# FEDERAL BAR ASSOCIATION – BANKRUPTCY SECTION NEWSLETTER

SUMMER 2017


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## NEWS & ANNOUNCEMENTS

FBA STATE OF THE COURT LUNCHEON

All members of the Bankruptcy Bar and their friends are invited to the 2017 State of the Court Luncheon to be held on Friday, October 13, 2017 at noon at the JW Marriott International Ballroom. For information and the reservation form, please see the flier attached to this newsletter.

PROPOSED AMENDMENTS PUBLISHED FOR PUBLIC COMMENT

The Judicial Conference Advisory Committees on Appellate, Bankruptcy, Criminal, and Evidence Rules have published proposed amendments to their respective rules and forms, and requested that the proposals be circulated to the bench, bar, and public for comment. The proposed amendments, rules committee reports explaining the proposed changes, and instructions on how to submit comments are posted on uscourts.gov. The public comment period ends February 15, 2018.

2017 BEST PRACTICES SEMINAR (U.S. BANKRUPTCY COURT, WESTERN DISTRICT OF MICHIGAN)

The Office of the United States Trustee and Chapter 13 Trustees Brett Rodgers and Barbara Foley are offering a free Bankruptcy Best Practices Seminar to be held Monday, September 18, 2017. For more information and to register, see the flier and registration form attached to this newsletter.

BANKRUPTCY SECTION WEBSITE

For more information and announcements, and to see photos from the recent 2017 FBA Bankruptcy Section Seminar held at Boyne Highlands, please visit the Bankruptcy Section's website – www.fbabankruptcy.com

SAVE THE DATE

The 2018 FBA Bankruptcy Section Seminar will be held July 27-28, 2018 in Traverse City, Michigan.

## LETTER FROM THE CHAIR
### BENJAMIN M. WHITE

First, a big "thank you" to everyone who worked so hard to make this year's Seminar at Boyne Highlands such a great success, and especially all of our sponsors, panelists and attendees. Special thanks to Michelle Wilson and Todd Almassian, our Seminar Co-Chairs, for all of their hard work in organizing, planning, and executing the event. We're so thankful for the time and effort they volunteer out of their busy schedules throughout the year to create such a wonderful event for all of us.

Another special thank you to our Educational Co-Chairs, the Honorable John T. Gregg and the Honorable James W. Boyd, for putting together an excellent educational program this year that offered attendees extremely valuable information covering a full range of bankruptcy topics. And finally, thank you to the Seminar's Keynote Speaker, Professor Mark Yochum, Esq., of Duquesne University School of Law, for his entertaining talk on how to live and practice ethically.

As always, and just as importantly, the Seminar also provided members of the bench and bar an opportunity to socialize and get to know each other outside the courtrooms and the conference rooms, which strengthens and raises the level of practice in our District.

We are actively planning next year's 30th Anniversary Seminar which will take place July 26-28, 2018 at the Park Place Hotel in Traverse City. The 2018 FBA Bankruptcy Seminar will be the 30th Anniversary installment of the seminar, so you won't want to miss it!

The Bankruptcy Section is pleased to again sponsor the upcoming Annual State of the Court Luncheon on October 13, 2017 at the JW Marriott in Grand Rapids. This year's Keynote Speaker will be Lawrence Ponoroff, Dean and Professor of Law at the Michigan State University College of Law. Professor Ponoroff is the author and co-author of numerous law review articles and essays, as well as six books in the areas of business and consumer bankruptcy, contracts, and commercial law. Professor Ponoroff has previously served on the Advisory Board of the American Bankruptcy Institute Law Review, and in 2003 he was elected Fellow of the American College of Bankruptcy.

*Benjamin M. White, Chair*

## THOSE WHO PURCHASE DEBT ARE NOT "DEBT COLLECTORS" UNDER THE FAIR DEBT COLLECTION PRACTICES ACT

ELIZABETH VON EITZEN
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In *Henson v. Santander Consumer USA Inc.*, issued June 12, 2017 (No. 16-349), the Supreme Court held that those who seek to collect on purchased debts are not considered "debt collectors" under the Fair Debt Collection Practices Act (the "FDCPA") and therefore are not required to abide by the statutory limitations on debt collection practices.

**The Court's Reasoning**

The FDCPA defines a "debt collector" as anyone who "regularly collects or attempts to collect . . . *debts owed or due* . . . *another*" (emphasis added). The Supreme Court held that under a plain reading, this language encompasses only a third party collecting on behalf of the debt owner, not a debt owner seeking to collect debts for itself.

The Court rejected the petitioners' argument that the word "owed" must mean *previously owed* to another and would therefore exclude loan originators but embrace loan purchasers as "debt collectors." This is because the word "owed" is often used to refer to present debt relationships, both generally and in other provisions of the FDCPA. The Court is therefore able to rely on the presumption that identical words carry the same meaning. Further, other portions of the statute make clear that when Congress wished to distinguish between loan purchasers and originators, it would leave no doubt in the matter.

The Court also rejected the argument that the exclusion of debt purchasers works against the FDCPA's purpose, which was to protect debtors from abusive collection practices not typically employed by creditors themselves. The petitioners argued that large-scale debt purchasers like the respondent are similarly likely to engage in abusive collection practices that are sometimes employed by third party debt collectors. However, the Court noted that it is not the Court's job to speculate about what Congress might have done if it had been confronted with the market for defaulted debt, which all parties agreed did not exist when the FDCPA was passed in 1977. Further, reasonable legislators could differ on how to deal with purchasers of defaulted debt.

**The Impact and Implications for Creditors and Debtors**

The Supreme Court's decision makes clear that the debt collection requirements imposed on "debt collectors" by the FDPCA do not apply to those collecting on debt that they purchased. Therefore, those who fall within this category are permitted to engage in collection practices that are prohibited for third party debt collectors under the FDCPA.

The Court did not decide whether the party seeking to collect the debt could qualify as a debt collector under the FDCPA because it regularly collected debts owed by other debtors on behalf third parties, as well as debts purchased for its own account. The Court also did not decide whether the party seeking to collect the debt could qualify as a debt collector under the provision for businesses whose principal purpose is to engage in the collection of debts. Finally, since the Court considered the issue in this case an issue for Congress to resolve, future legislation could change to address collection practices of debt purchasers.

## REVOLUTION COME, REVOLUTION GO . . .
## RECENT CHAPTER 13 DECISIONS OF NOTE

HON. JOHN T. GREGG
UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF MICHIGAN

The term "stagnant" should rarely, if ever, be used to describe Chapter 13. As a decision on one hotly debated legal issue is rendered, another rises to take its place. Courts and practitioners alike are thus challenged to remain informed of the constantly changing landscape in Chapter 13. The decisions discussed below are but a small sampling of recent noteworthy developments that may provide insight to various parties as they navigate through Chapter 13.[1]

### *A. Plan Can Require Secured Creditors to Provide Monthly Account Statements*

In a Chapter 13 bankruptcy case, a debtor often seeks to retain his or her principal residence, vehicle and other assets that are subject to a mortgage, security interest or other lien. Chapter 13 generally allows a debtor to cure arrearages on prepetition debts while maintaining the payments that come due and owing during the life of a plan. The debtor's ultimate goal, of course, is to emerge from bankruptcy with a fresh start, including by being current with respect to continuing secured debt. Yet a secured creditor's post-petition payment adjustments and charges can derail a debtor's plan and prevent even the most devoted debtor from achieving this ultimate goal. It is therefore understandable that a debtor may seek to obtain from a secured creditor as much information as possible throughout a Chapter 13 case to circumvent any surprises at the end of the case.

The Bankruptcy Court for the District of Massachusetts recently considered whether it was appropriate to confirm a plan that required secured creditors to provide the debtors with monthly account statements in order to ensure that the debtors received timely notice of any change in payment, including fees and charges related thereto. *See In re Sperry*, 562 B.R. 1 (Bankr. D. Mass. 2016).

In *Sperry*, the debtors proposed a "cure and maintain" Chapter 13 plan requiring them to pay arrears to the mortgagee over a sixty month period while continuing to make monthly mortgage payments. Using the model plan adopted in the district, the debtors included an additional provision which required the mortgagee to send monthly mortgage loan statements to the debtors "consistent with its prepetition practices."[2]

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[1] Neither the author nor the Bankruptcy Court for the Western District of Michigan express any opinion regarding the decisions discussed in this article. The discussion is by no means comprehensive. Practitioners are encouraged to review the actual decisions in order to thoroughly understand the issues and holdings.

[2] The debtors also included a similar additional provision with respect to the holder of the secured claim on their vehicle. The vehicle lender did not object to such provision.

The mortgagee objected to confirmation, arguing that the additional provision rendered the debtors' plan unconfirmable. First, the mortgagee contended that "logistical limitations" prevented it from sending the accounting statements and that it was "developing a system" to ensure that when it sends statements, they are not "confusing" to a debtor. As such, the mortgagee invited the debtors to call it at any time to obtain this information. Second, the mortgagee expressed concern that such statements might violate the automatic stay. Third, the mortgagee suggested that it was exempt from sending such statements under federal regulations, including 12 C.F.R. § 1026.1 *et seq*. under the Truth in Lending Act and 12 C.F.R. § 1024 *et seq*. under the Real Estate Settlement and Procedures Act.

In overruling the mortgagee's objection and confirming the debtors' plan, the court began by summarizing section 1322(b)(2), namely its prohibition on the modification of rights of a mortgagee with a security interest in real property that is the debtor's principal residence. The court noted that section 1322(b)(2) is not without its own exception – the cure and maintain provisions of section 1322(b)(5). Moreover, section 1322(b)(11) allows a plan to include "any other appropriate provision consistent with" the Bankruptcy Code.

The court also observed that in 2011, Rule 3002.1 of the Federal Rules of Bankruptcy Procedures was adopted to implement the cure and maintain provision set forth in section 1322(b)(5). Nonetheless, prior to the adoption of current Bankruptcy Rule 3002.1, numerous courts throughout the country had recognized the propriety of such a plan provision. Those courts emphasized that in order to protect a debtor's cure and maintain rights and thus mitigate the threat of defaults under the plan, it may be appropriate for the plan to require a secured creditor to provide additional accounting information.

The court rejected the mortgagee's argument that requiring a monthly statement is an impermissible modification under section 1322(b)(2) because Bankruptcy Rule 3002.1 already imposes numerous reporting requirements. According to the court, the adoption of current Bankruptcy Rule 3002.1 did not alter the propriety of such a provision and such statements were consistent with the purpose of the cure and maintain provision of section 1322(b)(5).

Furthermore, the court distinguished between modification of "rights" under section 1322(b)(2) and imposition on the mortgagee of an "obligation" that is designed to assist a debtor in satisfying the cure and maintain provision of section 1322(b)(5). Finally, even if the obligation could be characterized as a right, the court concluded that its procedural nature would exclude it from the anti-modification provision of section 1322(b)(2).

The court was also unpersuaded by the mortgagee's argument that requiring the mortgagee to send monthly statements would violate the automatic stay. Citing to *In re Solitro*, 382 B.R. 150 (Bankr. D. Mass. 2008) and *In re Rose*, 2015 WL 151221 (Bankr. W.D. Mich. Jan. 12, 2015), the court recognized that although additional provisions should be kept to a minimum, they are permissible so long as they "suit the circumstances." Because a fundamental purpose was served (i.e., ensuring timely notice of additional amounts that would need to be paid during the case), the court concluded that nothing prohibits a debtor from including an additional provision in a plan that states certain actions of creditors will be deemed not to violate the automatic stay.

Next, the court found that the regulations provided no support to the mortgagee. Although the regulations *excuse* a mortgagee from sending monthly statements during a bankruptcy case, the court recognized that they do not *prohibit* a mortgagee from sending such statements. The court stressed that because the post-confirmation monthly mortgage statements would be the same as those sent by the mortgagee prepetition, the additional provision did not impose any obligation on the mortgagee that it did not already have before the filing of the petition.

Lastly, the court rejected the mortgagee's argument that the statements would be a burden. According to the court, the burden to the mortgagee was outweighed by the harm to the debtors if the statements were not provided. The court therefore confirmed the debtors' plan over the mortgagee's objection.

### *B. Bankruptcy Court Has Discretion to Permit Curative Plan Payments After Sixty Months*

The Bankruptcy Code establishes certain limits regarding the amount of time that a debtor may remain in Chapter 13. It is axiomatic that a Chapter 13 plan cannot provide for payments over a period that is longer than five years. Debtors in bankruptcy are often confronted with situations where a small shortfall may exist at the end of a case as a result of, among other things, higher fees than projected, or larger secured claims than expected. A recent decision from the Third Circuit Court of Appeals addresses the sticky issue of whether a debtor is entitled to a short grace period (and ultimately, the entry of a discharge) when the debtor cures a plan payment arrearage shortly after the expiration of the five year plan term. *See In re Klaas*, 858 F.3d 820 (3d Cir. 2017).

In *Klaas*, the debtors confirmed a plan that required monthly payments for a period of sixty months. The debtors consistently made the requisite monthly payment. However, sixty-one months after "the start of the plan," the Chapter 13 trustee filed a motion to dismiss under section 1307(c)(6) because the debtors allegedly still owed just over $1,000 to complete their plan base.

In order to cure the deficiency, the debtors promptly remitted the necessary funds. The trustee thereafter withdrew her motion, but not before a creditor filed a joinder.[3] The creditor argued that the late payment made by the debtors was invalid because both the plan and Bankruptcy Code required all payments to be made within sixty months. The bankruptcy court disagreed and overruled the creditor's objection because the default was no longer material. The debtors had satisfied their obligations by curing the deficiency. The district court affirmed.

[3] The Third Circuit lightly criticized the trustee's practice of filing and then withdrawing motions to dismiss at the end of the plan because it arguably produces unnecessary litigation. Instead, the Third Circuit suggested that the trustee consider conducting an audit and thereafter requesting a status conference with the court. While the Third Circuit's approach seems practical, it may not be without some risk. *See In re Holman*, 567 B.R. 599 (Bankr. D. Kan. 2017) (trustee's motion to dismiss denied because plan payments completed, thus entitling debtor to discharge).

On appeal to the Third Circuit, the creditor argued that the plain meaning of the Bankruptcy Code precludes payment after conclusion of the plan term. Section 1322 provides that a proposed plan "may not" be confirmed if it schedules payments for more than a five year period. Similarly, any post-confirmation modification under section 1329 may not provide for plan payments for more than the same period.

The Third Circuit was not persuaded. According to the court, the relevant question is not whether a plan can be confirmed or even modified where the term is more than five years, as the creditor contended. The court observed it was clear that it cannot. Instead the court identified the relevant question as being whether a motion to dismiss can be denied to allow the discharge to enter at the end of the plan where the debtor is willing and able to cure a reasonable shortfall. The court therefore focused on sections 1307 and 1328, not sections 1322 and 1329.

The court noted that section 1307 has no express restriction on plan length and employs the permissive "may," not the mandatory "must", "shall" or "will", dismiss for cause. *See* 11 U.S.C. § 102(4). Rather, as recognized by several other courts, the requirements for plan confirmation and dismissal are quite different.

Additionally, section 1328(a) requires a court to enter a discharge if a debtor has completed all payments under a plan. According to the court, section 1328(a) does not impose an express requirement that the payments actually be made within five years. And while the phrase "under the plan" in section 1328(a) might arguably be read as a restriction, the court found that such an interpretation would be inconsistent with the use of the same phrase elsewhere in the Bankruptcy Code. *See* 11 U.S.C. § 1325(a)(6); *see also* 11 U.S.C. § 1146(c).

The court next noted that even absent the plain meaning of the statutory text, the legislative history further reinforces the need to allow for some flexibility. The court explained that when Congress enacted the Bankruptcy Code in 1978, it capped the plan term at five years in order to provide a shield for debtors, not a sword for creditors. The objective was to ensure that debtors were not trapped in payment plans indefinitely, thus creating indentured servitude. The court therefore concluded that it would be inconsistent with the purpose of the five year cap to require dismissal without giving the debtor a reasonable opportunity to cure a payment default.

The Third Circuit also rejected the creditor's argument that any payments beyond five years would constitute an informal modification under section 1329(c). Any truly curative payments would not be provided for by a modified plan; they would be payments made under the previously confirmed plan. The court explained that debtors are often permitted to cure defaults early in cases without formal modification. As such, the court saw no reason not to apply the same standard at the end of a case.

The creditor also attempted to argue that the hardship discharge under section 1328(c) is the exclusive remedy for a debtor who fails to make all payments within the five year plan period. The court found this argument equally unavailing. The court distinguished between a situation where a debtor cannot make payments due to circumstances beyond their control under section 1328(c) and a debtor who is able and willing to complete funding. The court further noted that, practically speaking, the creditor's argument would produce an absurd result because a debtor would be denied a discharge even where a debtor substantially complied with the plan and acted in good faith to cure any deficiency promptly upon being notified of a problem.

In sum, the court found that nothing precluded a bankruptcy court from granting a short grace period. The court commented that while the post-confirmation modification procedure may adjust for some of these changes during the life of a plan, "there will be the occasional case where the plan's insolvency is not apparent until very late in the case, and despite the trustee's and the debtor's best efforts to avoid the problem, the plan payments may not fund all dividends and expenses necessary to complete the plan base."

In order to assist bankruptcy courts in future cases, the Third Circuit identified the following non-exhaustive list of factors to consider when deciding whether to exercise its discretion:

(i) whether the debtor substantially complied with the plan, including the debtor's diligence in making prior payments thereunder;

(ii) the feasibility of completing the plan if permitted, including the length of time needed and amount of arrearage due;

(iii) whether allowing a cure would prejudice any creditors;

(iv) whether the debtor's conduct is excusable or culpable, taking into account the cause of the shortfall and the timeliness of notice to the debtor; and

(v) the availability and relative equities of other remedies, including conversion and hardship discharge.

Applying a fact intensive analysis, the Third Circuit found that the bankruptcy court did not abuse its discretion. The debtors not only consistently made payments, but they also promptly cured the deficiency upon being notified. Moreover, the arrearage was nominal in relation to the plan base, and the debtors had the financial wherewithal to cure the deficiency. Crucially, the court found that the cure did not adversely impact any creditor. Rather, it completed the plan and enhanced the distribution to creditors. In addition, the debtors did not cause an unreasonable delay, or even one for which the debtors could be culpable. The cause of the arrears was the trustee's fee increase, which was not brought to the debtors' attention until after the expiration of sixty months. Finally, the court summarily found both conversion and hardship discharge to be nonsensical.

### *C. Interest in Escrow Account Does Not Remove Mortgagee from Anti-Modification Protection*

Section 1322(b)(2) seems relatively straightforward on its face. Of course, it is not. Courts often grapple with the anti-modification provision embedded in section 1322(b)(2), as did the Bankruptcy Court for the Northern District of Ohio when it considered whether a mortgagee's security interest in an escrow account deprived it of the protections under section 1322(b)(2). *See In re Capretta*, 542 B.R. 774 (Bankr. N.D. Ohio 2015).

In *Capretta*, the debtors filed for relief under Chapter 13 in order to, among other things, keep their principal residence The debtors' mortgage established an escrow account with a monthly funding requirement to pay property taxes and hazard insurance. Like many mortgages, the mortgage stated that the escrow funds "are pledged as additional security for all sums secured" by the mortgage.

The debtors proposed an amended plan proposing to bifurcate the mortgagee's claim – secured for the fair market value of the residence, and unsecured for the remaining amount owed. The secured portion would be paid in full in five years with a lower interest rate, while the unsecured portion would be paid pro rata with other general unsecured creditors. The mortgagee objected, asserting that its claim should be entitled to the protections of the anti-modification clause under section 1322(b)(2), notwithstanding the pledge of additional security (i.e., the escrow account).

After generally reviewing section 1322(b)(2), including the definitions of "debtor's principal residence" and "incidental property" under section 101(13A) and (27B), respectively, the court attempted to harmonize two decisions from the Sixth Circuit Court of Appeals regarding incidental property and additional security. *See Reinhardt v. Vanderbilt Mortg. & Fin., Inc. (In re Reinhardt)*, 563 F3d 558 (6th Cir. 2009) (mobile home not real property for purposes of section 1322(b)(2); *Allied Credit Corp. v. Davis (In re Davis)*, 989 F.2d 208 (6th Cir. 1993) (requirement that debtor obtain hazard insurance not "additional security" that negates protections under section 1322(b)(2)). According to the court, those decisions provide the following two principles:

(i) additional security that is neither real property, incidental to real property, nor intended to protect real property takes a mortgage outside the anti-modification protection of section 1322(b)(2); and

(ii) an interpretation of section 1322(b)(2) that takes most mortgages outside the anti-modification protection of that section would eviscerate the protective exception for residential lenders and be contrary to Congressional intent when section 1322(b)(2) was enacted.

Applying these principles, the *Capretta* court turned to the escrow provision in the mortgage which stated that the escrowed funds were expressly "pledged as additional security." The court recognized that escrow funds generally do not constitute real property under Ohio law. Similarly, they are not included in the bundle of rights associated with real property such as rents, royalties, profits and fixtures. As such, an argument could be made that they are more akin to the personal property distinction made by the Sixth Circuit in *Reinhardt*, in which case the mortgagee would not be entitled to the protections of section 1322(b).

However, the court found more persuasive the fact that the escrow funds were intended to protect real property, much like hazard insurance, which the Sixth Circuit in *Davis* held does not remove the mortgagee from the protections of section 1322(b)(2). According to the *Capretta* court, an escrow for the payment of property taxes and insurance ensures that funds are ultimately available to protect the real property. If unpaid, the court stated, the mortgagee's real property collateral might be compromised.

In addition, much like the hazard insurance at issue in *Davis*, the court determined that an escrow for payment of taxes and insurance is prevalent, if not widespread, in mortgages. If a mere escrow were enough to remove the protective exception for residential mortgagees, Congress' intent in enacting section 1322(b)(2) would be thwarted.

Finally and seemingly with some reluctance, the court declined to follow the holding in a case decided a few months prior, thereby creating an intra-district split. *See Stevens v. Suntrust Mortg., Inc. (In re Stevens)*, Adv. Proc. No. 14-4059 (Bankr. N.D. Ohio Feb. 5, 2015). The *Capretta* court disagreed with the *Stevens* court's characterization of the escrow as personal property and not real property. The *Capretta* court explained that "were it not for the equally binding *Davis* decision . . . [it] would agree . . . that *Reinhardt* supports the conclusion that a pledge of escrow funds takes a mortgage outside the anti-modification protection of § 1322(b)(2)." Nonetheless, adhering to its interpretation of *Davis*, the *Capretta* court held that the escrow account pledged as additional security did not remove the mortgagee from the protections of section 1322(b)(2). Confirmation was therefore denied.

## WHAT CONSTITUTES CAUSE FOR RELIEF FROM THE AUTOMATIC STAY?

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As one of the fundamental protections of the Bankruptcy Code, the automatic stay halts and prevents certain actions from taking place upon the filing of a petition. The Bankruptcy Code also, however, gives parties in interest the opportunity to seek relief from the automatic stay, including for "cause," an amorphous concept that is subject to various interpretations. Specifically, section 362(d)(1) of the Bankruptcy Code provides that "[o]n request of a party in interest and after notice and a hearing, the court shall grant relief from the stay . . . such as by terminating, annulling, modifying, or conditioning such stay . . . for cause, including the lack of adequate protection." *See* 11 U.S.C. § 362(d)(1).

The Bankruptcy Code does not define cause, nor does it state under what circumstances—other than a lack of adequate protection—cause might exist to lift or otherwise modify the automatic stay. *Id.*; *see also* 11 U.S.C. § 102(3) (term "includes" is non-exhaustive). The Sixth Circuit Court of Appeals has generally held that what constitutes cause should be determined on a case-by-case basis under the totality of the circumstances. *See In re Trident Assocs. Ltd. P'ship*, 52 F.3d 127, 131 (6th Cir. 1995); *In re Laguana Assocs. Ltd. P'ship*, 30 F.3d 734, 737 (6th Cir. 1994). Nonetheless, the totality of the circumstances standard does not indicate precisely what is necessary to satisfy section 362(d)(1). Thus, practitioners are often uncertain whether cause to lift the stay exists as a case progresses. This article aims to provide three recent examples of "cause," or a lack thereof, under section 362(d)(1).

* The author was an intern for the Honorable John T. Gregg at the United States Bankruptcy Court for the Western District of Michigan in 2017. He is scheduled to receive his Juris Doctor in 2018.

## A. *Post-Confirmation Default Under Confirmed Chapter 13 Plan*

One of the most common scenarios is whether cause to lift the stay exists in the context of post-confirmation defaults on real property mortgage payments under Chapter 13 plans. After a debtor's plan has been confirmed, the debtor may cease making mortgage payments to the mortgagee. As a result, the mortgage holder may seek relief from the automatic stay to allow it to exercise its rights under applicable non-bankruptcy law. A fairly recent decision from the Bankruptcy Court for the Western District of Michigan addresses just such a situation. *See In re Frasier*, Case No. DG-14-06074, 2015 WL 1010761, at *2 (Bankr. W.D. Mich. Feb. 20, 2015) (Dales, C.J.).

In *Frasier*, the debtor filed for Chapter 13 and proposed a plan that was later confirmed. The plan proposed to cure and maintain mortgage arrearages on the debtor's principal residence. Almost contemporaneous to plan confirmation and the first payment made thereunder, the debtor lost his job and was unable to make the required payments. Non-payment lasted four months before the mortgagee filed a motion for relief from the automatic stay pursuant to section 362(d)(1). The mortgagee argued that cause existed to grant relief from the automatic stay because the debtor had failed to comply with the terms of his confirmed plan. In response, the debtor argued that because he had secured employment that would commence a month after the motion was filed, would receive an early tax-refund, and had $8,000 in equity in the mortgaged real property to adequately protect the mortgagee, cause did not exist to lift the stay.

The court rejected the debtor's plea for relief on statutory grounds. To begin, the court recognized the debtor's $8,000 equity cushion provided no basis to prevent lifting the stay because the mortgagee held a non-modifiable claim.[4] Specifically, under section 1322(b)(2), a mortgagee's interest in a debtor's principal residence cannot be modified beyond the cure and maintain provision of § 1322(b)(5). In other words, the only remedies available with respect to a debtor's principal residence are the automatic stay and the cure and maintain provision—not modification of a debtor's contractual rights. Thus, merely having equity to adequately protect a theoretical plunge in value does not alone preclude relief from the stay in a Chapter 13 where the collateral at issue is the debtor's principal residence.

The court further noted the debtor had already benefited from section 1322(b)(5) by approving a Chapter 13 plan that proposed to cure prepetition arrearages. When the plan was confirmed, the debtor and his creditors were bound. *See* 11 U.S.C. § 1327(a). The court held that preventing the bank from exercising its foreclosure rights after the debtor's post-confirmation default would "modify the [b]ank's [contractual] rights under § 1322(b)(2)," a remedy forbidden by the Bankruptcy Code. *See* 11 U.S.C. § 1322(b)(2). Thus, the stay was lifted.[5] *See also In re Long*,

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[4] The debtor cited to *In re Nichols*, 440 F.3d 850 (6th Cir. 2006) as support for his argument that the existence of an equity cushion should postpone relief from the automatic stay. The court distinguished *Nichols*, which involved personal property, not a primary residence.

[5] The court articulated that the mortgagee may have been "inclined to postpone its collection activity if, rather than relying on the statements of his counsel, the Debtor had documented his efforts to obtain an early 2014 tax refund, or provided details concerning his newly-found employment, or promptly taken steps to modify his plan."

453 B.R. 283 (Bankr. W.D. Mich. 2011) (holding post-confirmation default of mortgage under Chapter 13 plan was "cause" to lift the stay) (Hughes, J.).

## B. *Lack of Subject Matter Jurisdiction or More Appropriate Forum*

Cause to lift the automatic stay has also been found where the bankruptcy court either lacks subject matter jurisdiction or believes a state court is a more appropriate forum. *See In re Mason*, 514 B.R. 852, 860 (Bankr. E.D. Ky. 2014). In *Mason*, the debtor and his company were defendants in a civil action in federal district court for sexual harassment, among other things, brought by two employees of the debtor's company.

The debtor filed for Chapter 13 bankruptcy before the civil action could go to trial. Both creditors filed proofs of claim, and the debtor's schedules stated that such debts were contingent, disputed, and unliquidated debts. The creditors, who were the only creditors to file timely proofs of claim in the debtor's bankruptcy case, moved for relief from the automatic stay for cause under section 362(d)(1). The creditors argued their claims were "personal injury tort" claims exempted from bankruptcy court jurisdiction under 28 U.S.C. § 157(b)(5).

Upon consideration of the creditors' arguments, the court observed that if the creditors' claims were "personal injury tort" claims, then the court would be stripped of jurisdiction to hear the claims. The court recognized that bankruptcy courts cannot adjudicate "personal injury tort" claims because those claims have been reserved for district court determinations. *See* 28 U.S.C. § 157(b)(5); *see also* 28 U.S.C. §157(b)(2)(B) and (O). The court noted that "personal injury tort"—like "cause" under section 362(d)(1)—is undefined in the Bankruptcy Code. In fact, different jurisdictions have taken a narrow, broad, or broad-with-scrutiny approach to determine what claims fell within this exception. Therefore, the primary issue in *Mason* was whether the claims in the civil action were "personal injury tort" claims.

The court noted that some courts adopt a narrow definition of "personal injury tort" by holding that a tort without trauma or bodily injury is not a "personal injury tort" claim. Other courts adopt a broader view that includes a claim arising from an invasion of personal rights as a "personal injury tort" claim. Finally, a third approach adopts the broader definition with a twist - - it requires further scrutiny of the claim to determine whether it has "earmarks of financial, business or property tort claim, or a contract claim."[6]

The court ultimately opted for the broad-with-scrutiny standard to evaluate the creditors' claims. The court began by examining the gravamen of the claims to determine if they were contractual or trespassory in nature, the latter of which could not be evaluated by the court. The court noted that the core of the creditors' action was for discrimination and retaliation rather than a contractual right. In other words, the substance of the creditors' claims was focused on violation of the creditors' rights rather than an obligation owed under a contractual relationship. This

[6] The Bankruptcy Court for the Western District of Michigan has previously adopted this definition. *See*, *e.g.*, *In re Atron Inc. of Mich*., 172 B.R. 541 (Bankr. W.D. Mich. 1994). *See also In re von Volkmar*, 217 B.R. 561, 566–67 (Bankr. N.D. Ill. 1998) (broader definition); *In re Ice Cream Liquidation, Inc.*, 281 B.R. 154, 161 (Bankr. D. Conn. 2002) (broader definition with additional scrutiny).

distinction removed the creditors' claims from the court's authority because it was not "economic," but tortious.

The court also found statutory support from the enumeration of "bodily injury" in section 522(d)(11)(D). The court concluded that the use of "bodily injury" in section 522(d)(11)(D) and the use of "personal injury" in 28 U.S.C. § 157(b)(5) indicated that Congress intended that more tortious claims would be exempted from the bankruptcy court's jurisdiction under 28 U.S.C. § 157(b)(5). Thus, because of both the nature of the creditors' claims and the textual language of 28 U.S.C. § 157(b)(5), the court held that cause existed to lift the stay to allow the civil action in the federal district court to continue.

### C. *Cause Did Not Exist to Lift the Stay for Setoff*

Not every situation will provide creditors with the ability to lift the stay for cause. In fact, the timing of when certain provisions of the Bankruptcy Code become applicable to the bankruptcy case may preclude the granting of relief from the automatic stay for cause. *See In Matter of Flannery*, 556 B.R. 319, 325–26 (Bankr. E.D. Mich. 2016). In *Flannery*, the debtors obtained a loan for a vehicle from a credit union. As part of the loan agreement, the debtors gave bank a security interest in both the vehicle and "deposits in the credit union." In the event of default, the credit union could either repossess the vehicle, apply deposited funds to the outstanding loan balance, or both. In addition to traditional monetary default provisions, the loan agreement also contained an *ipso facto* clause that provided if the debtors "file[d] a petition in bankruptcy" they would be considered to be in default.

When the debtors filed for relief under Chapter 13, the remaining balance on the loan was $1,578.81, and the debtors maintained a balance of $751.51 in their account. At the time the debtors filed their petition, the vehicle loan was current with no missed payments. The credit union received notice of the debtors' bankruptcy petition, placed an "administrative freeze" on the debtors' account, and filed a motion to lift the stay regarding the $751.51 remaining in the debtors' account in order to assert a set-off right.

The court originally granted the credit union's motion, but the debtors filed a motion for reconsideration. After reviewing the debtors' motion, the court vacated its original order lifting the stay and granted the debtors' motion for reconsideration. The court began its opinion by noting that the credit union was asserting a setoff right as cause to lift the stay. The Bankruptcy Code does not create set-off rights, but does preserve a creditor's *pre-petition* right to setoff under state law. *See* 11 U.S.C. § 553(a); *Citizens Bank of Maryland v. Strumpf*, 229 U.S. 523, 528 (1913). Thus, if the credit union wanted to assert a set-off right to lift the stay, then the right needed to exist pre-petition to satisfy section 362(d)(1).

According to the court, the credit union would have held a pre-petition set-off right if the debtor had failed to make their required payments prepetition. Importantly, however, the debtors were current as of the petition date. Therefore, the monetary provisions of the loan agreement provided no cause to lift the stay.

The credit union attempted to rely on the *ipso facto* clause that created a contractual default if the debtors filed bankruptcy. However, the court refused to enforce this provision. Relying on *Strumpf*, the court held that a set-off right has to exist "*before*" bankruptcy is filed. In other words, if setoff did not exist before filing, then the mere act of filing a petition would not simultaneously create set-off rights because it did not temporally exist prior to bankruptcy.[7] Thus, cause did not exist to lift the stay.

In disagreeing with the credit union's arguments, the court stressed that this case was rare because it involved debtors who were *not* in default on their loan payments at the time they filed for bankruptcy. The court also noted that had the debtors been in monetary default before the bankruptcy petition was filed, a set-off right would have existed and given rise to cause to satisfy section 362(d)(1).

## **CONCLUSION**

*Fraiser*, *Mason*, and *Flannery* provide some guidance regarding "cause" for relief from the automatic stay. As is evident from the different approaches and holdings in each case, successfully advancing or defending cause arguments require significant attention to statutory text, detailed reading of contractual language, and full understanding of the circumstances of the case.

[7] The credit union also relied on parts of the Michigan Credit Union Act, which states "[a] domestic credit union may refuse to allow a withdrawal from any account on which it has a lien if the member is delinquent in any outstanding obligation to the domestic credit union at the time of the withdrawal." However, the court declined to recognize a right of setoff was created from this provision because the term "delinquent" implies that no monetary payments were made to the credit union. Thus, there was no basis other than the bankruptcy filing to obtain setoff.

THE BANKRUPTCY SECTION

OF

THE FEDERAL BAR ASSOCIATION
OF THE WESTERN DISTRICT OF MICHIGAN

ANNOUNCES

# THE STATE OF THE COURT LUNCHEON

A Luncheon With

The Bankruptcy Bench for the Western District of Michigan and our

Guest Speaker
*Lawrence Ponoroff*
*Newly Appointed*
*Dean of the MSU College of Law*

A graduate of Stanford Law School, Dean Ponoroff has previously taught as a visitor at the University of Michigan Law School. Prior to joining MSU, Dean Ponoroff was the former Dean of the University of Arizona and the Tulane University law schools. Dean Ponoroff has received outstanding teaching awards from four different law schools. Dean Ponoroff has also served by appointment of the Chief Justice of the United States on the Advisory Committee on Bankruptcy Rules to the U.S. Judicial Conference and the Bankruptcy Judges Education Committee of the Federal Judicial Center. Dean Ponoroff is a prolific writer of books, law review articles, and essays on bankruptcy and commercial law.

Noon, Friday, October 13, 2017

***JW Marriott International Ballroom***

Grand Rapids, Michigan

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THE STATE OF THE COURT LUNCHEON

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Yes, I will attend the State of the Court Luncheon on Friday, October 13, 2017, at noon. I have enclosed payment as follows:

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**The Office of the U.S. Trustee, Chapter 13 Trustee Barbara P. Foley, and Chapter 13 Brett N. Rodgers invite you to:**

# BANKRUPTCY BEST PRACTICES SEMINAR 2017

**WHO:** Any and all attorneys who practice bankruptcy in the Western District of Michigan (Legal support staff are welcome to attend as well PROVIDED that they are accompanied by their supervising attorney)

**WHEN:** Monday, September 18, 2017
9:00 am – 12:00 pm

**WHERE:** GVSU Eberhard Center
301 W. Fulton St.
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**COST:** FREE!! But, you **must pre-register**.

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