Consumer Bankruptcy Panel, June 1, 2024
Judge Tamara O. Mitchell
Career law clerk Donna G. McGee
United States Bankruptcy Court
Northern District of Alabama, Southern Division

CHAPTER 13: PRIORITIES, "BALLOON MORTGAGES", AND PLAN MODIFICATION

Claim priorities and plan modification are topics that frequently arise in Chapter 13 cases. The modification of mortgages that have either matured prior to filing or will mature during the case may not come up quite as often. While every attorney actively practicing bankruptcy law is likely familiar with these topics, it is nonetheless helpful to review them from time to time.

I. PRIORITIES IN CHAPTER 13

Bankruptcy Code § 507, titled "Priorities," applies to all chapters of the Code. Interestingly though, the application of § 507 depends on the chapter and courts have found that § 507 is applied quite differently in Chapter 13 than in Chapter 7. There are a few statutes at play when determining the effect of § 507 in Chapter 13 cases.

Bankruptcy Code §507 identifies the expenses and claims that are given priority by the Bankruptcy Code and provides, in relevant part:

> (a) The following expenses and claims have priority in the following order:
> (1) First:
> (A) Allowed unsecured claims for domestic support obligations that, as of the date of the filing of the petition in a case under this title, are owed to or recoverable by a spouse, former spouse, or child of the debtor, or such child's parent, legal guardian, or responsible relative, without regard to whether the claim is filed by such person or is filed by a governmental unit on behalf of such person, on the condition that funds received under this paragraph by a governmental unit under this title after the date of the filing of the petition shall be applied and distributed in accordance with applicable nonbankruptcy law.
> (B) Subject to claims under subparagraph (A), allowed unsecured claims for domestic support obligations that, as of the date of the filing

of the petition, are assigned by a spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative to a governmental unit (unless such obligation is assigned voluntarily by the spouse, former spouse, child, parent, legal guardian, or responsible relative of the child for the purpose of collecting the debt) or are owed directly to or recoverable by a governmental unit under applicable nonbankruptcy law, on the condition that funds received under this paragraph by a governmental unit under this title after the date of the filing of the petition be applied and distributed in accordance with applicable nonbankruptcy law.

(C) If a trustee is appointed or elected under section 701, 702, 703, 1104, 1202, or 1302, the administrative expenses of the trustee allowed under paragraphs (1)(A), (2), and (6) of section 503(b) shall be paid before payment of claims under subparagraphs (A) and (B), to the extent that the trustee administers assets that are otherwise available for the payment of such claims.

(2) Second, administrative expenses allowed under section 503(b) of this title, unsecured claims of any Federal reserve bank related to loans made through programs or facilities authorized under section 13(3) of the Federal Reserve Act (12 U.S.C. 343), and any fees and charges assessed against the estate under chapter 123 of title 28.

11 U.S.C. § 507(a)(1)-(2).

Another important section is § 1322, providing in relevant part:

(a) The plan –

. . . .

(2) shall provide for the full payment, in deferred cash payments, of all claims entitled to priority under section 507 of this title, unless the holder of a particular claim agrees to a different treatment of such claim;

. . . .

(b) Subject to subsections (a) and (c) of this section, the plan may –

. . . .

(4) provide for payments on any unsecured claim to be made concurrently with payments on any secured claim or any other unsecured claim;

11 U.S.C. § 1322(a)(2), (b)(4).

Also relevant is § 1326(b)(1):

(b) Before or at the time of each payment to creditors under the plan, there shall be paid –

(1) any unpaid claim of the kind specified in section 507(a)(2) of this title.

11 U.S.C. § 1326(b)(1). Federal courts in Alabama have had occasion to address the interplay of these statutes, particularly in regard to domestic relations claims.

A. ***In re Vinnie*, 345 B.R. 386 (Bankr. M.D. Ala. 2006) (Sawyer, J.)**

The Alabama Department of Human Resources ("DHR") filed three claims in the debtor's Chapter 13 case. The debtor proposed in his five-year-plan to pay $105 per week to the trustee, with DHR's claims to be paid along with other claims through the entire plan term. DHR objected to the proposed plan, asserting that its claims must be paid in full before any other creditor received a distribution. The bankruptcy court noted that § 507 "structures priority claims in a hierarchical manner. In other words, claims entitled to priority pursuant to 507(a)(1) are higher than those under 507(a)(2)." *Vinnie*, 345 B.R. at 388. DHR's domestic claims fall under § 507(a)(1) and thus the Court recognized that "the argument of DHR, to the effect that its claim has a higher priority than the claim of the Debtor's lawyer [given priority in § 507(a)(2)] is correct, as far as it goes." *Id.* Next looking at § 1322(a), "what must be in a plan," and § 1322(b), "what a Debtor may do with his Plan," the bankruptcy court noted that § 1322(a)(2) treats all of the priority subsections of § 507 the same no matter their order in § 507. In other words:

> "All" 507 priority claims must be paid in full over the life of the plan in deferred cash payments. There is nothing in the text of § 1322(a) which suggests that § 507(a)(1) claims must be paid in full before § 507(a)(2) claims are paid anything. Second, § 1322 contemplates that payments on priority claims will be made over the life of the plan. In other words, the statute contemplates the concurrent rather than sequential payment of secured claims.

Vinnie, 345 B.R. at 388.[1] Examining § 1322(b)(4), the bankruptcy court noted that

> [W]e find further evidence of Congressional intent which undermines the argument of DHR. "The plan may . . . provide for payments on any unsecured claim to be made concurrently with payments on any secured claim or any other unsecured

[1] Earlier in the opinion the bankruptcy court explained that it "will refer to the practice of paying claims in the order of their priority in full before claims with a lower priority are paid as 'sequential payment.' In contrast, payment of claims of various priorities and secured claims simultaneously will be referred to as 'concurrent payments.'" *Vinnie*, 345 B.R. at 387.

> claim,". This language further demonstrates that Congress contemplated that claims could be paid concurrently, rather than in sequence as urged by DHR.

Vinnie, 345 B.R. at 388 (quoting 11 U.S.C. § 1322(b)(4)). In addition, the bankruptcy court noted that the language of § 1326(b)(1) itself contradicts DHR's argument as § 1326(b)(1) states that claims under § 507(b)(2) are to be paid either "'[b]efore or at the time of each payment to creditors under the plan . . . .'" *Vinnie*, 345 B.R. at 389 (quoting 11 U.S.C. § 1326(b)). It is thus reasonable that an attorney with a priority claim under § 507(a)(2) could be paid before a domestic support claim with priority under § 507(a)(1). The bankruptcy court observed the contrast between the Bankruptcy Code's treatment of priority claims in Chapter 13 and Chapter 7 as Bankruptcy Code § 726 specifically directs that the claims listed in § 507 shall be paid first and in the order dictated by the statute.

B. *In re Sanders*, 341 B.R. 47 (Bankr. N.D. Ala. 2006) (Caddell, J.)

DHR filed two child support arrearage claims in the debtors' Chapter 13 case and objected to the proposed Chapter 13 plan as it provided for payment of attorney fees upon confirmation while DHR's claims would be paid in full but over time. DHR argued that the child support arrearage claims should be paid ahead of the attorney fees since the support claims were given a higher priority in § 507. Examining the issue, the bankruptcy court noted that pursuant to Bankruptcy Code § 1322(a)(2), priority claims listed in § 507 had to be paid in full, "in deferred cash payments," but nothing in that section "requires higher priority claims to be paid in full before lower priority claims." *Sanders*, 341 B.R. at 50. According to the court, the application of § 507 differs depending on the chapter under which a debtor has filed since § 1326 requires "only that the trustee pay § 507(a)(2) administrative expenses before or contemporaneously with payment to other claimholders under the plan," while § 726 mandates that priority claims are paid in the order provided in § 507. *Sanders*, 341 B.R. at 50-51. The bankruptcy court pointed out that if Congress

intended that § 507(a)(1) claims be paid first in a Chapter 13 then it could have expressly provided for that. Further, the bankruptcy court rejected the argument made by DHR that secured creditors should not be paid until DHR's claims were paid. Quoting another bankruptcy court opinion with favor, the court said:

> In a sense, secured claims may be said to have 'priority' over all unsecured claims . . . [Because a] secured claim represents the holder's rights in specific property . . . [t]he holder of an allowed secured claim has not just a general claim but property which it is entitled to receive. In that sense, secured claims are first priority claims in bankruptcy cases.

Sanders, 341 B.R. at 52 (quoting *In re Perez*, 339 B.R. 385 (Bankr.S.D.Tex.2006)) (alterations in original). The bankruptcy court was affirmed by the District Court for the Northern District of Alabama in *Alabama Dept. of Hum. Res. v. Sanders (In re Sanders)*, 347 B.R. 776 (N.D. Ala. 2006).

C. ***Alabama Department of Human Resources v. Boler (In re Boler)*, No. 06-30049, Civil Action No. 2:-6-CV-473, 2008 WL 205579 (M.D. Ala. Jan. 24, 2008) (Watkins, J.)**

DHR objected to the debtors' proposed plan because the plan did not provide that DHR's claims would be paid in full before administrative and secured claims received any payment. The bankruptcy court issued a memorandum opinion overruling the objection and DHR appealed.[2] As in *Vinnie* and *Sanders*, the district court determined that in Chapter 13 the order of payment is not controlled by § 507 and thus need not be followed. Looking at § 1322(a)(2) and 1322(a)(4), the court concluded that "a Chapter 13 plan must provide for full payment of priority claims, but there is no provision that requires higher-ranked priority claims to be paid before lower-ranked priority claims." *Boler*, 2008 WL 205579, at *2. Further, "if the court required domestic support

[2] The debtors amended their plan pre-confirmation, proposing to pay DHR directly and DHR objected to that as well. The bankruptcy court set a hearing on that objection and DHR appealed before the hearing was held. The district court remanded that issue to the bankruptcy court.

obligations to be paid prior to other priority claims, then it would have to ignore § 1326(b)(1), which clearly provides that priority claims for administrative expenses, including the attorney's fees, are to be paid first . . . ." *Boler*, 2008 WL 205579, at *3.

As to DHR's argument, made without citation to authority, that "a 'secured creditor is not be [sic] prejudiced by waiting over time for the bulk of its claim to be paid' in part because 'the secured creditor has the right to seek relief from the automatic stay to reclaim its collateral,'" the district court gave two reasons the argument did not hold up. First, DHR's argument ignores the fact that a secured creditor that seeks relief from the stay is not likely to get relief if the debtor complies with the plan. Second, as the bankruptcy court stated in *Sanders*, "'[b]ecause a secured claim represents the holder's rights in specific property . . . the holder of an allowed secured claim has not just a general claim but property which it is entitled to receive. In that sense, secured claims are first priority claims in bankruptcy cases.'" *Boler*, 2008 WL 205579, at *4 (quoting *Sanders*, 341 B.R. at 51). Furthermore, the district court addressed DHR's policy argument that "if secured creditors are paid first [the secured creditors] 'will have no incentive to be more selective in determining to whom they sell and finance property.'" *Boler*, 2008 WL 205579, at *4. According to the court:

> This argument turns the fundamentals of secured transactions and the separation of powers upside down. As the *Sanders* [district] court explained, "[p]erhaps DHR should lobby Congress for creditors to have incentives to not sell property to people with children (as they are most likely to have domestic support obligations), but that is not within the province of this court." *Sanders*, 347 B.R. at 781. This court is not at liberty to change the policy established by Congress in BAPCPA.

Boler, 2008 WL 205579, at *4 (quoting *Alabama Dept. of Hum. Res. v. Sanders (In re Sanders)*, 347 B.R. 776, 781 (N.D. Ala. 2006)).[3]

[3] Affirming *In re Sanders*, 341 B.R. 47 (Bankr. N.D. Ala. 2006) (Caddell, J.).

II. CHAPTER 13 PLAN TREATMENT OF MORTGAGES MATURING BEFORE OR DURING CASE

In some instances a Chapter 13 debtor has a mortgage that either matured before the case was filed or will mature during the debtor's Chapter 13 case. Ordinarily a debtor may not modify the rights of a mortgage holder with a lien on the debtor's residence. 11 U.S.C. § 1322(a)(2); however, Bankruptcy Code § 1322(c)(2) specifically provides an avenue for modification in certain circumstances:

> (c) Notwithstanding subsection (b)(2) and applicable nonbankruptcy law—
> . . . .
> (2) in a case in which the last payment on the original payment schedule for a claim secured only by a security interest in real property that is the debtor's principal residence is due before the date on which the final payment under the plan is due, the plan may provide for the payment of the claim as modified pursuant to section 1325(a)(5) of this title.

A. *In re Crumpton*, Case No. 23-11177 (Bankr. S.D. Ala. Dec. 19, 2023) (Callaway, J.) – Order Overruling Objection by PNC Bank in Part, Requiring PNC to File Amended Claim, and Continuing Confirmation Hearing (Doc. 34)

Judge Callaway in the Bankruptcy Court for the Southern District of Alabama has recently had occasion to address a case where Bankruptcy Code § 1322(c)(2) came into play. The Chapter 13 debtor had a home mortgage that would mature under its original terms during the pendency of her chapter 13 bankruptcy case. It appears that the debtor proposed in her plan to continue paying the mortgage debt according to the original terms; the mortgage company objected to the plan, arguing that the debtor was required to modify the loan terms to pay the debt through the Chapter 13 trustee with a *Till*[4] rate of interest that was higher than the original interest rate. The court overruled the mortgage company's objection to the extent that it argued the modification was

[4] *Till v. SCS Credit Corp.*, 541 U.S. 465, 124 S. Ct. 1951, 158 L.Ed.2d 787 (2004). In *Till*, the Supreme Court "addressed the issue of the appropriate rate of interest to be applied under § 1325(a)(5)(B)(ii). There the Court held that the so-called formula approach, which starts with the prime national interest rate and adjusts for risk of nonpayment, is the appropriate method in determining the adequate interest rate to be paid on secured claims." *In re Wright*, 338 B.R. 917, 919 (Bankr. M.D. Ala. 2006) (Williams, J.) (citing *Till*, 541 U.S. at 477, 124 S.Ct. 1951)).

required. According to the court, the plain language of Bankruptcy Code § 1322(c)(2) provided that the debtor "may" modify the terms, but did not require her to do so.

III. MODIFICATION OF A CONFRMED PLAN

Bankruptcy Code § 1329 controls when a debtor may modify a confirmed plan. That section provides:

> (a) At any time after confirmation of the plan but before the completion of payments under such plan, the plan may be modified, upon request of the debtor, the trustee, or the holder of an allowed unsecured claim, to--
>
> (1) increase or reduce the amount of payments on claims of a particular class provided for by the plan;
>
> (2) extend or reduce the time for such payments;
>
> (3) alter the amount of the distribution to a creditor whose claim is provided for by the plan to the extent necessary to take account of any payment of such claim other than under the plan; or
>
> . . . .
>
> (b)(1) Sections 1322(a), 1322(b), and 1323(c) of this title and the requirements of section 1325(a) of this title apply to any modification under subsection (a) of this section.
>
> (2) The plan as modified becomes the plan unless, after notice and a hearing, such modification is disapproved.
>
> (c) A plan modified under this section may not provide for payments over a period that expires after the applicable commitment period under section 1325(b)(1)(B) after the time that the first payment under the original confirmed plan was due, unless the court, for cause, approves a longer period, but the court may not approve a period that expires after five years after such time.

11 U.S.C. § 1329.

A. *Whaley v. Guillen (In re Guillen)*, 972 F.3d 1221 (11th Cir. 2020)

The Eleventh Circuit took a direct appeal from a bankruptcy court decision in the Northern District of Georgia "to answer a question of first impression that has divided our sister circuits: whether bankruptcy courts must find some change in circumstances before permitting debtors to modify confirmed plans under 11 U.S.C. § 1329." *Guillen*, 972 F.3d at 1223. In her Chapter 13 case the debtor contended that the bank holding the second lien on her home had not properly perfected its lien. The debtor filed an adversary proceeding that the parties settled, with the parties

agreeing that the bank held only an unsecured claim. After the settlement, the bankruptcy court confirmed the debtor's plan which provided for payment of $20,172 to unsecured creditors, of $4,900 for attorney fees, and for any attorney fees incurred in the adversary proceeding and approved by the court. Four months thereafter the debtor's attorney filed an application for $8,295 in fees from the adversary proceeding and, as a consequence, the debtor moved to modify her plan to pay the fees. The court noted that § 1329(a)(1), allowing modification to "increase or reduce the amount of payments on claims of a particular class under the plan," applied as the debtor wanted to reduce the amount to be paid to unsecured creditors by $8,295, leaving $11,877 for those claims. *Guillen*, 972 F.3d at 1225 (citing 11 U.S.C. § 1329(a)(1)). The Chapter 13 trustee objected to modification on the grounds that it both violated the "best interests of creditors" test and was barred by res judicata. The bankruptcy court overruled the objection and allowed the modification. As the Eleventh Circuit noted, pursuant to § 1329 a modification must comply with certain statutory requirements; the bankruptcy court had allowed modification as it found the proposal satisfied those express requirements. According to the Eleventh Circuit, "[t]he Trustee claims this was error. She asks us to read one additional requirement into § 1329 – that debtors show some change in circumstances before modifying confirmed plans." *Guillen*, 972 F.3d at 1226. Examining the plain text of § 1329, the Eleventh Circuit determined that § 1329 on its face does not require a change in circumstances as a prerequisite for modification:

> We can discern no reason to speak where Congress has not; adopting the Trustee's "argument would result not in a construction of the statute, but, in effect, an enlargement of it by the court, so that what was omitted, presumably by inadvertence, may be included within its scope. With a plain, nonabsurd meaning in view, we need not proceed in this way."

Guillen, 972 F.3d at 1226 (citing Lamie v. U.S. Tr., 540 U.S. 526, 538, 124 S. Ct. 1023, 157 L. Ed. 2d 1024 (2004)). Further:

> As we have often observed, when Congress knows how to say something but chooses not to, its silence is controlling. . . . We are confirmed in this interpretation of § 1329, not just by the statute's plain text, but by reference to the broader statutory scheme. After all, we read words in their context and with a view to their place in the overall statutory scheme. . . . Throughout the Bankruptcy Code, when Congress sought to impose a "circumstances" requirement, it said so. To list just a few examples: Debtors who apply for Chapter 13's so-called hardship discharge must show "circumstances for which the debtor should not justly be held accountable." 11 U.S.C. § 1328(b)(1). Further, a bankruptcy court may excuse a debtor's late filing of tax returns only upon a showing of "circumstances beyond the control of the debtor." *Id.* § 1308(b)(2). And, in fact, a bankruptcy court must deny the discharge to a Chapter 7 debtor who conceals or destroys financial records, "unless such act or failure to act was justified under all of the circumstances of the case." *Id.* § 727(a)(3).

Guillen, 972 F.3d at 1226-1227 (some citations and quotations omitted). The court noted that the reasons to modify a confirmed plan were limited under § 1329(a), and the proposed "modified plan must still satisfy the requirements of § 1325(a), along with the requirements of §§ 1322(a), (b), and 1323(c)" including the best interests of creditors test, and proposal in good faith. *Guillen*, 972 F.3d at 1229. Further, a court must confirm a proposed plan if it satisfies the § 1325 requirements but a court has the discretion to allow or deny modification of a plan; thus, bankruptcy courts have "'ample powers to prevent successive or abusive attempted modifications.'" *Guillen*, 972 F.3d at 1229 (quoting *In re Hoggle*, 12 F.3d 1008, 1011-12 (11th Cir. 1994)). In affirming the bankruptcy court's decision, the Eleventh Circuit determined:

> It remains true that an unforeseen change in circumstances is a good reason to permit a modification that otherwise satisfies § 1329. But that is not to say it is the only reason. And we reject the Trustee's attempt to convert a sufficient condition into a necessary one. When a bankruptcy court faces a modified plan that satisfies the requirements of § 1329, it may properly consider whether there has been some change in circumstances when deciding whether to confirm the plan as modified. But it is free to confirm the modified plan even where it has not found any change in circumstances. . . . We . . . hold that a debtor need not make any threshold showing of a change in circumstances before proposing a modification to a confirmed plan under § 1329.

Guillen, 972 F.3d at 1229-1230.

B. *In re Shumbera*, Case No. 6:20-bk-00100-LVV, 2020 WL 7183540 (Bankr. M.D. Fla. Dec. 2, 2020) (Vaughn, J.)

The debtor's confirmed plan took advantage of the court's "Mortgage Mediation program" that allowed a plan to be confirmed while the parties negotiated a mortgage modification, with the debtor making only adequate protection payments during negotiation. When the mediation was unsuccessful, the debtor moved to modify his plan "to make monthly mortgage payments, but paying [the mortgage holder's] prepetition mortgage arrears of $28,805.53 in a lump sum with the final plan payment in month sixty." *Shumbera*, 2020 WL 7183540, at *1. The mortgage holder objected to the proposal on the grounds that the final balloon payment violated Bankruptcy Code 1325(a)(5)(B)(iii)(I), which provides:

> (a) Except as provided in subsection (b), the court shall confirm a plan if—
> . . . .
> (5) with respect to each allowed secured claim provided for by the plan—
> . . . .
> (iii) if—
> (I) property to be distributed pursuant to this subsection is in the form of periodic payments, such payments shall be in equal monthly amounts[.]

11 U.S.C. 1325(a)(5)(B)(iii)(I). The court looked to Black's Law Dictionary to define the term "periodic payment" used in § 1325(a)(5)(B)(iii)(I) "as 'one of a series of payments made over time instead of a one-time payment for the full amount.'" *Shambera*, 2020 WL 7183540, at *2. Thus, the court determined that the proposed balloon payment was "not equal to the preceding fifty-nine monthly payments and therefore violates § 1325(a)(5)(B)(iii)(I) of the Bankruptcy Code." *Shambera*, 2020 WL 7183540, at 2. As a result, the motion to modify was denied for not meeting the requirements of § 1325(a).