

**CHAPTER 13 BANKRUPTCY:  
AN INTRODUCTION**

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# PART 1

## GENERAL TERMS AND CONCEPTS

Below are some general concepts and terminology that must be understood in order to appreciate the law and mechanics of chapter 13. These concepts include the policy behind bankruptcy, discharge, the common types of bankruptcy available to individuals, the bankruptcy estate, the trustee, and the automatic stay.<sup>1</sup>

### THE PURPOSE OF CONSUMER BANKRUPTCY

The purpose of bankruptcy is two-fold: 1) to provide individuals with a fresh start, and 2) to preserve the status quo in order to ensure an orderly and fair distribution of any non-exempt assets. The Supreme Court has described this fresh start as, “a new opportunity in life, unhampered by the pressure and discouragement of preexisting debt.”<sup>2</sup> The safety net provided by bankruptcy is an incentive to continue to be a productive member of society.<sup>3</sup> Fundamentally, this fresh start is intended for the “... honest but unfortunate debtor.”<sup>4</sup>

### THE DISCHARGE

The ultimate goal of nearly all personal bankruptcies is the discharge. Discharge releases the debtor from personal liability on nearly all debts and gives the debtor the “fresh start” that bankruptcy is meant to provide.<sup>5</sup> Certain debts are

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<sup>1</sup> Throughout these materials, all references to the code are to the Bankruptcy Code, Title 11 U.S.C.

<sup>2</sup> *Local Loan Co. v. Hunt*, 292 U.S. 234, 244, 54 S. Ct. 695, 78 L. Ed. 1230 (1934); *Perez v. Campbell*, 402 U.S. 637, 648; 91 S. Ct. 1704, 1710 (1971).

<sup>3</sup> *In re Kopstein*, 163 B.R. 573 (Bkrtcy. N.D. Cal. 1994).

<sup>4</sup> *Grogan v. Garner*, 498 U.S. 279, 286-87, 111 S. Ct. 654 (1991).

<sup>5</sup> 11 U.S.C. § 524.

nondischargeable and include, for example, domestic support obligations and certain taxes.<sup>6</sup>

### **THE TYPES OF BANKRUPTCY AVAILABLE**

The two most common types of relief are found in Chapters 7 and 13 of the Bankruptcy Code. In chapter 7, often referred to as “straight bankruptcy,” or “liquidation bankruptcy,” any non-exempt assets are liquidated for the benefit of creditors. Absent any irregularities, discharge is entered roughly ninety days from the commencement of the case. Chapter 13, often referred to as a “wage earner plan” or “reorganization,” allows an individual to restructure his financial affairs while retaining his assets. A chapter 13 plan typically involves payment of an individual’s debts over time and out of future income. Upon successful completion of the chapter 13 plan, the debtor receives a discharge.<sup>7</sup> The discharge obtained in chapters 7 and 13 are similar. There are, however, some differences between the chapter 7 and chapter 13 discharge, which will later be discussed in detail.<sup>8</sup>

### **THE BANKRUPTCY ESTATE**

A “bankruptcy estate” is an artificial legal entity created upon the commencement of the case.<sup>9</sup> The estate generally includes most interests of the debtor in any property, including community property, as of the filing of the case.<sup>10</sup> The nature of the debtor’s interest in property is generally a question of state law and the estate’s rights in the property do not exceed those of the debtor.<sup>11</sup> Generally, property acquired after a chapter 7 is filed does not become estate property.<sup>12</sup> Exceptions include inheritances acquired within 180 days of the petition date.<sup>13</sup> In chapter 13, all after-acquired property, including earnings, are estate property.<sup>14</sup>

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<sup>6</sup> 11 U.S.C. § 523(a).

<sup>7</sup> 11 U.S.C. § 1328.

<sup>8</sup> See, i.e. § 523(a)(15).

<sup>9</sup> 11 U.S.C. § 541(a).

<sup>10</sup> *Id.*

<sup>11</sup> *In re Crossman*, 259 B.R. 301 (Bankr. N.D. Ill. 2001).

<sup>12</sup> 11 U.S.C. § 541(a).

<sup>13</sup> 11 U.S.C. § 541(a)(5).

<sup>14</sup> 11 U.S.C. § 1306(a).

## THE DEBTOR'S EXEMPTIONS

When an individual files a petition for bankruptcy relief, he is entitled to claim as exempt certain property under Section 522. Exempt property is property which the debtor is permitted to retain and which cannot be liquidated for the benefit of creditors. The purpose of exemption laws is to allow debtors to retain property that is essential to daily life, such as home equity, vehicles, home furnishings, and clothing. In some states, including Washington, debtors may choose from state or federal exemptions depending upon which statutes best protects his assets.<sup>15</sup> The debtor's interests in nonexempt property of value are available for the benefit of his creditors.

## THE TRUSTEE

A trustee is appointed in every chapter 7 or 13 case.<sup>16</sup> The trustee's principal role is to represent the interests of the unsecured creditors.<sup>17</sup> The Bankruptcy Code imparts upon the trustee the duty to collect and liquidate non-exempt assets and to distribute the proceeds pursuant to the rules of distribution.<sup>18</sup> The chapter 13 trustee evaluates the plan and serves as a disbursing agent.<sup>19</sup> The trustee theoretically ensures that the parties act in good faith and play by the rules.

## THE AUTOMATIC STAY

One of bankruptcy's most powerful tools (if not *the* most powerful) is the automatic stay which arises by operation of law upon the filing of the case. The stay serves as an injunction which halts collection actions by creditors from the moment case is filed.<sup>20</sup> "It is designed to effect an immediate freeze of the *status quo* by precluding and nullifying post-petition actions, judicial or nonjudicial, in nonbankruptcy fora against the debtor or affecting the property of the estate."<sup>21</sup> The basic purpose of the stay is to protect the debtor and his property and affords the debtor a "breathing spell" from his creditors.<sup>22</sup>

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<sup>15</sup> 11 U.S.C. § 522(b); Title 6 RCW.

<sup>16</sup> 11 U.S.C. §§ 701, 1302.

<sup>17</sup> 11 U.S.C. §§ 704, 1302.

<sup>18</sup> 11 U.S.C. §§ 507, 704, 726, 1302.

<sup>19</sup> 11 U.S.C. § 1302(b).

<sup>20</sup> 11 U.S.C. § 362.

<sup>21</sup> *Hillis Motors, Inc. v. Hawaii Auto. Dealers' Ass'n*, 997 F.2d 581, 585 (9<sup>th</sup> Cir. 1993).

<sup>22</sup> H.R. Rep. No. 95-595, at 340 (1977); see *In re Ionosphere Clubs, Inc.*, 922 F.2d 984(2<sup>nd</sup> Cir. 1990).

## PART 2

### CHAPTER 13: THE FUNDAMENTALS

Drafting a confirmable chapter 13 plan can be complicated. In addition to understanding the substantive law, a debtor's attorney must be aware of and follow applicable federal and local rules. The following section is designed to provide an overview of the basic process and is not intended to be a "deep dive" into the mechanics of completing the required schedules and forms or of drafting a chapter 13 plan.

#### WHO IS ELIGIBLE TO BE A DEBTOR IN CHAPTER 13?

Chapter 13 is only available to individuals<sup>23</sup> (or legally married couples) with regular income and who reside, are domiciled, or have a place of business or property in the United States.<sup>24</sup> An "individual with regular income" is defined as "any individual whose income is sufficiently stable and regular to enable such individual to make payments under a plan under chapter 13."<sup>25</sup> Regular income is not limited to "wages," but includes government benefits, domestic support payments, retirement income, or any other "regular" income.<sup>26</sup> Courts have found that even regular payments from family or friends can qualify as regular income.<sup>27</sup>

In addition to the regular income requirement, a chapter 13 debtor must meet the so-called "debt limits." Chapter 13 is not available to debtors (whether individuals or married) with more than \$419,275 in non-contingent, liquidated, unsecured debts OR \$1,257,850 of non-contingent, liquidated, secured debts.<sup>28</sup> These amounts are adjusted every three (3) years.<sup>29</sup> Practically speaking, these limits do not often present an obstacle to chapter 13 relief.

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<sup>23</sup> 11 U.S.C. § 101(41).

<sup>24</sup> 11 U.S.C. §§ 109(a), 302(a).

<sup>25</sup> 11 U.S.C. §101(30)

<sup>26</sup> See H.R. Rep. No. 95-595, at 119 (1977).

<sup>27</sup> *In re Rowe*, 110 B.R. 712 \*Bankr. E.D. Pa. 1990).

<sup>28</sup> 11 U.S.C. § 109(e).

<sup>29</sup> 11 U.S.C. §104(b).

In an effort to prevent manipulation of the system, eligibility is also contingent on whether the debtor has *voluntarily* dismissed a previous chapter 13 case within 180 days of the petition date *following* a motion for relief from stay.<sup>30</sup> Similarly, a debtor must not have had a previous case dismissed by the court within the preceding 180 days for failure to comply with a court order.<sup>31</sup>

### **HOW DOES CHAPTER 13 “WORK?”**

The filing of the petition operates as an order for relief and sets the case into motion.<sup>32</sup> The automatic stay arises immediately<sup>33</sup> and a trustee is appointed.<sup>34</sup> The petition is accompanied by the schedules, statement of financial affairs, and other required documents.<sup>35</sup> Within fourteen (14) days of the petition date, the debtor must file the chapter 13 plan.<sup>36</sup> Some districts, such as the Eastern District of Washington, have adopted a form plan which must be utilized. The plan provides for payments from the debtor to the trustee on a regular basis.<sup>37</sup> Those funds are then distributed to creditors pursuant to the terms of the plan.<sup>38</sup>

Creditors' claims are divided into three (3) main categories: Priority, secured, and unsecured. The category into which a claim falls determines its treatment in the plan, giving debtors the ability to treat some claims better than others.<sup>39</sup> Priority claims, such as recently incurred taxes and child support arrears, enjoy special treatment and must be paid in full with few exceptions.<sup>40</sup> Holders of secured claims such as vehicle loans must receive either full payment, the value of the collateral, or the collateral itself.<sup>41</sup> It is not usually required that unsecured creditors be paid in full, but they must receive at least what would have been distributed in a theoretical chapter 7.<sup>42</sup> This is often referred to as the “best interests of the creditors test.” The debtor must commit his disposable monthly

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<sup>30</sup> 11 U.S.C. § 109(g).

<sup>31</sup> *Id.*

<sup>32</sup> 11 U.S.C. § 301.

<sup>33</sup> 11 U.S.C. § 362.

<sup>34</sup> In the Eastern District of Washington, there is a standing chapter 13 trustee.

<sup>35</sup> 11 U.S.C. § 521, Fed. R. Bankr. P. 1007(b).

<sup>36</sup> Fed. R. Bankr. P. 3015.

<sup>37</sup> 11 U.S.C. 1322.

<sup>38</sup> 11 U.S.C. 1302.

<sup>39</sup> 11 U.S.C. 1322(b)(1).

<sup>40</sup> 11 U.S.C. §§ 507, 1322(a)(2).

<sup>41</sup> 11 U.S.C. § 1325(a)(5).

<sup>42</sup> 11 U.S.C. § 1325(a)(4).

income to the funding of the plan; disposable income is what remains after payment of reasonable and necessary monthly expenses.<sup>43</sup> If the debtor's "current monthly income" is greater than the state median income, the term of the plan must be five (5) years and pay a certain amount of his unsecured debt.<sup>44</sup> This is otherwise known as the "means test," the mechanics of which are outside the scope of these materials.

Approximately two (2) months following the filing of the case, the court holds a confirmation hearing.<sup>45</sup> During the hearing, the court rules on whether the plan is feasible and otherwise meets the standards for confirmation.<sup>46</sup> Feasibility requires the debtor to demonstrate that he can make all payments under the plan and comply with the plan.<sup>47</sup> The best way to demonstrate feasibility is to begin making plan payments prior to the confirmation hearing as required under Section 1326(a). If the debtor can show an ability to make the required payments, then it is likely the court will give him the opportunity to attempt to comply with the terms of the plan.<sup>48</sup>

In order to be confirmable, the plan must also be proposed in good faith.<sup>49</sup> This is a vague, often subjective standard. Good faith under Section 1325(a)(3) is neither defined by statute nor explained in legislative history.<sup>50</sup> In the Ninth Circuit, bad faith is determined based on the totality of the circumstances.<sup>51</sup> Factors include, for example, the debtor's employment history and ability to earn, the accuracy of the debtor's schedules and whether inaccuracies are an attempt to mislead the court, and the extent to which secured claims are modified.<sup>52</sup>

Creditors and other parties-in-interest, such as the trustee, may object to confirmation.<sup>53</sup> If the plan is not confirmable, the debtor may modify his plan or

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<sup>43</sup> 11 U.S.C. § 1325(b)(1)(B).

<sup>44</sup> 11 U.S.C. §§ 1322(d), 1325(b).

<sup>45</sup> 11 U.S.C. § 1324.

<sup>46</sup> 11 U.S.C. § 1325.

<sup>47</sup> 11 U.S.C. § 1325(a)(6), *In re Terry*, 630 F.2d 634 (8<sup>th</sup> Cir. 1980).

<sup>48</sup> See *In re Ryals*, 5 B.R. 522 (Bankr. E.D. Tenn. 1980).

<sup>49</sup> 11 U.S.C. 1325(a)(3).

<sup>50</sup> *In re Goeb*, 675 F.2d 1386, 1389-90 (9<sup>th</sup> Cir. 1982).

<sup>51</sup> *In re Goeb*, 675 F.2d. 1386 (9<sup>th</sup> Cir. 1982); *In re Padilla*, 213 B.R. 349 (9<sup>th</sup> Cir. BAP 1997).

<sup>52</sup> *In re Warren*, 89 B.R. 87, 93 (9<sup>th</sup> Cir. BAP 1988).

<sup>53</sup> Fed. R. Bankr. P. 2002(b).

convert the case to a chapter 7.<sup>54</sup> Otherwise, the case is ultimately dismissed.<sup>55</sup> The confirmed plan operates as an order and binds the debtor and all creditors.<sup>56</sup> Should the debtor fail to make plan payments, to pay any domestic support obligations, or to file tax returns during the pendency of the plan, the case may be dismissed or converted to chapter 7 prior to plan completion.<sup>57</sup> Upon the successful completion of the plan, the court “shall grant the debtor a discharge...”<sup>58</sup> The discharge releases the debtor from liability for any dischargeable debt.<sup>59</sup>

## **PART 3**

### **THE ADVANTAGES OF CHAPTER 13**

Under the right circumstances, chapter 13 offers numerous advantages over chapter 7. Perhaps most notably, chapter 13 affords the debtor an opportunity to reorganize his finances without having to liquidate assets. Chapter 13 also enables a debtor to retain collateral, such as vehicles, while making installment payments through the plan under often modified contractual terms. Chapter 13 can also force the holder of a nondischargeable claim into an installment plan for the plan term. The following is a discussion of these advantages and other lesser-known but important relief available exclusively in chapter 13.

#### **FLEXIBILITY**

Perhaps one of the most appealing features of chapter 13 is its flexibility. Chapter 13 is voluntary and, although the plan must conform to the standards set forth in Sections 1322 and 1325, it is ultimately the debtor who dictates its terms.<sup>60</sup> Under Section 1325(b)(3), if the debtor’s current monthly income is less than or equal to

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<sup>54</sup> 11 U.S.C. §§ 1307, 1323.

<sup>55</sup> 11 U.S.C. § 1307(c).

<sup>56</sup> 11 U.S.C. § 1327.

<sup>57</sup> 11 U.S.C. §1307(c), (e).

<sup>58</sup> 11 U.S.C. § 1328(a).

<sup>59</sup> Id.

<sup>60</sup> 11 U.S.C. §§ 1307, 1322, and 1325.

the state median, plan payments are largely dependent on his average monthly income and expenses (disposable income).<sup>61</sup> Plan payments are calculated using a combination of disposable income and the amount necessary to accomplish the debtor's goals.<sup>62</sup> If the debtor's current monthly income is above the state median, he loses some flexibility because the requisite dividend to unsecured creditors is based on a fictional disposable income which is the product of a formula set forth in Section 1325. Practically speaking, however, it is not very often that the formula results in a payment that exceeds the debtor's ability to pay based on actual disposable income.

Although a confirmed chapter 13 plan is an order which binds the debtor and all creditors under Section 1327, it is also fluid. If a debtor experiences an unanticipated change in circumstances, the code provides a means by which to deal with the change. Section 1329(a) allows the debtor to modify the confirmed plan to increase or lower payments based on the debtor's financial condition. Post-confirmation modifications must conform to the same standards for confirmation as the original plan and are subject to objection by the trustee and creditors.<sup>63</sup>

### **RETENTION OF NONEXEMPT PROPERTY**

One of the principal functions of a chapter 7 trustee is to collect and liquidate nonexempt assets for the benefit of unsecured creditors.<sup>64</sup> If a debtor has significant nonexempt assets that would be liquidated in a chapter 7, a chapter 13 is generally preferable. Although the property which the debtor may claim as exempt is identical in either chapter, chapter 13 allows the debtor to retain the nonexempt property in exchange for paying to unsecured creditors the amount they would have received in a theoretical chapter 7.<sup>65</sup> The chapter 13 debtor essentially "buys back" his nonexempt property from his unsecured creditors.

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<sup>61</sup> 11 U.S.C. §1325(b)(2).

<sup>62</sup> See, i.e. 11 U.S.C. § 1325(a)(5).

<sup>63</sup> 11 U.S.C. § 1329(b).

<sup>64</sup> 11 U.S.C. § 704(a).

<sup>65</sup> 11 U.S.C. § 1325(a)(4).

## FORECLOSURE PREVENTION

Individuals may use a chapter 13 in order to save their home from foreclosure. The automatic stay stops the foreclosure proceeding immediately upon the filing of the petition.<sup>66</sup> Chapter 13 then enables the debtor to cure mortgage arrears over a reasonable period of time (within the plan term) and without interest.<sup>67</sup> This right to cure is not available under chapter 7. In the case of a long-term debt (a debt which extends beyond the plan term), the debtor must also maintain the ongoing mortgage payments.<sup>68</sup>

Curing the pre-petition arrears does not enable the debtor to otherwise modify the rights of a holder of a claim secured only by an interest in the debtor's principal residence.<sup>69</sup> A plan cannot, for example, alter the contractual interest rate or the amount of the ongoing monthly payments. Courts have found that when a plan otherwise conforms with Sections 1325(a) and 1322(b)(5), a "cure" is not a "modification" and it thus does not violate the anti-modification provisions.<sup>70</sup>

### MODIFICATION OF SECURED CREDITORS' RIGHTS ("CRAMDOWNS") AND LIEN STRIPPING

Chapter 13 debtors may generally modify the rights of secured creditors whose claims are *not secured only by a security interest in real property which is the debtor's principal residence*.<sup>71</sup> This right, commonly referred to as a "cramdown," is perhaps most commonly exercised in the context of vehicle loans and is not available in chapter 7.<sup>72</sup> [In chapter 7, the debtor's only options with respect to such claims are to redeem the collateral, surrender the collateral, or to continue paying under the terms of the original contract.]<sup>73</sup> Under the right circumstances, Section 1322(b)(2) essentially allows the debtor to refinance the debt, spread out the payments, and "cram" the balance down to the value of the collateral; any

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<sup>66</sup> 11 U.S.C. §362(a).

<sup>67</sup> 11 U.S.C. § 1322(b)(3), (5); *In re Hatcher*, 202 B.R. 626 (Bankr E.D.Okla. 1996), affirmed in part 208 B.R. 959, affirmed 133 F. 3d 932.

<sup>68</sup> *Id.*

<sup>69</sup> 11 U.S.C. § 1322(b)(2).

<sup>70</sup> *In re Litton*, 330 F.3d 636 (4<sup>th</sup> Cir. 2003).

<sup>71</sup> *Id.*

<sup>72</sup> *Dewsnup v. Timm*, 502 U.S. 410, 112 S. Ct. 773 (1992).

<sup>73</sup> 11 U.S.C. § 521(a)(2).

unsecured portion of the claim is then treated the same as other general unsecured claims. The right to “cram down” a secured claim extends to all terms of the original contract unless otherwise limited by the code; these limitations are discussed below in further detail.

The power of a chapter 13 debtor to “cram down” secured claims can often dramatically reduce a debtor’s total monthly cash outflow. This is because only the secured portion of the claim need be paid through the plan and with interest.<sup>74</sup> The secured portion of the claim is limited to the replacement value of the collateral on the date of the petition.<sup>75</sup> Below is a simple illustration of a cramdown.

	pursuant to original contract	under plan
secured claim	\$20,000 (balance of loan)	\$10,000 (collateral value)
interest rate	27.99%	5%
monthly payment	\$785.00	\$299.71 (over 36 months)

Under the right circumstances, some loans can be modified to such an extent that the *entire* monthly chapter 13 plan payment is less than the original installment payments.

The right to modify also extends to many short-term mortgages. Section 1322(c)(3) provides that *notwithstanding* the anti-modification provisions of 1322(b)(2), when the last contractual payment is due within the plan term, the plan may modify the creditor’s rights pursuant to Section 1325(a)(5). In such cases, the debtor may generally pay only the allowed secured claim, modify the payments and interest rates, and classify the unsecured portion of the claim as unsecured in the plan.<sup>76</sup> Additionally, the anti-modification provision of Section 1322(b)(2) does not apply if the creditor is secured by property *in addition to* the debtor’s principal residence. For example, mortgages and deeds of trust may

<sup>74</sup> 11 U.S.C. §§ 506(b), 1325(a)(5); *Till v. SCS Credit Corp.*, 539 U.S. 925, 123 S.Ct.2572 (2003) (The appropriate interest rate is “prime-plus,” based on the federal prime rate plus an adjustment to account for the increased risk presented by a bankruptcy borrower).

<sup>75</sup> 11 U.S.C. § 506(a)(2); *Associates Commercial Corp. v. Rash*, 520 U.S.953, 117 S.Ct. 1879 (1997).

<sup>76</sup> *In re Paschen*, 296 F.3d 1203(11<sup>th</sup> Cir. 2002).

include clauses granting security interests in appliances, rents, or escrow accounts.<sup>77</sup>

A chapter 13 debtor's right to bifurcate secured claims is subject to important limitations. Under Section 1325(a), claims secured by vehicles purchased for the personal use of the debtor within 910 days of the petition *cannot* be crammed down to the value of the collateral. However, the other contractual terms of so-called "910 claims," such as the interest rate and monthly payments, may be modified if the balance of the claim is paid in full through the plan.<sup>78</sup> Section 1325(a) also prohibits the cramdown of purchase money security interests in collateral *other than a vehicle* when purchased within one year of the petition.

As stated above, a chapter 13 debtor cannot modify the rights of the holder of a claim secured solely by the debtor's principal residence.<sup>79</sup> This prohibition applies only to a *secured claim*; if a claim is wholly *unsecured*, even if based on an obligation secured by the debtor's principal residence, it can be modified and treated as an unsecured claim; the lien is avoided upon successful completion of the plan.<sup>80</sup> This occurs in cases in which a junior mortgage is totally unsecured because the senior liens equal or exceed the property's value.<sup>81</sup> Additionally, a *partially* secured mortgage may be modified (crammed down) if the collateral is *not* the debtor's principal residence.<sup>82</sup>

The anti-modification provisions do not apply to liens that are not security interests in *real estate*. When collateral is *both* the debtor's principal residence *and* personal property under nonbankruptcy law, such as in the case of a mobile home, the lien may be stripped to the value of the collateral and the loan crammed down as described in the preceding section.<sup>83</sup>

### **CO-DEBTOR STAY WITH RESPECT TO CONSUMER DEBTS**

As previously mentioned, the automatic stay provided for in Section 362 may be bankruptcy's most powerful provision. As a companion statute, Section 1301

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<sup>77</sup> *Sapos v. Provident Inst. Of Sav.*, 967 F.2d 918 (3<sup>rd</sup> Cir. 1992).

<sup>78</sup> 11 U.S.C. § 1325(a).

<sup>79</sup> 11 U.S.C. §1322(b)(2).

<sup>80</sup> 11 U.S.C. §§ 506(a)(1), 1322(b)(2); *Zimmer v. PSB Lending Corp.*, 313 F.3d 1220 (9<sup>th</sup> Cir. 2002).

<sup>81</sup> *Nobleman v. American Savings Bank*, 508 U.S. 324, 113 S. Ct. 2106, 124 L Ed.2<sup>nd</sup> 228 (1993).

<sup>82</sup> 11 U.S.C. § 1322(b)(2).

<sup>83</sup> *In re Thompson*, 217 B.R. 375 (B.A.P. 2<sup>nd</sup> Cir. 1998).

enjoins creditors from taking any action to collect all or part of a consumer debt from a non-filing co-debtor, such as a co-signor, when the plan provides for full payment of such claims.<sup>84</sup> Unless a creditor obtains relief from the co-debtor stay, it protects the co-debtor for the entire term of the plan.<sup>85</sup> Relief from the co-debtor stay may be available in limited circumstances, such as when the debtor's proposed plan does not provide for full payment of the claim.<sup>86</sup>

### **INELIGIBILITY FOR DISCHARGE UNDER CHAPTER 7**

Under Section 109, any individual residing, domiciled, or owning property or a business in the United States may *file* a chapter 7.<sup>87</sup> However, that an individual may file a chapter 7 does not necessarily mean he is entitled to a discharge under chapter 7. The broad right to file chapter 7 is subject to limitations which often lead an individual debtor to chapter 13, either at the outset of the case or later by conversion.<sup>88</sup>

Section 727(a) lists the various bars to chapter 7 discharge. Most commonly, a discharge under chapter 7 is unavailable if a debtor received a discharge in a chapter 7 case filed less than eight (8) years earlier or in a chapter 13 case filed less than six (6) year earlier (unless the previous chapter 13 plan paid all or all or a significant portion of unsecured claims).<sup>89</sup> Under Section 1328(f), a debtor who previously received a discharge under chapter 7 becomes eligible for a discharge under chapter 13 four (4) years after the filing of a chapter 7 and two (2) years after the filing of a chapter 13. If a debtor is time-barred from receiving a discharge under chapter 7, chapter 13 may be his best and only option for relief.

An individual debtor may also be ineligible for discharge under chapter 7 if such discharge would be an "abuse." Section 707(b)(1) provides for median income and means tests which are designed to determine whether a debtor should be in chapter 13 rather than chapter 7 based on his income and expenses as calculated

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<sup>84</sup> 11 U.S.C. § 101 defines "consumer debt" as debt incurred by an individual primarily for a personal, family, or household purpose.

<sup>85</sup> 11 U.S.C. § 1301(c).

<sup>86</sup> 11 U.S.C. §1301(c); *In re Fink*, 115 B.R. 113 (Bankr. S.D. Ohio 1990).

<sup>87</sup> *But see* 11 U.S.C. § 109(g) which limits the eligibility of individuals to file if they had a previous case dismissed within the preceding 180 days for failure to abide by court orders OR voluntarily dismissed a case following a motion for relief from stay.

<sup>88</sup> 11 U.S.C. §§ 706, 707.

<sup>89</sup> 11 U.S.C. § 727(a)(8), (9).

under the code. Even if a debtor survives the means test under Section 707(b)(1), he may still be ineligible for chapter 7 under Section 707(b)(3) if his actual income and expenses demonstrate that he can make some form of debt repayment in chapter 13; this is otherwise known as the “totality of the circumstances test.” After considering all reasonable monthly expenses, a debtor with any meaningful disposable income will fail the totality of the circumstances test and his case will likely be dismissed or converted to a chapter 13. Practically speaking, the income of some individuals is simply too high to qualify for discharge under chapter 7, making chapter 13 their only option.

### **THE “SUPER DISCHARGE”**

As stated above, the chief goal of most bankruptcies is the discharge. Some debts are never dischargeable, such as domestic support obligations.<sup>90</sup> However, an important feature of the chapter 13 discharge is that it *includes* some types of debt *not* dischargeable in chapter 7. Section 523(a) specifies the general exceptions to discharge. Section 1328(a) specifies the exceptions to discharge in chapter 13; certain sub-sections of Section 523 are *not* included in the list of exceptions to discharge in chapter 13. Some of the debts discharged in chapter 13 which are *not* discharged in chapter 7 include:

- a. Willful and malicious injury to property (but not persons). Section 523(a)(6);
- b. Tax penalties and other penalties owed to governmental units, such as civil traffic fines. Section 523(a)(7);
- c. Debts incurred to pay nondischargeable tax obligations (i.e. credit cards). Section 523(a)(14);
- d. Debts arising from property settlements in divorce or separation proceedings. Section 523(a)(15).

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<sup>90</sup> 11 U.S.C. § 523(a).

## **SUMMARY**

Both chapters 7 and 13 offer advantages that are not available in the other chapter. In chapter 7, discharge is entered and the case concludes within about four (4) months. Chapter 7 requires no repayment plan; the debtor retains future earnings and any increase in those earnings is to his benefit.

Conversely, chapter 13 may offer relief to a debtor who, for various reasons, cannot qualify for a chapter 7. Chapter 13 also permits retention of assets that would otherwise be lost to liquidation, allows modification of some secured debts, provides an opportunity to cure mortgage arrears over time, and other relief not available in chapter 7.