

GOOD FAITH FILING IN CHAPTER 13

In describing pornography, Justice Potter Stewart of the United States Supreme Court once stated:

under the First and Fourteenth Amendments criminal laws in this area are constitutionally limited to hard-core pornography. I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it, and the motion picture involved in this case is not that. *Jacobellis v. Ohio*, 378 U.S. 184 (1964).

Trying to find a consistent and objective determination of good faith can be as elusive for Bankruptcy practitioners as defining pornography was for Justice Stewart. There are simply no hard and fast rules that a Bankruptcy Court will follow and, at best, counsel can simply “give it their best shot.”

Debtors file for relief under Chapter 13 for a wide variety of reasons. Some debtors have non-exempt assets they wish to preserve and protect. Others have excess disposable income and consumer debts and, therefore, simply don’t qualify for relief under Chapter 7 and must file for relief under Chapter 13. Some debtors have excessive arrears in home mortgages and need time to catch up in order to save their home. Some debtors owe tax debts or back Domestic Support Obligations and use Chapter 13 as a vehicle for curing those debts in full. For those clients, there is rarely a dispute as to whether the Chapter 13 plan has been filed in good faith, as is required by 11 U.S.C. § 1325(a)(3).

There are, however, certain debtors who file for relief under Chapter 13 in order to take advantage of what is left of the “super discharge” made available under 11 U.S.C. § 1328(a). In the aftermath of BAPCPA there is little left of the “super discharge” but one of the remaining debts which can be discharged in Chapter 13 but cannot be discharged in Chapter 7 is a non-Domestic Support Obligation that arises from a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court or record. These debts are non-dischargeable in Chapter 7 under 11 U.S.C. § 523(a)(15) but are dischargeable in Chapter 13, assuming the Plan has been filed in good faith and assuming a discharge is ultimately granted.

Since the recipient of the non-DSO divorce-related obligation cannot litigate the dischargeability of the debt, that former spouse will often turn to litigation over the good faith filing of the Chapter 13 Plan. How will the Court analyze the good faith of the proposed plan? What standards will be followed? How can counsel predict, with any certainty, the likely outcome of the dispute?

Courts throughout the country have struggled in trying to define “good faith.” In *In re Evans*, 2012 WL 2802228 (Bankr. S.D. Ind. 2012), the Debtor owed his ex-wife \$133,000 on an equalizer payment. He owed about \$55,000 in other debts. He had about \$30,000 of non-exempt property he wished to retain and proposed a Chapter 13 Plan in which he committed to pay \$88,000 over 60 months. Of that money, \$3,500 was to go to his attorney, \$30,000 in secured debt and the balance to unsecured creditors. The Court confirmed the plan, finding that the “totality of circumstances”, including the fact that the largest debt was not dischargeable in Chapter 7, titled in favor of Confirmation. The Court found that there was a sincere effort to pay debt and not simply use Chapter 13 as an avoidance device. The Court noted that the schedules were accurate as to debts, assets and expenses, there was no intent to manipulate the Code, no attempt to mislead the Court and that there was a fundamental fairness in dealing with creditors, including the ex-spouse.

An interesting analysis of the “good faith” test can be found in the Virginia Bankruptcy Court decision of *In re Green*, 2010 WL 396253 (Bankr. E.D. Va. 2010). The Debtor owed his ex-wife \$45,000 and filed for Chapter 13 to attempt to discharge the debt. His plan provided for a 21% distribution to unsecured creditors, paid out over 60 months. The Court applied the 4th Circuit standards in evaluating good faith:

A non-exclusive list of relevant factors includes “the percentage of proposed repayment, ... the debtor’s financial situation, the period of time payment will be made, the debtor’s employment history and prospects, the nature and amount of unsecured claims, the debtor’s past bankruptcy filings, the debtor’s honesty in representing facts, and any unusual or exceptional problems facing the particular debtor.” *Id.* at 972. Additionally, the use of chapter 13 to compromise a claim that would not be dischargeable in chapter 7, while not by itself a sufficient basis for finding bad faith, is nevertheless a relevant factor to be considered. *Green, supra* at page 2 of the decision.

The Court recognized the need for Chapter 13 relief for the Debtor. He met the liquidation test, the disposable income test, the plan duration test and lacked the present ability to pay the equitable distribution award, which was fully due and payable. The Court found the 21% dividend to be adequate under the circumstances of the case even though the major debt (80%) was not dischargeable in Chapter 7. In analyzing the last factor, the Court noted “a debtor in financial distress does not act in bad faith in simply taking advantage of a benefit Congress has chosen to provide.” *Green, supra* at page 3 of the decision. The Court, however, denied confirmation. Debtor had, over the 19 months prior to the Bankruptcy, increased his secured line of credit debt by almost \$65,000 and could not explain how that money was used. The Court also noted that the amount taken on the LOC exceeded by \$20,000 the amount owed the ex-spouse. The failure to provide an accounting and the fact that the

money taken exceeded what was owed the ex-spouse led to a finding of bad faith (or at least a lack of good faith).

It is safe to assume that a Debtor who wishes to get the benefit of a Chapter 13 “super discharge” must be “squeaky clean” in all other aspects of the filing. Schedules must be accurate. The Statement of Financial Affairs must give full, complete and accurate information. The Debtor’s living expenses must be reasonable, and all disposable income must be submitted to the Plan for the Applicable Commitment Period (I have not found case law that finds a lack of good faith for a below median income Debtor not expanding the plan beyond 36 months, but I am certain there are Courts that have made that ruling). In denying confirmation, the Bankruptcy Court in *In re Hopper*, 474 B.R. 872 (Bankr. E.D. Ark. 2012) noted too many “errors” and “irregularities” in the schedules and proposed plan. Debtor wanted to pay back family loans, was not accurate in listing all assets, overstated expenses and, as the Court found, simply wanted to avoid litigation with his ex-spouse and manipulate the Bankruptcy Court process for his own advantage. He lacked a sincere effort to repay his debts.

The timing of the filing of the Chapter 13 and the pre-Petition conduct of the Debtor led the Bankruptcy Court to deny confirmation of a Chapter 13 Plan in *In re Page*, 519 B.R. 908 (Bankr. M.D.N.C. 2014). The Debtor owed money to her ex-spouse’s attorney arising from divorce and post-divorce litigation. She filed for Chapter 13 relief to avoid a possible incarceration for non-payment and had shown an ongoing pattern of avoiding payment of the debt.

The Debtors’ motive for filing under Chapter 13 evidences bad faith. At a hearing on January 15, 2014, when Mrs. Page was asked why she filed for Chapter 13 instead of Chapter 7, she responded that in order “to include domestic attorney fees we needed to file Chapter 13.” By Mrs. Page’s own admission, she filed for Chapter 13 to circumvent the First Fee Order that required her to pay \$17,000. By filing for Chapter 13, Mrs. Page in essence stayed the Contempt Order and avoided jail. While it is understandable that Mrs. Page wanted to avoid going to jail, her persistent and wrongful behavior over a period of years accumulated a large amount of attorney fees that she made no effort pay. In contrast to a typical Chapter 13 case, the Debtors’ home was not in foreclosure, and their car was not repossessed. Instead, the Debtors filed for Chapter 13 to secure Mrs. Page from complying with a state court order *Page, supra* at page 914

The Court found as follows: “...after weighing the Debtors’ candidness against their bad motives, obvious timing, manner of accumulating debt, their dishonesty with the Court, and their questionable ineligibility to file for Chapter 13, it is clear that the Debtors filed their petition in bad faith. Their conduct is clearly atypical of the debtors that seek relief from this Court and rises to the level of bad faith.” *Page, supra* at page 915.

Each Circuit will adopt its own standards for “good faith” in Chapter 13. The following cases arise from each of the Circuit Courts of Appeal and may be helpful in identifying factors for confirmation of Chapter 13 in the context of good faith litigation:

- 1st *In re Puffer*, 674 F.3d 78
- 2d *In re Johnson*, 708 F.2d 865
- 3d *In re Lilley*, 91 F.3d 491
- 4th *Neufeld v. Freeman*, 794 F.2d 149
- 5th *In re Crager*, 691 F.3d 671
- 6th *In re Caldwell*, 851 F.2d 852
- 7th *In re Rimgale*, 669 F.2d 426
- 8th *In re LeMaire*, 898 F.2d 1346
- 9th *In re Goeb*, 675 F.2d 1386
- 10th *In re Rasmussen*, 888 F.2d 703
- 11th *In re Kitchens*, 702 F.2d 885

Each Circuit Court examines good faith under a “totality of circumstances” standard, although it may be labeled differently. It appears that the Courts will look to whether the Debtor is truly trying to make a good faith effort to pay debt or simply use the Bankruptcy Court to get from under the prior Court Order. Of course, each case is fact intensive. As a general rule, the more that is paid into the plan, the lack of pending state court litigation at the time of the filing, the over-all nature of the debts being discharged, the percentage of recovery to claimants and the ability of the Debtor to show an honest and sincere effort to repay debt, the higher the likelihood is of confirmation.