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THE MAZE OF CHAPTER 13 POST-PETITION CONSUMER CLAIMS

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While Section 1305 talks about the filing and allowance of post-petition claims it gives little insight into their practical use and effect. This article will discuss the proper use of consumer post-petition claims and their effect on Chapter 13 plans.
The article is designed for both debtors and creditors counsel in advising their clients regarding the intricacies of post-petition claims.

I. WHO CAN FILE A POST-PETITION CLAIM?

Section 1305 provides in part:

(a) A proof of claim may be filed by any entity that holds a claim against the debtor.

This Section does not authorize the debtor to file a claim for post-petition debt nor does Section 501(c) which states:

(c) "If a creditor does not timely file a proof of such creditor's claim, the debtor or the trustee may file a proof of such claim." (Emphasis added.)

Section 501(c) allows a debtor or trustee to file a proof of claim on a pre-petition claim but not for a post-petition claim. The distinction arises because the word creditor used in 501(c) is defined by Section 101(9)(A) as:

"(A) 'creditor' means - entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor;" (Emphasis added.)

Since 501(c) only applies to claims that arose pre-petition, the debtor has no statutory right to file a claim for a post-petition debt.

The debtor also cannot add post-petition creditors to a plan by amending his Schedule under Rule 1009(a) which states in relevant part:

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(a) "a voluntary petition, schedule, or statement of affairs may be amended as a matter of course at any time before the case is closed."

Rule 1009(a) must be read in conjunction with Section 521(1) which defines what is required in the debtor's petition, schedules, and statement of affairs. Section 521 states that a debtor shall:

(1) file a list of creditors, and unless the court orders otherwise, a schedule of assets and liabilities....etc.

Again, the use of the word creditors in Section 521(1) as defined by Section 101(9) limits the debtor to amendments relating to only pre-petition creditors.

In summary, only the post-petition creditor and not the debtor can file or amend to add post-petition claims. See In re Jerome Nowak (8 BCD 1098), In re Roseboro, 77 Bankr. 38 (Bankr. W.D.N.C. 1987) and In re Pritchett, 55 Bankr. 557 (Bankr. W.D. Va. 1985).

II. WHEN SHOULD AMENDED CHAPTER 13 PLANS ACCOMPANY POST-PETITION CLAIMS?

If an allowed post-petition claim results in a significant decrease in the amount to be paid to claimants already participating in a confirmed plan, then the plan must be modified. Likewise, an amended plan may also be necessary when payment of a post-petition claim would cause a plan to extend beyond three years. In re Nelson, 27 Bankr. 341, 10 BANKR. CT. DEC (CRR) 189, 8 COLLIER BANKR. CAS.2d (MB) 250 (Bankr. M.D. Ga. 1983). The Court in Nelson supra, applies a strict reading of Section 1329(c) which limits a plan to three years unless the Court for cause approves a longer period not to exceed five years.

According to Nelson supra, a post-petition claim may be allowed without an amendment by the debtor only when payment of the post-petition claim can be made through the plan without extending the plan beyond three years and without decreasing the amount paid to pre-petition claims. In the Western District of Michigan Chapter the 13 trustees often require plan amendments when payments to the pre-petition unsecured creditors are substantially delayed or decreased. The purpose of such an amendment is to give the pre-petition creditors an opportunity to object to the allowance of post-petition claims which adversely affect them.

From a practical standpoint, if a small post-petition claim is allowed that delays payment to the pre-petition unsecured creditors by one or two months or decreases their dividend by a few percentage points, the trustee may not require an amended plan be filed. The trustee or Court will weigh the administrative burden and cost of noticing out such an amendment without the benefit to be derived from notifying pre-petition creditors of matters which may marginally affect them.

III. HOW IS A POST-PETITION CLAIM TO BE TREATED IN A PLAN?

The answer to this question varies considerably. Some Courts believe any allowed post-petition claim is entitled to 100% payment and other Courts such as the one in Nelson supra, believe the allowed post-petition claim should be paid the same as the pre-petition creditors in the confirmed Chapter 13 plan.

Section 1305(b) which deals with filing and allowance of post-petition claims states in relevant part:

b .....; and shall be allowed under 502(a), 502(b), or 502(c) of this title, or disallowed under Section 502(d) or 502(e) of this title, the same as if such claim had arisen before the date of the filing of the petition. (Emphasis added.)

The implication of the above underlined language was interpreted in Nelson supra, to mean that an if the confirmed plan paid a 10% dividend to unsecured creditors, then the allowed post-petition creditor would also receive a 10% dividend.

In order to avoid any adverse affect on the pre-petition creditors, the Court and Chapter 13 trustees in the Western District of Michigan have generally allowed post-petition claims only if an amendment is filed paying them 100% after the pre-petition creditors are paid pursuant to the plan. The Court also requires that any amended plan which includes payment of post-petition claims must be completed within 60 months pursuant to Section 1329(c). This approach does not follow Nelson supra, which requires that a post-petition allowed claim be paid within the same priority and percentage amount as pre-petition creditors.

IV. WHEN SHOULD A CREDITOR FILE A POST-PETITION CLAIM?

Before filing a post-petition claim the creditor or creditor's attorney should investigate several factors which will affect the treatment of the claim. If the Nelson supra, approach is followed by the Court it may not be wise to file the post-petition claim in a 10% plan, particularly if the plan is near completion. In such a case the post-petition creditor can just wait for the plan to complete and when the debtor's discharge is granted the creditor can attempt to collect 100% on the post-petition debt. Since the post-petition claim is not filed it will not be provided for in the plan, and as a result the completion of the Chapter 13 plan will not discharge the post-petition debt, (Section 1328 (a)). See Roseboro supra, Pritchett supra, Accord Hester v. Powell, 63 Bankr. 607 (Bankr. E.D. Tenn. 1986).

Under the Nelson supra, treatment (post-petition claims paid same percentage as pre-petition creditors) the creditors must weigh the risks and advantages of Chapter 13 plans as the percentage dividend to unsecured creditors increases. For example, in a 60% plan which has two years left, the post-petition creditor has a decent chance of receiving sixty cents on the dollar within a two year period. If the post-petition creditors decides not to file a claim and wait the two years he runs the risk that the debtor's financial condition will diminish; the debtor could refile another lower percentage Chapter 13, or could file a Chapter 7 case.

With the Western District of Michigan approach, the post-petition creditor is given 100% dividend but only at the end of the plan. Here the post-petition creditor could just as easily not file the claim, let the plan end sooner and then pursue his State Court remedies. However, by filing the post-petition claim, the creditor may have a better chance of receiving payment through a Chapter 13 plan if the debtor continues on a payroll deduction order (it's like a free garnishment for the creditor) under the protection of the Court.

While there may be many approaches to the treatment of post-petition claims, the Nelson supra, approach is favored by Collier On Bankruptcy which states:

> " There is no requirement that the holder file proof of a post-petition claim under Section 1305. The congressional purpose behind Section 1305 is to permit the same treatment of certain post-petition credit extended to the Chapter 13 debtor as for a pre-petition claim for purposes of proof, allowance, and priority. The holder of such a

post-petition claim may refrain from filing proof of the post-petition claim, thereby waiving the right to distribution under the Chapter 13 plan, in hopes of recovering against the debtor after the closing of the case. A discharge granted in a Chapter 13 case would not relieve the debtor of liability on a post-petition claim, unless the debt had been provided for by the plan." (5 Collier on Bankruptcy, Para. 1305.01(2) (15th Edition 1982).

However, the post-petition claimant must always be wary of filing a post-petition claim particularly in Courts which follow the Nelson approach. For example, suppose the debtor has an 80% confirmed Chapter 13 plan and the post-petition creditor decides to file its post-petition claim. Assume further that prior to filing the claim the debtor amends the Chapter 13 plan and increases payments so the post-petition claim can be paid 80% without affecting the pre-petition creditors. Now suppose four months later the debtor has a legitimate change in circumstances and files a second Chapter 13 plan amendment which reduces plan payments and the percentage dividend to all unsecured creditors to 10% (assume the debtor's budget supports this and the debtor meets the good faith and liquidity test.) Unfortunately for the post-petition creditor, Section 1329(a)(1) will allow the debtor at any time after confirmation of the plan to modify the plan to:

(1) increase or reduce the amount of payments on claims of a particular class provided for by the plan. (Emphasis added.)

Here the word claim is not limited to claims which arose on or prior to the filing date but includes any claim including post-petition claims. (See Section 101(4) definition of "claim"). As a result the post-petition creditor has submitted to the jurisdiction of the amended plan causing his dividend to be substantially reduced!

While the above results appear unfair the economic reality is the same for a post-petition creditor whether or not the debtor is in Chapter 13. The creditor took the risk of dealing with a person who pursuant to the Bankruptcy Code could legally pay only 10% on the dollar.

V. WHAT TYPE OF POST-PETITION CONSUMER CLAIM WILL BE ALLOWED?

Section 1305 states in relevant part,

(a) A proof of claim may be filed by any entity that holds a claim against the debtor-

(2) That is a consumer debt, that arises after the date of the order for relief under this chapter, and that is for property or services necessary for the debtor's performance under the plan.

(b) Except as provided in subsection (c) of this section, a claim filed under subsection (a) of this section shall be allowed or disallowed under section 502 of this title, but shall be determined as of the date such claim arises, and shall be allowed under section 502(a), 502(b) or 502(c) of this title, or disallowed under section 502(d) or 502(e) of this title, the same as if such claim had arisen before the date of the filing of the petition.

(c) A claim filed under subsection (a)(2) of this section shall be disallowed if the holder of such claim knew or should have known that prior approval by the trustee of the debtor's incurring the obligation was practicable and was not obtained.

Clearly, post-petition consumer debts that are for property or services necessary for the debtor's performance under the plan may be filed by the entity that holds the claim against the debtor. However, allowance of such claims is limited by 1305(c) and other factors to be explained.

Pursuant to 1305(b), a post-petition claim filed under 1305(a) will be allowed under Section 502(a). Section 502(a) basically says the filed post-petition claim will be allowed unless a party in interest objects. A party in interest could be either the trustee, a pre-petition creditor or the debtor, and one of the grounds for such objection could be under Section 1305(c).

Under Section 1305(c) the objecting party must prove that the holder of the claim (post-petition claim) knew or should have known that prior approval by the trustee of the debtor's incurring of the obligation was practical and was not obtained. In my experience, the debtor rarely tells the post-petition creditor that he is in Chapter 13. In order for Section 1305(c) to have any real disallowance power, the Court would have to impose a presumption of knowledge on the post-petition creditor or actually require every retailer to do a Bankruptcy check on every customer. Many post-petition claims are for medical services and of an emergency nature which would excuse the provider from taking the time to check into the debtor's bankruptcy background. As a result, a Section 1305(c) objection is rarely successful.

Most objections to post-petition claims and plan amendments to add post-petition claims are successful under Section 1305(a)(2) which states the claim must be for property or services necessary for the debtor's performance under the plan. In <u>Roseboro</u> supra, the debtor's purchase of a telephone, a fan, an iron, a color television, a watch, a picture and a bedroom suite was not necessary for the debtor's performance under the plan and was not allowed as a post-petition claim under Section 1305(a)(2).

In re <u>Nelson</u> supra, Bankruptcy Judge Robert F. Hershner actually heard three separate cases (<u>Nelson</u>, <u>McDaniel</u> and <u>Singleton</u>) all dealing with Bibb Collection Service, Inc., who filed post-petition medical claims in each case. The Chapter 13 trustee filed objections to each claim. In <u>Nelson</u>, Bibb Collection filed a post-petition medical claim in the amount of $1,406.85 for the birth of a child to the Nelson's minor daughter. Without deciding the issues in Section 1305(a)(2) (necessary for debtor's performance of plan) and Section 1305(c) (knew or should have known prior approval necessary) the Court disallowed the $1,406.85 claim because the debtor did not file an amended plan to accommodate the affects the claim had on the existing plan.

The <u>Singleton</u> case dealt with a $206.00 post-petition claim filed by Bibb Collection for medical services. The Court was quick to determine that the medical services were necessary for the debtor's performance under the plan 1305(a)(2) and also found that Section 1305(c) was not applicable because of the emergency nature of such services. The Court reasoned that the $206.00 amount was small enough not to require a plan amendment but was large enough to stretch the debtor's budget to the breaking point, thus affecting the debtor's ability to make the payments under his Chapter 13 plan. Therefore, the Court allowed the post-petition claim without requiring an amendment by the debtor.

In the <u>McDaniel</u> case Bibb Collection filed a $46.00 medical services claim. The Court made exactly the same findings under Section 1305(a)(2) and 1305(c) as in the <u>Singleton</u> case but disallowed the claim. The Court reasoned that because the claim was a small routine medical expense the debtor should be prepared to pay it from his budget (the McDaniel's budget allocated $20.00 per month for medical needs).

The Court in the McDaniel's case basically said that if the debt is covered in the budget it may not be allowed. In the Western District of Michigan Judge David E. Nims has similarly ruled from the bench that amended Chapter 13 plans adding routine utility debts which should have been paid from the debtor's budget will not be allowed.

VI. DISCHARGE OF POST-PETITION CLAIMS - SECTION 1328(d)

Suppose under the Nelson supra, approach the debtor's 50% amended plan included a $1,200.00 post-petition allowed claim. Assume further that the amended plan paid the post-petition creditor $600.00 and that the plan was completed and a discharge granted. Under the above circumstances, would the balance of $600.00 be discharged? The answer depends on Section 1328(d) which deals with the discharge of Section 1305(a)(2) consumer debts.

Section 1328(d) states:

> (d) Notwithstanding any other provision of this section, a discharge granted under this section does not discharge the debtor from any debt based on an allowed claim filed under Section 1305(a)(2) of this title if prior approval by the trustee of the debtor's incurring such debt was practicable and was not obtained.

If it was practical for the debtor to obtain prior approval of the trustee before incurring the $1,200.00 debt, and the debtor failed to obtain such approval, then the $600.00 balance would not be discharged. As a result the debtor's fresh start could be jeopardized because the post-petition creditor may sue for the $600.00 balance after the Chapter 13 plan was completed.

Debtor's counsel should always advise their clients to obtain written approval from the Chapter 13 trustee prior to incurring any significant post-petition debt that cannot be paid for from their budget.

LOCAL BANKRUPTCY STATISTICS

The following is a summary of the number of bankruptcy cases commenced in the United States Bankruptcy Court for the Western District of Michigan during the period from January 1, 1990 through May 31, 1990. These filings are compared to those made during the same period one year ago, and two years ago.

	1/1/90 - 5/31/90	1/1/89 - 5/31/89	1/1/88 - 5/31/88
Chapter 7	1,694	1,390	1,215
Chapter 11	61	45	44
Chapter 12	6	4	15
Chapter 13	676	581	495

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF MICHIGAN

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The following are summaries of recent court decisions that address important issues of bankruptcy law and procedure. These summaries were prepared by Patrick E. Mears with the assistance of Larry A. Ver Merris.

United States v. Energy Resources Co., Case No. 89-255 (U.S.S.Ct. May 29, 1990). In this decision authored by Justice White, the United States Supreme Court held that a bankruptcy court, acting pursuant to its broad equitable powers under 11 U.S.C. § 105(a), has the authority to order the Internal Revenue Service "to treat tax payments made by Chapter 11 debtor corporations as trust fund payments where the bankruptcy court determines that this designation is necessary for the success of a reorganization plan." This decision effectively overrules In re DuCharmes & Co., 852 F.2d 194 (6th Cir. 1988), summarized in Volume 1, Number 1 of the Newsletter.

Minority Employees of the Tennessee Dept. of Employment Security, Inc. v. State of Tennessee, Case No. 88-5429 (6th Cir. April 26, 1990). In this decision, rendered in a non-bankruptcy case, the Sixth Circuit Court of Appeals construed Federal Rule of Appellate Procedure 3(c), which requires a notice of appeal to specify the party or parties taking the appeal. The Sixth Circuit, ruling en banc, held that a notice of appeal which includes the name of only one appellant in the caption and refers to the other appellants only by the designation "et al." does not confer appellate jurisdiction upon the unnamed parties to the appeal. If the parties unnamed in the caption are specified in the body of the notice of appeal, appellate jurisdiction will be conferred upon them although the Sixth Circuit warned that "[a]ny ambiguity will defeat the notice."

Kempf v. The City of Lansing (In re Diamond Reo Trucks, Inc.), Adversary Proceeding No. 88-0398 (June 20, 1990). This decision rendered by Bankruptcy Judge Laurence E. Howard arose from the Diamond Reo Trucks bankruptcy case that has been pending since 1974. In 1988, Diamond Reo's bankruptcy trustee commenced this adversary proceeding against the City of Lansing and others to collect for environmental cleanup costs at a manufacturing site formerly occupied by the debtor. The trustee, the City of Lansing and certain other defendants filed motions for summary judgment, all of which are addressed in the opinion (but not all of which will be summarized here). The trustee moved for summary judgment on the issue of whether the defendants' claims for indemnification and contribution under CERCLA were not allowed under section 57d of the Bankruptcy Act of 1898 since they were contingent and unliquidated. The trustee's motion also asked the bankruptcy court to hold that these claims, if allowed, would not be accorded administrative expense status. In denying this motion, Judge Howard noted that section 57d of the Bankruptcy Act of 1898 differs from section 502(e) of the Bankruptcy Code. Specifically, under section 57d a bankruptcy court could use its discretion "in allowing an unliquidated or contingent claim if the court believed that the claim could be reasonably estimated." In opposing the motion, defendants argued that since there were estimates of the cleanup costs and since the City of Lansing had nearly completed its remedial plans for the site, these claims were capable of reasonable estimation. Judge Howard also stated that if the City of Lansing expended monies to clean up the site and recovered monies from the other defendants under contribution or indemnity theories, the allowed claims of

those defendants for contribution against the debtor's estate would be entitled to administrative expense priority.

Robbins v. Comerica Bank-Detroit (In re Zwagerman), Adversary Proceeding No. 86-375 (Bankr. W.D. Mich. June 19, 1990). In this case, the Chapter 7 debtors, Gordon and Joan Zwagerman ("Debtors"), filed a voluntary Chapter 7 petition on December 30, 1985. Prior to that date, Debtors operated a farm at which they fattened hogs and cattle and then sold them for slaughter. Sometime in the early 1980s, the Debtors began to bring cattle owned by others into their feed lots for fattening. One of the persons for whom Debtors provided these fattening services was David Bradley ("Bradley"). Various shipments of cattle were made by Bradley over time pursuant to written contracts. These contracts recognized the ownership interest of Bradley in the cattle and provided for their sale when their body weight reached 1,100 pounds. Upon their sale, the cash proceeds would be delivered to Bradley who would then pay Debtors for their services. When Bradley's cattle were delivered to Debtors, they were not segregated from the other cattle on Debtors' farm nor were they branded or ear-tagged.

In 1983, Debtor obtained new loans from Comerica Bank-Detroit ("Comerica") to replace prior credit facilities with other financing institutions. As security for this new indebtedness, Debtors granted Comerica liens in their livestock. These liens were duly perfected by Comerica. During the 90-day preference period, Bradley received certain proceeds from the sale of his cattle on Debtors' farm. A few weeks prior to Debtors' bankruptcy, Debtors' counsel advised Comerica of Debtors' mounting financial difficulties and of Bradley's ownership interest in certain cattle on the farm. After the bankruptcy petition was filed, the bankruptcy trustee sold certain cattle from the farm and held the cash proceeds from these sales and other pre-petition sales in a special account.

In 1986, the Trustee commenced this adversary proceeding against Comerica, Bradley and others to determine the parties' respective rights and interests in these sale proceeds. In his Complaint, the Trustee also asserted a claim for recovery of monies paid to Bradley within the 90-day preference period. After trial, Bankruptcy Judge David E. Nims, Jr. held that the relationship between Bradley and the Debtors was a bailment and not a consignment within the scope of section 2-326 of the Uniform Commercial Code. Consequently, Comerica's lien failed to attach to the cattle or the proceeds of their sale and Bradley was entitled to receipt of these proceeds. Since the monies paid to Bradley during the preference period were not property of the Debtors, Bradley was not liable for the return of these as preferences. Alternatively, even if these monies were deemed to be the Debtors' property, Bradley would be entitled to the ordinary course of business defense of 11 U.S.C. § 547(c)(2). In conclusion, Judge Nims ordered that the trustee's complaint be dismissed and the trustee was directed to turn over all sale proceeds to Bradley less any reasonable charges incurred under 11 U.S.C. § 506(c).

In re Auto Specialties Mfg. Co., Case No. SK 88-03095 (Bankr. W.D. Mich. June 11, 1990). This decision, rendered by Bankruptcy Judge JoAnn Stevenson, addressed the "sixth and final" application for allowance of attorneys' fees and expenses incurred by counsel to the Chapter 11 debtor, Kirkland & Ellis ("K & E"). The United States Trustee objected to K & E's application "on the basis of the inordinate number of insufficiently documented entries, excessive 'lumping' of time entries and a disproportionate number of intra-office conferences where billing appear[ed] to be excessive."

In her opinion, Judge Stevenson first noted that all professionals appointed by the Bankruptcy Court for the Western District of Michigan must comply with "the standards for applications for compensation as set forth in 11 U.S.C. §§

328 and 330(a)(1), Bankruptcy Rule 2016, Local Rule 14 and the August 2, 1989 Fee Guidelines . . .. The burden of proof regarding all fee applications is imposed upon the applicant." Judge Stevenson then described certain instances of K & E's "lumping" or "bunching" a number of activities into a single entry in the application. These descriptions did not comply with the court's requirement that "[e]ach type of service must be listed with a corresponding specific time allotment." Finding that the K & E application improperly explained 359.5 hours of professional work or $61,985.50 in fees, this sum was deducted from their fee award. This ruling, however, was without prejudice to K & E's right to file within 60 days of the entry of the Court's order an amended fee application properly describing these services.

In re Luchenbill, 112 Bankr. 204 (Bankr. E.D. Mich. 1990). In a lengthy and detailed opinion, Bankruptcy Judge Arthur J. Spector refused to confirm a Chapter 12 plan over objections on good faith, best interest of creditors and feasibility grounds. Judge Spector also dismissed the Chapter 12 case under 11 U.S.C. § 1208(c)(5) because the plan had not been confirmed. Due to its length, this scholarly opinion will not be summarized here.

STEERING COMMITTEE MEETING MINUTES

A meeting was held on June 15, 1990 at noon at the Peninsular Club.

1. Discussion was had regarding publishing of the Steering Committee members. This will be done after the Steering Committee members have been selected at the August meeting.

2. I reported that the bulk mailing permit has now been obtained and that we are still working on getting the necessary information so as to, hopefully, obtain a special rate permit.

3. Ellen G. Ritteman announced that as of July 13, 1990 she will be leaving her position as Assistant U.S. Trustee for this District and will assume an administrative law judge position in Fort Wayne, Indiana. Best of luck to Ellen in this new endeavor. Ellen requested that anyone interested n applying for this soon-to-be-vacated position send his/her resume addressed to Conrad Morgenstern, c/o the Office of the U.S. Trustee, 190 Monroe Avenue, Suite 200, Grand Rapids, Michigan 49503.

4. A brief report was made on the progress of the Shanty Creek Seminar. Reservations are pouring in, so if you plan to attend, send your enrollment form at once, and no later than August 12, 1990. Also, if you are planning to stay at Shanty Creek Resort, your room reservation form should be in by no later than July 23 as they will not hold rooms after that date.

5. Discussion was also had regarding the Federal Bar Association October meeting and possible topics for the bankruptcy segment of such meeting.

6. The next Steering Committee meeting was scheduled for noon at the Peninsular Club on Friday, July 20, 1990.

Larry A. Ver Merris