

CHAPTER THREE

Adjustment of Debts Under Chapter 13

PART A - QUESTIONS AND ANSWERS ABOUT CHAPTER 13 CASES

1. What is a chapter 13 bankruptcy case and how does it work?

A chapter 13 bankruptcy case is a proceeding under federal law in which the debtor seeks relief under chapter 13 of the Bankruptcy Code. Chapter 13 is the chapter of the Bankruptcy Code which allows a person to repay all or a portion of his or her debts under the supervision and protection of the bankruptcy court. The Bankruptcy Code is the federal law that deals with bankruptcy. A person who files a chapter 13 case is called a debtor. In a chapter 13 case, the debtor must submit to the court a plan for the repayment of all or a portion of his or her debts. The plan must be approved by the court to become effective. If the court approves the debtor's plan, most creditors will be prohibited from collecting their claims from the debtor. The debtor must make regular payments to a person called the chapter 13 trustee, who collects the money paid by the debtor and disburses it to creditors in the manner called for in the plan. Upon completion of the payments called for in the plan, the debtor is released from liability for the remainder of his or her dischargeable debts.

2. How does a chapter 13 case differ from a chapter 7 case?

The basic difference between a chapter 7 case and a chapter 13 case is that in a chapter 7 case the debtor's nonexempt property (if any exists) is liquidated to pay as much as possible of the debtor's debts, while in chapter 13 cases a portion of the debtor's future income is used to pay as much of the debtor's debts as is feasible under the debtor's circumstances. As a practical matter, in a chapter 7 case the debtor loses all or most of his or her nonexempt property and receives a chapter 7 discharge, which releases the debtor from liability for most debts. In a chapter 13 case, the debtor usually retains his or her nonexempt property, but must pay off as much of his or her debts as the court deems feasible and receives a chapter 13 discharge, which is slightly broader than a chapter 7 discharge and releases the debtor from liability for a few types of debts that are not dischargeable under chapter 7. However, a chapter 13 case normally lasts much longer than a chapter 7 case and is usually more expensive for the debtor.

3. When is a chapter 13 case preferable to a chapter 7 case?

Chapter 13 is usually preferable for a person who - (1) wishes to repay all or most of his or her unsecured debts and has the income with which to do so within a reasonable time, (2) has valuable nonexempt property or has valuable exempt property securing debts, either of which would be lost in a chapter 7 case, (3) is not eligible under means testing to maintain a chapter 7 case, (4) is not eligible for a chapter 7 discharge, (5) has one or more substantial debts that are dischargeable under chapter 13 but not under chapter 7, or (6) has sufficient assets with which to repay most of his or her debts, but needs temporary relief from creditors in order to do so.

4. How does a chapter 13 case differ from a private debt consolidation service?

In a chapter 13 case, the bankruptcy court can provide relief to the debtor that a private debt consolidation service cannot provide. For example, the court has the authority to prohibit creditors from attaching or foreclosing on the debtor's property, to force unsecured creditors to accept a chapter 13 plan that pays only a portion of their claims, and to discharge a debtor from unpaid portions of debts. Private debt consolidation services have none of these powers.

5. What is a chapter 13 discharge?

It is a court order releasing a debtor from all of his or her dischargeable debts and ordering creditors not to collect them from the debtor. A debt that is discharged is one that the debtor is released from and does not have to pay. There are two types of chapter 13 discharges: (1) a full or successful plan discharge, which is granted to a debtor who completes all payments called for in the plan, and (2) a partial or unsuccessful plan discharge, which is granted to a debtor who is unable to complete the payments called for in the plan due to circumstances for which the debtor should not be held accountable. A full chapter 13 discharge discharges a few more debts than a chapter 7 discharge, while a partial chapter 13 discharge is similar to a chapter 7 discharge.

6. What types of debts are not dischargeable in chapter 13 cases?

A full chapter 13 discharge granted upon the completion of all payments required in the plan discharges a debtor from all debts except:

- (1) debts that were paid outside of the plan and not covered in the plan,
- (2) debts for domestic support obligations, which includes debts for child support and alimony,
- (3) debts for death or personal injury caused by the debtor's operation of a motor vehicle, vessel or aircraft while intoxicated,
- (4) most tax debts,
- (5) debts for restitution or criminal fines included in a sentence imposed on the debtor for conviction of a crime,
- (6) debts for fraud, embezzlement or larceny,
- (7) debts for student loans or educational obligations unless a court rules that not discharging the debt would impose an undue hardship on the debtor and his or her dependents,
- (8) debts for damages caused by willful or malicious conduct by the debtor,
- (9) installment debts whose last payment is due after the completion of the plan,
- (10) debts incurred while the plan was in effect that were not paid under the plan,
- (11) debts owed to creditors who did not receive notice of the chapter 13 case, and
- (12) long-term debts upon which payments were made under the plan.

A partial chapter 13 discharge, which is granted when a debtor is unable to complete the payments under a plan due to circumstances for which he or she should not be held accountable, discharges the debtor from all debts except:

- (1) secured debts (i.e., debts secured by mortgages or liens),
- (2) debts that were paid outside of the plan and not covered in the plan,
- (3) installment debts whose last payment is due after the completion of the plan,
- (4) debts incurred while the plan was in effect that were not paid under the plan,
- (5) debts owed to creditors who did not receive notice of the chapter 13 case,
- (6) debts that are not dischargeable in a chapter 7 case, and
- (7) long-term debts upon which payments were made under the plan.

7. What is a chapter 13 plan?

It is a written plan presented to the bankruptcy court by a debtor that states how much money or property the debtor will pay to the chapter 13 trustee, how long the debtor's payments to the chapter 13 trustee will continue, how much will be paid to each of the debtor's creditors, and certain other matters.

8. What is a chapter 13 trustee?

A chapter 13 trustee is a person appointed by the United States trustee to collect payments from the debtor,

make payments to creditors in the manner set forth in the debtor's plan, and administer the debtor's chapter 13 case until it is closed. In some cases the chapter 13 trustee is required to perform certain other duties. The debtor is required to cooperate with the chapter 13 trustee.

9. What debts may be paid under a chapter 13 plan?

Any debts whatsoever, whether they are secured or unsecured. Even debts that are nondischargeable, such as debts for student loans or child support, may be paid under a chapter 13 plan.

10. Must all debts be paid in full under a chapter 13 plan?

No. While priority debts, such as debts for domestic support obligations and taxes, and fully secured debts must be paid in full under a chapter 13 plan, only an amount that the debtor can reasonably afford must be paid on most debts. The unpaid balances of most debts that are not paid in full under a chapter 13 plan are discharged upon the completion or termination of the plan.

11. Must all unsecured debts be treated alike under a chapter 13 plan?

No. If there is a reasonable basis for doing so, unsecured debts (or claims) may be divided into separate classes and treated differently. It may be possible, therefore, to pay certain unsecured debts in full, while paying significantly less on others.

12. Is there a difference between a debt and a claim?

No, not in a practical sense. They are different terms for an obligation owed by the debtor to a creditor. A claim is the right of a creditor to the payment of an obligation by the debtor. A debt is a liability of a debtor on an obligation to a creditor. For example, if the debtor owes \$1,000 to the bank, the \$1,000 obligation is viewed as a debt by the debtor and as a claim by the bank.

13. How much of a debtor's income must be paid to the chapter 13 trustee under a chapter 13 plan?

Usually all of the disposable income of the debtor and the debtor's spouse for a 3 or 5 year period must be paid to the chapter 13 trustee. Disposable income is income received by the debtor and his or her spouse that is not deemed to be necessary for the support of the debtor and his or her dependents.

14. When must the debtor begin making payments to the chapter 13 trustee and how are the payments made?

The debtor must begin making payments to the chapter 13 trustee within 30 days after the chapter 13 case is filed with the court. The payments must be made regularly, usually on a weekly, bi-weekly, or monthly basis. If the debtor is employed, some courts require that the payments to be made directly to the chapter 13 trustee by the debtor's employer.

15. How long does a chapter 13 plan last?

The required length of a chapter 13 plan depends on the debtor's income. If the debtor's annual income is less than the median family income for the debtor's state and family size, the length of the plan must be 3 years, unless the debtor can justify a longer period, which may not exceed 5 years. If the debtor's annual income exceeds the median family income, the length of the plan must be 5 years unless all unsecured claims can be paid off in a shorter period. The debtor's annual income is his or her current monthly income multiplied by 12.

16. Is it necessary for all creditors to approve a chapter 13 plan?

No. To become effective, a chapter 13 plan must be approved by the court, not by the creditors. The court, however, cannot approve a plan unless each secured creditor is dealt with in the manner described in the answer to Question 18 below. Also, unsecured creditors are permitted to file objections to the debtor's plan, and these objections must be ruled on by the court before it can approve the debtor's chapter 13 plan.

17. What is the difference between a secured creditor and an unsecured creditor?

A secured creditor is a creditor whose claim against the debtor is secured by a valid mortgage, lien, or other security interest against property that is owned by the debtor. An unsecured creditor is a creditor whose claim against the debtor is not secured by a valid mortgage, lien or security interest against the debtor's property. In other words, a secured creditor has collateral for its claim and an unsecured creditor does not. The basic difference is that a secured creditor may collect all or a portion of its claim from its collateral, while an unsecured creditor may not. It is common for the amount of a secured creditor's claim to exceed the value of its collateral. This type of creditor is called a partially-secured (or undersecured) creditor. In chapter 13 cases the claims of most partially-secured creditors are divided into secured and unsecured portions. For example, a partially-secured creditor with a \$2,000 claim against the debtor that is secured by collateral that is worth \$1,500 has a \$1,500 secured claim and a \$500 unsecured claim. The only types of partially-secured creditors whose claim may not be treated in this manner are creditors secured by a mortgage on the debtor's home and certain creditors who advanced funds for the purchase of automobile or other personal property of the debtor. It is important to differentiate between secured and unsecured claims because they are treated quite differently in chapter 13 cases. Secured claims must be paid in full with interest, while only amounts that the debtor can reasonably afford need be paid to the holders of unsecured claims (except priority claims – see Question 36, *infra*).

18. How are the claims of secured creditors dealt with in chapter 13 cases?

There are four methods of dealing with secured claims in chapter 13 cases: (1) the creditor may accept the debtor's plan, (2) the creditor may retain its lien and be paid the full amount of its secured claim in equal monthly payments under the plan, (3) the debtor may surrender the collateral to the creditor, or (4) the creditor may be paid or dealt with outside the plan. It is important to understand that most partially-secured creditors have a secured claim only to the extent of the value of their collateral. If the debtor is in default to a secured creditor, the default must be cured (made current) within a reasonable time.

19. How are cosigned or guaranteed debts handled in chapter 13 cases?

A cosigned or guaranteed debt is a debt of the debtor that has been cosigned or guaranteed by another person. If a cosigned or guaranteed consumer debt is being paid in full under a chapter 13 plan, the creditor may not collect the debt from the cosigner or guarantor. However, if a consumer debt is not being paid in full under the plan, the creditor may collect the unpaid portion of the debt from the cosigner or guarantor. A consumer debt is a nonbusiness debt. Creditors may collect business debts from cosigners or guarantors even if the debts are to be paid in full under the debtor's plan.

20. Who is eligible to file a chapter 13 case?

Any individual (i.e., natural person) is eligible to file a chapter 13 case if he or she - (1) resides in, does business in, or owns property in the United States, (2) has regular income, (3) has unsecured debts of less than \$383,175*, (4) has secured debts of less than \$1,149,525*, (5) is not a stockbroker or a commodity broker, (6) has not intentionally dismissed another bankruptcy case within the last 180 days, and (7) has received a briefing from an approved credit counseling agency within the last 180 days (unless this requirement is not in effect in the local bankruptcy court). Corporations, partnerships, limited liability companies, and other business entities are not eligible to file a chapter 13 case.

* Subject to adjustment on April 1, 2016.

21. May a husband and wife file a joint chapter 13 case?

A husband and wife may file a joint chapter 13 case if each of them meets the requirements listed in the answer to Question 20 above, except that only one of them need have regular income and their combined debts must meet the debt limitations described in the answer to Question 20 above.

22. When should a husband and wife file a joint chapter 13 case?

If both spouses are liable for any significant debts, they should file a joint chapter 13 case, even if only one of them has income. Also, if both of them have regular income, they should file a joint case.

23. May a self-employed person file a chapter 13 case?

Yes. A self-employed person meeting the eligibility requirements listed in the answer to Question 20 above may file a chapter 13 case. A debtor engaged in business may continue to operate the business during his or her chapter 13 case.

24. May a chapter 7 case be converted to a chapter 13 case?

Yes. An existing chapter 7 case may be converted to a chapter 13 case at any time at the request of the debtor if the case has not previously been converted from chapter 13 to chapter 7.

25. Where is a chapter 13 case filed?

A chapter 13 case is filed in the office of the clerk of the bankruptcy court in the district where the debtor has lived or maintained a principal place of business for the greatest portion of the last 180 days. The bankruptcy court is a federal court and is a unit of the United States district court.

26. What fees are charged in a chapter 13 case?

There is a \$310 fee charged when the case is filed, which may be paid in installments if necessary. In addition, the chapter 13 trustee assesses a fee of up to 10 percent on all payments made by the debtor under the plan (up to a certain cap based on a variety of factors). Thus, if a debtor pays a total of \$5,000 under a chapter 13 plan, the total amount of fees charged in the case will be up to \$810 (up to a \$500 trustee's fee, plus the \$310 filing fee). These fees are in addition to the fee charged by the debtor's attorney.

27. Will a person lose any property if he or she files a chapter 13 case?

Usually not. In a chapter 13 case, creditors are usually paid out of the debtor's income and not from the debtor's property. However, if a debtor has valuable nonexempt property and has insufficient income to pay enough to creditors to satisfy the court, some of the debtor's property may have to be used to pay creditors.

28. How does the filing of a chapter 13 case affect collection proceedings and foreclosures that are filed against the debtor?

The filing of a chapter 13 case automatically stays (stops) all lawsuits, attachments, garnishments, foreclosures, and other actions by creditors against the debtor or the debtor's property. This stay is called the automatic stay. A few days after the case is filed, the court will mail a notice to all creditors advising them of the automatic stay. Certain creditors may be notified sooner, if necessary. Most creditors are prohibited from proceeding against the debtor during the entire course of the chapter 13 case. If the debtor is later granted a chapter 13 discharge, the creditors will then be prohibited from collecting the discharged debts from the debtor after the case is closed. If the debtor has had a prior bankruptcy case dismissed within the past year, he or she may be denied the protection of the automatic stay.

29. May a person whose debts are being administered by a financial counselor file a chapter 13 case?

Yes. A financial counselor has no legal authority to prevent a person from filing any type of bankruptcy case, including a chapter 13 case.

30. How does filing a chapter 13 case affect a person's credit rating?

It may worsen it, at least temporarily. However, if most of a person's debts are ultimately paid off under a chapter 13 plan, that fact may be taken into account by credit reporting agencies. If very little is paid on most debts, the effect of a chapter 13 case on a person's credit rating may be similar to that of a chapter 7 case.

31. Are the names of persons who file chapter 13 cases published?

When a chapter 13 case is filed, it becomes a public record and the name of the debtor may be published by some credit reporting agencies. However, newspapers do not usually publish the names of persons who file chapter 13 cases.

32. Is a person's employer notified when he or she files a chapter 13 case?

In most cases, yes. Many courts require a debtor's employer to make payments to the chapter 13 trustee on the debtor's behalf. Also, the chapter 13 trustee may contact an employer to verify the debtor's income. However, if there are compelling reasons for not informing an employer in a particular case, it may be possible to make other arrangements for the required information and payments.

33. Does a person lose any legal rights by filing a chapter 13 case?

No. A chapter 13 case is a civil proceeding and not a criminal proceeding. Therefore, a person does not lose any legal or constitutional rights by filing a chapter 13 case.

34. May employers or government agencies discriminate against persons who file chapter 13 cases?

No. It is illegal for either private or governmental employers to discriminate against a person as to employment because that person has filed a chapter 13 case. It is also illegal for local, state, or federal governmental agencies to discriminate against a person as to the granting of licenses, permits, student loans, and similar grants because that person has filed a chapter 13 case.

35. What is required for court approval of a chapter 13 plan?

The court will approve and confirm a chapter 13 plan if it finds that: (1) all required fees, charges and deposits have been paid, (2) all priority claims will be paid in full under the plan, (3) if the plan creates different classes of claims, it provides the same treatment for each claim within a particular class, (4) the plan was proposed in good faith, (5) each unsecured creditor will receive under the plan at least as much as it would have received had the debtor filed a chapter 7 case, (6) the debtor will be able to make the required payments and comply with the plan, and (7) each secured creditor is dealt with in one of the four methods described in the answer to Question 18 above.

36. What is a priority claim?

A priority claim is an unsecured claim that is given priority of payment under the Bankruptcy Code. It is a claim that must be paid before other unsecured claims are paid. Examples of priority claims are tax claims, wage claims, and claims for alimony, maintenance or support. Claims for administrative fees, such as the chapter 13 trustee's fee, the filing fee, and the fee of the debtor's attorney, are also priority claims in chapter 13 cases.

37. When does the debtor have to appear in court in a chapter 13 case?

Most debtors have to appear in court at least twice: once for a hearing called the meeting of creditors, and once for a hearing on the confirmation of the debtor's chapter 13 plan. The meeting of creditors is usually held about a month after the case is filed. The confirmation hearing may be held on the same day as the meeting of creditors or at a later date, depending on the scheduling practices in the local court. If difficulties or unusual circumstances arise during the course of a case, additional court appearances may be necessary.

38. What if the court does not approve a debtor's chapter 13 plan?

If the court will not approve the plan initially proposed by a debtor, the debtor may modify the plan and seek court approval of the modified plan. If the court does not approve a plan, it will usually give its reasons for refusing to do so, and the plan may then be appropriately modified so as become acceptable to the court. A debtor who does not wish to modify a proposed plan may either convert the case to a chapter 7 case or dismiss the case.

39. How are the claims of unsecured creditors handled in chapter 13 cases?

Unsecured creditors, including those with priority claims, must file their claims with the bankruptcy court within 90 days after the first date set for the meeting of creditors in order for their claims to be allowed. Unsecured creditors who fail to file claims within that period are barred from doing so, and upon completion of the plan their claims will be discharged. The debtor may file a claim on behalf of a creditor, if desired. After the claims have been filed, the debtor may file objections to any claims that he or she disputes. When the claims have been approved by the court, the chapter 13 trustee begins paying unsecured creditors in the manner and in the amounts provided for in the debtor's chapter 13 plan. Payments to secured creditors, priority creditors, and special classes of unsecured creditors may begin earlier, if desired.

40. What if the debtor is temporarily unable to make the chapter 13 payments?

If the debtor is temporarily out of work, injured, or otherwise unable to make the payments required under a chapter 13 plan, the plan can usually be modified so as to enable the debtor to resume the payments when he or she is able to do so. If it appears that the debtor's inability to make the required payments will continue indefinitely or for an extended period, the case may be dismissed or converted to a chapter 7 case.

41. What if the debtor incurs new debts or needs credit during a chapter 13 case?

Only two types of credit obligations or debts incurred after the filing of the case may be included in a chapter 13 plan. These are: (1) debts for taxes that become payable while the case is pending, and (2) consumer debts arising after the filing of the case that are for property or services necessary for the debtor's performance under the plan and that are approved in advance by the chapter 13 trustee. All other debts or credit obligations incurred after the case is filed must be paid by the debtor outside the plan. Some courts issue an order prohibiting the debtor from incurring new debts during the case unless they are approved in advance by the chapter 13 trustee. Therefore, the approval of the chapter 13 trustee should be obtained before incurring credit or new debts after the case has been filed. The incurrence of regular debts, such as debts for telephone service or utilities, do not require the trustee's approval.

42. What should the debtor do if he or she moves while the case is pending?

The debtor should immediately notify the bankruptcy court and the chapter 13 trustee in writing of the new address. Most communications in a chapter 13 case are by mail, and if the debtor fails to receive an order of the court or a notice from the chapter 13 trustee because of an incorrect address, the case may be dismissed. Many courts have change-of-address forms that may be used if the debtor moves.

43. What if the debtor later decides to discontinue the chapter 13 case?

The debtor has the right to either dismiss a chapter 13 case or convert it to a chapter 7 case at any time for any reason. However, if the debtor simply stops making the required chapter 13 payments, the court may compel the debtor or the debtor's employer to make the payments and to comply with the orders of the court. Therefore, a debtor who wishes to discontinue a chapter 13 case should do so through his or her attorney.

44. What happens if a debtor is unable to complete the chapter 13 payments?

A debtor who is unable to complete the chapter 13 payments has three options: (1) dismiss the chapter 13 case, (2) convert the chapter 13 case to a chapter 7 case, or (3) if the debtor is unable to complete the payments due to circumstances for which he or she should not be held accountable, close the case and obtain a partial chapter 13 discharge as described in the answer to Question 6 above.

45. What is the role of the debtor's attorney in a chapter 13 case?

The debtor's attorney performs the following functions in a typical chapter 13 case:

- (1) Examining the debtor's financial situation and determining whether a chapter 13 case is a feasible alternative for the debtor, and if so, whether a single or a joint case should be filed.
- (2) Assist the debtor in obtaining the required prebankruptcy briefing on budget and credit counseling.
- (3) Assisting the debtor in the preparation of a budget.
- (4) Examining the liens or security interests of secured creditors to ascertain their validity or avoidability, and taking the legal steps necessary to protect the debtor's interest in such matters.
- (5) Devising and implementing methods of dealing with secured creditors.
- (6) Assisting the debtor in devising a chapter 13 plan that meets the needs of the debtor and is acceptable to the court.
- (7) Preparing the necessary pleadings and chapter 13 forms.
- (8) Filing the chapter 13 forms and pleadings with the court.
- (9) Attending the meeting of creditors, the confirmation hearing, and any other court hearings required in the case.
- (10) Assisting the debtor in obtaining court approval of a chapter 13 plan.
- (11) Checking the claims filed in the case, filing objections to improper claims, and attending court hearings thereon.
- (12) Assisting the debtor in overcoming any legal obstacles that may arise during the course of the case.
- (13) Assisting the debtor in attending and completing the required instructional course on personal financial management.
- (14) Assisting the debtor in obtaining a discharge upon the completion or termination of the plan.

The fee charged by an attorney for representing a debtor in a chapter 13 case must be reviewed and approved by the bankruptcy court. This rule is followed whether the fee is paid to the attorney prior to or after the filing of the case, and whether it is paid to the attorney directly by the debtor or by the chapter 13 trustee. The court will not approve a fee unless it finds the fee to be reasonable.