

Chapter 13 Plan and Trustee Conduit Mortgage Payments: Challenges and Considerations

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By: Christopher W. Jones

I. WHAT IS A “CONDUIT” MORTGAGE PLAN?

- A Chapter 13 Plan that proposes to pay the Debtor’s post-petition mortgage payments through the Chapter 13 Trustee as disbursing agent for the payments.
- 11 USC 1326(c) establishes a presumption of Trustee disbursements but permits Chapter 13 Debtors to act as their own disbursing agent (“Except as otherwise provided in the plan or in the order confirming the plan, the trustee shall make payments to creditors under the plan”).
- Eastern District of Michigan Local Bankruptcy Rule 3070-1: “In a chapter 13 case, all claims must be paid by and through the chapter 13 trustee unless the debtor’s plan establishes cause for remitting payments on a claim directly to the creditor. Any timely objection to such a plan provision will be heard at the confirmation hearing.”
- Eastern District of Michigan Model Plan allows the Debtor to elect to pay post-petition mortgage payments directly or through the Chapter 13 Trustee.
- Classes 4.2 and 4.4 in the ED Model Plan relate to pre-petition arrearages on a continuing claim and by default are “to be paid by the Trustee” based on the language of the Plan (if not modified).

II. TRUSTEE CONDUIT MORTGAGE PAYMENTS: PROS AND CONS

A. PROS

- Integrity of financial records in event of dispute (motion for relief from stay or post-discharge)

- Less post-petition automatic stay litigation
- Fewer objections to confirmation
- No need to establish “cause”
- Consolidating the number of payments the Debtor has to pay helps prioritize
- Others?
- *See, generally*, Final Report of the ABI Commission on Consumer Bankruptcy (2019)
<https://www.nclc.org/wp-content/uploads/2022/08/rpt-abi-commission-on-consumer-bankruptcy.pdf> (recommending a national conduit plan requirement subject to exceptions).

Final Report of the ABI Commission on Consumer Bankruptcy (2019)

§ 4.06 Conduit Mortgage Payments

(a) The Commission supports conduit payment of mortgage claims. The Commission takes no position on whether conduit payment is beneficial for nonmortgage claims.

(b) Congress should amend the Bankruptcy Code to clarify that conduit payment of mortgage claims is required unless there are compelling reasons for the debtor to make direct payments to the mortgage holder. Examples of compelling reasons include:

- (1) The commission a trustee would charge on conduit mortgage payments would cause an unreasonable burden on debtors in that district.
- (2) In a particular case, the debtor would not be able to make plan payments because of the trustee commission.
- (3) A nonfiling co-debtor is making the payment.

(c) The USTP and bankruptcy administrators should facilitate the adoption and use of conduit payment of mortgage claims, including allowing bifurcated commission rates.

(d) Congress should adopt a clarifying amendment to 28 U.S.C. § 586(e) to allow bifurcated commission rates on mortgage payments and other payments in the plan.

<https://www.nclc.org/wp-content/uploads/2022/08/rpt-abi-commission-on-consumer-bankruptcy.pdf>

B. CONS

- Adding a fluctuating variable to an otherwise fixed reorganization plan complicates the administration and compliance with the plan. Post-petition mortgage payment changes complicates administration of case and necessitates more post-confirmation oversight and thus administrative expenses (Debtor attorney fees).
- Delay in post-filing disbursements can have adverse escrow implications and adverse co-debtor credit implications
- May complicate post-petition loss mitigation efforts due to various timing sensitivities
- May extend the amount of time needed to fund Plan and pay other priority or unsecured claims. If the conduit mortgage payment and Trustee fee consume 95% of the monthly payment it can take several additional months to pay a very small amount of debt (e.g., Plan payment = \$1200/month, mortgage payment is \$1000, trustee fee = \$120, the Trustee only has \$80 leftover which would unnecessarily extend a plan term by 12 months to pay a \$1000 priority claim.
- Others?
- Does the added cost and complexity justify conduit given the lack of apparent correlation between Plan success and conduit payments? *See, generally*, Greene, Sara S.; Patel,

Parina; and Porter, Katherine, "*Cracking the Code: An Empirical Analysis of Consumer Bankruptcy Outcomes*" (2017). Minnesota Law Review. 153 (finding no statistical relationship to Plan success); *See Also*, Rule, Craig, "*Chapter 13 Trustee Pay-All/Conduit Jurisdictions: Some Issues, Challenges, and Pointers*" (2016) (<https://www.usfn.org/blogpost/1296766/260680/Chapter-13-Trustee-Pay-All-Conduit-Jurisdictions-Some-Issues-Challenges-and-Pointers>) (discussing considerations from perspective of mortgage servicers).

IV. TRUSTEE CONDUIT MORTGAGE PAYMENTS: AROUND THE COUNTRY – CASES, LOCAL RULES, DATA

- Nationally, each district and Trustee varies with standards and practice being guided by Local Rules and case law.
- “A little less than half of chapter 13 trustees appear to be primarily administering plans providing for conduit mortgage payments. In the 2017 government fiscal year, 45.7% of chapter 13 trustees reported making ongoing mortgage payments that were 10% or more of their total disbursements.” Final Report of the ABI Commission on Consumer Bankruptcy (2019) <https://www.nclc.org/wp-content/uploads/2022/08/rpt-abi-commission-on-consumer-bankruptcy.pdf>
- District standards are driven by local Trustee and attorney practice, Local Rule, judicial direction.
- District practices vary:
 - Enforce statutory presumption of Trustee conduit absent a court order otherwise.
See, e.g., Bankr. E.D.N.C. R. 3070-2; Bankr. S.D. Tex. R. 3015-1; Bankr. E.D. MI 3070-1.

- Require conduit only when pre-petition arrearage exists. *See, e.g.*, Bankr. M.D. Ga. R. 3015-1(c); Bankr. S.D. Ind. R. 3015-1; Bankr. D. Kan. R. 3015(b)2; Bankr. D. Nev. R. 3015(g); Bankr. Dist. Az 2084-4(b). Note, although EDM LBR 3070-1 doesn't expressly state such local practice has evolved to this.
- Non-conduit (i.e., "hybrid"), the mortgage claim is "bi-furcated" and pre-petition arrearages are paid by the Trustee and post-petition mortgage payments are paid directly by the Debtor. *See, e.g.*, Bankr. North Dakota Model Plan; W. D. Tex. (San Antonio) Model Plan; *See also, In re Miles*, 415 BR 108 (Bankr. ED Pa, 2009).

Case Law Examples: Conduit presumption LBR, Trustee fee no excuse

- *Perez v Peake*, 373 BR 468 (SD Tex, 2007) affirming *In re Perez*, 339 B.R. 385 (Bankr. S.D. Tex. 2006).
- SD Tex has local rule requiring conduit mortgage payments unless Court exercises discretion to waive requirement in an individual case.
- Debtors argued the LBR violated the Code because it effectively made a conduit payment mandatory.
- Bankruptcy Court and District Court upholding both included comprehensive discussions of policies and considerations in ruling that presumption of conduit LBR is acceptable and Debtor's argument did not justify excusing.
- Bankruptcy Court opinion cited *In re Foster*, 670 F.2d 478 (5th Cir. 1982) , *In re Reid*, 179 B.R. 504, 507 (E.D. Tex. 1995) , and *In re Genereux*, 137 BR 411 (Bankr WD Wash, 1992) and listed twenty-one factors to consider when deciding to permit a Debtor to be the mortgage claim disbursing agent the degree of responsibility of the debtor, as evidenced by

his past dealings with creditors; (2) the reasons contributing to the debtor's need for filing a Chapter 13 petition and plan; (3) any delays that the trustee might make in remitting the monthly payment to the targeted creditor; (4) whether the proposed plan modifies the debt; (5) the sophistication of the target creditor; (6) the ability and incentive of the target creditor to monitor payments; (7) whether the debt is a commercial or consumer debt; (8) the ability of the debtor to reorganize absent direct payments; (9) whether the payment can be delayed; (10) the number of payments proposed to pay the targeted claim; (11) whether a direct payment under the proposed plan will impair the trustee's ability to perform his standing trustee duties; (12) unique or special circumstances of a particular case; (13) the business acumen of the debtor; (14) the debtor's post-filing compliance with statutory and court-imposed duties; (15) the good faith of the debtor; (16) the plan treatment of each creditor to which a direct payment is proposed to be made; (17) the consent, or lack thereof, by the affected creditor to the proposed plan treatment; (18) the ability of the trustee and the court to monitor future direct payments; (19) the potential burden on the trustee; (20) the possible effect upon the trustee's salary or funding of the U.S. Trustee system; and (21) the potential for abuse of the bankruptcy system. *In re Perez*, 339 B.R. 385 (Bankr. S.D. Tex. 2006).

Case Law Examples: Same Court, Different Facts, Different Result

- *In re Miles*, 415 B.R. 108, 2009 Bankr. LEXIS 2639, 2009 WL 2902443 (Bankr. E.D.Pa. 2009)
- The court considered two sets of Debtors (with significantly divergent circumstances) and two Chapter 13 Plans and approved one plan with post-petition mortgage payments to be paid directly by the Debtors and rejected one plan. The Court considered and compared various factors specific to each case in approving one direct pay claim and denying another.

Case Law Examples: Non-Filing Co-Debtor

- *In re Calder*, Case No. 14-31181 (Bankr. W.D. N.C., March 4, 2015)
- Chapter 13 debtor established "extraordinary circumstances" warranting approval of debtor's motion (required per local rule) to be excepted from the court's conduit mortgage program
- Local rule allows a debtor to be excused from the program "only upon the showing of good cause and extraordinary circumstances sufficient to warrant such an exception."
- Note, seemingly a lower standard than the EDM LBR 3070-1 which requires only "cause."
- Debtor and non-filing spouse were jointly liable on historically and presently current mortgage. Spouse choose not to file to protect her credit standing. The inherent delay in mortgage payments during the confirmation process would adversely affect her credit. A bankruptcy filing should not impose upon the co-signor the adverse credit implications for a party that choose not to file a bankruptcy and is not receiving the protections and benefits of the bankruptcy.

Case Law Examples: Mortgage Modification

- *In re Klave*, ___BR___; 2018 Bankr LEXIS 633 (Bankr D Ariz, Mar. 7, 2018)
- Notwithstanding a pre-petition mortgage default that would otherwise require conduit payments pursuant to district local rule, the Court determined that a loan modification and lender consent will justify an exception to the conduit mortgage payment requirement.

Case Law Examples: Trustee Fee Is Not Excuse

- *In re Ayodele*, 590 BR 342 (Bankr EDNC, 2018)
- Bankr. E.D.N.C., R. 3070-2(b)(2) specifically allows a debtor to be excused from the Local Rule in the discretion of the Chapter 13 trustee or by order of the court.

- Comprehensive discussion of LBR vs. Code and policies and considerations of conduit vs. non-conduit
- Debtor filed a motion seeking an exception from the conduit requirement as to his pre-petition mortgage arrearage and post-petition mortgage payment and argued:
- Local rule is invalid and impermissibly modifies his statutory rights under the Code
- Forcing conduit will affect his mortgage interest tax deduction
- Forcing conduit will delay discharge due to end of case requirements
- Add unnecessary surcharge for Trustee fee expense
- Court denied motion to excuse conduit requirement, dismissing the Debtor's concerns as inadequate to justify an exception to the Code and LBR presumption of conduit payments
- The 8% commission "is entirely reasonable in light of the services rendered by the trustee for the benefit of the debtor." Noting that the trustee system is "funded entirely by commissions," she said that excusing a debtor from compliance with the local rule would be "inappropriate."

Case Law Examples: Hybrid District, Post-confirmation Plan modification

- *Dehart v Stonier (In re Stonier)*, 417 BR 702 (Bankr MD Pa, 2009)
- Middle District of PA has no local rule requiring conduit payments and it is customary in the district to treat pre-petition default cure in the Plan as a Trustee payment while paying post-petition mortgage payments directly
- Plan confirmed with post-petition payments to be paid directly by the Debtor.
- Post confirmation motion for relief from stay was filed by mortgage lender

- Debtor proposed a plan modification to treat the pre and post-petition arrears through the Plan/Trustee while proposing to keep the future mortgage payments as a debtor pay obligation
- Trustee objected, arguing that the future mortgage payments should also be disbursed by the Trustee
- The Court recognized the district custom of hybrid approach and approved the Plan modification. The Court dismissed the Trustee's reliance on a Texas case because the local rule in the Texas case created a conduit presumption

V. TRUSTEE CONDUIT MORTGAGE PAYMENTS: E. Dist. Mich. LBR 3070:

What constitutes "cause" pursuant to Local Bankruptcy Rule 3070-1?

- Although local practice has evolved to "current" = "cause" and "not current" = "no cause" the LBR makes no such distinction
- The LBR creates a presumption that all claims, including post-petition mortgage payments, shall be paid by Trustee.
- However, LBR 3070-1 recognizes that a case-by-case analysis is available and a Debtor has an opportunity to establish "cause."
- Classes 4.2 and 4.4 in EDM Model Plan (pre-petition arrearages) include default language that such claims shall be paid by Trustee.
- Local practice dictates that the pre-petition and post-petition payments are treated consistently (i.e., both either paid by the Trustee or both paid by the Debtor).
- However, a Plan can propose that the pre-petition arrearages are paid by the Trustee and post-petition payments are paid directly, assuming that the Debtor can establish "cause" pursuant to LBR 3070-1.

TRUSTEE CONDUIT MORTGAGE PAYMENTS: WHAT CONSTITUTES “CAUSE”

- Mortgage is in a forbearance status as of the petition date. “Cause?”
- Mortgage has a pending trial loan modification with time sensitive disbursements.
“Cause?”
- Trustee fee is expensive, generally. “Cause?” Argument likely fails given this is a general considerations for all claims in all plans.
- Administrative expense (i.e., Trustee fee) associated with conduit mortgage (i.e., 10% on \$2,000 per mo. mortgage = \$200/mo x 60 = \$12,000) causes infeasibility. “Cause?”
Does it matter if this additional \$200 per month is the difference between feasibility and infeasibility? Relying exclusively on this factor seems to fail in the case law.
- Non-filing co-signor that wishes to avoid adverse credit implications. “Cause?”
- Does a pre-petition default change the “cause” analysis as to the post-petition payments?
Note, while some districts have local rules that specifically reference a pre-petition default and may require conduit, EDM LBR does not.
- Others?

VI. TRUSTEE CONDUIT MORTGAGE PAYMENTS: PROOF OF CLAIM “DEFAULT”

- Given the importance that a claim being “current” has taken on in the context of LBR 3070-1 it is important to consider the nature of a “default” on the proof of claim (Box 9. on Part 2 of official claim form; “Amount necessary to cure any default as of the date of the petition”).
- Pre-petition “default” on proof of claim does not always mean there is a contractual default or a claim is not current in contractual monthly payments.

- Amounts reflecting as “default” on proof of claims (Part 3 of Mortgage Proof of Claim Attachment):
 - Principal and Interest (note, may include amounts due as of the 1st of the month for cases filed in same month, including contractual “grace period” payments)
 - Prepetition fees (e.g., late charges)
 - Escrow deficiency for funds advanced
 - Projected escrow shortage
- Should a “default” amount attributable to items other than Principal and Interest (such as pre-petition late charges, escrow shortages, projected escrow shortages) require that the post-petition mortgage payments be paid by the Trustee?
- A proof of claim “default” creates a practical impediment as the default language of the Plan states that the proof of claim governs and also states that such amounts will be paid by the Trustee
- If proof of claim reflects non-payment default, Debtor counsel must consider on a case-by-case basis and discuss with the Debtor what is in the best interest of the Debtor.
- If paying the post-petition mortgage payments directly is in the Debtor’s best interest, consider:
 - Treat the proof of claim arrearage in class 4.2/4.4 and change the default language of the Plan and indicate that the claim shall be paid directly by the Debtor.

- Add language to the OCP specifying that the loan is contractually current as to monthly payments and that the proof of claim default shall be paid directly (likely requiring creditor counsel signature).

VII. TRUSTEE CONDUIT MORTGAGE PAYMENTS: Varying Context

Considerations

- Pending pre-petition loan modification
- Post-petition and pre-confirmation loan modification
- Post-confirmation loan modification
- Forbearance agreement

VIII. TRUSTEE CONDUIT MORTGAGE PAYMENTS: Misc. Considerations

- No timely proof of claim = no disbursements in a conduit district, to the detriment of all.
- FRBP 3002(a) now requires secured creditors to timely file a proof of claim.
- When a claim is not timely filed, no disbursements can be made by the Trustee thus the potential for a technical impediment to payment of the post-petition mortgage payment exists.
- Case law suggests that bankruptcy courts lack discretion to allow a late filed claim.
See, e.g., In re Hogan, 346 BR 715 (Bankr ND Tex, 2006).
- Escrow account implications

- Delay in disbursement of mortgage payments where mortgage payment includes an escrow component may result in a shortage in the escrow account and corresponding increase in the mortgage payment.
- Mortgage creditors routinely credit the escrow account with petition date escrow shortage that will be collected as part of arrearage claim.
- However, it is common that the first post-confirmation escrow analysis includes a shortage that in part results from a delay in mortgage disbursements.
- Question: should the escrow analysis “credit” the escrow account with the escrow component of the payments to be paid by the Trustee as part of the post-petition amounts due but yet-to-be-paid? Should the monthly mortgage payment be inflated to collect an amount that is already accounted for and to be paid?

IX. TRUSTEE CONDUIT MORTGAGE PAYMENTS: End of Case Considerations

- Completion of Plan pursuant to V.J.4. (“Debtor has remitted a sum sufficient to pay all allowed claims”): Does this include the following month’s yet-to-be-due mortgage payment? Or, does the order of payment of claims require that the Trustee always pay a mortgage payment with any given distribution?
- If a Plan is tightly funded and the monthly mortgage payment accounts for 95% of the Plan payment amount Plan must always account for an additional “next month” mortgage payment even though the Trustee may have adequate funds to pay all other claims if the following month’s mortgage is transitioned back to Debtor (e.g., Plan payment = \$1200/month, mortgage payment is \$1000, trustee fee = \$120, the Trustee

only has \$80 leftover which would unnecessarily extend a plan term by 12 months to pay a \$1000 priority claim).

- Post-expiration mortgage payments: E.g., 60 month expiration is October 15.

Debtor's October Plan payment posts with Trustee on October 10 and is sufficient to pay all remaining claims but Trustee files a motion to dismiss claiming Plan is not complete because the Trustee insists on paying an additional mortgage payment (November).

Transition of mortgage payments from Trustee disbursed to Debtor disbursed following Plan completion

- Note, there is no formal notice filed specifying the month that the mortgage is being transitioned back to the Debtor for payment
- Lack of formal notice to creditor creates confusion when Debtor seeks to pay 1st direct payment post-transition
- Creditor may refuse to accept payments or at least take an indifferent position (as not to "collect")
- Often results in unnecessary (and uncompensated) time consuming litigation related to Notice of Final Cure due to the post-transition payments
- Timing is tight. Chapter 13 payments stop (in theory) and following month's mortgage is due.
- If wage order release implementation is delayed by employer (or USPS or other factors) this exacerbates this problem.

- Northern District of Texas has a system that attempts to help resolve this problem with the Plan accounting for and the Trustee paying 2 additional post-expiration mortgage payments
- Trustee practices vary with respect to when a mortgage is transitioned, the amount of notice a debtor receives, and what type of information the debtor is provided in relation to the mortgage transition which causes additional challenges for debtors' attorneys advising debtors and setting expectations
- Chapter 13 Plan does not specify when conduit mortgage payments stop. Should it? If it does not, the transition should be a collaborative process with the Debtor fully informed on timing and details of the transition.
- Given the Plan's silence (and the practical challenges with specifying in the Plan) a formal Notice filed by the Trustee at case expiration that identifies the transition month would seem beneficial

Non-conduit mortgages (i.e., direct mortgage payments) may still be payments “under the plan”

- Failure to pay all post-petition mortgage payments may impede discharge. *See, e.g., In re Coughlin*, 568 BR 461 (Bankr EDNY, 2017); *In re Heinzle*, 511 BR 69 (Bankr WD Tex, 2014); *But See, In re Gibson*, 582 BR 15 (Bankr CD Ill, 2018).

X. TRUSTEE CONDUIT MORTGAGE PAYMENTS: Pre-filing considerations

Best practices to avoid a timing issue resulting in a proof of claim reflecting “default”

- Don't simply ask client “is your mortgage current?”
- Clients often don't understand the meaning and importance of the concept of “current”

- Ask the due date for next payment
- Ask the date of the last payment they paid and what contractual payment that payment was applied to
- Ask whether they are aware of any late charges or other fees on the account
- Ask client to verify with lender that payment has posted
- Be mindful of “grace periods” and hesitate before filing a petition during a typical grace period (if flexibility permits)

Misc. Resource

See, generally, Gordon Bermant & Jean Braucher, Making Post-Petition Mortgage Payments Inside Chapter 13 Plans: Facts, Law, Policy, 80 Am. Bankr. L.J. 261, 270 (2006).

To Conduit, Or Not To Conduit. That Is The Question

By John P. Gustafson

Conduit vs. Direct Mortgage Payments – The Case Law To Consider

The requirement that debtors pay their mortgages using the Chapter 13 Trustee as a “conduit” has advantages and disadvantages. One advantage is the fact that the Chapter 13 Trustee’s records are readily accepted by both the court and creditors. The cost can be a disadvantage, although in many Chapter 13 cases – those with a percentage to unsecured creditors in the middle range (not near 0% or requiring 100%) the conduit mortgage payment fee is effectively paid for by the unsecured creditors, not the debtor(s).

In addition to these considerations, there are a series of case law decisions that should be considered in determining whether or not to pay Chapter 13 debtors’ mortgages through the Trustee – whether that decision is being made by debtors’ counsel, or imposed by the bankruptcy court.

There is no uniform approach to mortgage payments in Chapter 13. There has been a trend toward requiring that mortgages be paid through the Trustee, but many courts either make it the debtor’s choice, or only require it when the mortgage is seriously delinquent.

As a general rule, whether a Chapter 13 debtor should be allowed to act as a disbursing agent on some payments to creditors is very much a matter left to the considered discretion of the bankruptcy court. *See e.g., In re Hoyt-Kieckhaben*, 546 B.R. 868 (Bankr. D. Colo. 2016); *In re Giesbrecht*, 429 B.R. 682 (BAP 9th Cir. 2010). Some courts assert that it is not a right, but a privilege. *In re Perez*, 339 B.R. 385 (Bankr. S.D. Tex. 2006), *aff’d*, 373 B.R. 468 (S.D. Tex. 2007).

Thus, while plan payments are generally made through the Chapter 13 trustee, the debtor is permitted to act as the disbursing agent and to make payments to the creditor directly. *In re Coughlin*, 568 B.R. 461 (Bankr. E.D.N.Y. 2017).

It is not only the Chapter 13 and/or the bankruptcy court that may oppose direct payments – sometimes it is the secured creditor. *In re Sanford*, 390 B.R. 873 (Bankr. E.D. Tex. 2008)(debtor did not provide any justification for direct payment, and IRS’s objection to direct payments would be sustained).

As one court in the Western Division has stated that by enacting the provision “the trustee shall make payments under the plan” except as otherwise provided in the plan or in the plan confirmation order, Congress created a presumption that Chapter 13 trustees should disburse payments to creditors under confirmed Chapter 13 plans. This presumption may be defeated only by including in the plan or in the plan confirmation order a provision allowing direct payments by the debtor or some entity other than the trustee. *See, In re Vela*, 526 B.R. 230 (Bankr. W.D. Mich. 2015); *see also, In re Carey*, 402 B.R. 327 (Bankr. W.D. Mo. 2009)(looking at the same statutory language, and finding that Chapter 13 debtors are not barred from making

direct payments to creditors, but neither do debtors have an unfettered right to make such direct payments in all cases).

Some courts have made the distinction between creditors whose claims are not being modified in any way, and situations where a mortgage delinquency is being cured over time. *See, In re Waldman*, 75 B.R. 1005 (Bankr. E.D. Pa. 1987). It is notable that one of the very few circuit level decisions to address Chapter 13 direct payment issues is quite old – 1982 – and required that the Chapter 13 trustee receive the normal fee even for payments that were made directly. *In re Foster*, 670 F.2d 478 (5th Cir. 1982). *Foster* specifically holds that debtors are permitted to make direct mortgage payments. 670 F.2d at 486.

If direct payments by the debtor are permitted in Chapter 13 cases, there is an important question: are those payments considered to be “payments under the plan”? Because, if they are, the failure to make all of those direct mortgage payments may result in a debtor not receiving a Chapter 13 discharge because they have failed to make all payments required under the plan. *See*, §1328(a).

This issue has been the subject of a great deal of litigation in recent years. The majority view appears to be that direct mortgage payments are “payments under the plan” for purpose of §1328(a), and the failure to make all of them generally results in a denial of discharge, even if all plan payments to the Chapter 13 trustee have been made.

Section 1328(a) has two requirements for the entry of a Chapter 13 discharge: 1) the debtor must have completed all payments under the plan; and, 2) the debtor must certify that certain domestic support obligations have been paid.

In *Rake v. Wade*, the Supreme Court stated that the phrase “provided for by the plan” is “commonly understood to mean that a plan ‘makes a provision’ for ‘deals with’ or even ‘refers to’ a claim.” *Rake v. Wade*, 508 U.S. 464 474, 113 S.Ct. 2187, 124 L.Ed.2d 424 (1993). Courts have cited this provision to hold that if a plan provision addresses the claim, irrespective of who disburses the payments to the creditor, those payments are payments under the plan. *In re Thornton*, 572 B.R. 738, 742 (Bankr. W.D. Mo. 2017).

This position is reflected in the majority view that a debtor who fails to make all of their direct mortgage payments has not completed all payments under the plan as required by §1328(a). The cases that support the majority view include: *Kessler v. Wilson (In re Kessler)*, 655 Fed. Appx. 242, 244 (5th Cir. 2016); *Derham-Burk v. Mrdutt (In re Mrdutt)*, 600 B.R. 71, 80-82 (BAP 9th Cir. 2019); *Evans v. Stackhouse*, 564 B.R. 513, 526 (E.D. Va. 2017); *Simon v. Finley (In re Finley)*, 2018 WL 4172599 (Bankr. S.D. Ill. Aug. 28, 2018); *In re Coughlin*, 568 B.R. 461, 468-74 (Bankr. E.D.N.Y. 2017); *In re Downey*, 580 B.R. 168, 173-174 (Bankr. D.S.C. 2017); *In re Hanley*, 575 B.R. 207, 213 (Bankr. E.D.N.Y. 2017); *In re Thornton*, 572 B.R. 738, 740-742 (Bankr. W.D. Mo. 2017); *In re Hoyt-Kieckhaben*, 546 B.R. 868, 872 (Bankr. D. Colo. 2016); *In re Tumblson*, 2016 WL 8897722 (Bankr. E.D. Okla. 2016); *In re Formanek*, 534 B.R. 29, 34 (Bankr. D. Colo. 2015); *In re Ramos*, 540 B.R. 580 (Bankr. N.D. Tex. 2015); *In re Gonzales*, 532 B.R. 828, 831-832 (Bankr. D. Colo. 2015); *In re Doggett*, 2015 WL 4099806 at *3 (Bankr. D. Colo. July 6, 2015); *In re Heinzle*, 511 B.R. 69, 80 (Bankr. W.D. Tex. 2014).

On the other hand, there are cases that hold that direct mortgage payments are not payments under the plan for purposes of Section 1328(a), and therefore failure to make those payments does not prevent a debtor from receiving their Chapter 13 discharge: *In re Simmons*, 608 B.R. 602 (Bankr. S.D. Ga. 2019); *In re Rivera*, 599 B.R. 335, 339-342 (Bankr. D. Ariz. 2019); *In re Gibson*, 582 B.R. 15, 24 (Bankr. C.D. Ill. 2018); and *c.f.*, *Dukes v. Suncoast Credit Union (In re Dukes)*, 909 F3d 1306, 1317-1318 (11th Cir. 2018)(as matter of first impression, mere reference to mortgage debts in plan, when plan specified that mortgage debts which were current would be paid outside plan, was not “providing for” these mortgage debts, as required for the debts to be discharged upon completion of debtor's plan payments).

Some Wrinkles And Nuances

1. What about mortgage modifications?

A Motion to dismiss was denied, and the debtor was permitted to modify the plan where she was approved for a loan modification that would bring her mortgage current. *In re Diggins*, 561 B.R. 782 (Bankr. Colo. 2016); *In re Young*, 2017 WL 4174363, 2017 Bankr. LEXIS 3170 (Bankr. M.D. La. 2017)(same).

2. What about unpaid late charges, fees and expenses?

Outstanding postpetition fees and expenses as stated in response to notice of final cure did not prevent debtor from receiving a discharge because these obligations were not addressed in the plan. *In re Roper*, 621 B.R. 899 (Bankr. D. Colo. 2020); *In re Brown*, 632 B.R. 295 (Bankr. D.S.C. 2021).

3. What can a debtor do if the direct mortgage payments have not been made?

a. Pay it off or get a loan modification – but can they?

There are several cases where the debtor attempted to pay off the unpaid mortgage payments. The first issue, is there still time to make up the missed payments?

If the case “completed” in less than 60 months, the debtor can usually request a modification and extend the plan, allowing it to end after the missed payments are made up.

However, courts have held that where the last payment is made under the plan, the plan cannot be revived.

Where the plan runs 60 months, any attempt to complete payments to save the plan may run up against the statutory maximum plan length of 60 months. *In re Hanley*, 575 B.R. 207 (Bankr. E.D.N.Y. 2017)(modification had to be approved prior to the expiration of the 60 months).

b. Move to modify the plan.

The debtor could try to modify the plan to provide a different treatment of the mortgage claim. *See, In re Coughlin*, 568 B.R. 461, 480 (Bankr. E.D.N.Y. 2017)(granting modification to surrender property after discharge was granted as an alternative to vacating the discharge). The problem is, there is case law that says you cannot modify the plan after the last payment has been

made to the trustee. *See*, 11 U.S.C. Section 1329(a); *Baud v. Carroll*, 634 F.3d 327, 356 (6th Cir. 2011)(“The meaning of “completion of payments” under §1329(a) is an interesting question that is not before us and therefore must await another day.”); *In re Stanke*, 638 B.R. 571, 575 (Bankr. N.D. Tex. 2022)(“the only interpretation of §1329(a) that remains true to the text and in harmony with the broader context of chapter 13 is that the phrase ‘completion of payments’ refers exclusively to payments made by the debtor to the trustee.”); *In re Ezzell*, 438 B.R. 108 (Bankr. S.D. Tex. 2010)(“completion of payments” under §1329(a) means completion of payments by the trustee to creditors); *In re Ripley*, 2018 WL 737678 at *4, 2018 Bankr. LEXIS 311 at **9-10 (Bankr. E.D.N.C. Feb. 6, 2018)(completion of payments means payment of all unsecured creditors in full or the end of the applicable commitment period).

c. Surrender the property to the creditor

If paying off the mortgage creditor is not possible, one alternative that has been tried is surrendering the property to the mortgage creditor. *In re Dennett*, 548 B.R. 733 (Bankr. N.D. Tex. 2016)(surrender allowed where debtors were 40 months into a 60 month plan). Usually, this is part of a Motion to modify. *Id.*

One problem has been, where the 60 month period has passed, it may be too late – for purposes of obtaining a discharge - to surrender the property. *See, In re Mrdutt*, 600 B.R. 72 (BAP 9th Cir. 2019).

d. Seek a hardship discharge.

A debtor who has defaulted on postpetition mortgage payments may seek a hardship discharge, like any other debtor who cannot “complete” their plan. The problem is obtaining a hardship discharge requires that the completion of the plan be both “not practicable”, and “due to circumstances for which the debtor should not justly be held accountable”. *See*, 11 U.S.C. §1328(b). If those circumstances both exist, that may be an avenue for the debtor to get a discharge – just not the “super discharge” usually obtained in Chapter 13.

e. Convert to a proceeding under Chapter 7.

In several cases where a court has held that the debtor is not entitled to a Chapter 13 discharge, the court has allowed the debtor the opportunity to seek conversion to Chapter 7, and obtain a discharge under that Chapter. *See e.g., In re Ramos*, 540 B.R. 580 at 596 (granting debtors who had petitioned for a discharge but failed to complete direct payments under Chapter 13 plan ten days to convert their plan to a Chapter 7 one or face dismissal without prejudice); *In re Heinzle*, 511 B.R. at 83 (granting the debtors fourteen days within which to convert their case to a Chapter 7 one, with the condition that the debtors' failure to convert would result in a dismissal).

On the plus side, all of the debts up to the date of conversion can be discharged in the converted Chapter 7 case. *See*, §348(d).

On the negative side, conversion from Chapter 13 to Chapter 7 does not change the date of filing for purposes of §727(a)(8). If the reason for filing was, for example, the 8 year bar to a Chapter 7 discharge, that bar would prevent the debtor from receiving a Chapter 7 discharge, even though

the case was converted more than 8 years from the filing date of the previous Chapter 7 case. *See, In re Leduc*, 2011 WL 3204599, 2011 Bankr. LEXIS 2825 (Bankr. N.D. Iowa July 27, 2011)(“An ‘unwavering line of cases’ applies the plain language of these statutes to hold that ‘the date of filing the Chapter 13 controls over the date of conversion for the purposes of measuring § 727(a)(8).’”)(citing cases).

f. Argue that the missed payments are de minimis.

If the amount of the mortgage payment(s) that have been missed are – arguably – not large enough to be material, that is an argument that debtor could make. At some point – a thousand dollars, a hundred dollars, a single dollar or a single penny – the failure to make the direct mortgage payment is too small to warrant denial of the debtor’s discharge. *In re McCollum*, 624 B.R. 604 n.3 (Bankr. D.S.C. 2021)(“The Court also notes that the amount of missed payments appears to be de minimis, and therefore, should not preclude Debtors from receiving a discharge.”).

Judge, I See That Most Of Your Case Law Is After 2014 – Did You Just Leave Out All The Old Stuff?

While I can’t say that I have looked at all the older case law – this is an issue that has only arisen recently. Why? Because bankruptcy courts, and Chapter 13 trustees, didn’t used to know if a direct mortgage payment was current. In the past, if the mortgage creditor did not file a motion for relief from stay, no one knew of the direct payment delinquency, and the Chapter 13 discharge would be entered at the end of the case.

What changed that? Federal Rule of Bankruptcy Procedure 3002.1. “Rule 3002.1 became effective on December 1, 2011, and applies to all cases filed after that date ‘and, insofar as just and practicable, all proceedings then pending.’” *In re Martins*, 2013 WL 9868648 (Bankr. S.D. Fla. 2013). Not surprisingly, decisions involving these issues started popping up about three years later.

One of the unintended consequences of Rule 3002.1 was that it provided Chapter 13 trustees and the courts with information on the status of the debtor’s mortgage payments just before the Chapter 13 discharge could be entered.

Consumer Protections Statute, I’d like you to meet Unintended Consequence.

There are cases that specifically note the apparent unfairness of a statute intended to help consumers get a fully realized fresh start resulting in debtors losing their discharge. *See, In re Rivera*, 599 B.R. 335, 342 (Bankr. D. Ariz. 2019)(“The only thing that has changed is that a new disclosure requirement, Rule 3002.1, was recently adopted. This Court agrees with *Gibson* that Rule 3002.1 is being misapplied by courts that deny discharges and dismiss cases based solely on direct pay post-petition mortgage defaults.”).

Presumably, this is also why the issue of missed direct payments rarely comes up in the context of a motor vehicle payment, or student loans: nobody knows about the payment failure, so no one objects or otherwise raises the issue.

Arguably, we are now in a *Law v. Seigel* world where equitable considerations take a back seat (if they are even in the car) to the “plain meaning” of statutes and bankruptcy rules. But, at this point, the case law debate continues.

The Bottom Line – In Pushing For More Direct Pay Flexibility, Understand That It May Not Be As Beneficial As Debtor’s Attorneys Envision It To Be!

SURVEY OF DISTRICTS: CONDUIT VS. NON-CONDUIT*

*(*note, the following information was gathered through informal sources and prepared only for the general purpose of demonstrating the substantial variance district practice)*

<i>State</i>	<i>Does Trustee pay post if mortgage is delinquent?</i>	<i>Notes</i>
AL	DIRECT	
AK		
AR	CONDUIT	
AZ	CONDUIT	
CA (CD)	DIRECT	Class 2 & Class 4: Direct Pay Direct except riverside Division - Judge Johnson is conduit
CA (CD)	DEBTOR'S CHOICE	
CA (ED)	CONDUIT	Class 1: Conduit/Trustee Pay-All Class 4: Direct Pay
CA (ED)	CONDUIT	
CA (ND)	CONDUIT	Class 1: Conduit/Trustee Pay-All Class 4: Direct Pay
CA (ND)	CONDUIT	
CA (SD)	DIRECT	
CA (SD)	DIRECT	
CO	DIRECT	
CT	DIRECT	
de		
FL	DIRECT	
GA (Middle)	CONDUIT	Conduit if 4 or more payments delinquent at filing
GA (ND)	DIRECT	
GA (SD)	DIRECT	
HI		

IA	DIRECT	
ID (D)	DIRECT	
IN	CONDUIT	
KS	CONDUIT	
KY	DIRECT	.
KY	DEBTOR'S CHOICE	
LA		
MA	DIRECT	
MD	DIRECT	
ME	DIRECT	
MI	CONDUIT	
MO (ED)	DEBTOR'S CHOICE	
MO (WD)	CONDUIT	
MN	DIRECT	
MS		
MT		
NC (ED)	DIRECT	
NC (WD)	DIRECT	
NC (MD)	CONDUIT	
NE	DIRECT	
NH	DIRECT	
NJ	DIRECT	
NM		
NV	CONDUIT	
NY		
North Dakota	DIRECT	
OH (Northern)	DIRECT EXCEPT JUDGE CLEVELAND AND JUDGE CANTON	Judge Cleveland and Judge Canton have Administrative Orders that indicate all plans are conduit, but allow a motion to pay outside to be filed on current loans to be paid direct. The plan language in the North

		indicates debtor chooses either trustee or debtor pay ongoing payment but all arrears are paid by trustee.
OH (Southern)	CONDUIT	
OK		
OR (D)	DIRECT	
PA (WD)	CONDUIT	
RI	DIRECT	
SC	CONDUIT	Conduit for Judges Duncan and Gasparini. For Judge Burris, ongoing is likely still by the Debtor but it is the choice of the Debtor
SOUTH DAKOTA	DIRECT	
TN	CONDUIT	
TN (Middle)	CONDUIT	
TN (ED)	CONDUIT	
TX (ED)	DIRECT	Direct
TX (ND)	CONDUIT	Conduit
TX (SD)	CONDUIT	Conduit
TX (WD)	CONDUIT	Conduit
UT		
VA (ED)	DIRECT	
VT	CONDUIT	
WA (ED)	CONDUIT	
WA (WD)	CONDUIT	
WA (ED)	CONDUIT	
WA (WD)	CONDUIT	
WV	CONDUIT	
WI		
WY		

