"THE HARD KNOCKS"
EVERYTHING YOU WANTED TO KNOW ABOUT HARDSHIP DISCHARGE BUT WERE AFRAID TO ASK

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HARDSHIP DISCHARGE

11 USC §1328(b) and (c) provide:

(b) Subject to subsection (d), at any time after the confirmation of the plan and after notice and a hearing, the court may grant a discharge to a debtor that has not completed payments under the plan only if—

(1) the debtor' failure to complete such payments is due to circumstances for which the debtor should not be justly held accountable;

(2) the value, as of the effective date of the plan of property actually distributed under the plan on account of each allowed unsecured claim is not less than the amount that would have been paid on such claim is the estate of the debtor had been liquidated under chapter 7 of this title on such date; and

(3) modification of the plan under section 1329 of this title is not practical.

(c) A discharge granted under subsection (b) of this section discharges the debtor from all unsecured debts provided for by the plan or disallowed under section 502 of this title, except any debt—

(1) provided for under section 1322(b)(5) of this title; or

(2) of a kind specified in section 523(a) of this title.

1. ESSENTIAL ELEMENTS

   a. In order to qualify for a hardship discharge the debtors much persuade the court that they have complied with each subsection of 1328(b). *In re White*, 126 B. R. 542 at 545

   b. The debtors bear the burden of proof and must satisfy the court on all three elements. *In re Spencer*, 301 B. R. 730, 733 (B.A.P. 8th Cir. 2003)

   c. Most courts have limited it to "compelling or catastrophic circumstances" *In re Dark*, 87 B.R. 497 (Bankr. N. D. Ohio 1988), *In re Miller*, 2006 Bankr. Lexis 2474, 2006 WL 2711775 (Bankr. N.D. Ohio Sep. 21, 2006), *In re Graham*, 63 B.R. 95 (Bankr. E.D. Pa. 1986) Noted Chapter 13 commentator Keith Lundin notes it is reserved "for the truly worst of the awfuls—something more than just the temporary loss of a job or

temporary physical disability" K. Lundin, *Chapter 13 Bankruptcy*, §9.18 at 9-26 (4th Ed.). Courts have often required catastrophic rather than merely economic circumstances. *In re Cummins*, 266 B.R. 855 (Bankr. N.D. Iowa 2001)

d. Other Courts take a more relaxed approach and allow a hardship discharge "due to economic circumstances that did not exist nor were foreseeable at the time of confirmation of the plan, where those circumstances are beyond the debtor's control, and where the debtor has made every effort to overcome those circumstances but is unable to complete his plan payments. *In re Edwards*, 207 B.R. 728 (Bankr. N. D. Fl. 1997). Also see *In re Bacon*, 2003 Bankr. Lexis 2386 (S.D. GA August 19, 2003). The requirements of 1328(b)(1) are met where: (1) a debtor was unable to complete payments under a Chapter 13 plan due to a change of circumstance for which the debtor was not accountable, (2) that the change was substantial in nature, (3) that it was not foreseeable at the time of the confirmation of the plan, and (4) debtor had made every effort to overcome such circumstances but is still unable to complete his plan payments. This appears to be the minority view.

e. The plan must have met and paid the "liquidation" or "best interest" test to unsecured creditors prior to the filing of the motion for hardship discharge. *In re Griffin*, 352 B.R. 475, 479 (B.A.P. 8th Cir. 2006), *In re Schleppi*, 103 Bankr. 901 at 904, *In re Bond*, 36 Bankr. 49 at 51; *In re McNealy*, 31 Bankr. 932 (Bankr. S.D. Ohio 1983). The best interest test under section 1328(b)(2) is essentially the same as that required for the confirmation of a plan under section 1325(d)(4) except that their temporal perspectives differ. *Collier on Bankruptcy*, para. 1328.01[2][b][ii] (16th Ed.)

f. Modification of the plan must not be practical. Modification is not "practicable" if there is no source of income to fund the modified plan. *Bond*, 36 B.R. at 51. This prong is not satisfied where circumstances changed after confirmation but the debtor waited to request relief until it was too late to modify the plan. *Nelson*, 135 B.R. 303 at 308.

g. The analysis of an alleged hardship situation is necessarily fact-driven and focuses on the nature and quality of the intervening event or events upon which the debtor relies. *In re Bandilli*, 231 B.R. 836, 841 (1st Cir. BAP 1999). Factors the court should consider include:
    1) whether the debtor has presented substantial evidence that he or she had the ability and intention to perform under the plan at the time of confirmation;
    2) whether the debtor did materially perform under the plan form the date of confirmation until the date of the intervening event or events;

3) whether the intervening event or events were reasonably foreseeable at the time of confirmation of the Chapter 13 plan;
4) whether the intervening event or events are expected to continue in the reasonably foreseeable future;
5) whether the debtor had control, direct or indirect, of the intervening event or events; and
6) whether the intervening event or events constituted a sufficient and proximate cause for the failure to make payments. *Bandilli* at 841.

2. EXAMPLES OF CASES WHERE A HARDSHIP DISCHARGE WAS ALLOWED

a. A hardship discharge is a recognized solution for administering a Chapter 13 case in which the debtor has died prior to completing payments under a confirmed plan. 9 COLLIER ON BANKRUPTCY ¶1016.04 (16th Ed.) *In re Graham*, 63 B.R. 95, (Bankr. E. D. Pa. 1986), the death of the debtor warranted a hardship discharge. Also *In re Redwine*, 2011 Bankr. Lexis 946 (N.D. GA 2011), *In re Bevelot*, 2007 Bankr. LEXIS 3970, 2007 WL 4192926 (Bankr. S.D. IL 2007). A review of the few cases considering whether circumstances are beyond the debtor's control for purposes of 11 U.S.C.S 1328(b) discloses that hardship discharges are rarely granted other than in the case of a debtor's death. *In re Cummings*, 266 B.R. 852 (N.D. Iowa 2001) But compare to *In re Sales*, 2006 Bankr. LEXIS 2373 (N.D. Ohio Sep. 15, 2006) where although a hardship discharge would result in a benefit to debtor's estate, the benefit was minimal compared to the benefit creditors would have in have in pursuing claims in probate court and the case was dismissed.

b. Debtor had no income due to unemployment, had exhausted their 401k plan, had been unable to find employment and the Trustee and Department of Education did not object to the hardship discharge so long as student loans are not included in the discharge. *In re Schmitt*, 2011 Bankr. Lexis 3985 (N.D. Iowa October 20, 2011).

c. Court granted a motion for hardship discharge conditioned upon the debtor paying the Trustee an amount equal to income tax refunds that Debtor received or was otherwise entitled to receive during the duration of the plan (due to specific plan language), after debtor was diagnosed with cancer, had surgery, used up all of her sick time as a school bus driver, was forced to retire and also continued to support her disabled adult child. *In re Green*, 319 B.R. 141, 2004 Bankr. Lexis 2074 (E.D. MI 2004).

d. Court enforced a relaxed standard of hardship discharge and granted a discharge where the debtor's business deteriorated after his Chapter 13 plan was confirmed due to increased competition in the market. Debtor was forced to sell his business in the

face of a foreclosure. Following the business loss the debtor suffered depression requiring medication and also suffered the breakup of his marriage. He searched extensively for employment and finally obtained employment with an income of only $1,500.00 per month, leaving no disposable income to make plan payments. *In re Edwards*, 207 B.R. 728, 1997 Bankr. Lexis 515 (N.D. FL 1997)

e. Debtor suffered from Post-Traumatic Stress Disorder "PTSD" as a result of service in Vietnam and the PTSD plus a back injury forced him to retire. His reduction in income prevented the debtor from completing plan payments. The only response was filed by the IRS and it asserted that if the application was granted, the entire claim of the IRS, plus interest and penalties accruing post-petition would not be dischargeable. Court granted a hardship discharge (with very little discussion) and noted that the discharge will not include taxes that would be non-dischargeable in a Chapter 7. *In re Parrott*, 1991 Bankr. Lexis 1868, (S.D. IN December 3, 1991)

3. EXAMPLES OF CASES WHERE A HARDSHIP DISCHARGE WAS NOT ALLOWED

a. *In re Bandilli*, 231 B.R. 836 (1st Cir. BAP 1999), Debtors confirmed a 10% plan and after three and one half months filed a Motion for Hardship Discharge due to deteriorated health, Court found that disability payments were the functional equivalent of what the debtors were earning at confirmation, that the debtors had not acted in good faith and that the debtors circumstances had not changed substantially from the date of the confirmation hearing and denied a hardship discharge.

b. *In re White*, 126 B. R. 542 (Bankr. N.D. IL 1991), burden of proof to demonstrate all aspects of 1328(b) is on debtor, unsubstantiated and conclusory statements regarding an inability to fund a plan are insufficient to grant a hardship discharge.

c. *In re Bond*, 36 Bankr. 49 (Bankr. E. D. N.C. 1984). Hardship discharge was denied where debtor's marriage had terminated, debtor had lost the financial assistance from her mother due to the mother's death, and debtor had surgery which resulted in a reduction of her employment and income.

d. *In re Miller*, 2006 Bankr. Lexis 2474 (N.D. Ohio Sep. 21 2006). Epilepsy, divorce, the inability to work, drive a car or even bathe oneself, together with being a candidate for brain surgery are insufficient, if there is a lack of evidence by the debtors to prove grounds for the court to determine if the debtors were entitled to a hardship discharge.

e. *In re Cummings*, 266 B. R. 852, 2001 Bankr. Lexis 1364, (N.D. Iowa 2001) Debtor's injuries, unemployment, coupled with debtor wife's need to stay home to care for their children was not a hardship of purposes of §1328 because while they posed a financial hardship, the circumstances were the type of economic reason that did not support a hardship discharge. Moreover since they could not complete their plan payments and they had asserted that modification was not possible then dismissal was appropriate. A hardship discharge is reserved for extraordinary circumstances which are described as catastrophic.

f. *In re Bacon*, 203 Bankr. Lexis 2386 (S.D. GA August 19, 2003). Even after the Court determined to apply the more relaxed standard for a hardship discharge the debtor failed to meet his evidentiary burden. Debtors presented no evidence that they are earning less income today then when the plan was confirmed or that their fragile medical condition has changed. Debtors further failed to prove that modification is not "practicable" when they argued that modification would not be advantageous as it would not further the goal of saving their house.

g. *In re Edmond*, 247 B.R. 592, 2000 Bankr. Lexis 457, (RI 2000). Debtors are not entitled to a hardship discharge in light of their failure to pay post-petition trust fund taxes due to the IRS. Defendants not entitled to hardship discharge as their own acts led to failure of the plan.

h. *In re Easley*, 240 B.R. 563, 1999 Bankr. LEXIS 1344, (W.D. MO 1999). Debtor's loss of job when it was eliminated following a buy-out the company and the inability to make plan payments since that time was not sufficient grounds for a hardship discharge. A request for hardship discharge is to be treated with some gravity, and the loss of employment alone is insufficient.

i. *In re Harrison*, 1999 Bankr. Lexis 1830 (E.D. VI, July 30 1999). After debtors confirmed a plan the husband was hospitalized for congestive heart failure and diagnosed with diabetes and high blood pressure. As a result he lost his driver's license, and his job. Hardship discharge was denied because the Court found that the debtors failed to offer any evidence that they fulfilled the Chapter 7 liquidation test imposed by 11 USC §1328(b)(2) or that plan modification was not possible under 11 USC §1328(b)(3).

j. *In re Nelson*, 135 B.R. 304, 1992 Bankr. Lexis 1922, (N.D. IL 1991). Debtor's loss of truck, inability to find full time employment and an unexpected expenses are circumstance provide economic hardship but they are not the type of catastrophic events such as death or disability which prevent a debtor, through no fault of his or

her own to complete plan payments. Thus the debtors should not be granted a hardship discharge.

4. WHAT GETS DISCHARGED?

a. Section 1328(c)(2) provides that a hardship discharge granted under §1328 discharges the debtors from all unsecured debts provided for by the plan except any kind of debt specified in §523(a).

b. Student loans are not discharged under a hardship discharge. *In re Schmitt*, 2011 Bankr. Lexis 3985 (N.D. Iowa October 20, 2011)

c. Most tax debts are also not discharged. *Schmitt* at 3985, citing *In re Spencer*, 301 B.R. 730, (B.A.P. 8th Cir. 2003). A hardship discharge will not include taxes that would be non-dischargeable in a Chapter 7. *In re Parrott*, 1991 Bankr. Lexis 1868, (S.D. IN December 3, 1991)

d. Restitution payments due to a state court criminal prosecution are not discharged under a hardship discharge. *In re Barth*, 211 B.R. 945, 1997 Bankr. Lexis 1290, (KA 1997)

e. A hardship discharge does not discharge a debtor from eighteen different types of claims that are non-dischargeable under the various discharge provisions of the Bankruptcy Code. *In re Vasquez*, 261 B.R. 654, 2001 Bankr. Lexis 409, Bnkr. L. Rep. (CCH) P78,463 (ND TX 2001)

f. In essence, a hardship discharge is the equivalent of a chapter 7 discharge. *In re Green*, 319 B.R. 141; 2004 Bankr. LEXIS 2074 (E.D. MI 2004), A hardship discharge more closely resembles a Chapter 7 discharge as all of the debts specified in 11 U. S. C. 523(a) are excepted. *In re Bacon*, 2003 Bankr. Lexis 2386 (S.D. GA August 19, 2003)

g. No discharge of long term debts. 11 U.S.C. 1328(c)(1).

5. MISCELLANEOUS INFORMATION

a. Proper mechanism for filing for a hardship discharge is by motion and not by adversary proceeding. *In re Nelson*, 135 B.R. 304, 1992 Bankr. Lexis 1922, (N.D. IL 1991).

IN THE UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re:	§	Case No. xx-xxxxx
	§	
Debtor 1	§	
Debtor 2	§	Chapter 13
	§	
Debtor(s)	§	Judge xxxxxxxxxx.

DEBTOR'S MOTION FOR ENTRY OF CHAPTER 13 DISCHARGE DUE TO HARDSHIP AND AFFIDAVIT REQUESTING ENTRY OF HARDSHIP DISCHARGE ORDER

LR 9013-1 NOTICE - THE DEBTOR HAS FILED PAPERS WITH THE COURT TO ENTER A HARDSHIP DISCHARGE IN THIS CASE. YOUR RIGHTS MAY BE AFFECTED. YOU SHOULD READ THESE PAPERS CAREFULLY AND DISCUSS THEM WITH YOUR ATTORNEY, IF YOU HAVE ONE IN THIS BANKRUPTCY CASE. IF YOU DO NOT HAVE AN ATTORNEY, YOU MAY WISH TO CONSULT ONE. IF YOU DO NOT WANT THE COURT TO GRANT RELIEF SOUGHT IN THIS MOTION, THEN ON OR BEFORE TWENTY-ONE (21) DAYS FROM THE DATE SET FORTH IN THE CERTIFICATE OF SERVICE FOR THE MOTION, YOU MUST FILE WITH THE COURT AT 170 NORTH HIGH STREET, COLUMBUS, OHIO 43215 OR VIA ECF A RESPONSE EXPLAINING YOUR POSITION. IF YOU OR YOUR ATTORNEY DO NOT TAKE THESE STEPS, THE COURT MAY DECIDE THAT YOU DO NOT OPPOSE THE RELIEF SOUGHT IN THE MOTION AND MAY ENTER THE ORDER GRANTING RELIEF WITHOUT FURTHER NOTICE OR HEARING. A TIMELY RESPONSE IS REQUIRED. YOU SHOULD SERVE YOUR RESPONSE AS REQUIRED BY LR 9013-1.

*****IN A JOINT CASE, EACH DEBTOR MUST COMPLETE A SEPARATE AFFIDAVIT TO BE ELIGIBLE FOR A DISCHARGE*****

COMES NOW, _____the Debtor and moves for entry of an Order of Discharge pursuant to 11 U. S. C. §1328(b) ("hardship discharge") despite the debtor's failure to complete plan payments under the confirmed plan. In support thereof the undersigned Debtor testifies under penalty of perjury to the following (complete all sections and provide all required information) and requests that the Court enter a hardship discharge.

1. My current address is:_____

2. The name, address and telephone number of my most recent or current employer is:

Employer's Name: _____
Address: _____
Telephone: _____

3. Completion of Financial Management Course (Debtor Education) Pursuant to 11 U.S.C. § 1328(g)(1)*[check the appropriate box]*

☐ I have completed a Financial Management Course (Debtor Education) and have previously filed a certificate of completion (Form 23).
or

☐ I have completed a Financial Management Course (Debtor Education) and a certificate of completion (Form 23) is attached hereto.
or

☐ The Court, by Order entered_____, has determined that no Financial Management Course (Debtor Education) is required due to incapacity, disability or active duty in a military combat zone.

4. I have not received a discharge in a Chapter 7, 11 or 12 bankruptcy case within four (4) years prior to the filing of this Chapter 13 case.

5. I have not received a discharge in another Chapter 13 bankruptcy case within two (2) years prior to the filing of this Chapter 13 case.

6. I did not have, either at the time of filing this bankruptcy case or at the present time, equity in the type of property described in 11 U.S.C. § 522(p)(1) {generally the debtor's homestead} in excess of the aggregate value specified therein.

7. There is no proceeding pending in which I may be found guilty of a felony of the kind described in 11 U.S.C. § 522(q)(1)(A) or liable for a debt of the kind described in 11 U.S.C.§ 522(q)(1)(B).

8. Certification Regarding Domestic Support Obligations Pursuant to 11 U.S.C. § 1328(a).

☐ I have not been required by a judicial or administrative order or by statute to pay any domestic support obligation as defined by 11 U.S.C. §101(14A) either before this bankruptcy filing or at any time after the filing of this bankruptcy case.

or

☐ I am required by judicial or administrative order or by statute to pay a domestic support obligation as defined by 11 U.S.C. §101(14A). {This refers to a debt owed to or recoverable by a spouse, former spouse or child of the debtor or such child's parent, legal guardian or responsible relative or a governmental unit in the nature of alimony, maintenance or support.} If you checked this box, you must list the name, address, and telephone number for each holder of a domestic support obligation in the space provided below:

The name, address and telephone number of each holder of a domestic support obligation are:

Name: _____
Address: _____
Telephone: _____
[check the appropriate box]

☐ I certify that as of the date of this affidavit I have paid all amounts required by a judicial or administrative order or by statute to be paid pursuant to any domestic support obligation as defined by 11 U.S.C. § 101(14A). Amounts due before this bankruptcy filing were paid to the extent provided for by the confirmed plan.
or

☐ I have executed, and the Court has approved, a written waiver of discharge pursuant to 11 U.S.C. § 1328(a).

9. The debtor's failure to complete such payments is due to circumstances for which the debtor should not justly be held accountable in that _____
_____
_____
_____
_____ 11 U.S.C. §1328(b)(1).

10. The value, as of the effective date of the plan, of property actually distributed und the plan on account of each allowed unsecured claims is not less than the amount that would have been paid on such claim is the estate of the debtor has been liquidated under Chapter 7 of this title on such date. 11 U.S.C. §1328(b)(2).

11. Modification of the plan under section 1329 of this title is not practicable in that
_____
_____

_____

_____ 11 U.S.C. §1328(b)(3)

WHEREFORE, Debtor(s) prays that the Court enter an Order of Discharge pursuant to 11 U. S. C. §1328(b) ("hardship discharge").

Respectfully submitted,

Debtor(s) Attorney

I declare under penalty of perjury that all of the above statements are true and correct to the best of my knowledge, information, and belief, and that the Court may rely on the truth of each statement in determining whether to grant a discharge in this Chapter 13 case. The Court may revoke my discharge if the statements relied upon are not accurate.

Date:_____ _____

Signature of Debtor

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing document was sent to all parties listed on the matrix on file with the Bankruptcy Clerk's Office at the time this document was electronically filed with the Clerk on _____. A copy of the matrix is attached hereto and all parties were either served electronically or by first class mail, postage prepaid.

Electronically signed by
Debtor(s) Attorney

APPLICATIONS TO EMPLOY AND FEE APPLICATIONS
IN CHAPTER 13 CASES INVOLVING A DIVORCE

SAMPLE FACT PATTERN:

Bob and Suzie Debtor file a Chapter 13 in the Southern District of Ohio and confirm a plan. Eighteen months after the confirmation order is entered Bob and Suzie determine they want a divorce. Bob hires a divorce lawyer and pays her $1,500.00 and Suzie hires her own lawyer and pays him $2,500.00. Other than filing a Motion for Relief from Stay and getting an order, no other action is taken in the Bankruptcy Court. The parties are divorced. Bob ends up paying $5,500.00 in attorney's fees for his divorce and Suzie ends up paying $12,000.00 in attorney's fees. Suzie doesn't like the results obtained by her lawyer and writes a letter to the Bankruptcy Judge.

Question #1. Are Bob and Suzie's divorce lawyers required to file an Application for Employment with the Bankruptcy Court pursuant to 11 U.S.C. §327?

Answer: Depends on the Court.

Some Court's say no, in family law matters, "Section 327 requires that a Trustee obtain court approval to employ an attorney or other professional. The Bankruptcy Code contains no provisions requiring court approval of bankruptcy counsel of a Chapter 13 debtor." *In re Powell*, 314 B. R. 567, 569 (Bankr. N. D. Tex. 2004). "If, as here, a Chapter 13 debtor wishes to employ a professional for a matter not involving estate property, no court approval is necessary to employ counsel." *In re Webb*, 2005 Bankr. Lexis 1407, (ND GA April 11, 2005)

However *Webb*, does state that suing on a claim or cause of action that is property of the estate does require court approval.

See also, *In re French*, 111 B.R. 391, (ND NY 1989). This Court has adopted the position that there is no requirement for court ordered appointment of a professional as a condition precedent to the award of a fee in a case filed under Chapter 13.

The contrary position is non-family law case of *In re Price*, 2007 Bankr. Lexis 1366 (ND AL April 16, 2007). Citing *French* and *Powell* as "unpersuasive" because both opinions seem to overlook section 103(a), as section 103(a) of the Bankruptcy Code provides that "chapters 1, 3, 5 of this title apply in a case under Chapter 7, 11, 12, or 13 of this title. "Surely, if Congress intended section 327 to apply only to non-chapter 13 cases the section would clearly mandate that."

As summarized in the case of *In re: Overstreet*, 2010 Bankr. Lexis 448 (SC March 5, 2010) "Several courts have indicated that § 327 is not applicable to the employment of attorneys or other professionals by a Chapter 13 debtor, reasoning that the statutory language is limited to a trustee or Chapter 11 debtor-in-possession. *In re Tirado*, 329 B.R. 244, 248-50 (Bankr. E.D. Wis. 2005); *see also In re Powell, 314 B.R. 567, 569-70 (Bankr. N.D. Tex. 2004); In re Harris*, 298 B.R. 319, 320-21 (Bankr. E.D. Tenn. 2003); *In re Dugger*, No. 97-30410, 1999 WL 33486706, at *4 (Bankr. D. Idaho Mar. 5, 1999). However, other courts have reached the contrary conclusion on the basis that if the statute was intended to apply only to cases other than Chapter 13, it would have clearly provided for that, and that there would be no requirement for special counsel to be disinterested or not hold an interest adverse to the debtor absent § 327. *Price v. Crawford (In re Price)*, Bankr. No. 05-04807-TOM-13, Adv. No. 07-00017, 2007 Bankr. LEXIS 1366, 2007 WL 1125639, at *3-6 (Bankr. N.D. Ala. Apr. 16, 2007); *see also In re Davis*, No. 07-51337-NPO, 2009 Bankr. LEXIS 4099, 2009 WL 4856199, at *4 (Bankr. S.D. Miss. Dec. 9, 2009); *In re Glover*, No. 01-43454, 2003 Bankr. LEXIS 2089, 2003 WL 23811474, at *3 (Bankr. S.D. Ga. June 13, 2003).

Question 2. Are Bob and Suzie's divorce lawyers required to file a fee application?

Answer: Yes, with one possible exception.

If you like the ruling in *Webb*, *French* or *Powell* the answer is yes, if being paid from property of the estate. "An attorney representing a Chapter 13 debtor must file a fee application to get paid from property of the estate, as set forth in section 330(a)(4)(B)…" "A Chapter 13 debtor may not, however, pay such counsel from estate property without court approval." *Webb* at 1407 A possible exception, if the debtor's family provided these funds then a fee application need not be filed but the debtor may not pay additional fees from estate property, including from her current income, without an order authorizing her to do so. *Webb* (HN 11).

Question 3. Assuming they are required to do any of the above, what's the penalty if they do not?

Answer: The Bankruptcy Court my order disgorgement of attorney's fees and cancel any compensation agreement.

Bankruptcy courts have broad and inherent authority to deny any and all compensation when an attorney fails to meet the requirements of the Bankruptcy Code governing fee awards. *In re Prudhomme*, 43 F 3d 1000, 1003 (5th Cir. 1995), *In re Anderson*, 936 F. 2nd 199, 204 (5th Cir. 1991). Section 329(b) of the Bankruptcy Code authorizes this Court to review all compensation received by counsel in connection with bankruptcy cases. 11 U.S.C. § 329; *Rittenhouse v. Eisen*,

404 F. 3d 395, 397 (6th Cir. 2005) (§ 329 requires the court to examine the reasonableness of fees); *cert. denied*, 126 S. Ct. 378, 163 L. Ed. 165 (2005). Specifically, if "such compensation exceeds the reasonable value of any such services, the court may cancel any such agreement, or order the return of any such payment, to the extent excessive to…the entity that made such payment." 11 U.S.C. § 329(b). Thus, any payment or agreement considered under § 329(b) is valid only to the extent it is deemed "reasonable" by the court and a bankruptcy court may cancel a compensation agreement and order the return of any compensation previously paid. In matters involving challenges to attorney fees under 11 U.S.C. § 329, the burden of proof rests with the attorney to establish that his fees are reasonable. *See, In re Geraci,* 138 F. 3d 314, 318 (7th Cir. 1998). In examining compensation, the Court may evaluate whether a debtor has received the quality of services for which he bargained: "Clients come to attorneys for a service. Where the service is not provided, or provided poorly, they should not be required to pay for the service, regardless of the validity of the excuse offered." *In re LaFrance,* 311 B.R. 1, 25 (Bankr. D. Mass. 2004). What constitutes a "reasonable" fee or fee agreement is a question of fact to be determined by the particular factual circumstances of each case. *See, In re Diamond Mortgage Corp. of Illinois*, 135 B.R. 78 (Bankr. N.D. Ill. 1990).

CHAPTER 13 TRUSTEE'S (NORMAN) POSITION STATEMENT ON 11 USC §1325(a)(4)
BEST INTEREST OR LIQUIDATION TEST

Background

Prior to October 1, 2011, the mathematical equation to determine the liquidation test of 11 USC §1325(a) in Chapter 13 cases was liberally construed. In determining whether or not a plan met the best interest test typically there was a deduction of 10% for costs of sale and/or a hypothetical Chapter 7 Trustee fee without further calculation or evidence. The problem with this calculation was that it was formulaic; it ignored the time value of money and/or required no evidence from the debtor that such costs of sale were reasonable. The Trustee set out to evaluate the mathematical equation and recalculate it as necessary.

Interest Rate

In assuming for purposes of the best interest or liquidation test of 11 USC §1325(a)(4) that a stream of Chapter 13 plan payments were the same as a lump sum payment, the pre October 1, 2011 calculation ignored the time value of money. Clearly given a choice, a creditor and the Chapter 13 Trustee would prefer a lump sum payment and not deferred monthly payments in the form of a Chapter 13 plan payment. "A debtor's promise of future payments is worth less than an immediate payment of the same total amount because the creditor cannot use the money right away, inflation may cause the value of the dollar to decline before the debtor pays and there is always some risk of nonpayment. The challenge for bankruptcy courts reviewing such repayment schemes, therefore, is to choose an interest rate sufficient to compensate the creditor for those concerns." *Till v. SCS Credit Corporation*, 541 U.S. 465, 124 S. Ct. 1951 (2004) at 474.

11 USC §1325(a)(4) provides as follows:

(a) Except as provided in subsection (b), the court shall confirm a plan if—

(4)the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;

The Trustee's position is that unsecured creditors must receive the "value, as of the effective date of the plan" of property they would have received in a Chapter 7 liquidation "on such date." In other words, the plan must pay the liquidation value and account for the time value of money.

The Trustee's position is that *Till* interest is the interest rate that should be compounded for each period of time that payment is delayed.

The Chapter 13 Trustee position based on *Till*, is that an interest rate of 2 points over the Wall Street Journal prime rate, as of the day of filing, should be set as the effective *Till* interest rate in all Chapter 13 cases. "We think it likely that Congress intended bankruptcy judges and trustees

to follow essentially the same approach when choosing an appropriate interest rate under any of these provisions. Moreover we think Congress would favor an approach that is familiar in the financial community and that minimizes the need for expensive evidentiary proceedings." *Till* at 474-75. "Taking its cue from ordinary lending practices, the approach begins by looking to the national prime rate, reported daily in the press, which reflects the financial market's estimate of the amount a commercial bank should charge a creditworthy commercial borrower to compensate of the opportunity costs of the loan, the risk of inflation and the relative slight risk of default. Because bankrupt debtors typically pose a greater risk of nonpayment than solvent commercial borrowers, the approach then requires a bankruptcy court to adjust the prime rate accordingly. The appropriate size of that risk adjusted depends, of course, on such factors as the circumstances of the estate, the nature of the security, and the duration and feasibility of the reorganization plan." *Till* at 478-79.

In *Hardy v. Cinco Fed. Credit Union (In re Hardy)*, 755 F.2d 75 (6th Cir. 1985), the 6th Circuit held that in a solvent estate, a plan which proposed to pay 100% of unsecured claims without interest did not comply with §1325(a)(4), because it did not account for the time value of money—hence the "interest is required for solvent estates" rule of thumb. But §1325(a)(4) is not limited to solvent estates. In a case decided later the same year as *Hardy*, the 6th Circuit interpreted *11 U.S.C. §1325(a)(4)* to require interest on all deferred payments to be made under the plan. "In our view, a contrary conclusion would prevent the creditor from realizing the full present value of the amount owed." *Cardinal Fed. Savings & Loan Assoc. v. Colegrove (In re Colegrove)*, 771 F.2d 119, 121 (6th Cir. 1985).

Unfortunately in the context of a Chapter 13 these calculations are not simple or routine. Very rarely in a Chapter 13 case do unsecured creditors receive the same amount monthly from a plan payment. However, if they did receive equal monthly payments over the life of a Chapter 13 plan the excel calculation for the present value (PV) of a stream of future payments is:

=pv(rate, nper, payment,[fv],[type])

1. pv is the present value and is the calculated amount.
2. rate is the interest rate per month (Till interest).
3. nper is the number of payments.
4. payment is the payment amount as a negative number.
5. fv is future value.
6. type is either 0 end of period or 1 beginning of period.

So the present value of an even stream of $500.00 monthly to unsecured creditors over 60 months is:

=PV(.0525/12,60,-500)

=$26,335.22

Adding the variables of most Chapter 13 plans which include payments of conduit mortgage payments, secured creditors and attorney's fees, all ahead of unsecured creditors makes the calculation even more difficult. The priority payment of conduit mortgages, adequate protection payments and the like leads to a stream of uneven monthly payments to unsecured creditors. Calculating present value of a stream of uneven payments to unsecured creditors is difficult because each payment must be considered to be a component of the total present value. Calculating the present value of each differing monthly payment to unsecured creditors using the same formula above but leaving the recurring payments argument blank is time consuming.

So by example the present value of a single $500.00 payment, 36 months from now is:

=PV(.0525/12,36,,500)

=$427.29

But if you have 60 differing monthly amounts this calculation must be done sixty times and then summed. Adding up the present value of each of the single payments or string of payments gives the total present value of the stream of payments to unsecured creditors. An excel spreadsheet makes these calculations much easier but a calculated valuation of "best interest" or "liquidation" can be time consuming and for many lawyers/paralegals who are math/computer challenged impractical.

Costs of Sale

Still further the Trustee believed that a blanket 10% deduction for costs of sale was excessive, not supported by any evidence (in most cases) or by local case law. Cases cited by the debtor's bar that a 10% deduction for costs was a reasonable standard, did not seem applicable.

Based on a review of real estate closing transactions processed by the Trustee's office, it was determined that the average closing costs in a real estate transaction were 6.74%.

Based on a review of sales of personal property processed by the Trustee's office, it was determined that there were very few cases that involved costs of sale.

In the case of *In re Weber*, 140 B.R. 707 (BK S.D. Ohio 1992), the Court sustained a deduction of 10% of costs only because "No argument has been advanced that 10% is an unreasonable estimate of those costs." *Weber* at 711. *Weber* did not seem to the Trustee to stand for the proposition that a debtor gets an automatic 10% deduction for hypothetical costs of sale; it is limited by its facts, specifically that there was no objection to the unreasonableness of these costs.

In addition a blanket deduction of 10% without hearing effectively eliminates the introduction of evidence as to reasonableness. It also usurps the debtor's burden of proof as the plan proponent under 11 USC §1325.

Conclusion

Based on a net present value calculation the Trustee determined that the difference between calculating "best interest" with costs of sale plus *Till* interest vs. calculating "best interest" with no costs of sale with no *Till* interest was statistically insignificant. By example a debtor who has $30,000.00 of non-exempt assets who deducts 10% for costs of sale must make a stream of payments that has a net present value of $27,000.00. This equates to $512.62 per month to unsecured creditors in a Chapter 13 plan. Calculating a nonexempt value of $30,000.00, with no costs of sale and no *Till* interest, $500.00 per month for sixty months is the required plan payment to unsecured creditors and the net present value is $26,335.22 (as calculated above). In most calculations, taken by the Trustee, the difference in best interest calculations as adopted below was less than 2% and therefore insignificant.

The Trustee therefore adopted for administration of Chapter 13 cases the following rules regarding satisfying the best interest or liquidation tests of 11 USC §1325(a)(4):

1. A debtor may deduct reasonable costs of sale and a Chapter 7 Trustee fee for determining the present value of the sum that must be paid to unsecured creditors to meet the "best interest" test of 11 USC §1325(a)(4). Counsel however must pay *Till* interest on any deferred payment to unsecured creditors.

   OR

2. For ease of administration the debtor may pay liquidation value without any deductions and forgo any required *Till* interest calculation to meet the "best interest" test of 11 USC §1325(a)(4).