the plan. The judge concluded, “absent compelling circumstances meriting a plan modification or discharge under § 1328(b), this court views granting a discharge to a debtor who has not paid substantial sums dedicated to post-petition mortgage payments as contrary to the Chapter 13 process.”

Looking at this another way, Judge Trust later stated that Chapter 13 debtors who do not pay their post-petition mortgage payments are essentially claiming a deduction to which they are not entitled.

The *Coughlin* decision actually addressed two unrelated Chapter 13 cases with similar issues, the other case being *In re Sangamaya*. In that case, the debtor was behind with post-petition mortgage payments but filed a motion to modify the plan in the final week of the five-year plan. In analyzing the “temporal limits” of the Bankruptcy Code, Judge Trust held the debtor just barely filed his motion on time. He ruled that as long as the debtor files the motion before the completion of the plan, it is timely.

The judge nevertheless admonished the Sangamayas’ counsel for waiting 18 months since they defaulted on their post-petition payments to bring the modification motion. “It would certainly

have been better for the Sangamayas’ counsel to have been proactive and diligent in bringing these issues to the court’s attention much sooner and with greater clarity.”

Judge Grossman addressed a similar issue in *Hanley*. However, that debtor filed a motion to modify the plan *after* the expiration of the 60<sup>th</sup> month of the plan. Here, the judge differed with Judge Trust and held that while debtors may be able to cure a default in post-petition mortgage payments, the cure must be accomplished by a consensual loan modification approved by the court, or through a modification of the debtor’s Chapter 13 plan, *and either of these options must be approved by the Court prior to the expiration of the Chapter 13 plan term*. So, important was this timing requirement that Judge Grossman emphasized the text in his decision.

This position is not the majority position. Noting that other courts permit debtors to cure post-petition arrears after the 60-month period of the plan has expired, Judge Grossman stated, “This court must depart from the majority opinion on this issue. The court finds that the plain language of the statute dictates a drop-dead date of payments made pursuant to a chapter 13 plan.”

Here are some practical pointers. First, this new case law illustrates the importance of making sure that clients understand that they must maintain their Chapter 13 plan obligations in order to get their discharges. In addition, the sooner the client advises counsel that he or she has fallen behind, the sooner

counsel can consider options for addressing the default.

It appears that Judge Trust may have carved out an exception to the harsh result of dismissing a case without discharge if there are “compelling circumstances” or if the debtor has paid “substantial sums” towards the post-petition mortgage payments. Demonstrating such exceptions may be the only way to succeed in opposing a trustee’s motion to dismiss.

If a debtor who initially intended to pay his mortgage loses the ability to do so because he lost his job or incurred unanticipated expenses, he could seek to modify the plan to better reflect his changed financial circumstances or seek a hardship discharge under § 1328(b). However, as demonstrated in the *Hanley* case, it would be prudent to bring the motion early enough so that the hearing is held before the plan expires.

Finally, as some of the issues here involve a minority view, counsel can consider the extraordinary move of bringing an appeal.

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