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## THE RES JUDICATA WORTH OF ILLEGAL BANKRUPTCY REORGANIZATION PLANS

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## I. INTRODUCTION

In the mad chaos of the American bankruptcy system, courts unwittingly confirm illegal reorganization plans, especially in the highly frenetic context of a Chapter 13 case. What is the worth of these plans?

Each reorganization chapter<sup>1</sup> includes a sweeping statement to the effect that confirmed plans are *binding*. According to the Chapter 11 provision:

(a) [T]he provisions of a confirmed plan bind the debtor . . . and any creditor . . . whether or not the claim or interest of such creditor . . . is impaired under the plan and whether or not such creditor . . . has accepted the plan.

(b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

(c) [E]xcept as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors . . . in the debtor.<sup>2</sup>

The parallel provision in Chapter 13 is:

(a) The provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan.

(b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

(c) Except as otherwise provided in the plan or in the order confirming the plan, the property vesting in the debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan.<sup>3</sup>

These provisions are so sweeping and categorical that they cannot be, and are not, taken literally. Suppose the debtor writes a plan in Chapter 11 or 13 that permits him to murder a creditor in revenge. The creditor does not object through inattention or despair. The plan is confirmed, and the creditor never appeals. Surely

1. In this Article I will ignore Chapter 9, which pertains to municipalities. Chapter 12, pertaining to farmers, is highly similar to Chapter 13 wage-earner plans in all respects material to this subject. Unless I say otherwise, any observation about Chapter 13 applies to farm reorganizations as well. Chapters 11 and 13 are indeed quite different, and it is on the difference between them on which I shall primarily focus.

2. 11 U.S.C. § 1141 (2006).

3. § 1327.

this plan term does not bind the creditor. Common sense requires that exceptions mitigate the absoluteness of § 1141(a) and § 1327(a).<sup>4</sup>

The finality sections—§ 1141(a) and § 1327(a)—“generally codif[y] the doctrine of res judicata with respect to confirmed” reorganization plans.<sup>5</sup> What is res judicata? Roughly translated from Latin, this term means, “Plaintiff! Get lost!” Res judicata exalts finality over justice and the rule of law. To be sure, one can find words in praise of finality. Res judicata “relieve[s] parties of the cost and vexation of multiple lawsuits . . . [and] encourage[s] reliance on adjudication.”<sup>6</sup> But certainty and thrift are virtues only in the cause of some underlying virtue. Where efficiency and cost cutting emanate from the mouth of a villain, they are vices. For this reason, courts often say that “the principle of res judicata should be invoked only after careful inquiry because it blocks unexplored paths that may lead to truth.”<sup>7</sup>

Modernly, res judicata is called “claim preclusion.”<sup>8</sup> It is to be distinguished from collateral estoppel, recently renamed “issue preclusion.”<sup>9</sup> The difference between them is that claim preclusion bars any claim that *could* have been litigated. Issue preclusion bars any claim based on facts that were *actually* litigated.<sup>10</sup> Possibility and history distinguish these two doctrines.

Res judicata is a mere defense to a claim under applicable nonbankruptcy law.<sup>11</sup> Accordingly, the Supreme Court has ruled that a state law cause of action cannot be removed to federal court solely because of a res judicata defense arising from confirmation of a bankruptcy reorganization plan.<sup>12</sup> Absent diversity of citizenship, removal requires the assertion of a federal cause of action, not the presence of a federal defense.<sup>13</sup> But so what? If the debtor needs a federal remedy to protect against acts in violation of a reorganization plan, she can reopen the old

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4. These limits may be constitutional. For the view that the debtor must suffer some form of insolvency and that legislation which provides direct external benefits to persons other than the debtor and her creditors cannot be justified under the Bankruptcy Clause, see Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 487, 546–65 (1996).

5. *Hutchinson v. Del. Sav. Bank FSB*, 410 F. Supp. 2d 374, 378 (D.N.J. 2006).

6. *Allen v. McCurry*, 449 U.S. 90, 94 (1980); cf. *Travelers Indem. Co. v. Bailey*, 129 S. Ct. 2195, 2206 (2009) (finding res judicata serves “practical necessity”).

7. *Ladd v. Ries (In re Ladd)*, 450 F.3d 751, 755 (8th Cir. 2006) (quoting *Lovell v. Mixon*, 719 F.2d 1373, 1379 (8th Cir. 1983)).

8. *Universal Am. Mortgage Co. v. Bateman (In re Bateman)*, 331 F.3d 821, 830 (11th Cir. 2003).

9. *Rivet v. Regions Bank of La.*, 522 U.S. 470, 476 (1998) (citing *Blonder-Tongue Labs., Inc. v. Univ. of Ill. Found.*, 402 U.S. 313, 350 (1971)). In praise of pouring the old wine of res judicata into such glittering new bottles, see generally Christopher Klein et al., *Principles of Preclusion and Estoppel in Bankruptcy Cases*, 79 AM. BANKR. L.J. 839 (2005).

10. *In re Bateman*, 331 F.3d at 830 (citing *In re Starling*, 251 B.R. 908, 910 n.2 (Bankr. S.D. Fla. 2000)).

11. *Rivet*, 522 U.S. at 476.

12. *Id.* at 476–78.

13. *Id.*

bankruptcy proceeding to get a protective order.<sup>14</sup> Here (not for the first time), the Supreme Court has taught us nothing of value about bankruptcy litigation.

A standard account of res judicata in the context of bankruptcy reorganization can be found in *Corbett v. MacDonald Moving Services, Inc.*:<sup>15</sup>

To determine whether the doctrine of res judicata bars a subsequent action, we consider whether 1) the prior decision was a final judgment on the merits, 2) the litigants were the same parties, 3) the prior court was of *competent jurisdiction*, and 4) the causes of action were the same. In the bankruptcy context, we ask as well whether an independent judgment in a separate proceeding would “impair, destroy, challenge, or invalidate the enforceability or effectiveness” of the reorganization plan. This last inquiry may also be viewed as an aspect of the test for identity of the causes of action.<sup>16</sup>

The weak point in the citadel of res judicata is “competent jurisdiction.” It turns out that bankruptcy courts *do* lack jurisdiction to do many things under the guise of plan confirmation. When jurisdiction fails, justice and fairness may penetrate the citadel. But jurisdiction, it turns out, is not the only limit on res judicata in the context of bankruptcy reorganization. What other limits to the res judicata worth of confirmed plans might there be?

In *Corbett*, a Chapter 11 plan discharged a third party of suretyship liability, in spite of Bankruptcy Code § 524(e), which provides that the “discharge of a debt of the debtor does not affect the liability of any other entity on . . . such debt.”<sup>17</sup> The assured creditor attempted a collateral attack on the plan on the theory that the bankruptcy court had no subject matter jurisdiction to discharge nondebtors—the talisman that is wont to scare off res judicata.<sup>18</sup> The appellants contended:

[T]he district court’s reasoning . . . creates a circularity problem: if the bankruptcy court potentially lacked subject matter jurisdiction to discharge [the guarantor], then how can one determine that the bankruptcy court was a “court of competent jurisdiction” for purposes of res judicata without considering the merits of the jurisdictional challenge? There may be circumstances in which a bankruptcy court lacks competent jurisdiction, such as where it acts as a traffic court or a court of domestic relations. But we are not faced with a situation in

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14. See *Local Loan Co. v. Hunt*, 292 U.S. 234, 239 (1934) (holding that bankruptcy court had jurisdiction over debtor’s action to enjoin lender’s state suit which threatened interference with its previous order), *superseded by statute*, 11 U.S.C. § 541; *Homebanc, Inc. v. Chappell (In re Chappell)*, No. 91 C 20070, 1991 U.S. Dist. LEXIS 19204, at \*12–13 (N.D. Ill. Aug. 13, 1991) (finding bankruptcy court properly reopened bankruptcy case and ordered creditor to release lien which was in violation of prior discharge order), *aff’d*, 984 F.2d 775 (7th Cir. 1993); Frank R. Kennedy & Gerald K. Smith, *Postconfirmation Issues: The Effects of Confirmation and Postconfirmation Proceedings*, 44 S.C. L. REV. 621, 631–34, 713 (1993) (discussing basis for bankruptcy court jurisdiction over bankruptcy case following confirmation of reorganization plan).

15. 124 F.3d 82 (2d Cir. 1997).

16. *Corbett*, 124 F.3d at 87–88 (emphasis added) (citations omitted).

17. 11 U.S.C. § 524(e) (2006).

18. See *Freeman v. San Diego Ass’n of Realtors*, No. 01-56199, 2003 U.S. App. LEXIS 7731, at \*10 n.8 (9th Cir. Mar. 10, 2003) (noting inapplicability of res judicata to claims previously heard in incompetent forum).

which a bankruptcy court has expunged the points on a debtor's driver's license or annulled her marriage, nor are we evaluating a question of jurisdiction over a person or a res. Here, the bankruptcy court exercised powers that are within its competent jurisdiction: e.g., confirm a plan of reorganization; classify claims; discharge claims; and provide the means for implementing a reorganization plan. The bankruptcy court may or may not have had subject matter jurisdiction to discharge [the guarantor]; but even if it did not, the bankruptcy court was competent to confirm a plan of reorganization, and the aggrieved party was free to appeal.<sup>19</sup>

As I read *Corbett*, a bankruptcy court *can* remove points on a driver's license or award custody in a divorce, so long as it is done as part of a Chapter 11 plan. The *Corbett* formulation exalts form (was it done in a plan?) over substance and suggests no limit at all to the res judicata principle.

Yet, in spite of *Corbett*'s intimation that anything goes so long as it is done in a plan, courts have discovered all sorts of implicit limits to § 1141(a) and especially to § 1327(a). My purpose in this Article is to survey these limitations. My analysis covers Chapters 11 and 13 (with the assumption that whatever goes for Chapter 13 also goes for Chapter 12). Readers, however, will get the impression that greater weight is given to Chapter 13 cases. This is because there are hundreds of thousands of Chapter 13 cases per year and only a few thousand Chapter 11 cases.<sup>20</sup> Also, Chapter 13 procedure is so accelerated that the opportunity for error is much increased. Chapter 13, "the last great bankruptcy frontier,"<sup>21</sup> still remains largely untheorized. Nevertheless, although courts do not always agree, I will maintain that the law of Chapter 13 generally applies to Chapter 11 as well. Sections 1141 and 1327 each articulate the same policy.<sup>22</sup>

What do I make of the various exceptions to res judicata that courts have discovered? Clearly Congress could not have intended to make every confirmed plan binding *no matter what*. Courts are certainly justified in discovering implicit exceptions hidden in broad statements of law. To borrow an old chestnut from jurisprudence, New York had a rule that the legatee of a proper will inherits absolutely. But, in *Riggs v. Palmer*,<sup>23</sup> the New York Court of Appeals discovered that there is an exception for murderers.<sup>24</sup> In fact, the *Riggs* experience is repeated

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19. *Corbett*, 124 F.3d at 89 (citations omitted).

20. Press Release, Fed. Judiciary, Bankruptcy Filings Up in Calendar Year 2008 (Mar. 5, 2009), [http://www.uscourts.gov/Press\\_Releases/2009/BankruptcyFilingsDec2008.cfm](http://www.uscourts.gov/Press_Releases/2009/BankruptcyFilingsDec2008.cfm) (reporting that in calendar year 2008, 362,762 Chapter 13 cases and 10,160 Chapter 11 cases were filed).

21. Ingrid Michelsen Hillinger & Michael G. Hillinger, *Section 365 in the Consumer Context: Something Old, Something New, Something Borrowed, Something Blue*, 104 COM. L.J. 377, 378 (1999).

22. The Fourth Circuit holds otherwise. See *Universal Suppliers, Inc. v. Reg'l Bldg. Sys., Inc.* (*In re Reg'l Bldg. Sys., Inc.*), 254 F.3d 528, 532 (4th Cir. 2001) (treating § 1141 and § 1327 differently because Chapter 11 and Chapter 13 serve different purposes). I criticize this view *infra* in the text accompanying notes 216–32.

23. 22 N.E. 188 (N.Y. 1889). This case has become a standard jurisprudential example thanks to RONALD DWORKIN, *TAKING RIGHTS SERIOUSLY* 15–20 (1977).

24. *Riggs*, 22 N.E. at 190.

frequently in the bankruptcy courts as judges discover just how unfair *res judicata* can be, and how untenable Congress's broad declaration of bindingness is. Debtors (and others) often try to get away with murder, but the courts will not stand for *res judicata* in a variety of circumstances.

With the aim of elucidating the various exceptions to the principle of finality so absolutely proclaimed in Bankruptcy Code § 1141(a) and § 1327(a), Part II begins with a short overview of bankruptcy reorganization and what it takes to confirm a plan. Surprisingly, the matter is in doubt for Chapter 13 cases, thanks to a venerable Third Circuit case, which I will suggest was effectively overruled in 2008.<sup>25</sup> Part III covers the exceptions to finality by subject matter. These include plan terms that: (1) eliminate a lien (without a prior adversary proceeding avoiding the lien); (2) set claims in spite of contrary proofs of claim; and (3) declare debts as discharged, setoffs as nonexistent, and home mortgages as illegally crammed down.

Many of these exceptions are based on not following some procedural rule in the Bankruptcy Code or the Federal Rules of Bankruptcy Procedure. Accordingly, Part IV considers whether the due process clause of the Fifth Amendment requires that these rules be followed, even though the affected creditor has been notified of the confirmation hearing. I will argue that, as the Supreme Court has defined it, the procedural rules have a constitutional dimension which overrides the *res judicata* effect of a plan.

Judgments can often be revoked. If they are, the judgment loses its *res judicata* worth. Part V considers the circumstances under which an illegal plan can be revoked. Part VI considers whether plan modification, which Chapters 11 and 13 both invite, can be used to correct legal errors in a confirmed plan. Finally, Part VII summarizes the conclusions that I have reached that are new or at some level surprising.

## II. AN OVERVIEW OF BANKRUPTCY REORGANIZATION

All the reorganization regimes<sup>26</sup> turn on the basic idea that every creditor should be at least as well off under a reorganization plan as she would have been in a Chapter 7 liquidation.<sup>27</sup> This principle, which economists call Pareto superiority,<sup>28</sup> is, in bankruptcy circles, awkwardly named the “best-interest-of-creditors” test.<sup>29</sup> If reorganization produces a surplus for creditors, this principle can be honored. In Chapter 11, the surplus may come from “going concern value”—the premise that the debtor's estate is more valuable if held together than if it is sold piecemeal.<sup>30</sup> In Chapter 13, the surplus comes from the postpetition wages of

25. See *infra* Part II.B.1 for a discussion of *In re Szostek*, 886 F.2d 1405 (3d Cir. 1989).

26. Chapter 9, pertaining to municipalities, is an exception to the stated principle.

27. See 11 U.S.C. §§ 1129(a)(7)(A)(ii), 1325(a)(4) (2006) (setting requirements for approval of reorganization plan under Chapters 11 and 13).

28. David A. Hoffman & Michael P. O'Shea, *Can Law and Economics Be Both Practical and Principled?*, 53 ALA. L. REV. 335, 367 (2002).

29. *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 441 (1999).

30. See *Pioneer Tel. & Tel. Co. v. State*, 167 P. 995, 999 (Okla. 1917) (defining “going concern value” as value of plant as whole, rather than bare physical value).

the debtor—property that otherwise would not be part of the Chapter 7 bankruptcy estate.<sup>31</sup>

All the reorganization regimes are supposed to culminate in the confirmation of a binding plan. The minimum criteria for confirmation in the two chapters is, however, quite different. In Chapter 13, the criteria are surprisingly indeterminate.

*A. Chapter 11*

Chapter 11 plans must meet the minimum criteria of § 1123(a) and § 1129(a). In § 1123(a), we learn that a plan must classify claims against the debtor,<sup>32</sup> specify which claims are unimpaired, specify the treatment of creditors (which must not be discriminatory), and provide adequate means of implementation, among other things.<sup>33</sup> Section 1129(a) adds many more requirements, including the best-interest-of-creditors test.<sup>34</sup> Administrative creditors must receive payment on the effective date of the plan.<sup>35</sup> Creditors must cash out tax claims in five years or less.<sup>36</sup> Chapter 11 involves voting by class.<sup>37</sup> Voting has two points of significance. First, at least one class of creditors with impaired claims must vote in favor of the plan.<sup>38</sup> So long as this is true, Chapter 11 is potentially indifferent to the creditors' overwhelming opposition to the plan. Second, if a class does vote no, it is entitled to receive the so-called cramdown protections.<sup>39</sup> For secured creditors, this means, generalizing broadly, retention of a lien and distributions equating with the value of the original collateral.<sup>40</sup> For unsecured creditors, cramdown means the absolute priority rule—assurance of 100% payment before any junior person receives a dime.<sup>41</sup>

*B. Chapter 13*

Chapter 13 is rather different from Chapter 11, and, surprisingly, at this advanced state of history, there is still controversy over what the minimum criteria are.

Everyone admits that the criteria of § 1322(a) are mandatory. According to § 1322(a), a plan must

- (1) provide for sufficient payment of wages to accomplish the plan;
- (2) pay off all priority claimants in full; and

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31. § 541(a)(6).

32. "Interests" must also be classified. § 1123(a)(1). An "interest" is an undefined term, but it basically describes equity ownership—shareholders and partners, for example.

33. Many examples are given. These include retention of property by the debtor, sale, merger, modification of liens, etc. § 1123(a)(5).

34. § 1129(a)(7).

35. § 1129(a)(9).

36. § 1129(a)(9)(C).

37. §§ 1122, 1126.

38. § 1129(a)(10).

39. § 1129(b).

40. § 1129(b)(2)(A).

41. § 1129(b)(2)(B).

(3) treat all claims within a class equally.<sup>42</sup>

A plan must also comply with § 1322(b), which provides what a plan *may* do. But, significantly and in the Freudian style, hidden within the permissions of § 1322(a) are some prohibitions. According to § 1322(b)(1), a plan may (but need not) provide classes of creditors, but if it does so, the plan may not discriminate unfairly between classes.<sup>43</sup> The all-important prohibition against cramming down home mortgages appears in § 1322(b)(2)—another prohibition lurking within a permission.<sup>44</sup> Thanks to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”), § 1322(b)(10) now includes the restriction that interest on nondischargeable debts may not be paid unless the debtor has sufficient disposable income to pay all dischargeable debts in full.<sup>45</sup> Finally, the court may not confirm a plan if it fails to meet the provisions of § 1325(b)(1), which requires that a debtor apply all disposable income to the plan for the applicable commitment period.<sup>46</sup> This prohibition, however, is conditioned upon “the trustee or the holder of an allowed unsecured claim” objecting to the confirmation of an offending plan.<sup>47</sup> If such an objection has been filed, the debtor must commit all disposable income to the plan for the applicable commitment period—three years for below-median debtors and five years for above-median debtors.<sup>48</sup>

Section 1325(a) is really the heart of Chapter 13. Here is a short list of some of the ideas it contains:

- (1) The fees required by Chapter 123 of Title 28 have been paid.
- (2) The plan is proposed or the case was commenced in good faith.
- (3) Every creditor will get at least what she would have received in a Chapter 7 case.
- (4) Every secured creditor has either received the collateral or is entitled to receive a cash flow equal to the value of collateral (i.e., cramdown).
- (5) The debtor can make the payments that the plan requires.
- (6) The debtor is not a deadbeat on domestic support obligations.
- (7) The debtor has filed tax returns before the first scheduled creditors’ meeting.

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42. § 1322(a). Section 213(8) of the Bankruptcy Abuse Prevention and Consumer Protection Act adds one new concept, but it is not a requirement. Rather, the provision is permissive. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 213(8), 119 Stat. 23, 53 (codified at 11 U.S.C. § 1322(a)(4) (2006)). According to § 1322(a)(4), a plan need *not* pay an administrative claim in full if the plan has a five-year term during which all disposable income is dedicated to the plan.

43. See *In re Crawford*, 324 F.3d 539, 543–44 (7th Cir. 2003) (finding discrimination in favor of nondischargeable creditor improper). Even so, discrimination is permitted where some nondebtor individual has guaranteed a consumer debt owed by the debtor. § 1322(b)(1).

44. *Universal Am. Mortgage Co. v. Bateman (In re Bateman)*, 331 F.3d 821, 826 (11th Cir. 2003).

45. § 1322(b)(10), as amended by Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, § 213(9)(C).

46. The applicable commitment period is three years for below-median debtors and five years for above-median debtors. § 1325(b)(4).

47. § 1325(b)(1).

48. § 1325(b)(1), (4).



All of these concepts are to be found in § 1325(a). These conform roughly to the minimal criteria of Chapter 11. Most observers of the bankruptcy scene think that these items are included in the minimal criteria for confirming a Chapter 13 plan.<sup>49</sup>

Surprisingly, some courts believe that § 1325(a) is *not* required to confirm a plan.<sup>50</sup> And there is a decent textual argument to support such a belief. According to § 1325(a), “the court shall confirm a plan” if all the subparagraphs of § 1325(a) are met.<sup>51</sup> Compare the equivalent § 1129(a): “The court shall confirm a plan *only if* all of the following requirements are met . . . .”<sup>52</sup> “Only if” is the language of necessary and sufficient conditions. Chapter 13 merely uses that great peacemaker “if”—indicating sufficiency, but perhaps not necessity. This is taken as evidence that Congress intended to grant courts discretion to approve Chapter 13 plans that do *not* comply with § 1325.<sup>53</sup>

Further evidence that § 1325(a) is not a mandatory provision is Bankruptcy Code § 1323(a), which invites a debtor to modify a plan before it is confirmed. Section 1323(a) admonishes the modified plan to meet the requirements of § 1322, but *not* § 1325(a).<sup>54</sup> On the other hand, Chapter 13 (unlike Chapter 11) permits modification of binding plans.<sup>55</sup> Such plan modifications must meet the requirements of § 1325(a).<sup>56</sup> Surely Congress could not have meant for § 1325(a) to be optional in original plans but mandatory in modifications.<sup>57</sup>

The premise that § 1325(a) is optional, if true, would make a mockery of BAPCPA.<sup>58</sup> BAPCPA includes a clumsy attempt to improve the cramdown rights of car lenders. This was done in the famous “hanging paragraph,”<sup>59</sup> the meaning of

49. *E.g.*, *Assocs. Commercial Corp. v. Rash*, 520 U.S. 953, 956 (1997).

50. See *infra* Parts II.B.1 and II.B.2 for a discussion of the Third and Seventh Circuits’ view that courts can confirm Chapter 13 plans that do not fully conform with the provisions of § 1325(a).

51. § 1325(a).

52. § 1129(a) (emphasis added). One court called this “another bit of congressional humor.” *In re Brady*, 86 B.R. 166, 169 n.4 (Bankr. D. Minn. 1988).

53. See *In re Szostek*, 886 F.2d 1405, 1411 (3d Cir. 1989) (finding “unmistakable intent on the part of Congress that a plan may be confirmed” without comporting with § 1325(a)(5) requirements based on absence of “only if” language in § 1325(a)).

54. § 1323(a).

55. See *infra* Part V for a discussion of when courts can revoke reorganization plans.

56. § 1329(b)(1).

57. See *Wachovia Dealer Servs. v. Jones (In re Jones)*, 530 F.3d 1284, 1290 (10th Cir. 2008) (holding § 1325(a) requirements mandatory for confirmation of Chapter 13 plan). Similarly, § 1330(a) provides:

On request of a party in interest at any time within 180 days after the date of the entry of an order of confirmation under section 1325 of this title, and after notice and a hearing, the court may revoke such order if such order was procured by fraud.

§ 1330(a). Arguably, this provision assumes that Chapter 13 plans are confirmed *under* § 1325. If not, the meaning of this provision becomes bizarre: plans that conform to § 1325(a) can be revoked only if fraudulent. Plans that do not conform to § 1325(a) can be revoked even if not fraudulent.

58. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified at 11 U.S.C. § 1322(a)(4) (2006)).

59. The “hanging paragraph” refers to a new, lengthy sentence that dangles “unnumbered” at the end of § 1325(a). *Ford v. Ford Motor Credit Corp. (In re Ford)*, No. 08-3192, 2009 U.S. App. LEXIS 17198, at \*5 (10th Cir. Aug. 3, 2009). According to this paragraph:

which continues to dumbfound the courts as of this writing.<sup>60</sup> Why would Congress (or the lobbyists to whom Congress delegated that woeful legislation) have labored over a provision that has proved so irritating to bankruptcy judges if cramdown is not mandatory in the first place?

If § 1325(a) is not mandatory, what then does it mean? Clearly, where all the criteria of § 1325(a) are met, the court is *required* to confirm a plan. But where one or more of the criteria are *not* met, a court may decide to confirm nevertheless, even if the Chapter 13 plan is not Pareto superior to a Chapter 7 liquidation and even if the cramdown rules are not followed.<sup>61</sup>

Currently, two circuits hold to the view that the criteria of § 1325(a) are not mandatory. This Article concerns itself with the res judicata worth of illegal reorganization plans. But if a plan in violation of § 1325(a) is not illegal, there is little point in discussing res judicata, as it is principally a *defense* to the claim of illegality and unfairness. Accordingly, we pause to take a look at what the criteria for Chapter 13 plans are in these two circuits.

### 1. The Third Circuit

In *In re Szostek*,<sup>62</sup> a Chapter 13 plan did not provide a secured creditor with full cramdown rights—"the value . . . of property to be distributed under the plan" equal to the value of the collateral.<sup>63</sup> Nevertheless, the bankruptcy court confirmed the plan when the secured creditor did not show up to object.<sup>64</sup> Later, casting its slough and moving with newfound legerity, the secured creditor moved to revoke confirmation under § 1330(a) because it was "procured by fraud."<sup>65</sup> The

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For purposes of paragraph (5), section 506 shall not apply to a claim described in that paragraph if the creditor has a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle (as defined in section 30102 of title 49) acquired for the personal use of the debtor, or if collateral for that debt consists of any other thing of value, if the debt was incurred during the 1-year period preceding that filing.

§ 1325(a).

60. Summarizing very broadly, the hanging paragraph is thought to prevent the cramdown of cars where the car debt exceeds the value of the car. Instead, the car is basically deemed to be worth the outstanding balance on the car debt. *See generally* David Gray Carlson, *Cars and Homes in Chapter 13 After the 2005 Amendments to the Bankruptcy Code*, 14 AM. BANKR. INST. L. REV. 301 (2006). This meaning is mysteriously suspended when debtors try to surrender the wreck to the car lender. In that case, the car's value is relevant to cramdown after all, as car lenders would be prejudiced by a uniform application of the hanging paragraph. *E.g.*, *AmeriCredit Fin. Servs., Inc. v. Long (In re Long)*, 519 F.3d 288, 294–95 (6th Cir. 2008) (refusing to interpret "hanging paragraph" literally when debtor surrendered collateral under § 1325(a)(5)(C)).

61. *See In re Burgess*, 143 F. App'x 692, 695 (7th Cir. 2005) (finding that bankruptcy courts have discretion to confirm plans that do not meet § 1325(a) requirements).

62. 886 F.2d 1405 (3d Cir. 1989).

63. § 1325(a)(4).

64. *In re Szostek*, 886 F.2d at 1407.

65. *Id.* at 1408.

bankruptcy court refused to revoke the confirmation order, as there was no fraud.<sup>66</sup> The district court reversed on appeal.<sup>67</sup> It agreed that there was no fraud, but it reversed because the plan did not conform to § 1325(a)(5).<sup>68</sup>

The court of appeals reversed again because it was within the discretion of the bankruptcy court to confirm a plan that did not comport with § 1325(a):

[T]he Code section which explicitly contains mandatory requirements for confirmation of a debtor's Chapter 13 plan is . . . § 1322, which unequivocally states "the plan shall" do three things. . . . By comparison, the language of § 1325(a) states that a "court shall confirm a plan if" certain things occur. However, it does not state "only if" the described events occur. Thus, the logical interpretation is that if the conditions of § 1325(a) occur, the court *must* confirm the plan. On the other hand, if the conditions of § 1325(a) are not met, although the requirements of § 1322 are fulfilled, the court has the discretion to confirm the plan. If Congress had intended for § 1325(a) to be mandatory, it could have included that requirement with the requirements already listed in § 1322.<sup>69</sup>

Under *Szostek*, the provisions of § 1325(a) are "sufficient . . . but not necessary conditions for confirmation of a chapter 13 plan."<sup>70</sup>

This holding, however, is an alternative one: the secured creditor also failed to make a timely objection to confirmation of the plan. Therefore, the case can be viewed as *also* holding that under § 1327(a), confirmed plans bind creditors, provided no fraud occurred and provided proper notice of the confirmation hearing was given.<sup>71</sup> *Szostek* both is and is not a res judicata case and is indeed cited for both purposes.<sup>72</sup> The difference between the two holdings is this: under the first, a secured creditor cannot get appellate relief if the bankruptcy court denies cramdown rights. Under the second, a secured creditor might indeed get appellate relief from a confirmation order, but, in the absence of an appeal, the confirmation of a plan deserves res judicata respect.

*Szostek*, however, can be viewed as inconsistent, or at least highly uncomfortable, with a subsequent Third Circuit opinion. In *SLW Capital, LLC v.*

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66. *Id.*

67. *Id.*

68. *Id.*

69. *In re Szostek*, 886 F.2d at 1411.

70. *Id.* (quoting *In re Brady*, 86 B.R. 166, 169 (Bankr. D. Minn. 1988)); see *In re Massey*, No. 94-4001, 1995 U.S. Dist. LEXIS 12978, at \*4-5 (E.D. La. Sept. 7, 1995) (holding that best-interest-of-creditors test is not mandatory); *Nat'l City Bank of Rome v. Purdy (In re Purdy)*, 16 B.R. 847, 850 (N.D. Ga. 1981) (finding only § 1322(a) contains mandatory provisions of plan).

71. For lower court cases holding that, in spite of *Szostek*, cramdown protections are mandatory predicates for confirming a plan, see *United States v. Haas (In re Haas)*, 203 B.R. 573, 567 (E.D. Pa. 1996); *Members First Fed. Credit Union v. Fickel (In re Fickel)*, Nos. 1-07-bk-02822 RNO, 1-07-bk-02824 RNO, 2008 Bankr. LEXIS 1311, at \*6-7 (Bankr. M.D. Pa. Apr. 10, 2008).

72. See, e.g., *Hutchinson v. Del. Sav. Bank FSB*, 410 F. Supp. 2d 374, 378 (D.N.J. 2006) (citing *Szostek* as res judicata precedent); *In re Burgess*, 143 F. App'x 692, 695 (7th Cir. 2005) (citing *Szostek* as upholding court's discretion to confirm plans in violation of § 1325(a)).

*Mansaray-Ruffin* (*In re Mansaray-Ruffin*),<sup>73</sup> the debtor's confirmed plan declared that a mortgage lender was to be treated as an unsecured creditor, unless the mortgagee came forth to claim a lien.<sup>74</sup> The mortgage lender did not comply by the deadline in the plan.<sup>75</sup> Later, the mortgage lender filed an adversary proceeding to establish that, in spite of the plan, it had a valid lien that passed through bankruptcy.<sup>76</sup> The lender's point was that lien avoidance requires the commencement and conclusion of an adversary proceeding, which never occurred; lien avoidance cannot be accomplished by a Chapter 13 plan alone.<sup>77</sup> According to the Federal Rules of Bankruptcy Procedure, "[t]he following are adversary proceedings: . . . (2) a proceeding to determine the validity, priority, or extent of a lien or other interest in property."<sup>78</sup> An adversary proceeding requires a complaint, an answer, and a great many of the bells and whistles set forth in the Federal Rules of Civil Procedure. Plan confirmation requires much less red tape.

At all levels, the courts in *Mansaray-Ruffin* agreed with the secured lender. But if a plan may be confirmed in spite of a violation of § 1325(a), why was the absence of an adversary proceeding even relevant? It could only be relevant if the lender had a right to the lien separate and apart from § 1325(a). But § 1325(a)(5) is the only provision that suggests that the creditor in a Chapter 13 proceeding has a right to retain an otherwise valid lien. Therefore, *Mansaray-Ruffin* logically relies on the premise that § 1325(a) is mandatory.

Nevertheless, Judge Marjorie O. Rendell, writing for the majority,<sup>79</sup> explicitly endorsed the *Szostek* proposition that § 1325(a) is not mandatory for confirming a plan:

However, in *Szostek*, the secured creditor argued that the plan provision setting forth the amount to which it was entitled violated . . . § 1325(a)(5), because the provision failed to require the payment of interest necessary for the secured creditor to receive the present value of the claim. We examined whether this Code provision was mandatory, stating that "[i]f the provisions of § 1325(a)(5) are mandatory, as [the creditor] contends, then a plan cannot be confirmed if it does not meet the requirements of that section." We concluded that this provision was not mandatory. Thus, while *Szostek* does note the importance of finality, it

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73. 530 F.3d 230 (3d Cir. 2008).

74. *In re Mansaray-Ruffin*, 530 F.3d at 232–33.

75. *Id.*

76. *Id.*

77. *Id.*

78. FED. R. BANKR. P. 7001.

79. Judge Morton Ira Greenberg dissented on the ground that a confirmation of a plan is final and binding on creditors, notwithstanding the fact that the debtor failed to follow the Federal Rules of Bankruptcy Procedure. *In re Mansaray-Ruffin*, 530 F.3d at 244 (Greenberg, J., dissenting). Judge Greenberg objected to Judge Rendell's equation of the Federal Rules of Bankruptcy Procedure with the mortgage lender's right to due process under the Fifth Amendment. *Id.* at 248. In fact, the mortgage lender was duly notified of the hearing to confirm the plan. *Id.* at 246.

recognizes that the policy of finality must yield to the principle that a plan cannot violate a mandatory provision of the Code.<sup>80</sup>

Judge Rendell's idea seems to be that § 1325(a)(5)(B)(ii) requires interest compensation, but since § 1325(a)(5)(B)(ii) itself is not a condition for confirmation of the plan, *Szostek* was correctly decided. On the other hand, the *Mansaray-Ruffin* plan denied that the mortgage lender had an allowed secured claim at all.<sup>81</sup> Since Rule 7001 makes an adversary proceeding mandatory when the "validity, priority, or extent" of the lien is challenged,<sup>82</sup> confirmation of a Chapter 13 plan could not affect the mortgage lender, in spite of the principle of finality intrinsic in § 1327(a).

So the implication is that if the debtor's plan had said, "We acknowledge that the mortgage lender has a lien; we nevertheless plan to pay the lender *nothing*, since we don't have to," *this* plan is confirmable because the "validity, priority and extent" of the lien—"the three concepts included in Rule 7001(2)"<sup>83</sup>—are not in question. Rather, the debtor simply chose to ignore the provisions of § 1325(a)(5). As these are not required for plan confirmation, the plan may be confirmed over the indignant and thunderous objection of the secured creditor. This would make the law of the Third Circuit fatuous indeed. It would be better to confess that *Szostek* is overruled.

## 2. The Seventh Circuit

The Seventh Circuit also follows the premise of *Szostek*. In *In re Burgess*,<sup>84</sup> a creditor claimed that it could collaterally attack a confirmed plan because the plan failed to meet the best-interest-of-creditors test.<sup>85</sup> The court of appeals, however, ruled that this provision is not a necessary condition to the confirmation of the plan—ergo, no collateral attack.<sup>86</sup> "The proper interpretation of [§ 1325(a)]," the court wrote, "is that if the requirements of § 1325(a) are met, the bankruptcy court must confirm the plan, but if they are not met (but § 1322(a) is satisfied), the bankruptcy court still has the discretion to confirm the plan. Section 1325(a), therefore, is not mandatory, but only discretionary."<sup>87</sup> The court distinguished another successful collateral attack in *In re Escobedo*.<sup>88</sup> There, the Seventh Circuit permitted a collateral attack on a plan that failed to comply with § 1322(a)(2),

80. *Id.* at 238 (majority opinion) (alterations in original) (citations omitted) (quoting *In re Szostek*, 886 F.2d 1405, 1411 (3d Cir. 1989)).

81. *Id.* at 236.

82. FED. R. BANKR. P. 7001(2).

83. *In re Mansaray-Ruffin*, 530 F.3d at 235.

84. 143 F. App'x 692 (7th Cir. 2005).

85. *In re Burgess*, 143 F. App'x at 692–94.

86. *Id.* at 694–95.

87. *Id.* at 695 (citation omitted); see *Case v. Wells Fargo Bank, NA*, 394 B.R. 469, 478 (Bankr. E.D. Wis. 2008) (holding § 1322(e) provision is not mandatory because it does not appear in § 1322(a)); *In re Averhart*, 372 B.R. 441, 444 (Bankr. E.D. Wis. 2007) (holding cramdown provision is not mandatory). Courts could have decided these cases based on the res judicata effect of the plan.

88. *In re Burgess*, 143 F. App'x at 694–95 (citing *In re Escobedo*, 28 F.3d 34, 35 (7th Cir. 1994)).

requiring priority claimants to be paid in full.<sup>89</sup> Failure to comply with § 1322(a) warrants a collateral attack, but failure to conform to § 1325(a) does not.<sup>90</sup> *Burgess* simply took the earlier *Escobedo* dictum and elevated it to a rule.

If *Burgess* represents the law of the Seventh Circuit after 2005,<sup>91</sup> it certainly reverses the unstated assumption in *In re Till*,<sup>92</sup> where a bankruptcy court had confirmed a plan with a low interest rate.<sup>93</sup> The Seventh Circuit vacated the judgment of the district court because the interest was too low.<sup>94</sup> But if, per *Burgess*, cramdown is not a requirement for plan confirmation, *no* interest rate could be too low. So the Seventh Circuit in *Till* simply ignored the *Szostek* interpretation, even though in dictum it had earlier (arguably) agreed with the *Szostek* premise.<sup>95</sup> When the Supreme Court reversed again,<sup>96</sup> no justice offered the *Szostek* rationale for upholding the bankruptcy court. Rather, the Supreme Court simply assumed that § 1325(a) provisions must be met in order for a plan to be confirmed.<sup>97</sup> It then proceeded in a tripolar opinion to confuse the law of cramdown by proposing three different theories of interest compensation.<sup>98</sup>

### 3. Other Courts

Whatever theory of Chapter 13 holds sway in the Third and Seventh Circuits, other courts hold that a plan may never be confirmed if it does not conform to the complete letter of § 1325(a).<sup>99</sup>

89. *In re Escobedo*, 28 F.3d at 35.

90. See *infra* Part III.C.1 for choice words on *Escobedo*.

91. Of course, a court may *choose* to follow § 1325(a) in *refusing* to confirm a plan, consistent with *Burgess*. See, e.g., *In re Grabow*, 323 B.R. 236, 238–39 (Bankr. E.D. Wis. 2005) (refusing to confirm plan where it treated secured tax claim as unsecured and creditor objected before confirmation).

92. 301 F.3d 583 (7th Cir. 2002), *rev'd sub nom.* *Till v. SCS Credit Corp.*, 541 U.S. 465 (2004).

93. *In re Till*, 301 F.3d at 585.

94. *Id.* at 592–93.

95. See *In re Escobedo*, 28 F.3d 34, 35 (7th Cir. 1994) (noting agreement with *Szostek* that § 1325(a)(5) “may be discretionary”). There is a subjunctive note in this dictum that may fall short of a categorical assertion.

96. *Till*, 541 U.S. at 485.

97. *Id.* at 486–90 (Thomas, J., concurring).

98. See generally *id.*; Jacob D. Krawitz, Note, *Till v. SCS Credit Corp. (In re Till): A Rash Conclusion?*, 23 ANN. REV. BANKING & FIN. L. 889 (2004). Happily, it seems as if courts treat the *Till* plurality opinion as governing and accordingly employ the formula of prime rate plus some risk factor. See, e.g., *In re Price Funeral Home, Inc.*, No. 08-04816-8-ATS, 2008 Bankr. LEXIS 3462, at \*8 (Bankr. E.D.N.C. Dec. 12, 2008) (following *Till* plurality in using prime rate plus risk factor).

99. See, e.g., *Shaw v. Aurgroup Fin. Credit Union*, 552 F.3d 447, 449 (6th Cir. 2009) (holding that provisions in § 1325(a) are mandatory and therefore finding no discretion to approve plan not in compliance); *Wachovia Dealer Servs. v. Jones (In re Jones)*, 530 F.3d 1284, 1291 (10th Cir. 2008) (holding that bankruptcy court erred in approving noncompliant plan over creditors’ objections because provisions in § 1325(a) are mandatory); *Barnes v. Barnes (In re Barnes)*, 32 F.3d 405, 407 (9th Cir. 1994) (holding that bankruptcy court erred in confirming noncompliant plan because subsection of § 1325(a) is mandatory); *Sparks v. HSBC Auto Fin.*, No. 1:06cv670, 2007 U.S. Dist. LEXIS 51943, at \*11–12 (S.D. Ohio July 18, 2007) (finding that plain statutory language and legislative history support conclusion that provisions of § 1325(a) are mandatory); *Horr v. Jake Sweeney Smartmart, Inc.*, No. 1:07-CV-00010, 2007 U.S. Dist. LEXIS 49063, at \*10–11 (S.D. Ohio July 6, 2007) (finding that plain

After BAPCPA added the egregious hanging paragraph to § 1325(a), apparently strengthening the position of car lenders, Judge Robert D. Berger of Kansas ruled that, according to the hanging paragraph, car lenders falling thereunder are not entitled to interest compensation as part of their cramdown rights.<sup>100</sup> But Judge Berger went further. Relying on *Szostek*, he ruled that he was not obligated to follow the hanging paragraph or any cramdown protections at all.<sup>101</sup> On appeal, however, the Tenth Circuit Court of Appeals ruled that § 1325(a) was indeed mandatory,<sup>102</sup> mainly because any other conclusion would have been monstrous.

For example, § 1325(a)(3) permits confirmation when “the plan has been proposed in good faith and not by any means forbidden by law.” If we were to adopt the debtors’ reading of the statute, a bankruptcy court would have the discretion to confirm a plan even if it were proposed in bad faith or by illegal means.<sup>103</sup>

Perhaps the Supreme Court has implicitly decided that § 1325(a) is a mandatory provision. In *Associates Commercial Corp. v. Rash*,<sup>104</sup> the debtors proposed to cram down a truck at wholesale value.<sup>105</sup> The bankruptcy court confirmed the plan.<sup>106</sup> Under *Szostek*, the appeal was a loser. Nevertheless the creditor appealed on the ground that the truck should have been valued at replacement cost,<sup>107</sup> as if economically that is a different standard. The creditor proceeded to win most of the appeals, including an appeal to the Supreme Court.<sup>108</sup> At the Supreme Court level, Justice Ruth Bader Ginsburg remarked that “[t]o qualify for confirmation under Chapter 13, the [debtors’] plan had to satisfy the requirements set forth in § 1325(a) of the Code.”<sup>109</sup> This statement does not cohere with *Szostek*.

To summarize, most courts think that Chapter 13 plans must conform to § 1325(a). Under § 1325(a), every creditor gets the basic reorganization deal: dividends at least equal to those she would have received in Chapter 7. Additionally, liens must be preserved for secured creditors. In the Third Circuit, the principle that § 1325(a) is not mandatory has been substantially compromised

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statutory language and weight of case law support conclusion that provisions of § 1325(a) are mandatory).

100. See *In re Kinsey*, 368 B.R. 888, 894 (Bankr. D. Kan. 2007) (noting that § 1325(a) does not entitle 910 creditor to interest it would have earned from renewed plan), *vacated sub nom. In re Jones*, 530 F.3d 1284 (10th Cir. 2008); *In re Wampler*, 345 B.R. 730, 735 (Bankr. D. Kan. 2006) (holding that 910 creditor is not entitled to postpetition interest if debtor retains collateral).

101. *In re Kinsey*, 368 B.R. at 897; *In re Wampler*, 345 B.R. at 743–44.

102. *In re Jones*, 530 F.3d at 1291.

103. *Id.* at 1290 (quoting § 1325(a)(3)).

104. 520 U.S. 953 (1997).

105. *Rash*, 520 U.S. at 957.

106. *Id.* at 958.

107. *Id.*

108. *Id.* at 965.

109. *Id.* at 956; see *Universal Am. Mortgage Co. v. Bateman (In re Bateman)*, 331 F.3d 821, 829 n.7 (11th Cir. 2003) (observing, without deciding, that *Rash* seems to have settled question that provisions of § 1325(a) are mandatory).

by subsequent developments. Only in the Seventh Circuit may we doubt that the provisions of § 1325(a) are mandatory.

### III. PLANS IN VIOLATION OF § 1129 OR § 1325(A)

Sometimes courts confirm plans even though the plans violate some part of § 1129 or § 1325(a). Generally, the mere failure to meet some term of § 1129 or § 1325(a) does not warrant a collateral attack. The plan is *res judicata* as to the good faith of the plan,<sup>110</sup> as to early release of the lien,<sup>111</sup> as to the best-interest-of-creditors test,<sup>112</sup> and as to valuation of collateral.<sup>113</sup> But where the violation of § 1129 or § 1325(a) is a violation of some other provision as well, perhaps a collateral attack can succeed.

#### A. *Liens*

Suppose the plan wrongly declares that a secured creditor has no lien. In other words, the plan fails to conform to § 1129(b). The plan is nevertheless confirmed, and the secured creditor neglects to appeal. Is the lien dead? To be distinguished are plans that invalidate an otherwise valid lien and plans that value the collateral wrongly—perhaps at the level of zero. *Res judicata* operates rather differently in these two circumstances.

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110. *Lawrence Tractor Co. v. Gregory (In re Gregory)*, 705 F.2d 1118, 1119 (9th Cir. 1983).

111. *Burrell v. Town of Marion (In re Burrell)*, 346 B.R. 561, 569 (B.A.P. 1st Cir. 2006). In *In re Harvey*, the plan provided that a lien would be released as soon as the secured portion of the loan was paid, even if the unsecured portion had not been paid and the plan had not been completed. 213 F.3d 318, 319 (7th Cir. 2000). This term was given *res judicata* effect, even though the creditor claimed it was illegal. *In re Harvey*, 213 F.3d at 321. BAPCPA reverses the plan term in a converted case, but it does not seem to deny the legality of the term pending conversion. *See* 11 U.S.C. § 348(f)(C)(i) (2006) (providing that in cases converted from Chapter 13, creditor's claim is secured unless full amount of claim has been paid by date of conversion).

112. *See In re Hedrick*, 343 B.R. 762, 765–66 (Bankr. E.D. Va. 2006) (holding that creditor was not entitled to postpetition interest in Chapter 13 case, despite availability of postpetition interest in Chapter 7 case, because creditor failed to raise issue before confirmation). This test turns on the amount of exemptions the debtor would be entitled to in Chapter 7. *In re Greene*, 359 B.R. 262, 265 (Bankr. D. Ariz. 2007). If a plan is confirmed based on faulty claims of exemption, the plan is nevertheless entitled to *res judicata*. *Id.* at 266.

113. *See infra* Part III.A.3 for a discussion of *res judicata* as it relates to valuation of collateral. An exception is *In re Kincaid*, where a Chapter 13 plan stated that a secured claim for \$175,000 would be paid in full. 316 B.R. 735, 736–37 (Bankr. E.D. Cal. 2004). The payments required by the plan palpably failed to pay the secured claim. *Id.* at 737. Nevertheless, the plan was confirmed without objection. Even though the plan was completed, the secured claims were not satisfied. The court ruled that there were grounds to dismiss the case under 11 U.S.C. § 1307(c)(6). *Id.* at 742. But that provision refers to “material default by the debtor with respect to a term of a confirmed plan.” 11 U.S.C. § 1307(c)(6) (2006). The debtor complied with the plan by making the payments. *In re Kincaid*, 316 B.R. at 742. And the plan announced that payment was “in full.” *Id.* at 736–37. That the payments did not add up to \$175,000 did not mean that the debtor was in default under the plan.



1. Avoidance Without an Adversary Proceeding

- a. *No Res Judicata*

A plan may describe a secured creditor as being unsecured, omitting to mention her lien. Occasionally, one reads that “[a] bankruptcy plan does not eliminate a lien by merely failing to refer to, or provide for the lien.”<sup>114</sup> Such a holding perhaps goes to the meaning of the plan in question. Where the plan is vague about the lien, the plan shall be interpreted as not terminating it. This is not a res judicata idea but is simply an interpretive rule of thumb.

What if the plan is adequately explicit that the creditor is to have no lien or that a particular claim is unsecured? Many courts believe that a plan cannot avoid a lien without the aid of an adversary proceeding. Any such attempt is ultra vires and entitled to no res judicata respect.

According to Federal Rule of Bankruptcy Procedure 7001:

The following are adversary proceedings: . . . (2) a proceeding to determine the validity, priority, or extent of a lien or other interest in property, other than a proceeding under Rule 4003(d) . . .<sup>115</sup>

What do these words—“validity, priority, or extent”—mean?<sup>116</sup>

Validity presumably goes to existence, and it encompasses a trustee’s avoidance theories, such as voidable preference or fraudulent conveyance.<sup>117</sup> “Priority” presumably means that, if the trustee’s view of proper priority conflicts with the creditor’s assumption, the trustee may proceed on her own assumption only after obtaining declaratory relief in an adversary proceeding. “Extent” should be limited to attachment theories. For example, a creditor may claim a lien on after-acquired property. The trustee may claim that the security agreement does not authorize this type of claim. An adversary proceeding is therefore required to determine whether the lien “extends” to the after-acquired property. “Extent,” however, should *not* encompass the size of a secured creditor’s claim or the value of the collateral. These matters should be left to motions practice.

In *SLW Capital, LLC v. Mansaray-Ruffin (In re Mansaray-Ruffin)*,<sup>118</sup> the plan transformed a sizable home mortgage into a \$1,000 unsecured claim, because

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114. *IRS v. DiPasquale*, No. 06-106 (MLC), 2006 U.S. Dist. LEXIS 24068, at \*10 (D.N.J. Apr. 28, 2006); *see also* *Cen-Pen Corp. v. Hanson*, 58 F.3d 89, 94 (4th Cir. 1995) (holding that lien passes through bankruptcy intact if Chapter 13 plan fails to address lien); *Bisch v. United States (In re Bisch)*, 159 B.R. 546, 550 (B.A.P. 9th Cir. 1993) (enforcing lien even though it was not addressed in Chapter 13 plan); *In re Vankell*, 311 B.R. 205, 214 (Bankr. E.D. Tenn. 2004) (holding that creditor’s lien still encumbered property where Chapter 13 plan failed to address lien).

115. FED. R. BANKR. P. 7001. Rule 4003(d) permits avoidance of a lien on exempt property pursuant to § 522(f) to proceed by motion. FED. R. BANKR. P. 4003(d).

116. *See infra* Part III.A.3 for further discussion of “validity, priority, or extent.”

117. *See* *SLW Capital, LLC v. Mansaray-Ruffin (In re Mansaray-Ruffin)*, 530 F.3d 230, 235 (3d Cir. 2008) (observing that validity refers to “legal force” (internal quotation marks omitted)).

118. 530 F.3d 230 (3d Cir. 2008).

the mortgage lender had violated the Truth in Lending Act.<sup>119</sup> The plan was confirmed without objection from the lender.<sup>120</sup> After confirmation, the mortgage lender commenced an adversary proceeding to obtain a declaration that it still had a lien in spite of the plan.<sup>121</sup> At all levels, the court held that the mortgage lender had a valid cause of action.<sup>122</sup>

According to Rule 7001(2), an action questioning “the validity, priority, or extent of a lien” is an adversary proceeding.<sup>123</sup> But § 1327(a) directly states that a confirmed plan is binding.<sup>124</sup> There is a conflict between the Bankruptcy Code and the federal rules. At such moments, usually the courts assume that the statute outranks the rule.<sup>125</sup> But this seems not to be the case with regard to lien avoidance. Indeed, the debtor in *Mansaray-Ruffin* claimed that the plan term in question was directly authorized by Bankruptcy Code § 1322(b)(10), which permits any plan term not inconsistent with the Bankruptcy Code.<sup>126</sup> Even if the debtor’s plan term contradicted Rule 7001, the term at least did not violate any provision of the Bankruptcy Code and so was arguably permissible.<sup>127</sup> This point had been rejected years before in *In re McKay*,<sup>128</sup> and Judge Rendell affirmed this holding.<sup>129</sup> According to the *McKay* court, “we do not believe that a substantive catch-all provision such as section 1322(b)(10) contains the requisite specificity or force to suggest that Congress intended it to override the [Federal Rules of Bankruptcy Procedure].”<sup>130</sup> In other words, the *McKay* court simply did not think that Congress intended the statute to be taken literally. If the Federal Rules of Bankruptcy Procedure can override § 1322(b)(11) on grounds of congressional intent, then certainly they can do so with regard to § 1327(a), which is equally and incredibly as broad in scope. The premise is that when Congress makes broad categorical statements like those in § 1322(b)(11) or § 1327(a), it did not seriously intend to give the bankruptcy courts jurisdiction to ignore the Federal Rules of Bankruptcy Procedure.<sup>131</sup>

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119. *In re Mansaray-Ruffin*, 530 F.3d at 232–33. On the rescission remedy in the Truth in Lending Act, see *Dawson v. Thomas (In re Dawson)*, 411 B.R. 1 (Bankr. D.D.C. 2008); Elwin Griffith, *Truth in Lending—The Right of Rescission, Disclosure of the Finance Charge, and Itemization of the Amount Financed in Closed-End Transactions*, 6 GEO. MASON L. REV. 191, 199–39 (1998).

120. *In re Mansaray-Ruffin*, 530 F.3d at 232.

121. *Id.* at 233; see FED. R. BANKR. P. 7001(9) (including proceeding to obtain declaratory judgment as adversary proceeding).

122. *In re Mansaray-Ruffin*, 530 F.3d at 233.

123. FED. R. BANKR. P. 7001(2).

124. See 11 U.S.C. § 1327(a) (2006).

125. See, e.g., *BFP Invs., Inc. v. BFP Invs. Ltd.*, 150 F. App’x 978, 979 (11th Cir. 2005) (observing that Federal Rules of Bankruptcy Procedure Advisory Committee Notes indicate that Federal Rule of Civil Procedure 60(b) could not override Bankruptcy Code § 1144).

126. *In re Mansaray-Ruffin*, 530 F.3d at 236.

127. *Id.* at 237.

128. 732 F.2d 44, 47–48 (3d Cir. 1984).

129. *In re Mansaray-Ruffin*, 530 F.3d at 236.

130. *In re McKay*, 732 F.2d at 48.

131. Suppose the debtor wins an adversary proceeding avoiding a lien. Even this is not enough for a plan to foreclose a lien, so long as the creditor has not exhausted the appeal in the adversary

A challenge for the premise underlying *Mansaray-Ruffin* involves plans that establish priorities for competing creditors. In *First Union Commercial Corp. v. Nelson, Mullins, Riley & Scarborough (In re Varat Enterprises, Inc.)*,<sup>132</sup> a Chapter 11 plan listed creditor *A* as senior with respect to a payment intangible and creditor *B* as junior.<sup>133</sup> Creditor *B* voted in favor of the plan, which was confirmed.<sup>134</sup> Later, *B* had second thoughts and sought a declaration that *B* was senior after all.<sup>135</sup> The court held that *B* was precluded from challenging *A*'s priority by res judicata.<sup>136</sup> But Rule 7001(2) requires an adversary proceeding to establish "the validity, priority, or extent of a lien."<sup>137</sup> Under the *Mansaray-Ruffin* holding, *B* might have been immune from res judicata. In other words, the plan can never establish lien priorities. Perhaps, however, creditor *B* waived its due process right to an adversary proceeding by voting in favor of the plan.<sup>138</sup>

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proceeding. In *Russo v. Seidler (In re Seidler)*, the debtor claimed in an adversary proceeding that a mortgage had been satisfied. 44 F.3d 945, 946–47 (11th Cir. 1995). The creditor appealed. *In re Seidler*, 44 F.3d at 947. The district court stayed confirmation of a plan conditional on the creditor posting a \$50,000 bond by a certain date. *Id.* When the creditor posted no bond, the bankruptcy court confirmed a plan giving the creditor nothing. *Id.* The district court then ruled that confirmation rendered the appeal moot. *Id.* The court of appeals reversed. *Id.* at 949. Plan confirmation could not affect the creditor so long as the appeal was still pending. *In re Seidler*, 44 F.3d at 948.

132. 81 F.3d 1310 (4th Cir. 1996).

133. *In re Varat*, 81 F.3d at 1313.

134. *Id.* at 1314.

135. *Id.*

136. *Id.* at 1317.

137. FED. R. BANKR. P. 7001(2).

138. The court alternatively found estoppel did exist, but the statement was failing to object to *A*'s claim, not affirmatively voting for the plan. *In re Varat*, 81 F.3d at 1317–18. A mirror image of sorts was presented in *Templeton Mortgage Corp. v. Chesnut (In re Chesnut)*, No. 09-10145, 2009 U.S. App. LEXIS 27686 (5th Cir. December 17, 2009). In *Chesnut*, *D*'s nondebtor spouse obtained property from *V* on secured credit. *In re Chesnut*, 2009 U.S. App. LEXIS 27686, at \*2. The spouse defaulted, and *V* commenced foreclosure proceedings. *Id.* at \*2–3. *D*, but not the spouse, then filed for bankruptcy in Chapter 13. *Id.* at \*3. Concluding that *D* had no interest in the collateral, *V* continued with the foreclosure and emerged as the owner of the fee simple. *Id.* *D*, however, claimed that under the community property law of Texas, *D* had an interest in his spouse's property. *Id.* *D* sought relief for violation of the automatic stay. *In re Chesnut*, 2009 U.S. App. LEXIS 27686, at \*3–4. While that litigation was pending, *D* wrote a Chapter 13 plan that treated *V* as a lien creditor, not a fee owner. *Id.* at \*4–5. The plan called for *V* to be paid in full. *Id.* *V* was required to supply a release of the lien once payment was accomplished. *Id.* *V* did not object to confirmation and was indeed paid in full. *Id.* at \*5–6. This was inconsistent with *V* being a fee owner of the premises, and so *V* presumably accepted the claim that it merely had a lien on the premises. When payment was completed, *V* refused to release the lien, claiming that the amount of the secured claim had not been paid in full (though the plan said otherwise). *In re Chesnut*, 2009 U.S. App. LEXIS 27686, at \*6. All of the courts reviewing the matter held that *V* was stuck with res judicata of the plan and therefore had to release the lien. *Id.* at \*7, \*21. Significantly, *V* claimed that no adversary proceeding had been filed against him, thereby destroying the res judicata worth of the plan. *Id.* at \*15. The Fifth Circuit rejected this claim on the interesting ground that the plan upheld the lien and did not attack its validity. *Id.* at \*15–16. Therefore, no adversary proceeding was required. This was accurate enough, but the plan also confiscated *V*'s fee simple interest and awarded it to the debtor. According to Rule 7001(1), an adversary proceeding is required "to recover . . . property." FED. R. BANKR. P. 7001(1). Arguably the plan was incompetent to make *D* the owner of the fee simple (minus *V*'s mortgage, which *V* retained under the plan). But, since *V* accepted tender of payment on the secured claim, it is surely the case that *V* could not rely on this point to attack the plan. On this premise,

The procedure for lien avoidance has recently undergone a change. In prior times, liens could be challenged in the process of objecting to a proof of claim. An early holding which ruled against res judicata of plans with regard to lien validity is *Simmons v. Savell (In re Simmons)*,<sup>139</sup> which is expressed not in terms of failing to bring an adversary proceeding but rather failure to object to proofs of claim. The plan purported to destroy a materialman's lien.<sup>140</sup> The plan had been sent to a secured creditor, who objected, after a fashion.<sup>141</sup> On the proof of claim form that he filled out, he checked a box indicating that he accepted the Chapter 13 plan, but he added a note: "Creditor objects to his claim being scheduled as unsecured."<sup>142</sup> Unaware of this objection, the bankruptcy court approved the plan.<sup>143</sup> The creditor filed no appeal.<sup>144</sup>

Later, to facilitate sale of the collateral, the debtor commenced an adversary proceeding to require the creditor to cancel the lien in the state records of Mississippi.<sup>145</sup> The bankruptcy court ruled that the secured creditor still had a valid lien.<sup>146</sup> On appeal, the Fifth Circuit affirmed.<sup>147</sup> According to the *Simmons* court, Bankruptcy Rule 3007 required the debtor to file an *objection* to a secured claim, which the debtor had not done.<sup>148</sup> Unless this objection was filed, the claim was deemed allowed per § 502(b).<sup>149</sup> "The Code and the Rules do not envision the use of a plan as a means for objecting to proofs of claims."<sup>150</sup>

At the time of *Simmons*, Rule 3007 indicated that, where the trustee guessed wrong and filed an objection to a proof of claim instead of commencing an adversary proceeding, the objection was to be considered an adversary proceeding without any need for starting over.<sup>151</sup> After 2007, that is no longer the case. Rule 3007(b) now provides that "[a] party in interest shall not include a demand for relief of a kind specified in Rule 7001 in an objection to the allowance of a

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the case reduces to this: the plan is res judicata on the issue of the size of the allowed secured claim. On res judicata in this context, see *infra* text accompanying notes 224–32.

139. 765 F.2d 547, 553 (5th Cir. 1985).

140. *In re Simmons*, 765 F.2d at 549.

141. *Id.*

142. *Id.* (internal quotation marks omitted).

143. *Id.*

144. *Id.*

145. *In re Simmons*, 765 F.2d at 550.

146. *Id.*

147. *Id.* at 559.

148. *Id.* at 552.

149. *Id.* at 553.

150. *In re Simmons*, 765 F.2d at 553; accord *In re McKay*, 732 F.2d 44, 48 (3d Cir. 1984) (holding that plan could not be used to declare security interest void under § 522(f)); *In re Elecs. & Metals Indus., Inc.*, 153 B.R. 36, 38 (Bankr. W.D. Tex. 1992) (rejecting debtor's argument that 11 U.S.C. § 1141(c) could be used to void lien); *Still v. Tennessee (In re Rogers)*, 57 B.R. 170, 173 (Bankr. E.D. Tenn. 1986) (holding that debtor could not use plan to convert secured debt into unsecured debt).

151. FED. R. BANKR. P. 3007 (2007) (repealed 2008).

claim.”<sup>152</sup> Today, objecting to a proof of claim no longer suffices to substitute for an adversary proceeding. As a result, *Simmons* is not, strictly speaking, good law.

Confusing matters is § 502(d), which provides:

Notwithstanding subsections (a) and (b) of this section, the court shall disallow any claim of any entity from which property is recoverable under section . . . 550 . . . of this title or that is a transferee of a transfer avoidable under section . . . 544, 545, 547, [or] 549 . . . of this title, unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable under . . . this title.<sup>153</sup>

No one is quite sure what this provision means.<sup>154</sup> It seems to imply *temporary* disallowance since the claim can be reinstated if the creditor turns over property. But it also certainly suggests that avoidance can be established by mere objection to a claim. After 2007, objections that should have been adversary proceedings are no longer deemed to be adversary proceedings. Does the change in rules therefore mean that an objection to a secured claim on grounds of § 502(d) must now be accomplished by an adversary proceeding? Frankly, no one knows.<sup>155</sup>

Before creditors become too exuberant, they should consider what it means to have a lien in spite of the terms of a reorganization plan. All these decisions mean is that the lien securing the claim is not dead. But perhaps the plan is still binding in other respects. In *In re Vankell*,<sup>156</sup> a Chapter 13 plan proclaimed that a secured creditor had no lien.<sup>157</sup> It proposed to pay out the creditor as if it were unsecured.<sup>158</sup> Later, the debtor sold the collateral.<sup>159</sup> The creditor claimed its lien still lived, in spite of the plan.<sup>160</sup> The court agreed.<sup>161</sup> But when the secured creditor attempted to lift the automatic stay, this motion was denied.<sup>162</sup> The court’s idea was that the creditor had to live with the plan until its conclusion.<sup>163</sup> Only then could the lien be enforced.

There is much that is amiss in *Vankell*, where the debtor had sold the collateral to a third party.<sup>164</sup> The court implied that there could be no enforcement

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152. FED. R. BANKR. P. 3007(b).

153. 11 U.S.C. § 502(d) (2006).

154. See generally 1 GRANT GILMORE & DAVID GRAY CARLSON, GILMORE AND CARLSON ON SECURED LENDING: CLAIMS IN BANKRUPTCY § 2.06 (2000).

155. Meanwhile, *Simmons* might be considered overruled by the Fifth Circuit’s subsequent opinion in *Elixir Industries Inc. v. City Bank & Trust Co. (In re Ahern Enterprises, Inc.)*, 507 F.3d 817 (5th Cir. 2007). See *infra* notes 202–16 and accompanying text for a discussion of whether *Ahern Enterprises* overrules *Simmons*.

156. 311 B.R. 205 (Bankr. E.D. Tenn. 2004).

157. *In re Vankell*, 311 B.R. at 208.

158. *Id.*

159. *Id.* at 209.

160. *Id.*

161. *Id.* at 218.

162. *In re Vankell*, 311 B.R. at 214–16.

163. *Id.* at 215–16.

164. See *id.* at 216 (noting that purchasers of debtor’s real property were “entitled to a ‘co-debtor stay’ of sorts” despite not being co-debtors).

even against the third party—a nice windfall for that person.<sup>165</sup> Clearly the automatic stay does not protect third-party property. It must have been the res judicata effect of the plan that meant that the creditor could take no foreclosure actions.

*b. Res Judicata Upheld*

Some cases, especially Chapter 11 cases, have allowed plans to extinguish liens without an adversary proceeding.<sup>166</sup> Most notorious of such opinions is *In re Penrod*,<sup>167</sup> where Chief Judge Richard Posner ruled that a plan can indeed eliminate a security interest, and the plan is binding on the secured party as written, even though the plan itself violates the secured party's procedural rights and the substantive requirements of the Bankruptcy Code itself. In *Penrod*, a Chapter 11 plan made no reference to the retention of a lien, though it proposed that the secured claim would be paid in full.<sup>168</sup> "The question we must decide," Judge Posner wrote, "is whether preexisting liens survive a reorganization when the plan (or the order confirming it) does not mention the liens."<sup>169</sup> The answer Judge Posner derived was that if the plan says nothing about a creditor's lien, the lien is dead.<sup>170</sup>

165. See *id.* (noting that creditor must wait until reorganization plan concludes before action can be enforced against third party).

166. See, e.g., *Universal Suppliers, Inc. v. Reg'l Bldg. Sys., Inc. (In re Reg'l Bldg. Sys., Inc.)*, 254 F.3d 528, 532 (4th Cir. 2001) (noting that where property comes within ambit of confirmed Chapter 11 plan, claims not expressly preserved are extinguished). *But cf.* *Fed. Deposit Ins. Corp. v. Union Entities (In re Be-Mac Transp. Co.)*, 83 F.3d 1020, 1027 (8th Cir. 1996) (observing that claims unmentioned in confirmed Chapter 11 plans are not extinguished where creditor was not party to reorganization). See generally *Wachovia Dealer Servs. v. Jones (In re Jones)*, 530 F.3d 1284 (10th Cir. 2008) (discussing extinguishment of liens in Chapter 13 context). In *Jones*, the court stated in dictum, "if a secured creditor fails to object to confirmation, the creditor will be bound by the confirmed plan's treatment of its secured claim under § 1325(a)(5)." *Id.* at 1291. But this comment should probably be limited to cases in which the amount of the secured claim or the value of the collateral is at stake. Thus, *Jones* reversed a case in which secured creditors were denied interest compensation in the plan. The court cited an earlier opinion involving a plan term requiring the release of a lien once a secured claim was paid. *Id.* (citing *United States v. Richman (In re Talbot)*, 124 F.3d 1201, 1209 n.10 (10th Cir. 1997)).

167. 50 F.3d 459 (7th Cir. 1995).

168. *In re Penrod*, 50 F.3d at 461. If the secured party was not in support of the plan, then the plan was illegal, in that § 1129(b)(2)(A)(i)(I) requires that the secured party retain its lien. See 11 U.S.C. § 1129(b)(2)(A)(i)(I) (2006) (requiring plans to provide for secured creditors to retain liens, regardless of whether debtor retains property or transfers property to third party). We do not learn from *Penrod* whether the secured party supported or opposed the plan, or whether the secured party was merely apathetic about it. We can presume, however, that a "yes" vote on the plan surely would have been mentioned as estopping the secured party's later protest. Nor is it possible that the secured claim was left unimpaired by the plan, since unimpairment would require preservation of the secured party's prepetition security interest. § 1124(2)(D). If the secured party had been unimpaired, it would have been deemed to vote yes on the plan. See § 1126(f) (providing conclusive presumption of acceptance of plan by unimpaired claimholders).

169. *In re Penrod*, 50 F.3d at 462.

170. *Id.* at 463. For cases following *Penrod*, see *In re Harnish*, 224 B.R. 91, 94 (Bankr. N.D. Iowa 1998), where a lien was extinguished because the plan made no mention of it. For a contrary case,

After confirmation, the debtor sold the collateral.<sup>171</sup> The secured party brought an action in an Indiana court to sequester the proceeds.<sup>172</sup> The debtor responded by seeking an order in bankruptcy court holding the secured party in contempt for “violating the order confirming the plan.”<sup>173</sup> The bankruptcy court, appropriately, held that the creditor was not in violation of the automatic stay, which no longer applies once a Chapter 11 plan is confirmed and an individual debtor is granted a discharge.<sup>174</sup> Unless the plan itself provided for injunctive relief, the bankruptcy court should not have entertained such a motion from the debtor. Also, so long as the plan was not in default, the secured party had no right to demand possession of the proceeds. This matter would depend on a plan term that described some event of default triggering the secured creditor’s right of possession.

The grounds cited by Judge Posner were different. According to Judge Posner, if a plan mentions a claim but not a lien for the claim, then the plan has eliminated the lien,<sup>175</sup> at least when the secured party actually filed a proof of claim.<sup>176</sup>

*Penrod* is proof that even Homer nods. Judge Posner has on occasion proved a brilliant theorist of the Bankruptcy Code, but few could confuse his *Penrod* opinion with insightful analysis.<sup>177</sup>

Judge Posner was keen to limit his holding to cases in which the secured creditor “participates” in the reorganization proceeding—i.e., has filed a proof of claim. Thus, we learn that the *Penrod* holding applies only if “the holder of the lien participated in the reorganization. If he did not, his lien would not be ‘property dealt with by the plan,’ and so [§ 1141(c)] would not apply.”<sup>178</sup>

This does not even begin to follow. Section 1141(c) states that “except as otherwise provided in the plan . . . after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors.”<sup>179</sup> If a plan expressly deals with a security interest in the absence of a proof of claim, how can one say that the collateral is not “property dealt with by the plan”? Indeed, Judge Posner himself informed us of the truism: “Property dealt with by the plan is

see *Shook v. CBIC (In re Shook)*, 278 B.R. 815, 824 (B.A.P. 9th Cir. 2002), where a plan silent about a lien did not void the lien or determine its value.

171. *In re Penrod*, 50 F.3d at 461.

172. *Id.* Judge Posner did not describe the nature of this lawsuit. Presumably it was based on an event of default in the secured party’s prepetition security agreement. The plan itself was not in default.

173. *Id.*

174. 11 U.S.C. § 362(c)(2)(C) (2006).

175. *In re Penrod*, 50 F.3d at 463 (interpreting § 1141(c) as extinguishing lien upon confirmation of reorganization, unless plan was in place that specifically preserved lien).

176. *Id.*; accord *Tor Husjord Shipping v. Port Isabel/San Benito Navigation Dist. (In re Burton Sec. S.A.)*, 202 B.R. 411, 419–20 (S.D. Tex. 1996) (holding that plan voided creditor’s lien where creditor participated in plan but plan made no mention of lien); *In re Hamish*, 224 B.R. 91, 93–95 (Bankr. N.D. Iowa 1998) (holding that lien was extinguished where plan provided for creditor but did not mention lien); *In re Siemers*, 205 B.R. 583, 586 (Bankr. D. Minn. 1997) (holding that plan voids liens of all secured creditors provided for in plan unless plan states otherwise).

177. *But see* 3 KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY § 231.1 (3d ed. 2000 & Supp. 2004) (“*Penrod* is well reasoned and true to the structure of the Code.”).

178. *In re Penrod*, 50 F.3d at 463 (quoting 11 U.S.C. § 1141(c) (2006)).

179. § 1141(c).

property dealt with by the plan . . . .”<sup>180</sup> This tautology was offered to answer a straw-man argument of Judge Posner’s devise:

One could argue that the quoted phrase [“property dealt with by the plan”] should be equated to “property of the estate,” . . . and that at the start of the bankruptcy proceeding the liens of the secured creditors are not the debtor’s property—which indeed they are not. But the suggested equation is not especially plausible. Property dealt with by the plan is property dealt with by the plan, whether it was part of the debtor’s estate when bankruptcy was first declared or was tossed into the pot later.<sup>181</sup>

The statement “[p]roperty dealt with by the plan is property dealt with by the plan” is supposed to invoke the plain meaning of the plan itself against this straw-man argument—that plans cannot affect liens because liens are *dehors* property of the estate.<sup>182</sup> Yet, in making it, Posner undermined his other assertion that the plan somehow does not deal with property when the lien creditor does not participate in the bankruptcy. Happily, none of this “logic” is even pertinent, as the secured party in *Penrod* did indeed file a proof of claim.

Nor is Judge Posner’s citation of cases any better than his logic. In *Penrod*, Judge Posner informed us that no appellate cases theretofore existed on the power of the plan to kill off liens without an adversary proceeding or its equivalent.<sup>183</sup> He then admitted to the existence of *Simmons*—an appellate opinion—but distinguished it as a mere Chapter 13 case, whereas *Penrod* was a Chapter 11 case.<sup>184</sup> This point, while true, overlooks the fact that *Simmons* rests on specific Federal Rules of Bankruptcy Procedure which are applicable to both Chapter 13 and Chapter 11.<sup>185</sup> How is it that the Federal Rules of Bankruptcy Procedure override Chapter 13 provisions but not Chapter 11 provisions? Judge Posner omitted to explain—though the Fourth Circuit would later attempt to do so.<sup>186</sup>

Judge Posner further chastised the *Simmons* court for relying on his own opinion<sup>187</sup> in *In re Tarnow*,<sup>188</sup> which held that liens are not forfeited when the

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180. *In re Penrod*, 50 F.3d at 463.

181. *Id.* (citation omitted).

182. Judge Posner’s straw-man argument is in fact an intriguing alternative way to analyze property under the Bankruptcy Code. At stake is whether “property of the estate” means a debtor’s interest in a thing or whether it means the thing in itself. The Supreme Court opted for the highly noumenal position that the bankruptcy estate is comprised of things in themselves. See *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983) (holding that reorganization estate includes all of debtor’s property). On this view, a bankruptcy trustee can recover a thing, even though a creditor has the right of possession. For a critique of these metaphysics, see Thomas E. Plank, *The Outer Boundaries of the Bankruptcy Estate*, 47 EMORY L.J. 1193 (1998).

183. *In re Penrod*, 50 F.3d at 463.

184. *Id.* at 464.

185. See *supra* Part III.A.1.a for a discussion of the relationship between the Federal Rules of Bankruptcy Procedure and the provisions of Chapter 11 and Chapter 13.

186. See *infra* text accompanying notes 216–27 for a discussion of the Fourth Circuit’s reasoning in *Universal Suppliers, Inc. v. Regional Building Systems, Inc.* (*In re Regional Building Systems, Inc.*), 254 F.3d 528 (4th Cir. 2001).

187. *In re Penrod*, 50 F.3d at 464.

188. 749 F.2d 464 (7th Cir. 1984).



secured party misses the bar date.<sup>189</sup> Reliance by *Simmons* on *Tarnow* supposedly disqualifies it as a valid authority. Yet the use of *Tarnow* by the *Simmons* court seems fair—liens pass through bankruptcy unless someone steps forward to avoid it. Citing *Tarnow* did no discredit to the *Simmons* court.

Finally, Judge Posner also referred the reader to *Lee Servicing Co. v. Wolf (In re Wolf)*,<sup>190</sup> for further reasons to distinguish *Simmons*.<sup>191</sup> In *Wolf*, the court thought that *Simmons* was a case in which the plan was unclear in its intent to destroy a lien.<sup>192</sup> If anything, this suggestion undercuts Judge Posner, who admitted that the intent of the *Penrod* plan and the state of the law was most unclear.<sup>193</sup> Given the plan's lack of clarity, *Simmons* should have been right on point.<sup>194</sup>

The elimination of the security interest in *Penrod* is also tempered by the possibility that the secured creditor would be paid entirely, if the Chapter 11 plan were to be completed.<sup>195</sup> But with regard to the security interest, a major omission in this opinion is its failure to discuss the Federal Rules of Bankruptcy Procedure, which impose strictures on the way a bankruptcy trustee may avoid a security interest. If these procedural failures are due process failures—constitutional lapses—then the finality provisions of Chapter 11 or Chapter 13 can be given no effect, where the Federal Rules of Bankruptcy Procedure are violated.<sup>196</sup>

Yet Judge Posner did raise a valid policy concern. He warned that, unless the plan is able to kill liens by opting not to mention them, third parties dealing with the debtor might be misled—in short, the secret lien concern.<sup>197</sup> This concern, however, could be solved if it is agreed that the secured party has a mere “equitable lien”—one that is valid against the debtor but not against third-party bona fide purchasers.<sup>198</sup> Subsequent bona fide purchasers would then be free to deal with the debtor as if no security interest existed. Such a device solves the secret

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189. *In re Tarnow*, 749 F.2d at 465–66.

190. 162 B.R. 98 (Bankr. D.N.J. 1993).

191. *In re Penrod*, 50 F.3d at 464.

192. *In re Wolf*, 162 B.R. at 108 n.16.

193. *In re Penrod*, 50 F.3d at 464.

194. Although formerly a law professor and still a lecturer in law, Judge Posner shows a careless attitude toward citing cases indeed. One example must suffice. Posner wrote: “Nor had the plan in *Estate of Lellock v. Prudential Ins. Co.*, 811 F.2d 186, 188–89 (3d Cir. 1987), made provision for the secured creditor; the debtor had never even listed the property subject to the lien as an asset of the estate.” *In re Penrod*, 50 F.3d at 463. A careful or even casual review of *Lellock* reveals that *Lellock* involved a Chapter 7 discharge and the claim that discharge of the debt also discharges the lien. See *Lellock*, 811 F.2d at 187–88 (summarizing facts of case and appellant's claims). There was no “plan” in *Lellock* and hence no reason to explain it away.

195. See Beth A. Buchanan Staudenmaier, Note, *Survival of Liens: “Liens Pass Through Bankruptcy Unaffected”—Or Do They?* In re *Penrod—Challenging an Adage*: In re *Penrod*, 50 F.3d 459 (7th Cir. 1995), 21 U. DAYTON L. REV. 445, 463 (1996) (noting likely importance *Penrod* court placed on plan's provision for full repayment on principal and interest owed to creditor).

196. See *infra* Part IV for a discussion of due process issues and bankruptcy.

197. *In re Penrod*, 50 F.3d at 463.

198. See generally AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, THE LAW OF TRUSTS § 284 (4th ed. 1987).

lien concern and prevents debtors from sneaking illegal plans past their dozing creditors, so long as no bona fide purchaser appears on the scene.

Another possible argument in support of *Penrod* is that, under it, secured creditors cannot hold back and engage in later collateral attacks on the plan. Rather, secured creditors would have an incentive to contest the confirmation of the plan, thereby improving the quality of the system.<sup>199</sup> Against this benefit, however, is the damage that might be done if obviously illegal plans are binding on all parties who do not appeal from the confirmation order. These wrongs can be considerable where debtors try to sneak an illegal plan past an unvigilant judge. The balance between finality and the danger of stealthy illegal plans, however, has already been struck in the Federal Rules of Bankruptcy Procedure. According to these rules, the secured party is entitled to an adversary proceeding before the lien can be eliminated.<sup>200</sup> For this reason, cases like *Mansaray-Ruffin* and *Simmons* not only represent the weight of authority but of wisdom as well.

Nevertheless, the Fifth Circuit has recently adopted the *Penrod* rule. In *Elixir Industries, Inc. v. City Bank & Trust Co. (In re Ahern Enterprises, Inc.)*,<sup>201</sup> a creditor had a valid junior judicial lien on the debtor's real property.<sup>202</sup> The debtor filed for Chapter 11 protection, and the creditor filed a proof of claim.<sup>203</sup> The creditor erroneously described its claim as unsecured but as entitled to a priority.<sup>204</sup> The debtor objected to the assertion of priority.<sup>205</sup> The bankruptcy court sustained the objection.<sup>206</sup> A Chapter 11 plan was confirmed, which treated the creditor as unsecured.<sup>207</sup> Later, the case was converted to Chapter 7.<sup>208</sup> The Chapter 7 trustee and the senior mortgage lender jointly moved for a deed in lieu of foreclosure whereby the real estate was conveyed to the senior mortgage lender in satisfaction of a portion of the lender's claim.<sup>209</sup> The court granted the motion,<sup>210</sup> and the trustee

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199. See *In re Harvey*, 213 F.3d 318, 321 (7th Cir. 2000) (stating that to allow creditors to collaterally attack confirmed plans would be inefficient and would skew balance of creditors' and debtors' interests determined in initial proceedings).

200. FED. R. BANKR. P. 7001(2).

201. 507 F.3d 817 (5th Cir. 2007).

202. *In re Ahern*, 507 F.3d at 818–19.

203. *Id.* at 819.

204. *Id.*

205. *Id.*

206. *Id.*

207. *In re Ahern*, 507 F.3d at 819.

208. *Id.*

209. *Id.*

210. It may be questioned whether such an order is authorized by the Bankruptcy Code. Section 363(f) permits sales free and clear of liens only under limited conditions. For example, a free-and-clear sale is permitted if "the price at which such property is to be sold is greater than the aggregate value of all liens on such property." 11 U.S.C. § 363(f)(3) (2006). Where the property is under water, the sale can never exceed (though it can equal) the value of all the liens. See Housing Disaster Area Foreclosure Prevention Act of 2009, H.R. 906, 111th Cong. § 102(b) (2009) (defining "qualifying existing underwater mortgages" as mortgages on homes with appraised values below value of all outstanding mortgage obligations on property). Subsection (5) provides that a free-and-clear sale is permitted if the lien creditor "could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of

deeded the property to the senior lender.<sup>211</sup> Later, in anticipation of a sale, the lender sought a declaration from the bankruptcy court that the judgment creditor's lien was dead.<sup>212</sup> At all levels of appeal, this decision was upheld.<sup>213</sup> Judge E. Grady Jolly perhaps could have found that the lien was eliminated when the debtor-in-possession objected to the proof of claim. But he ruled that, whatever status the proof of claim had, § 1141(c) decided the matter: "[E]xcept as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors . . . ."<sup>214</sup> Judge Jolly emphasized that the case was one where the debtor had "participated" in the Chapter 11 case by filing a proof of claim.<sup>215</sup>

Does *Ahern* overrule *Simmons*? This question turns on whether the finality provisions applicable to *Simmons* (a Chapter 13 case) are different from the finality provisions in Chapter 11.

Personally, I can see no difference between Chapters 11 and 13 on this score, but the Fourth Circuit purported to find § 1141(c) to be fundamentally different from § 1327(c). In *Universal Suppliers, Inc. v. Regional Building Systems, Inc.* (*In re Regional Building Systems, Inc.*),<sup>216</sup> a Chapter 11 case, Chief Judge J. Harvie Wilkinson III found:

Section 1327(c) states that the property covered by a Chapter 13 plan is free and clear of only those claims of creditors that the plan addresses. Under the plain terms of the statute, therefore, property of a Chapter 13 debtor can be subject to the continuing claims of creditors so long as those claims were not "provided for" by the debtor's Chapter 13 reorganization plan.<sup>217</sup>

Under § 1141(c), the plan need only deal with property of the bankruptcy estate.<sup>218</sup> If it does, then the property is cleansed of all liens, unless the plan says otherwise.<sup>219</sup> The distinction between the chapters, Judge Wilkinson wrote, is

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such interest." 11 U.S.C. § 363(f)(5) (2006). Although the judgment creditor certainly received no money, it was at least capable of being compelled to take money in, for example, the senior lender's foreclosure proceeding. Also, a free-and-clear sale is permitted if "applicable nonbankruptcy law permits sale of such property free and clear of such interest." § 363(f)(1). Arguably, because the senior lender consented to the procedure, it had, in effect, conveyed its mortgage to the bankruptcy trustee, who then used the senior power of sale to dispatch the junior judicial lien.

211. *In re Ahern*, 507 F.3d at 819.

212. *Id.*

213. *Id.* at 819, 825.

214. *Id.* at 820 (quoting § 1141(c)). In *In re Ahern*, the plan had a clause in it that stated that the plan was binding only "[u]pon consummation of the Plan." *Id.* at 824 (quoting art. 8.14 of Plan) (internal quotation marks omitted). Judge Jolly concluded that § 1141(c) works to avoid liens even if the bindingness of the plan is generally deferred to some future time. *In re Ahern*, 507 F.3d at 824–25.

215. *Id.* at 823.

216. 254 F.3d 528 (4th Cir. 2001).

217. *In re Reg'l Bldg. Sys.*, 254 F.3d at 532. Judge Wilkinson similarly interpreted § 1327(c)'s "provided for" language in *Cen-Pen Corp. v. Hanson*, 58 F.3d 89, 94 (4th Cir. 1995).

218. 11 U.S.C. § 1141(c) (2006).

219. *Id.*

“quite sensible.”<sup>220</sup> Chapter 13 is a consumer chapter.<sup>221</sup> Chapter 13 debtors do not always operate a business.<sup>222</sup> Chapter 13 creditors do not vote on the plan.<sup>223</sup> Chapter 13 invites creditors to “ignore” secured claims (which then pass through the bankruptcy unaffected).<sup>224</sup> Chapter 11 does not permit the debtor to ignore secured claims.<sup>225</sup> Because creditors vote in Chapter 11, they need definitive information about property of the estate.<sup>226</sup> All of this was identified as the intent of Congress as wisely embodied in the wording differences in § 1327(c) and § 1141(c).<sup>227</sup>

None of this is entirely convincing. For one thing, whatever § 1327(c) and § 1141(c) may say, § 1327(a) and § 1141(a) provide that confirmation of a plan binds the creditors. According to § 1141(a),

the provisions of a confirmed plan bind . . . any creditor . . . whether or not the claim . . . of such creditor . . . is impaired under the plan and whether or not such creditor . . . has accepted the plan.<sup>228</sup>

Section 1327(a) states that

[t]he provisions of a confirmed plan bind . . . each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan.<sup>229</sup>

Whatever differences exist in § 1327(c) and § 1141(c), these differences are erased by the two above-quoted statutes, which make the plan binding on creditors. But even if we ignore § 1141(a) and § 1327(a) and put on blinders to examine § 1141(c) and § 1327(c) only, the distinction proposed in *Regional Building Systems* is simply not believable. If Chapter 13 proclaims that a claim is unsecured, why is not that claim “provided for by the plan,” within the meaning of § 1327(c)? If it is, the plan has killed off the lien.

The Supreme Court itself has said as much. In *Rake v. Wade*,<sup>230</sup> the Court interpreted “provided for by the plan” to mean simply that the plan “‘makes a provision’ for, ‘deals with,’ or even ‘refers to’ a claim.”<sup>231</sup> Any plan that describes

220. *In re Reg'l Bldg. Sys.*, 254 F.3d at 532.

221. *Id.*

222. *Id.* This is likewise true of Chapter 11 debtors. See *Toibb v. Radloff*, 501 U.S. 157, 166 (1991) (holding that individuals not in business are eligible for Chapter 11).

223. *In re Reg'l Bldg. Sys.*, 254 F.3d at 532. But see *In re Chappell*, 984 F.2d 775, 782 (7th Cir. 1993) (noting that creditor's failure to object to Chapter 13 plan's confirmation is considered acceptance of plan).

224. *In re Reg'l Bldg. Sys.*, 254 F.3d at 532.

225. *Id.*

226. *Id.*

227. *Id.* at 533.

228. 11 U.S.C. § 1141(a) (2006).

229. § 1327(a).

230. 508 U.S. 464 (1993).

231. *Rake*, 508 U.S. at 474. In *Rake*, debtors proposed to cure past defaults on a mortgage without paying interest to compensate for the delayed payment. *Id.* at 466. The Court held that reinstated mortgages are entitled to the cramdown protections of § 1325(a)(5), which refers to “‘each allowed secured claim provided for by the plan.’” *Id.* at 473 (quoting § 1325(a)(5)). To be precise, the Court made its remark with regard to § 1328(a)(1)—Chapter 13's discharge provision. *Id.* at 474.

a creditor as unsecured therefore “provides for” that claim. Hence § 1327(c) applies to kill off the lien (unless due process constitutionally proclaims otherwise).<sup>232</sup>

Yet the opinion in *Regional Building Systems* has a certain “legal realist” validity. Chapter 11 is slow and deliberative. Chapter 13 is a madhouse where mistakes are quite common. Perhaps res judicata should mean less in Chapter 13 under the circumstances. But it is certainly hard to justify this directly from the text of Chapter 13. The issue cannot be whether “provided for” in § 1327(c) means “give the secured creditor everything she is entitled to.” The issue must be of a constitutional dimension: Can the secured creditor be deprived of a lien without an adversary proceeding, and does due process require that the procedures of the Bankruptcy Rules be followed? If the answers are no and yes respectively, then whatever the rule for Chapter 13 is, this must also be the rule for Chapter 11, as the Constitution, tickling skittish spirit though it may be, does not change meaning from chapter to chapter in bankruptcy litigation.

*Penrod* empowers the plan to kill liens without an adversary proceeding, provided the secured creditor “participate[s]” in the reorganization proceeding.<sup>233</sup> This requirement offers courts the opportunity to undermine res judicata by finding that the creditor did not, somehow, participate. In *Federal Deposit Insurance Corp. v. Union Entities (In re Be-Mac Transport Co.)*,<sup>234</sup> an oversecured creditor erroneously filed a proof of claim showing itself to be unsecured.<sup>235</sup> The plan was drafted accordingly, but a little before confirmation, the secured creditor sought to amend its proof of claim to show its oversecured state.<sup>236</sup> The bankruptcy court ruled that the amendment was too late and confirmed the plan on the bifurcation that the secured party initially proposed in the original proof of claim.<sup>237</sup> The secured creditor appealed the confirmation order.<sup>238</sup> The Eighth Circuit Court of Appeals ruled that confirmation was improper.<sup>239</sup> It went further, however, and implied that, even if the secured creditor had not appealed the confirmation order, the plan would have no res judicata worth.<sup>240</sup>

Here, the [secured creditor] was not permitted to participate as a secured creditor in the reorganization for purposes of voting and distribution because its second amended proof of claim had been denied . . . . Since the [secured creditor] could only vote on the plan and receive distributions as an unsecured creditor, its lien was never brought into the bankruptcy

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232. Judge Lundin makes two good statutory points about this interpretation of “provided for” in § 1327(c). First, it makes § 1327(c) entirely redundant of the cramdown provision; second, it “drains of meaning the introductory phrase ‘except as otherwise provided in the plan or the order confirming the plan.’” 3 LUNDIN, *supra* note 177, § 234.1.

233. *In re Penrod*, 50 F.3d 459, 463 (7th Cir. 1995).

234. 83 F.3d 1020 (8th Cir. 1996).

235. *In re Be-Mac Transp.*, 83 F.3d at 1022.

236. *Id.* at 1022–23.

237. *Id.* at 1023–24.

238. *Id.* at 1024.

239. *Id.* at 1027.

240. *In re Be-Mac Transp.*, 83 F.3d at 1027.

proceedings and could therefore not be extinguished by confirmation of the plan.<sup>241</sup>

Citing § 506(d)(2), Judge Diana E. Murphy held that the confirmed plan could not treat the creditor as unsecured and that the security interest must pass through bankruptcy unaffected by the plan.<sup>242</sup> Such a holding is a very shaky reading of § 506(d)(2), which provides:

(d) To the extent that a lien secures a claim against the debtor that is not an allowed secured claim, such lien is void, unless . . . (2) such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title.<sup>243</sup>

If *no* proof of claim had ever been filed, citation of § 506(d)(2) would certainly have been appropriate. But, in *Be-Mac Transport*, the secured party *did* file a proof of claim, which constitutes prima facie evidence of the amount of collateral to which the secured party is entitled.<sup>244</sup>

A better interpretation of this case is that it stands for this: res judicata may be ignored if, somehow, the creditor's "participation" in the Chapter 11 proceeding was defective. In *Be-Mac Transport*, the secured creditor was not permitted to participate *as a secured creditor* (though it participated as an unsecured creditor). Participation did not exist because the secured creditor was wrongly made to adhere to its original proof of claim. In effect, by amending its proof of claim, the secured creditor terminated its participation in Chapter 11.<sup>245</sup> It therefore would have escaped the ill aspects of res judicata (even if it had not appealed from the confirmation order).

*Be-Mac Transport* may be compared to *Regional Building Systems*,<sup>246</sup> discussed earlier.<sup>247</sup> In *Regional Building Systems*, a creditor thought its collateral was gone and so filed a proof of claim as an unsecured creditor.<sup>248</sup> Just before confirmation, the debtor-in-possession achieved a settlement of a lawsuit that was

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241. *Id.*

242. *Id.*

243. 11 U.S.C. § 506(d)(2) (2006).

244. See FED. R. BANKR. P. 3001(f) (indicating that filing proof of claim establishes prima facie evidence of claim's value and validity).

245. *In re Be-Mac Transp.*, 83 F.3d at 1023. Lack of participation was found to be an "out" from the *Penrod* rule in *In re Swanson*. 312 B.R. 153, 155 (Bankr. N.D. Ill. 2004). The court had confirmed a Chapter 13 plan that listed the IRS as a creditor, but not as a secured creditor. *Id.* The IRS did not lose its lien, however. *Id.* at 160–61. The court read *Penrod*'s "participation" condition to mean that, if a creditor is not expressly mentioned as having a lien, it has not "participated." *Id.* Therefore, its lien is not eliminated. *Id.* But such a holding completely undermines *Penrod*. In that case, the secured creditor was to be paid in full, but nothing was said about the lien. *In re Penrod*, 50 F.3d 459, 461 (7th Cir. 1995). The lien was therefore lost. *Id.* at 462–63. In *Swanson*, the IRS was to be paid in full but nothing was said about the lien. *In re Swanson*, 312 B.R. at 155. These are *precisely* the facts in *Penrod*.

246. Universal Suppliers, Inc. v. Reg'l Bldg. Sys., Inc. (*In re Reg'l Bldg. Sys., Inc.*), 254 F.3d 528 (4th Cir. 2001).

247. See *supra* notes 216–27 and accompanying text for a discussion of *Regional Building Systems*.

248. *In re Reg'l Bldg. Sys.*, 254 F.3d at 529–30.

apparently encumbered by the creditor's prepetition security agreement.<sup>249</sup> A month after the settlement was approved, the Chapter 11 plan was confirmed, treating the creditor as unsecured (consistent with the proof of claim).<sup>250</sup> The creditor did not object to the plan.<sup>251</sup> Later, it claimed a lien on the settlement on the theory that a plan cannot terminate a security interest without filing an adversary proceeding.<sup>252</sup> Judge Wilkinson held that res judicata prevented the creditor's postconfirmation assertion of its lien.<sup>253</sup>

Can the two cases be reconciled? In *Be-Mac*, the creditor objected to confirmation, though the court wrote as if the plan was incompetent to eliminate the lien whether the creditor objected or not. In *Regional Building*, there was no objection, and res judicata was given full reign. Perhaps the distinction is this: where an erroneous proof of claim is filed, the secured creditor is "participating" in the proceeding and is subject to the res judicata effects of the plan, but where the proof of claim is somehow withdrawn prior to confirmation, the creditor is not "participating," and therefore the plan has no res judicata worth.

Other examples of res judicata respect for lien avoidance can be found. In *Countrywide Home Loans v. Davis (In re Davis)*,<sup>254</sup> a debtor's Chapter 13 plan treated his home mortgage as unperfected.<sup>255</sup> The creditor did not object, and the plan was confirmed.<sup>256</sup> Later, the creditor moved to lift the automatic stay.<sup>257</sup> At the hearing, counsel sought three remedies: modification of the plan, a declaration that the debtor had to file an adversary proceeding to kill off the lien, and denial of discharge.<sup>258</sup> The bankruptcy court refused to lift the stay, citing the res judicata effect of the plan.<sup>259</sup> The creditor did not appeal from denial of relief from the stay.<sup>260</sup> Instead, the creditor filed an adversary proceeding for a declaration that the creditor had a valid mortgage.<sup>261</sup>

The bankruptcy court granted relief to the creditor, but the appellate courts reversed.<sup>262</sup> Both the appellate panel and the court of appeals thought that the denial of relief from the automatic stay on the basis of res judicata had res judicata worth.<sup>263</sup> Therefore, the creditor was not entitled to litigate whether it had properly perfected its mortgage lien.<sup>264</sup>

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249. *Id.* at 530.

250. *Id.*

251. *Id.*

252. *Id.* at 531.

253. *In re Reg'l Bldg. Sys.*, 254 F.3d at 533.

254. 188 F. App'x 671 (10th Cir. 2006).

255. *In re Davis*, 188 F. App'x at 672.

256. *Id.* at 673.

257. *Id.*

258. *Id.*

259. *Id.* at 673–74.

260. *In re Davis*, 188 F. App'x at 674.

261. *Id.*

262. *Id.* at 674–75.

263. *Id.* at 676.

264. *Id.*

An appellate panel has ruled that confirmation of a Chapter 13 plan can destroy the security interests of a creditor even if she has never filed a claim in the debtor's bankruptcy. In *Factors Funding Co. v. Fili (In re Fili)*,<sup>265</sup> a secured creditor did not show up to protest a plan that allocated it nothing.<sup>266</sup> The debtor thereafter objected to the secured creditor's postconfirmation proof of claim on grounds of res judicata.<sup>267</sup> The bankruptcy court sustained the objection, and the bankruptcy appellate panel affirmed.

[I]n the face of notice that timely and unambiguously informs a creditor that his claim will be disallowed in total and discharged under a Chapter 13 plan pending for confirmation, the creditor may not ignore the confirmation process and fail to object simply because the bar date for filing a proof of claim has yet to expire.<sup>268</sup>

This holding is radical in two ways. First, it repeals the old saw that a secured creditor can ignore a bankruptcy proceeding and rely on her lien.<sup>269</sup> Under *Fili*, she can lose the lien if the plan provides for its loss, even where there is no adversary proceeding. Second, under *Fili*, confirmation terminates the bar date early. This Article will have much to say later on bar dates scheduled after plan confirmation.<sup>270</sup>

## 2. Strong-Arm Cases

Cases like *Mansary-Ruffin* that preserve liens from the res judicata effects of a plan have merit, but a case turning on the strong-arm power should be viewed as proceeding on a different basis. According to § 544(a), a bankruptcy trustee has "the rights and powers" of a hypothetical judicial lien creditor as of the time of the bankruptcy petition, and the trustee "may avoid any transfer of property of the debtor" voidable by a lien creditor.<sup>271</sup> "Rights/powers" and "avoidance" are two different concepts entirely. Let us consider how this provision plays out against an unperfected security interest in personal property.

According to section 9-317(a)(2) of the Uniform Commercial Code ("UCC"), an unperfected security interest is "subordinate to the rights of . . . a person that becomes a lien creditor before . . . the security interest . . . is perfected."<sup>272</sup> To make the matter concrete, imagine that *D* has a thing worth \$100 and grants a security interest to *SP* in exchange for \$80. *SP* forgets to perfect. *C* obtains a money

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265. 257 B.R. 370 (B.A.P. 1st Cir. 2001).

266. *In re Fili*, 257 B.R. at 371.

267. *Id.*

268. *Id.* at 374; accord *In re Bryant*, 323 B.R. 635, 640 (Bankr. E.D. Pa. 2005) (holding that creditor who had notice and had not objected prior to confirmation to debtor's Chapter 13 plan in prior case was precluded from subsequently challenging treatment of its claim).

269. See *Cen-Pen Corp. v. Hanson*, 58 F.3d 89, 92 (4th Cir. 1995) (noting that traditional rule holds that property remains subject to security interest following confirmation unless debtor takes affirmative action to avoid security interest).

270. See *infra* Part III.B for a discussion of the courts' treatment of plans confirmed prior to the bar date and the impact on court decisions based on where in the process a proof of claim is filed.

271. 11 U.S.C. § 544(a) (2006).

272. U.C.C. § 9-317(a)(2) (2008).



judgment against *D* for \$500. Pursuant to a writ of execution from the court, *C* becomes a lien creditor when the sheriff levies the thing.

On these facts, we know that *SP* is subordinated. What precisely does this mean? The drafters of the UCC have not troubled to explain.<sup>273</sup> But it must mean this: *C*'s judicial lien encumbers *D*'s \$20 equity, of course, but it also encumbers *SP*'s lien. When we say that *C* is senior to *SP*, what we are really saying is that *C*'s lien encumbers *SP*'s lien. For the moment there are three property claimants, *C*, *SP*, and *D*. *C* has foreclosure power over *D* and *SP*.

Suppose the sheriff holds an execution sale where *B* is the buyer. *C*'s seniority implies that *C* can sell all three property interests to *B*—*D*'s equity, *SP*'s lien, and *C*'s lien. All three of these property interests are foreclosed, and *B* is the absolute owner by virtue of merging these three interests together. Accordingly, after *C* became a lien creditor, *SP*'s unperfected security interest continued to exist, for a time. But it was inherently foreclosable by *C*. Once the foreclosure sale was accomplished, *SP* was foreclosed.

Translating this to bankruptcy, the trustee is like *C*—someone who has become a lien creditor. *SP*'s unperfected security interest is subordinated but not, for the moment, destroyed. But *SP*'s security interest will die as soon as a sale occurs. In a Chapter 7 case, a sale might occur under the purview of § 363. If out of the ordinary course of a debtor's business, such a sale requires court approval.<sup>274</sup> If the court approves, the sale destroys the unperfected security interest without any need for an adversary proceeding or the like.

In *GAF Linden Employees Federal Credit Union v. Robertson (In re Robertson)*,<sup>275</sup> Judge Duncan W. Keir speculated that a Chapter 7 trustee

can dispose of the asset and treat the proceeds consistent with the priorities established by state law vis-à-vis the unperfected security interest. . . . Thus, without exercising any avoidance action, the Chapter 7 trustee may sell the asset and first disburse the proceeds to the benefit of the estate, paying all allowed claims and disbursements in accordance with 11 U.S.C. § 726. . . .

If the disposition of the asset (and liquidation of other assets of the estate) is sufficient to fully pay all claims . . . and the claim of the unperfected security interest holder has been allowed as unsecured and has been paid in full with other claims, the lien is terminated by reason of satisfaction of the underlying indebtedness. If there is such a surplus but the creditor did not file a proof of claim or otherwise is not allowed an unsecured claim, the surplus proceeds of the collateral would go to the creditor on account of its subordinated unperfected security interest, to the extent of the unpaid balance of the secured debt. The unperfected

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273. For the meaning of "subordination" before the 2000 amendments to the UCC, see generally David Gray Carlson, *Death and Subordination Under Article 9 of the Uniform Commercial Code: Senior Buyers and Senior Lien Creditors*, 5 CARDOZO L. REV. 547 (1984). For the situation after the 2000 amendments, see David Gray Carlson, *Critique of Money Judgment (Part Two: Liens on New York Personal Property)*, 83 ST. JOHN'S L. REV. 43, 55–65 (2009).

274. 11 U.S.C. § 363(b) (2006).

275. 232 B.R. 846 (Bankr. D. Md. 1999).

security interest is subordinated to the trustee in bankruptcy . . . but not to the non-bankruptcy estate interests of the debtor. As between the debtor's individual non-estate interests and the secured party, the unperfected security interest is valid as between debtor and creditor.<sup>276</sup>

Judge Keir theorized that if the Chapter 7 trustee relied on § 544(a) alone, an adversary proceeding would be required to destroy an unperfected security interest. But bankruptcy trustees are directly named lien creditors by the UCC itself.<sup>277</sup> This state-law reference, Judge Keir thought, was needed to make his theory work. But in fact this is not so. One of the rights of the trustee is priority over *SP*. One of the powers is the ability to sell free and clear. The strong-arm power makes reference to the "rights and powers" of a judicial lien creditor.<sup>278</sup> Even if the UCC had not awarded the bankruptcy trustee status of the lien creditor, federal law does so, and that suffices to vindicate Judge Keir's theory.

In Chapter 7, sale of the collateral is free and clear of the unperfected security interest, whether or not there has been an adversary proceeding. Confirmation of a reorganization plan must be considered a sale, which has the effect of destroying all unperfected security interests. In the context of Chapter 11, § 1141(b) establishes the principle: "Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor."<sup>279</sup> In Chapter 13, § 1327(b) is to the same effect.<sup>280</sup>

So, in the context of the confirmation of a plan, which treats *SP* as an unsecured creditor, confirmation transfers to *D* whatever debtor equity *D* had before the bankruptcy, the trustee's senior lien, and *SP*'s subordinated unperfected security interest. These coalesce in *D* and make *D* the owner free and clear of *SP*, without any need to commence an adversary proceeding.

Something very much like this is asserted by Judge Keir in *Robertson*, where a Chapter 13 plan treated an unperfected security interest as nonexistent.<sup>281</sup> The creditor was treated as unsecured by the plan.<sup>282</sup> When the unperfected secured party sought a declaration that its security interest still existed, Judge Keir denied the relief.<sup>283</sup> Judge Keir did not go so far as to equate confirmation of the plan with a

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276. *In re Robertson*, 232 B.R. at 851.

277. U.C.C. § 9-102(a)(52)(C).

278. According to Bankruptcy Code § 544(a), "[t]he trustee shall have, as of the commencement of the case, . . . the rights and powers of . . . (1) a creditor . . . [with] a judicial lien on all property on which a creditor on a simple contract could have obtained such a judicial lien." 11 U.S.C. § 544(a)(1) (2006).

279. § 1141(b).

280. Sections 1141(c) and 1327(c) repeat the idea. According to § 1141(c): "Except as provided in subsections (d)(2) and (d)(3) of this section and except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor." § 1141(c). Similarly, according to § 1327(c): "Except as otherwise provided in the plan or in the order confirming the plan, the property vesting in the debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan." § 1327(c).

281. *In re Robertson*, 232 B.R. at 852.

282. *Id.* at 853.

283. *Id.*

judicial lien foreclosure, but nothing he said contradicts this idea, and it perfectly explains the result reached.<sup>284</sup>

One impediment to this theory is that the strong-arm power, like the genuine avoidance powers, is vested in the bankruptcy trustee. Thus, § 544(a) indicates that the *trustee* shall have the strong-arm power.<sup>285</sup> Section 547(b) indicates that the *trustee* may avoid preferences.<sup>286</sup> Yet, in Chapter 13, the debtor—not a trustee—writes the plan,<sup>287</sup> triggering the sale that terminates the unperfected security interest. A majority of courts have found that a Chapter 13 debtor does *not* have avoidance powers.<sup>288</sup>

The question of standing does not pertain in Chapters 11 or 12. In Chapter 11, § 1107(a) states specifically that “a debtor in possession shall have all the rights . . . and powers, and shall perform all the functions and duties . . . of a trustee serving in a case under this chapter.”<sup>289</sup> Section 1203, which usually follows the Chapter 13 pattern, replicates the Chapter 11 delegation.<sup>290</sup> The analogous Chapter 13 provision gives the debtor certain powers, but avoidance powers are not among them. According to § 1303:

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284. Judge Keir makes an excellent point. If the unperfected security interest is valid in the absence of an adversary proceeding, then *SP* has cramdown rights under § 1325(a)(5). In order for *D* to retain the collateral, the plan would have to pay *SP* the value of the car. Meanwhile, the other unsecured creditors must be paid what they would have received in Chapter 7. This amount would be calculated as if *SP* had no security interest (because in Chapter 7 the unperfected security interest on the car could be avoided). So, if *SP* were to prevail, *D* would be forced to pay for the car twice over in a Chapter 13 case. “This is contrary to the purpose and provisions of Chapter 13 . . . .” *Id.* at 852; *see also* *Houston v. Eiler (In re Cohen)*, 305 B.R. 886, 897 (B.A.P. 9th Cir. 2004) (describing odd system that requires Chapter 13 debtor to depend on recovery of avoidance transfer to have confirmable plan but also disallowing debtor to avoid transfer).

285. § 544(a).

286. § 547(b).

287. § 1321 (“The debtor shall file a plan.”). To my knowledge, this is the shortest federal statute on the books—the “Jesus wept” of the United States Code.

288. *Stangel v. United States (In re Stangel)*, 219 F.3d 498, 501 (5th Cir. 2000); *Realty Portfolio, Inc. v. Hamilton (In re Hamilton)*, 125 F.3d 292, 296 (5th Cir. 1997) (but finding debtor standing to recover exempt property under § 522(h)); *Hansen v. Green Tree Servicing, LLC (In re Hansen)*, 332 B.R. 8, 16 (B.A.P. 10th Cir. 2005); *LaBarge v. Benda (In re Merrifield)*, 214 B.R. 362, 364 (B.A.P. 8th Cir. 1997); *Crawley v. Aurora Loan Servs. (In re Crawley)*, 318 B.R. 512, 515–16 (Bankr. W.D. Wis. 2004); *Ryker v. Current (In re Ryker)*, 315 B.R. 664, 669–70 (Bankr. D.N.J. 2004); *Wood v. Mize (In re Wood)*, 301 B.R. 558, 561–62 (Bankr. W.D. Mo. 2003) (cataloguing cases); *In re Binghi*, 299 B.R. 300, 306 (Bankr. S.D.N.Y. 2003); *In re Steck*, 298 B.R. 244, 247–48 (Bankr. D.N.J. 2003) (permitting, however, debtor to pursue strong-arm theory on exempt property under § 522(h)); *Montoya v. Boyd (In re Montoya)*, 285 B.R. 490, 493 (Bankr. D.N.M. 2002); *Holcombe v. Debis Fin. Servs., Inc. (In re Holcombe)*, 284 B.R. 141, 143 (Bankr. N.D. Ala. 2001); *LR Partners v. Steiner (In re Steiner)*, 251 B.R. 137, 139–40 (Bankr. D. Ariz. 2000) (permitting, however, debtor to pursue strong-arm theory on exempt property under § 522(h)); *Hacker v. Hodges (In re Hacker)*, 252 B.R. 221, 223 (Bankr. M.D. Fla. 2000).

289. § 1107(a).

290. § 1203; *see In re Merrifield*, 214 B.R. 362, 364 (B.A.P. 8th Cir. 1997) (stating that in Chapter 11 and Chapter 12 cases, “*debtors in possession* enjoy the powers of a trustee”); *Hearn v. Bank of N.Y. (In re Hearn)*, 337 B.R. 603, 608 (Bankr. E.D. Mich. 2006) (stating Chapter 11 and 12 debtors have more rights and powers than Chapter 13 debtors).

Subject to any limitations on a trustee under this chapter, the debtor shall have, exclusive of the trustee, the rights and powers of a trustee under sections 363(b), 363(d), 363(e), 363(f), and 363(l) of this title.<sup>291</sup>

The entire standing controversy, however, can be avoided in the case of the strong-arm power. It is the sale of property of the estate that terminates the unperfected security interest, not an “avoidance power,” which requires an adversary proceeding. And confirmation of a plan constitutes a *sale* of the property of the estate (including the property encumbered by the unperfected security interest) to an entity (here, the debtor) free and clear of the security interest.

A different problem arises when the unperfected secured party has filed a proof of claim asserting a valid lien. Proofs of claim are supposed to be prima facie evidence of the claim on behalf of the creditor.<sup>292</sup> Parties in interest are supposed to object to the claim under Rule 3007; otherwise it is allowed as “proved.” But this is not properly an impediment. *SP* *does* have a secured claim during the pendency of the reorganization proceeding. Confirmation of the plan, however, kills it off, whether a party in interest objects or not.<sup>293</sup> The proof of claim may be accurate at the time it is filed, but subsequent sale/confirmation terminates the unperfected security interest.

Although Judge Keir in *Robertson* ably theorizes the unperfected security interest, there is another impediment. How can this holding be reconciled with the Fourth Circuit’s earlier opinion in *Cen-Pen Corp. v. Hanson*?<sup>294</sup> In *Cen-Pen*, the debtors conveyed a mortgage to a lender, who properly recorded the mortgage deed.<sup>295</sup> The debtors then sued the lender for violations of the Truth in Lending Act.<sup>296</sup> In settlement, the lender and the debtors agreed that the debtors would get refinancing, in exchange for which the lender would release the mortgage lien.<sup>297</sup> Foolishly, the lender signed the release before being paid.<sup>298</sup> The crafty debtors then filed for Chapter 13 protection.<sup>299</sup> They wrote a plan that treated the lender as unsecured.<sup>300</sup> The lender never objected to the plan.<sup>301</sup>

According to Judge Wilkinson, the plan was incompetent to terminate the mortgage because no adversary proceeding was filed.<sup>302</sup> But based on what has been asserted, the case is wrongly decided. The mortgage should have been

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291. § 1303.

292. See FED. R. BANKR. P. 3001(f) (stating that proof of claim executed and filed in accordance with Federal Rules of Bankruptcy Procedure “shall constitute prima facie evidence” of claim’s amount and validity).

293. See *In re Lewis*, 363 B.R. 477, 482 (Bankr. D.S.C. 2007) (holding that creditor’s security interest was subject to avoidance because it was subordinate to Chapter 13 trustee’s rights).

294. 58 F.3d 89 (4th Cir. 1995).

295. *Cen-Pen*, 58 F.3d at 91.

296. *Id.*

297. *Id.*

298. *Id.*

299. *Id.*

300. *Cen-Pen*, 58 F.3d at 91.

301. *Id.*

302. *Id.* at 93.

terminated by the very fact that the plan was confirmed. In fact, it was not the plan that killed the lien. It was the strong-arm power. As of the time of the bankruptcy petition, the trustee was a bona fide purchaser of the debtors' real property.<sup>303</sup> Such a purchaser takes free and clear of the mortgage lien<sup>304</sup> long before the plan was confirmed.<sup>305</sup> Confirmation of the plan stands for the moment when the debtor (as buyer) finally took free and clear of the mortgage.

To summarize, *Cen-Pen* seems to contradict *Robertson*, which held that confirmation of a plan destroys unperfected liens.<sup>306</sup> But *Robertson* is on sound theoretical footing, as the trustee has the rights and powers of a judicial lien

303. 11 U.S.C. § 544(a)(3) (2006).

304. See *Bacon v. Van Schoonhoven*, 87 N.Y. 446, 449–50 (1882) (holding that bona fide purchaser took free of mortgage where lender issued erroneous satisfaction). If § 544(a)(3) means that the trustee takes a fee simple interest as bona fide purchaser, the lender's equitable mortgage died at the moment the bankruptcy petition was filed. The better view is that the trustee is a mortgagee—a creditor representative. In such a case, confirmation (not the bankruptcy petition) kills the lien. David Gray Carlson, *Bankruptcy's Organizing Principle*, 26 FLA. ST. U. L. REV. 549, 560–65 (1999).

305. There is a second aspect to *Cen-Pen* worth addressing. The debtors' plan had a clause stipulating that any secured claim for which a proof of claim was never filed is void. *Cen-Pen*, 58 F.3d at 92. The court ruled that such a plan term was worthless. *Id.* According to § 506(d), a lien securing a claim that is not an allowed claim is void, *unless* "such claim is not an allowed secured claim due only to the failure of any entity to file a proof of such claim under section 501 of this title." § 506(d)(2). This language "was intended 'to make clear that the failure of the secured creditor to file a proof of claim is not a basis for avoiding the lien of the secured creditor.'" *Cen-Pen*, 58 F.3d at 93–94 (1983) (quoting *In re Tarnow*, 749 F.2d 464, 467 (7th Cir. 1984)). If a secured creditor files a proof of claim, she has an "allowed secured claim." *Cen-Pen*, 58 F.3d at 93. If she does not file a proof of claim, she has a valid lien, but no allowed secured claim. § 506(d)(2). In light of these well accepted definitions, it is pertinent to ask: Where in Chapter 13 does it say that lien creditors are entitled to anything at all? There are two such sources. First, § 1325(a)(5) gives cramdown rights, but only to creditors with "allowed secured claim[s]." § 1325(a)(5). If we read the Bankruptcy Code literally, we would have to admit that creditors are entitled to cramdown rights only when they have allowed secured claims. *But see In re Hudson*, 260 B.R. 421, 438 (Bankr. W.D. Mich. 2001) (stating that if proof of claim is untimely filed, "the secured portion of the claim, as determined by the plan confirmation process, is deemed allowed because there is no bar date for secured claims"). That there is no bar date for secured claims seems a non sequitur on the issue of whether a secured claim without a proof of claim is an allowed secured claim. According to § 502(a), a claim, "proof of which is filed under section 501 of this title, is deemed allowed." § 502(a). The negative pregnant of this provision is that claims without a proof of claim are not allowed. Also, the *Hudson* court contradicted itself when it asserted that secured creditors who never file proofs of claim cannot have distributions under the plan. *In re Hudson*, 260 B.R. at 431. If they really have allowed claims, they are entitled to distributions under Rule 3021. FED. R. BANKR. P. 3021. Where there is no proof of claim, there can be no cramdown rights. The second source is the best-interest-of-creditors test in § 1325(a)(4). According to this test, every creditor is entitled to receive at least as much under the plan as she would have received from a Chapter 7 liquidation. In Chapter 7, secured creditors obtain distributions under § 725, where there is no reference to an allowed claim. Therefore, creditors such as the one in *Cen-Pen* have a lien by virtue of this test only. Yet, in Chapter 7, the unperfected equitable lien could be avoided by the trustee. This is a point ignored by almost all courts, which seem to assume that cramdown rights do not turn on the existence of an allowed secured claim.

306. See *GAF Linden Employees Fed. Credit Union v. Robertson (In re Robertson)*, 232 B.R. 846, 851 (Bankr. D. Md. 1999) (stating that unperfected security interests in property are subordinate to bankruptcy estates' interests in property, "without regard to the chapter under which the case is pending").

creditor and also of a bona fide purchaser of real property under state law.<sup>307</sup> Because of this status, no adversary proceeding is required to kill the lien. Plan confirmation or sale does so.

The obverse situation may exist as well. Creditors whose liens are honored in the plan may try to claim that *res judicata* bars avoidance in a later adversary proceeding. In *Celli v. First National Bank of Northern New York (In re Layo)*,<sup>308</sup> a mortgage lender had “inadvertently discharged” the mortgage.<sup>309</sup> Accordingly, the Chapter 13 trustee’s status as a purchaser of the debtor’s property was senior to the (basically) unrecorded mortgage. When the plan was confirmed, the debtor “bought” the property free and clear of the mortgage. Unfortunately, the plan itself confirmed the existence of the mortgage, and so the mortgage lender obtained the benefit of *res judicata*.<sup>310</sup> Had the plan proclaimed the mortgage dead, the mortgage would have been terminated, even in the absence of an adversary proceeding.

In contrast, in *Hildebrand v. Hays Imports, Inc. (In re Johnson)*,<sup>311</sup> the plan referenced an unperfected security interest as being a secured claim.<sup>312</sup> The secured creditor asserted that the plan was entitled to *res judicata* and that the lien could not therefore be avoided.<sup>313</sup> Judge Keith M. Lundin (the reigning genius of Chapter 13) read the plan as saying nothing about allowance of claims<sup>314</sup> (while holding open the possibility that it *could* have established the validity of claims).<sup>315</sup> Therefore, the Chapter 13 trustee was not precluded from objecting to the claim on the ground that it was voidable. A point that Judge Lundin missed is that the unperfected security interest was already dead by the mere fact that the plan was confirmed. Confirmation of the plan is itself a sale that destroys unperfected

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307. This strong-arm theory might explain the result of the confusing case of *Wallis v. Justice Oaks II, Ltd. (In re Justice Oaks II, Ltd.)*, 898 F.2d 1544 (11th Cir. 1990). In this case, a debtor settled with various mortgage lenders by selling the property partly on credit. *In re Justice Oaks II*, 898 F.2d at 1546. Guarantors of one of the loans (who had not then paid on their obligation) objected to confirmation and also commenced an adversary proceeding to declare that they had an equitable lien on the proceeds of the sale, because they had been defrauded into guaranteeing a lender. *Id.* at 1547. Over the objection of the guarantors, the bankruptcy court confirmed a Chapter 11 plan. *Id.* at 1547–48. The guarantors made no effective appeal. *Id.* at 1548. Later, the bankruptcy court dismissed the guarantor’s adversary proceeding on *res judicata* grounds; plan confirmation ended any equitable lien. *Id.* This was upheld on appeal. *Id.* at 1554. If confirmation of a plan constitutes the foreclosure of the debtor-in-possession’s senior bona fide purchaser rights, the guarantor’s equitable lien (assuming it existed) would have disappeared at confirmation of the plan.

308. 460 F.3d 289 (2d Cir. 2006).

309. *In re Layo*, 460 F.3d at 291 (quoting stipulation of parties).

310. *Id.* at 291, 295–96.

311. 279 B.R. 218 (Bankr. M.D. Tenn. 2002).

312. *In re Johnson*, 279 B.R. at 219–20.

313. *Id.* at 220–21.

314. *See id.* at 221 (observing that confirmed Chapter 13 plan neither allowed nor disallowed any claim).

315. *See id.* at 224 (noting, but discouraging, plans stating that confirmation will allow all claims); *see also In re Fareed*, 262 B.R. 761, 768 (Bankr. N.D. Ill. 2001) (stating that debtors may choose to treat claims as allowed or may propose payment terms irrespective of allowance process).

security interests. So, even if the plan did not indicate that the lien was destroyed, confirmation nevertheless destroyed it.<sup>316</sup>

### 3. Valuation of Collateral

According to Bankruptcy Code § 506(a)(1):

An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . and is an unsecured claim to the extent that the value of such creditor's interest . . . is less than the amount of such allowed claim. Such value shall be determined in light of the purpose of the valuation and of the proposed disposition or use of such property, and *in conjunction with any hearing on such disposition or use or on a plan affecting such creditor's interest*.<sup>317</sup>

This all-important provision takes an undersecured claim and cleaves it in twain, so that the creditor has a perfectly secured and perfectly unsecured claim, based on the valuation of the collateral.<sup>318</sup>

Avoidance of a lien goes to the “validity, priority, or extent of a lien.”<sup>319</sup> It should be apparent that these terms do *not* mean that an adversary proceeding is required to determine the value of the collateral. The italicized language from § 506(a) indicates as much. “Value” is what bifurcates an undersecured claim in twain. Bifurcation does not implicate the *validity* of the lien. As one court put it: “[T]he term ‘validity’ means the existence or legitimacy of the lien itself, ‘priority’ means the lien’s relationship to other claims to or interests in the collateral, and ‘extent’ means the scope of the property encompassed by or subject to the lien.”<sup>320</sup> Accordingly, no adversary proceeding is needed to value collateral. This task can be achieved by humble motions practice.<sup>321</sup> Accordingly, the plan serves as res

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316. In *Johnson*, the security interest was perfected postpetition. *In re Johnson*, 279 B.R. at 219–20. Accordingly, the case was a true strong-arm case. Judge Lundin, however, treated the case as a postpetition transfer of estate property voidable under § 549. *Id.* at 223. In fact, this theory of the case is untenable. Postpetition perfection of a prepetition transfer does not make it a postpetition transfer.

317. 11 U.S.C. § 506(a)(1) (2006) (emphasis added).

318. David Gray Carlson, *Bifurcation of Undersecured Claims in Bankruptcy*, 70 AM. BANKR. L.J. 1 (1996).

319. FED. R. BANKR. P. 7001(2).

320. *In re King*, 290 B.R. 641, 648 (Bankr. C.D. Ill. 2003).

321. See FED. R. BANKR. P. 3012 (allowing court to value collateral on motion of any party in interest).

judicata for the value of the collateral,<sup>322</sup> if the creditor fails to object to confirmation or fails to pursue an appeal.<sup>323</sup>

Valuation can also occur under Rule 3012 apart from plan confirmation.<sup>324</sup> Where the proof of claim has been filed prior to confirmation, service of the plan itself has been held to constitute a motion under Rule 3012.<sup>325</sup> More broadly, Rule 3012 objections are in fact entirely unnecessary where a secured creditor who has filed a proof of claim received due notice that the Chapter 13 plan will contradict the proof. In *In re Duggins*,<sup>326</sup> Judge Thomas L. Perkins made this following observation in aid of his ruling:

As a practical matter this Court fails to see how a debtor or another creditor could be required to object pre-confirmation when proofs of claim may be filed in the days, hours, even minutes prior to confirmation with no notice to the debtor or other creditors. The position [the secured creditor] advocates would permit a creditor to “lay in the weeds” by not objecting to confirmation and instead filing a proof of claim shortly before confirmation and then when the plan is confirmed jumping up and yelling “GOTCHA!” Such a rule would chill the fair and open negotiation between the debtor and creditors that the plan confirmation process encourages.<sup>327</sup>

In short, according to Judge Perkins, a Rule 3012 proceeding is permissible but not required. The plan can simply contradict the proof of claim, whether or not the Rule 3012 motion procedure is followed.<sup>328</sup> However, as Judge Perkins emphasized

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322. See *Branchburg Plaza Assocs., L.P. v. Fesq (In re Fesq)*, 153 F.3d 113, 119 (3d Cir. 1998) (holding creditor could not attack confirmed plan without alleging fraud); *In re Pence*, 905 F.2d 1107, 1109 (7th Cir. 1990) (holding debtor could not challenge confirmed plan, even where he had not received notice of confirmation hearing); *In re Rascon*, 321 B.R. 48, 52–54 (N.D. Cal. 2005) (holding that creditor could not attack confirmed plan based on due process grounds where he was adequately provided for); *In re Duggins*, 263 B.R. 233, 236–38 (Bankr. C.D. Ill. 2001) (holding that value of collateral determined in plan was binding on creditors).

323. The plan, however, must explicitly say that a lien is being limited on grounds of valuation; otherwise, the court may presume that an impermissible avoidance is being attempted. *In re Zimmerman*, 276 B.R. 598, 603 (Bankr. C.D. Ill. 2001).

324. According to Rule 3012:

The court may determine the value of a claim secured by a lien on property in which the estate has an interest on motion of any party in interest and after a hearing on notice to the holder of the secured claim and any other entity as the court may direct.

Fed. R. Bankr. P. 3012.

325. See *In re Searcy*, 333 B.R. 617, 623 (Bankr. D. Mass. 2005) (holding that “adequately noticed” plan serves as “functional equivalent” of § 502(a) objection); *In re Hoskins*, 262 B.R. 693, 697–98 (Bankr. E.D. Mich. 2001) (noting that filing of plan is implicit request for its confirmation, thus making it equivalent to Chapter 13 motion).

326. 263 B.R. 233 (Bankr. C.D. Ill. 2001).

327. *In re Duggins*, 263 B.R. at 241 (footnote omitted). Something like this happened in *Federal Deposit Insurance Corp. v. Union Entities (In re Be-Mac Transport Co.)*, 83 F.3d 1020, 1025 (8th Cir. 1996). See *supra* text accompanying notes 234–45 for a discussion of *Be-Mac Transport*.

328. *In re Duggins*, 263 B.R. at 236–37; accord *Hildebrand v. Hays Imps., Inc. (In re Johnson)*, 279 B.R. 218, 223–24 (Bankr. M.D. Tenn. 2002) (finding that Rule 3012 motion procedure is not necessary where plan contradicts proof of claim); *In re Fareed*, 262 B.R. 761, 769–70 (Bankr. N.D. Ill. 2001) (same).



in a later opinion, notice to the secured creditor must be specific as to his fate; therefore, unless specifically provided for, a security interest cannot be dispatched by boilerplate language stating that all liens are dead.<sup>329</sup>

### B. Claims

In previous sections, we examined whether a plan can declare a lien invalidated or limited. The weight of authority answers “no” with regard to lien validity, in the absence of a prior adversary proceeding. It answers “yes” if the lien is unperfected or if the question goes to a limit on the value of the collateral.

We must, however, distinguish valuation from calculating the total amount of the prebifurcated claim in the case of secured creditors. Or, in the case of unsecured creditors, there is the matter of calculating the amount of the allowed claim. Can plan confirmation set this amount?<sup>330</sup>

The case law is mixed as to whether the plan deserves *res judicata* respect. But before we review that answer, we must consider an irksome, oft-overlooked provision of the Bankruptcy Code. According to Bankruptcy Code § 502(j), “[a] claim that has been allowed . . . may be reconsidered for cause.”<sup>331</sup> This provision obviously conflicts with the finality provisions of § 1141(a) and § 1327(a). Perhaps, when it comes to claims allowance, plan confirmation is *never* *res judicata*.

Section 502(j) contains within it a rule that prevents creditors from disgorging dividends in a case where a claim is newly allowed.

[B]ut if a reconsidered claim is allowed and is of the same class as such holder’s claim, such holder may not receive any additional payment or transfer from the estate on account of such holder’s allowed claim until the holder of such reconsidered and allowed claim receives payment on account of such claim proportionate in value to that already received by such other holder.<sup>332</sup>

This rule seems to imagine an income stream paid to creditors. At first, the creditor was wrongly excluded from the income stream; later, thanks to § 502(j), the creditor is cut in on a senior basis. It is hard (though not impossible) to imagine sequential payments in a Chapter 7 case. Federal Rule of Bankruptcy Procedure 3009 instructs Chapter 7 trustees to pay dividends “as promptly as practicable.”<sup>333</sup> Nothing requires that a single distribution be made at the end of the case. Sequential

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329. *In re Zimmerman*, 276 B.R. 598, 604 (Bankr. C.D. Ill. 2001).

330. To be distinguished are cases where the plan is simply ambiguous. In *Fawcett v. United States (In re Fawcett)*, the IRS, an oversecured creditor, submitted a proof of claim for a fixed amount plus an unquantified claim for postpetition interest pursuant to § 506(b). 758 F.2d 588, 589 (11th Cir. 1985). The confirmed plan merely stated that the IRS was to be paid “in full.” *In re Fawcett*, 758 F.2d at 589. The court decided that the plan meant that the debtor must pay the stated tax debt *and* postpetition interest. *Id.* at 590. Thus, when the debtor moved to sell collateral and remit proceeds to the IRS as a secured creditor, the IRS was entitled to the basic claim plus the interest. *Id.*

331. 11 U.S.C. § 502(j) (2006); *see also* FED. R. BANKR. P. 3008 (allowing parties in interest to seek reconsideration of orders that decide claims made against estate).

332. § 502(j).

333. FED. R. BANKR. P. 3009.

Chapter 7 dividends can be imagined. Sequential payments are common in reorganization cases, but only after the plan has been confirmed. The rule against disgorgement and the “catch-up” rule expressed in § 502(j) certainly can be read as consistent with a congressional intent to privilege § 502(j) over § 1144 or § 1327(a).

Some courts think that any power under § 502(j) ends when a plan is confirmed.<sup>334</sup> Other courts think that § 502(j) is independent grounds to cancel the res judicata effect of a confirmed plan.<sup>335</sup> Some courts use estoppel to prevent debtors from using § 502(j), suggesting that, absent estoppel, claims allowance can always be revisited.<sup>336</sup>

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334. See *Ruskin v. DaimlerChrysler Servs. N. Am., L.L.C. (In re Adkins)*, 425 F.3d 296, 304 (6th Cir. 2005) (holding that § 502(j) addresses “allowance,” not rebifurcation); *Case v. Wells Fargo Bank, NA*, 394 B.R. 469, 475–76 (Bankr. E.D. Wis. 2008) (holding that debtors could not challenge plan after confirmation based on allegedly illegal interest determinations in plan under § 502(j)); *In re Kuhasz*, No. 07-20282, 2008 Bankr. LEXIS 3677, at \*2 (Bankr. D. Kan. Nov. 19, 2008) (denying ability to reconsider previously confirmed plan under § 502(j)). Some courts think that § 502(j) simply invokes the standards of Federal Rule of Civil Procedure 60(b), when relief is sought after confirmation. *Nationsbank Mortgage/Fed. Nat’l Mortgage Ass’n v. Williams (In re Williams)*, 276 B.R. 899, 906 (C.D. Ill. 1999). Other courts disagree. See, e.g., *In re Disney*, 386 B.R. 292, 299 (Bankr. D. Colo. 2008) (questioning workability of standard guided by Federal Rule of Civil Procedure 60). On Federal Rule of Civil Procedure 60(b) as a means of evading the res judicata effect of confirmed plans, see *infra* notes 638–71 and accompanying text.

335. See, e.g., *United States v. Zieg (In re Zieg)*, 206 B.R. 974, 978 (D. Neb. 1997) (noting that bankruptcy court can consider § 502(j) motion anytime, even after confirmation); *In re Disney*, 386 B.R. at 301–02 (recognizing that § 502(j) motions escape § 1329 finality, but only in exceptional circumstances); *In re Ross*, 373 B.R. 656, 659–60 (Bankr. W.D. Mo. 2007) (noting that bankruptcy courts can reconsider plans after confirmation for cause, and that determination of cause is broad discretionary power); *Coastal Credit, L.L.C. v. Mellors (In re Mellors)*, 372 B.R. 763, 775–76 (Bankr. W.D. Pa. 2007) (allowing reconsideration after confirmation based on § 502(j)); *In re Hibble*, 371 B.R. 730, 737 (Bankr. E.D. Pa. 2007) (allowing § 502(j) motions to challenge postconfirmation plans when fairness and equity demand it); *In re Jefferson*, 345 B.R. 577, 581 (Bankr. N.D. Miss. 2006) (recognizing that § 502(j) motions fall outside finality provisions of § 1329); *In re McBride*, 337 B.R. 451, 462 (Bankr. N.D.N.Y. 2006) (ordering \$2,448.80 to be paid to creditor years after confirmation to cover depreciation in debtor’s asset pursuant to § 502(j)); *In re Mason*, 315 B.R. 759, 760–62 (Bankr. N.D. Cal. 2004) (quoting *Zieder* to allow postconfirmation § 502(j) motion); *In re Zieder*, 263 B.R. 114, 118 (Bankr. D. Ariz. 2001) (holding that § 502(j) motions do not modify or reclassify claim and thus do not fall within purview of § 1329’s finality provisions); *Davis-McGraw, Inc. v. Johnson (In re Johnson)*, 247 B.R. 904, 908 (Bankr. S.D. Ga. 1999) (noting that § 502(j) deals with claim allowance while § 1329’s finality provisions deal with plan modification and thus do not implicate § 502(j)’s claims); *Coleman v. First Family Fin. Servs., Inc. (In re Coleman)*, 200 B.R. 403, 406 (Bankr. S.D. Ala. 1996) (allowing bankruptcy courts to reconsider claims after confirmation under § 502(j) until discharge of case).

336. Where the debtors could have made an objection before confirmation, they could not lean on § 502(j) to overcome the plan. *In re Cushion*, 349 B.R. 919, 921–22 (Bankr. M.D. Fla. 2006); *In re Arguin*, 345 B.R. 876, 880 (Bankr. N.D. Ill. 2006). Where the debtor and the creditor settled on the amount of the claim, the debtor was estopped from moving to reconsider under § 502(j). *In re Arguin*, 345 B.R. at 882. If the debtor relied on the proof of claim to formulate the plan, it would be inequitable at the behest of a creditor to alter the amount of the claim by means of § 502(j). *In re Pitts*, 354 B.R. 58, 66 (Bankr. E.D. Pa. 2006).

If § 502(j) overrides the finality provisions of Chapters 11 and 13, plans have no res judicata worth with regard to proofs of claim. In the discussion that follows, I will assume that § 502(j)'s virility comes to an end when a plan is confirmed.

#### 1. Plan Confirmation Before the Bar Date Has Lapsed

In Chapter 11, the bar date is set by court order.<sup>337</sup> Naturally, a court will likely set a bar date well before confirmation of a Chapter 11 plan. Not so in Chapter 13. The Federal Rules set the Chapter 13 bar date at ninety days after the first creditors' meeting.<sup>338</sup> The first creditors' meeting in turn must be scheduled no more than forty days after the bankruptcy petition.<sup>339</sup>

An extraordinary fact about Chapter 13 is that the procedure is so accelerated that, often, a plan is confirmed even before the bar date occurs.<sup>340</sup> According to Bankruptcy Rule 3015(b):

The debtor may file a chapter 13 plan with the petition. If a plan is not filed with the petition, it shall be filed within 15 days thereafter . . . . If a case is converted to chapter 13, a plan shall be filed within 15 days thereafter . . . .<sup>341</sup>

Meanwhile, the court is enjoined to hold the confirmation hearing not later than forty-five days after the first creditors' meeting is scheduled.<sup>342</sup> Ergo, a court is required to hold the confirmation hearing before the bar date has passed.

Because of this curious state of affairs, a Chapter 13 plan will tend to describe and treat claims for which proofs of claim are not yet filed.

#### a. *Proof of Claim Never Filed*

Suppose, after confirmation, the bar date lapses and a creditor has never filed a proof of claim. If the plan is confirmed according to its terms, then the Chapter 13 trustee may be asked to pay out to creditors who never filed proofs of claim. Yet the Federal Rules of Bankruptcy Procedure require that only *allowed* claims are

337. FED. R. BANKR. P. 3003(c)(3).

338. FED. R. BANKR. P. 3002(c). Claims by a governmental unit are subject to a different rule. Such a claim is "timely filed if it is filed before 180 days after the date of the order for relief or such later time as the Federal Rules of Bankruptcy Procedure may provide." 11 U.S.C. § 502(b)(9) (2006). BAPCPA also adds that a taxing authority is timely if it files sixty days after the filing of a tax return described by § 1308. *Id.* Section 1308(a) (also added by BAPCPA) requires the debtor to file any tax return that is due prior to the first scheduled creditors' meeting. Although April 15 tends to be the deadline for filing a return, § 1308(a) effectively changes that deadline when the first scheduled creditors' meeting is before April 15. § 1308(a).

339. FED. R. BANKR. P. 2003(a).

340. See Arpan K. Punyani, Note, *Debtor-Filed Acknowledgements of Creditors' Claims: An Alternative Approach to Proof of Claim in Chapter 13*, 28 CARDOZO L. REV. 511, 524–26 (2006) (discussing problem of plans confirmed before bar date). *But see In re Cason*, 190 B.R. 917, 920 n.1 (Bankr. N.D. Ala. 1995) (noting surveys claiming that one-third of Chapter 13 plans are confirmed after bar date).

341. FED. R. BANKR. P. 3015(b).

342. § 1324(b).

entitled to distributions.<sup>343</sup> Trustees, therefore, like to assert that late claims are not “allowed,” and hence are not entitled to distributions.<sup>344</sup>

Can this be sustained? According to Bankruptcy Code § 1326(c):

Except as otherwise provided in the plan or in the order confirming the plan, the trustee shall make payments to creditors under the plan.<sup>345</sup>

The bankruptcy rules may limit distributions under the plan, but § 1326(c) states that *creditors* under the plan (whether or not they have allowed claims) are to be paid. Courts that permit the trustee *not* to pay creditors under the plan because they have not filed proofs of claim are countenancing a violation of the Bankruptcy Code in the name of the Federal Rules of Bankruptcy Procedure. Yet these rules are not supposed to contradict statutory enactments.<sup>346</sup> For this reason, some trustees assume that they must seek modification of the confirmed plan under § 1329(a), since otherwise the plan is binding.<sup>347</sup>

When courts deny the res judicata worth of the plan and punish creditors for not filing proofs of claim, who is the winner? After BAPCPA, this irksome point of law is of no concern to the debtor when dischargeable unsecured creditors are involved.<sup>348</sup> Under § 1325(b), the debtor must contribute all disposable income to the plan for three years (if below the median income) or five years (for above-median debtors).<sup>349</sup> The failure of a creditor to file a proof of claim does not change this rule.

343. FED. R. BANKR. P. 3021. In *In re Mehl*, the court ruled that the secured creditor could have no distributions without a proof of claim, but, as the bar date does not apply to secured claims in Chapter 13, the secured creditor could file late, thereby triggering a right to payment late in the case. No. 04-85570, 2005 Bankr. LEXIS 2092, at \*3-4 (Bankr. C.D. Ill. Oct. 25, 2005). Presumably, the debtor can file on behalf of the secured creditor for this purpose.

344. See *Universal Am. Mortgage Co. v. Bateman* (*In re Bateman*), 331 F.3d 821, 827 (11th Cir. 2003) (emphasizing importance of debtor filing claim on time because late claims are invalid); *In re Greenig*, 152 F.3d 631, 635-36 (7th Cir. 1998) (barring late claims from receiving distributions from plans and ruling that court has no discretion to extend bar date); *In re Hogan*, 346 B.R. 715, 722 (Bankr. N.D. Tex. 2006) (explaining that court has no discretion to permit late claims); *In re Baldridge*, 232 B.R. 394, 396 (Bankr. N.D. Ind. 1999) (explaining importance of filing proof of claim to ensure allowed claim); *In re Macias*, 195 B.R. 659, 663 (Bankr. W.D. Tex. 1996) (allowing secured party to file proof of claim and obtain payments under plan because question was one of first impression, but ruling that in future, court would not permit late filing); *In re Schaffer*, 173 B.R. 393, 397-98 (Bankr. N.D. Ill. 1994) (refusing permission to secured creditor to file claim after Chapter 13 plan was confirmed); *In re Tucker*, 174 B.R. 732, 744 (Bankr. N.D. Ill. 1994) (forbidding late claim filing under § 502(b)); cf. *Andrews v. Loheit* (*In re Andrews*), 49 F.3d 1404, 1406-07 (9th Cir. 1995) (holding that Chapter 13 trustees also have standing to oppose confirmation on behalf of secured creditors who are not adequately protected under plan).

345. § 1326(c).

346. *United States v. Towers* (*In re Pac. Atl. Trading Co.*), 33 F.3d 1064, 1066 (9th Cir. 1994).

347. See *In re Witkowski*, 16 F.3d 739, 745 (7th Cir. 1994) (discussing § 1329 modifications as means for creditor to circumvent plan's binding effect).

348. See *Hildebrand v. Hays Imps., Inc.* (*In re Johnson*), 279 B.R. 218, 222 (Bankr. M.D. Tenn. 2002) (“When a claim is disallowed after confirmation, the money that would have been paid to that creditor under the confirmed plan is simply redistributed through the base or pot and paid to other creditors holding allowed claims.”).

349. According to § 1325(b)(1), if the trustee or unsecured creditor objects to the plan, and if less than 100% payment is contemplated, the plan must require the debtor to pay “all of the debtor’s projected disposable income to be received in the applicable commitment period.” § 1325(b)(1)(B).

The debtor must stay in for the requisite period, no matter what. So, at stake is whether the timely filing creditors will receive a higher percentage of the disposable income because a creditor has missed the bar date.

When the claim in question is a secured claim, but the claim is not allowed for want of proof, the lien passes through the bankruptcy proceeding and continues to be valid, even though the secured creditor is not entitled to distributions under the plan.<sup>350</sup> This disadvantages the debtor. If the secured creditor had received distributions, the secured debt after the plan would be reduced at the expense of the unsecured creditors. But if the secured creditor receives no plan distributions, the debtor must bear the entire debt later, to the extent of the collateral's value.<sup>351</sup> For that reason, it is advantageous for debtors to exercise their right to file a claim on behalf of the secured creditor.<sup>352</sup> Any payment to a secured creditor comes entirely at the expense of unsecured creditors. The same point can be made for nondischargeable claims for which no proof of claim is filed.

In effect, the majority view is that the creditor who misses the bar date is *not* entitled to res judicata of the plan, where the plan provides that the creditor is in a class that is to be paid. When a creditor tried to assert res judicata for its claim when it did not timely file a proof of claim, the Seventh Circuit, in *In re Greenig*<sup>353</sup> (a Chapter 12 case), ridiculed the presumption:

The problem with [the creditor's] argument is that the fact that a confirmed plan is binding does not mean that a plan based on legal errors should not be reversed: just as a trial verdict is binding but may be reversed if it is founded on legal errors, so a reorganization plan is binding but may be reversed if it is not in accord with the context of the Bankruptcy Rules and Bankruptcy Rules of Procedure.<sup>354</sup>

For this proposition, the court cited a case in which a confirmation order was reversed for failing to comply with § 1129(a).<sup>355</sup> It should be apparent that the court was fobbing off the creditor with a gross non sequitur. Granted, plans erroneously confirmed should be reversed on appeal. But plans that are confirmed

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Applicable commitment period is defined as three years, but it is not less than five years if the income of the debtor and his spouse is above the median income for the state where the debtor resides. § 1325(b)(4).

350. *In re Greenig*, 152 F.3d 631, 635 (7th Cir. 1998).

351. Whatever the plan pays a secured creditor is money that the debtor does not have to pay later to exonerate the collateral. For this reason, courts sometimes find it is bad faith for a debtor to accelerate payment to secured creditors beyond the payments required in the installment contract, as this shifts the burden of payment from debtors to the unsecured creditors who receive less disposable income. *In re Pearson*, 398 B.R. 97, 101–02 (Bankr. M.D. Ga. 2008).

352. See *In re Kincaid*, 316 B.R. 735, 741 (Bankr. E.D. Cal. 2004) (warning of risks in not filing before unsecured claims bar date, including court disallowing unsecured claim entirely); *In re Hudson*, 260 B.R. 421, 438 (Bankr. W.D. Mich. 2001) (same).

353. 152 F.3d 631 (7th Cir. 1998).

354. *In re Greenig*, 152 F.3d at 635.

355. *Id.* at 635 (citing *In re Burgess Wholesale Mfg. Opticians, Inc.*, 721 F.2d 1146 (7th Cir. 1983)).

and are never appealed become final.<sup>356</sup> Just because they contain errors does not mean they are not final.

Normatively, it is impossible to admire the mean-spirited, petty gamesmanship involved in putting a creditor to the bother of filing a proof of claim when the plan fully recognizes the scope of the creditor's claim. This is not done in Chapter 11, when the claim is scheduled as undisputed.<sup>357</sup> Why can't a creditor rely on the confirmed plan and be done with it? The Bankruptcy Code does not strictly require a contrary result, in my view. According to § 502(a), "[a] claim . . . , proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest . . . objects."<sup>358</sup> This only proves that those who file a proof of claim have allowed claims. It need not be taken to mean that those who do *not* file proofs of claim do *not* have proofs of claim.<sup>359</sup> Not all negatives are pregnant.<sup>360</sup>

True, Chapter 11 has the following provision: "A proof of claim . . . is deemed filed under section 501 of this title for any claim . . . that appears in the schedules filed under section 521[(a)](1) . . . ."<sup>361</sup> Perhaps this proves that in Chapter 7 or 13, a scheduled creditor is *not* deemed to have filed a proof of claim. But still this begs the question of whether a claim might be deemed allowed even if no proof of claim has been filed. It is certainly open for courts to rule that any claim validated by a confirmed plan is allowed whether a proof of claim is filed or not.

As we have seen,<sup>362</sup> some courts think that when a proof of claim *has* been filed prior to confirmation of the plan, the plan itself constitutes an objection to the proof of claim.<sup>363</sup> If this is so, it is entirely open for courts to treat the plan as a proof of claim filed by the debtor on behalf of the creditor. Also, the debtor is entitled to file a proof of claim on behalf of the creditor.<sup>364</sup> Why can't the plan *itself* be a form of a proof of claim?<sup>365</sup>

Only a small number of courts think that, whether or not creditors have filed proofs of claim, the plan is entitled to res judicata respect. On this view, the Chapter 13 trustee must pay creditors according to the plan even if they have filed proofs of claim.<sup>366</sup> One appellate case implies that Chapter 13 plans obviate the need for a creditor to file a proof of claim after confirmation. In *Factors Funding Co.*

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356 . 11 U.S.C. §§ 1141(a), 1327(a) (2006).

357 . § 1110(a).

358 . § 502(a).

359 . For a contrary view, see *Hildebrand v. Hays Imps., Inc. (In re Johnson)*, 279 B.R. 218, 223–24 (Bankr. M.D. Tenn. 2002).

360 . *Field v. Mans*, 516 U.S. 59, 66–68 (1995).

361 . § 1111(a).

362 . See *supra* notes 324–29 and accompanying text for a discussion of how courts treat a proof of claim filed prior to confirmation of a plan.

363 . *In re King*, 290 B.R. 641, 648 (Bankr. C.D. Ill. 2003).

364 . § 501(c).

365 . One court held open the idea that a plan *could* allow a claim (without a proof of claim), but reasoned that, under the wording of the plan before it, the plan did not intend to do so, making it necessary for creditors to file a proof of claim. *Hildebrand v. Hays Imps., Inc. (In re Johnson)*, 279 B.R. 218, 222 (Bankr. M.D. Tenn. 2002).

366 . *In re Edwards*, 162 B.R. 868, 869–70 (Bankr. D. Colo. 1993).

*v. Fili (In re Fili)*,<sup>367</sup> a plan was confirmed before the bar date.<sup>368</sup> The plan was held binding on a secured creditor.<sup>369</sup> Therefore, by implication, the secured creditor would have rights under the plan whether or not it filed a proof of claim.

The plan, however, gave zero rights.<sup>370</sup> Before the bar date had lapsed, but after confirmation, the secured creditor filed a proof of claim.<sup>371</sup> An objection to the proof of claim was sustained and upheld on appeal.<sup>372</sup> According to the appellate panel:

[I]n the face of notice that timely and unambiguously informs a creditor that his claim will be disallowed in total and discharged under a Chapter 13 plan pending for confirmation, the creditor may not ignore the confirmation process and fail to object simply because the bar date for filing a proof of claim has yet to expire.<sup>373</sup>

Is this holding consistent with the bankruptcy rules? According to Rule 9006(c)(2), a bankruptcy court “may not reduce the time for taking action” under Rule 3002(c).<sup>374</sup> Rule 3002(c) is the bar date. Effectively, a plan cannot shorten the bar date. But only unsecured creditors are required to file a proof of claim.<sup>375</sup> Therefore, the *Fili* opinion does not illegally shorten the bar date because there is no bar date for secured creditors. But, bizarrely, had the creditor been unsecured (as the plan itself asserted), the right to file after confirmation would have been abridged. Since, according to some courts, violating the Federal Rules of Bankruptcy Procedure is tantamount to a due process violation,<sup>376</sup> the plan that shortens the bar date for unsecured creditors would be entitled to no res judicata respect.

*b. Proof of Claim Eventually Filed*

A confirmed Chapter 13 plan may deal with a creditor who thereafter files a proof of claim. Courts have allowed these claims if they are timely filed.<sup>377</sup> Under this world view, the plan is entitled to no res judicata respect with regard to timely filed proofs of claim.<sup>378</sup> Other courts assume that plan confirmation is worthy of res

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367. 257 B.R. 370 (B.A.P. 1st Cir. 2001).

368. *In re Fili*, 257 B.R. at 371.

369. *Id.* at 374.

370. *Id.* at 371.

371. *Id.*

372. *Id.* at 371–72.

373. *In re Fili*, 257 B.R. at 374; accord *In re Bryant*, 323 B.R. 635, 642–43 (Bankr. E.D. Pa. 2005) (adopting holding from *Fili* that creditors with “timely and unambiguous notice” that their claims will be “compromised and discharged” cannot disregard confirmation process and not object because there is no bar date to file claim or period to file claims has not expired).

374. FED. R. BANKR. P. 9006(c)(2).

375. FED. R. BANKR. P. 3002(a).

376. See *infra* Part IV for a discussion of the impact of due process on res judicata.

377. See *In re Matthews*, No. 03-00998, 2004 Bankr. LEXIS 2496, at \*3–5 (Bankr. D. Idaho Apr. 15, 2004) (discussing debtor’s objection to proof of claim).

378. See *Ruhl v. HSBC Mortgage Servs., Inc.*, 399 B.R. 49, 59 (E.D. Wis. 2008) (leaving plans “intact” since such long amount of time had passed since plan confirmation); *Aubain v. LaSalle Nat’l Bank (In re Aubain)*, 296 B.R. 624, 627 (Bankr. E.D.N.Y. 2003) (finding that where debtor does not

judicata respect against the creditor who did not object to confirmation but who timely filed.<sup>379</sup> The expansive *Fili* decision falls into this category.

In *In re Shank*,<sup>380</sup> the court described an unusual plan:

In accordance with the usual practice in this Court, the debtor's plan specifies the treatment of claims based on their status as priority, secured or unsecured, but does not state their amount or specific payment terms. With regard to unsecured claims, the plan provides that allowed claims will be paid in full out of payments made to the chapter 13 trustee after priority and secured claims are paid in full.<sup>381</sup>

Naturally, in a plan like this, res judicata is out of the question because the plan itself is incomplete.<sup>382</sup> Subsequent proofs of claim, as edited through the objection process, are required to complete the plan.<sup>383</sup> Incidentally, if plans like the one in *Shank* are imposed on debtors, they probably run afoul of § 1322(b)(4), which *permits* "payments on any unsecured claim to be made concurrently with payments on any secured claim."<sup>384</sup> The practice described in *Shank* requires that the secured creditors be paid in full before the unsecured creditors get anything. This would appear to be an encroachment on the debtor's right to advantage herself of § 1322(b)(4).

Such a privilege of the proof of claim over the plan does not, apparently, apply to valuations of the collateral, where the plan always predominates.<sup>385</sup>

## 2. Plan Confirmation After a Proof of Claim Is Filed

The res judicata worth of the plan improves where the creditor has filed a proof of claim prior to confirmation. If the plan conforms to the proof of claim, then courts think that the plan is binding on both the debtor and the creditor.<sup>386</sup> If the plan

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object to proof of claim, proof supersedes plan); *In re Grogan*, 158 B.R. 197, 199 (Bankr. E.D. Cal. 1993) (defining limits to res judicata effect of confirmed plan).

379. See *In re Friedman*, 184 B.R. 883, 890 (Bankr. N.D.N.Y. 1994) (finding that notice defect destroyed res judicata of confirmation).

380. 315 B.R. 799 (Bankr. N.D. Ga. 2004).

381. *In re Shank*, 315 B.R. at 801.

382. *Finova Capital Corp. v. Larson Pharmacy Inc. (In re Optical Techs., Inc.)*, 425 F.3d 1294, 1300–01 (11th Cir. 2005) (concluding that plan ambiguity negates res judicata).

383. *In re Adams*, 270 B.R. 263, 268–69 (Bankr. N.D. Ill. 2001) (explaining that court can bifurcate undersecured claim postconfirmation where plan failed to do so); *Strong v. United States (In re Strong)*, 203 B.R. 105, 116 (Bankr. N.D. Ill. 1996) (stating that court can bifurcate IRS claim where plan was incomplete).

384. 11 U.S.C. § 1322(b)(4) (2006).

385. See *In re Hill*, 304 B.R. 800, 805 (Bankr. S.D. Ohio 2003) (holding creditor bound by terms of confirmed plan); *In re Duggins*, 263 B.R. 233, 244 (Bankr. C.D. Ill. 2001) (holding that debtor's valuation of secured claim with confirmed plan binds creditor); *In re Hudson*, 260 B.R. 421, 437 (Bankr. W.D. Mich. 2001) (finding that confirmed plan binds both parties as to valuation); *In re Fareed*, 262 B.R. 761, 771 (Bankr. N.D. Ill. 2001) (denying motion for valuation because valuation is fixed at time of plan confirmation).

386. See *Litton Loan Servicing, L.P. v. Ephraim*, No. 07-c-2605, 2008 U.S. Dist. LEXIS 62308, at \*14–15 (N.D. Ill. Aug. 14, 2008) (finding creditor's challenge to be impermissible collateral attack on already confirmed plan). Similarly, if the debtor writes a plan that sets an amount of interest to which the creditor is entitled, and if the plan is confirmed, the debtor cannot later seek a disgorgement. See *Ruhl v.*



contradicts the proof of claim, then the matter turns cloudy. Some courts think the plan prevails.<sup>387</sup> The plan is interpreted as an objection to the proof of claim, and confirmation is the contested matter at which the objection is litigated.<sup>388</sup>

Some courts think that where the proof of claim is filed before the confirmation hearing, the plan cannot contradict the proof of claim unless the debtor has previously objected to the claim under Rule 3007.<sup>389</sup> In *Sun Finance Co. v. Howard (In re Howard)*,<sup>390</sup> a secured creditor had filed a proof of claim and had received notice of the confirmation hearing, but no notice that its rights under the plan would be far less than it had expected.<sup>391</sup> The reductions, apparently, were explained by setoffs the debtor wished to assert for lender liability claims.<sup>392</sup> The Chapter 13 plan was confirmed.<sup>393</sup> The secured creditor moved to lift the automatic stay, but the bankruptcy court denied the motion on the res judicata power of plan confirmation.<sup>394</sup> Paying no attention to the general lack of notice as to the plan terms, Judge Patrick E. Higginbotham rested instead upon the general incompetence of a plan to contradict the proof of claim.<sup>395</sup> It is far from clear that this logic is limited to secured claims. It may apply to unsecured claims as well.

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HSBC Mortgage Servs., Inc., 399 B.R. 49, 58–59 (E.D. Wis. 2008) (applying preclusive effect of confirmed plan to debtors' subsequent objection).

387. See *infra* note 389 for sources discussing what happens if the plan contradicts the proof of claim.

388. FED. R. BANKR. P. 3007(a); see *In re King*, 290 B.R. 641, 647 (Bankr. C.D. Ill. 2003) (explaining that when one party raises Chapter 13 plan objection, court treats confirmation process as "contested matter").

389. See, e.g., *Universal Am. Mortgage Co. v. Bateman (In re Bateman)*, 331 F.3d 821, 828–29 (11th Cir. 2003) (stating that debtor's objection during postconfirmation period was incorrect way to resolve "inconsistency" between plan and proof of claim); *Deutchman v. Internal Revenue (In re Deutchman)*, 192 F.3d 457, 460 (4th Cir. 1999) (finding debtor's failure to object before confirmation as insufficient to remove IRS's liens); *Fireman's Fund Mortgage Corp. v. Hobdy (In re Hobdy)*, 130 B.R. 318, 320 (B.A.P. 9th Cir. 1991) (finding debtor's failure to object properly pursuant to Rule 3007 did not put creditors on notice and violated due process).

390. 972 F.2d 639 (5th Cir. 1992).

391. *In re Howard*, 972 F.2d at 640.

392. *Id.*

393. *Id.*

394. *Id.* at 640–42.

395. *Id.* at 641. The debtor in *Howard* cited *Republic Supply Co. v. Shoaf*, 815 F.2d 1046 (5th Cir. 1987). In this notorious case, a debtor wrote a plan that excused some insiders of their suretyship liability. *Shoaf*, 815 F.2d at 1047–48. Such a plan provision is quite illegal, as a plan can only affect relations between the debtor and its creditors, not creditors and third parties. See Ralph Brubaker, *Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-debtor Releases in Chapter 11 Reorganizations*, 1997 U. ILL. L. REV. 959, 969 (1997) (explaining that automatic stay and discharge injunction cannot bind third party). Unabashed, the debtor sent the plan to the assured creditor. *Shoaf*, 815 F.2d at 1047. The assured creditor did nothing, figuring that it could rely on its suretyship rights. *Id.* The plan was confirmed, at which time the assured creditor proceeded against the surety. *Id.* at 1048–49. The surety was able to assert the contents of the debtor's plan as a defense, because the plan established res judicata against the hapless assured creditor. *Id.* at 1049. If such a plan is binding on a creditor, so is a plan that writes down a secured claim below the amount asserted in the proof of claim. The debtor in *Howard* therefore justifiably asserted *Shoaf* as authority for its position that a plan could, without following the objection procedure, adversely affect the amount of a secured claim. An embarrassed Judge Higginbotham wrote:

C. *Matters Covered in § 1322*

1. Section 1322(a)

Section 1322(a) provides a very short list of things a Chapter 13 plan must do.<sup>396</sup> What if the court confirms a plan that does not do one or more of these things?

A very common conflict arises when a confirmed plan sets tax debt at an amount the IRS thinks is too low. Suppose that the IRS does not object to confirmation and wishes to mount a collateral attack. Many courts hold for res judicata of the plan.<sup>397</sup> But in *In re Escobedo*,<sup>398</sup> the Seventh Circuit upheld dismissing a plan “that apparently had already been confirmed and completed.”<sup>399</sup> Said the *Escobedo* court, “[a] bankruptcy court lacks the authority to confirm any plan unless it ‘complies with the provision of this chapter and with the other applicable provisions of this title.’”<sup>400</sup>

The *Escobedo* rule can be criticized for removing all incentives for taxing authorities and administrative claimants to participate in the confirmation hearing. Under *Escobedo*, a priority claim cannot be affected by the plan. Even worse, a secured lender who did not object to the plan and who now regrets valuation of the collateral can obtain dismissal of the plan by showing that the IRS or some other priority creditor was shortchanged in the plan.<sup>401</sup>

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The apparent tension between *Simmons* and *Shoaf* reflects no more than the difficulty in striking a workable balance between the interest in the protection of secured creditors and the interest in finality for Chapter 13 debtors. To the extent that these cases might be in conflict, we would be bound to follow *Simmons* as the earlier decision of this court on the subject.

*In re Howard*, 972 F.2d at 641. Judge Higginbotham stopped short of declaring the egregious *Shoaf* case a dead letter. Rather, he ruled that *Shoaf* simply does not apply to secured creditors holding claims to which the trustee has not objected. *Id.* Therefore, under *Howard*, debtors cannot contradict proofs of claim without first filing an objection under Rule 3007. *Id.* at 641–42; cf. *Stoll v. Gottlieb*, 305 U.S. 165, 174–77 (1938) (holding that creditor who challenged reorganization plan in federal court because it discharged third-party sureties is barred from enforcing suretyship obligation in state court).

396. See 11 U.S.C. § 1322(a) (2006) (stating that plan must provide for submission of future earnings, provide for full payment to priority claims, and treat all equal claims equally).

397. See *State v. Randolph (In re Randolph)*, 273 B.R. 914, 918 (Bankr. M.D. Fla. 2002) (finding Florida Department of Revenue was bound by confirmed Chapter 13 plan in absence of fraud); *In re White*, No. 95-10194, 2000 Bankr. LEXIS 1661, at \*4, \*7 (Bankr. D. Wyo. Dec. 8, 2000) (binding IRS to terms of confirmed Chapter 13 plan and discharging debt pursuant to successful completion of plan); *In re Moseley*, 74 B.R. 791, 805 (Bankr. C.D. Cal. 1987) (denying IRS’s motion to modify amount of claim postconfirmation), *vacated as moot*, 101 B.R. 608 (B.A.P. 9th Cir. 1989).

398. 28 F.3d 34 (7th Cir. 1994).

399. *In re Escobedo*, 28 F.3d at 34. Judge Eugene R. Wedoff complains that, under § 1307(c), cases (not plans) are dismissed. *In re Puckett*, 193 B.R. 842, 849–50 (Bankr. N.D. Ill. 1996). Judge Wedoff also makes some telling points against the remedy of dismissal of the entire case. *Id.* These matters are discussed *infra* in the text accompanying notes 421–26.

400. *In re Escobedo*, 28 F.3d at 35 (quoting § 1325(a)(1)). Ironically, the court also intimated that nothing in § 1325(a) is mandatory. *Id.* The citation to § 1325(a)(1) is, therefore, contradictory.

401. For this reason, Judge Wedoff proposes that *Escobedo* be read simply as denying res judicata effect as to the IRS, not that the entire plan is per se invalid because the confirming court has overstepped its authority. *In re Puckett*, 193 B.R. at 850.

Chafing under its harsh rule, lower courts in the Seventh Circuit have already begun the hard task of whittling away and undermining *Escobedo*. In *Illinois Department of Revenue v. Ayre (In re Ayre)*,<sup>402</sup> a tax creditor submitted a proof of claim.<sup>403</sup> A plan contradicting it was later confirmed.<sup>404</sup> Even though the creditor had a § 507(a) priority, the plan was res judicata as to the tax creditor.<sup>405</sup> The district court distinguished *Escobedo*.<sup>406</sup> In *Escobedo*, the parties agreed that the priority creditors were not paid in full.<sup>407</sup> In *Ayre*, the taxing authority claimed insufficient payment, but the debtors thought otherwise.<sup>408</sup> They claimed that the taxing authority *was* paid in full.<sup>409</sup> In effect, the amount of the tax claim was litigated (and the taxing authority did not show up).<sup>410</sup> In *Escobedo*, there was no litigation.<sup>411</sup>

How is it that “litigation” occurred in *Ayre*? This requires peering deeply into the murky insalubrious waters of Chapter 13 procedure. According to the *Ayre* court, the matter was litigated because a “contested matter” existed.<sup>412</sup> According to Rule 9014(a), a “contested matter” is one for which relief must be requested by motion.<sup>413</sup> Confirmation of a plan, however, is not brought on by motion. Rather, § 1324 (as amended by BAPCPA) states:

(a) Except as provided in subsection (b) and after notice, the court shall hold a hearing on confirmation of the plan. A party in interest may object to confirmation of the plan.

(b) The hearing on confirmation of the plan may be held not earlier than 20 days and not later than 45 days after the date of the meeting of creditors under section 341(a), unless the court determines that it would be in the best interests of the creditors and the estate to hold such hearing at an earlier date and there is no objection to such earlier date.<sup>414</sup>

So, once the plan is submitted, a court must hold the confirmation hearing whether a motion is filed or not. So far, then, just because a plan is confirmed does not prove it was confirmed as a “contested matter.”<sup>415</sup>

Rule 3015(f) expands the scope of the contested matter:

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402. 360 B.R. 880 (C.D. Ill. 2007).

403. *In re Ayre*, 360 B.R. at 882.

404. *Id.* at 883.

405. *Id.* at 887.

406. *Id.*

407. *In re Escobedo*, 28 F.3d 34, 34 (7th Cir. 1994).

408. *In re Ayre*, 360 B.R. at 881.

409. *Id.*

410. *Id.* at 887.

411. *In re Escobedo*, 28 F.3d at 34–35.

412. *In re Ayre*, 360 B.R. at 887.

413. FED. R. BANKR. P. 9014(a).

414. 11 U.S.C. § 1324 (2006).

415. See, e.g., *In re Swanson*, 312 B.R. 153, 158–59 (Bankr. N.D. Ill. 2004) (finding that IRS was not entitled to special notice rules for governmental entities [Rules 7004(b)(4) & (5)] because confirmation hearing is not “contested matter”).

An objection to confirmation of a plan shall be filed and served on [designated parties] . . . . An objection to confirmation is governed by Rule 9014. If no objection is timely filed, the court may determine that the plan has been proposed in good faith and not by any means forbidden by law without receiving evidence on such issues.<sup>416</sup>

If an objection to confirmation is filed, confirmation becomes a contested matter (i.e., under Rule 9014). But the taxing authority in *Ayre* never did object.

The *Ayre* court, nevertheless, noted that the taxing authority had filed a proof of claim.<sup>417</sup> It implied that filing the plan constituted an objection to the proof of claim.<sup>418</sup> And, supposedly, objecting to a proof of claim results in a contested matter.<sup>419</sup> Yet Rule 3007, which governs objections to proofs of claim, nowhere says so, even though Rule 3015(f) quite explicitly makes objections to confirmation contested matters.<sup>420</sup> Still, one must admit that a proof of claim is a “matter,” and objection thereto makes it a “contested matter,” even if it does not conform to what Rule 9014(a) requires.

On such a view, the taxing authority was at a disadvantage for filing a proof of claim. Had it not done so, the plan could hardly count as an “objection” to a proof of claim. Hence, the proof of claim would not have engendered a contested matter. Or if the taxing authority had filed after confirmation, the plan could not very well constitute an objection to a proof of claim not yet asserted.

A further limitation of *Escobedo* occurs in *In re Puckett*,<sup>421</sup> where the IRS sought to reopen a case and then have it dismissed (on the assumption that this amounted to revocation of the plan itself).<sup>422</sup> Judge Eugene R. Wedoff denied the relief.<sup>423</sup> He read *Escobedo* as not revoking the plan as a whole but only destroying res judicata for the IRS (but not for the other creditors).<sup>424</sup> The IRS might have obtained modification of the plan, but this opportunity ends with a discharge order.<sup>425</sup> According to § 1329, a motion to modify a Chapter 13 plan must occur “before the completion of payments under such plan.”<sup>426</sup>

## 2. Home Mortgages Under § 1322(b)(2)

Secured creditors may be crammed down under § 1325(a)(5), but claims “secured only by a security interest in real property that is the debtor’s principal

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416. FED. R. BANKR. P. 3015(f).

417. *In re Ayre*, 360 B.R. at 882.

418. *Id.* at 881.

419. *Id.* at 887.

420. FED. R. BANKR. P. 3007, 3015(f).

421. 193 B.R. 842 (Bankr. N.D. Ill. 1996).

422. *In re Puckett*, 193 B.R. at 843.

423. *Id.* at 851.

424. *Id.* at 849–51.

425. *Id.* at 847.

426. 11 U.S.C. § 1329(a) (2006).

residence”<sup>427</sup> may not be modified.<sup>428</sup> Chapter 11 has a similar rule.<sup>429</sup> The Supreme Court has proclaimed that any sort of bifurcation is a forbidden modification.<sup>430</sup>

Suppose a plan crams down a mortgage in violation of § 1322(b)(2). The plan is confirmed because the mortgage lender did not object. Some courts have ruled that the plan is res judicata; it overrules § 1322(b)(2).<sup>431</sup> Other courts have ruled that the plan is incompetent to modify such a mortgage.<sup>432</sup> In *Universal American Mortgage Co. v. Bateman (In re Bateman)*,<sup>433</sup> a mortgage lender filed a proof of claim for arrearage and the debtor wrote a plan awarding the lender considerably less. The bankruptcy court confirmed the plan, and the lender filed no objection.<sup>434</sup> The U.S. Court of Appeals for the Eleventh Circuit ruled that the plan had no res judicata worth in extinguishing the lender’s claim for arrearage. Rather, the unpaid portion of the lender’s claim survived confirmation.<sup>435</sup> Presumably, the debtor could object to the claim after confirmation, but res judicata could play no role in determining the amount of the claim.

Neither did the court of appeals invalidate the plan.<sup>436</sup> As a result, the automatic stay<sup>437</sup> would prevent the lender from enforcing its claim for arrearages until the end of the plan.<sup>438</sup>

The alternative to cramming down a secured claim is to reinstate it after curing past defaults. Any agreement is eligible for reinstatement,<sup>439</sup> though home

427. § 1322(b)(2).

428. § 1329(a)(5).

429. § 1124(b)(5).

430. *Nobelman v. Am. Sav. Bank*, 508 U.S. 324, 332 (1993), *superseded by statute*, Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106. Prior to *Nobelman*, several courts thought that it was possible to bifurcate home mortgages consistent with § 1322(b)(2). *See, e.g.*, *Bellamy v. Fed. Home Loan Mortgage Corp. (In re Bellamy)*, 962 F.2d 176, 180 (2d Cir. 1992) (finding that bifurcation does not “modify” creditor’s rights within meaning of § 1322(b)(2)). A bifurcating plan confirmed before *Nobelman* was held to be res judicata after *Nobelman* established the illegality of such a plan. *See, e.g.*, *Lumbermen’s Inv. Corp. v. Moretti (In re Moretti)*, No. 95-6323, 1996 U.S. App. LEXIS 29597, at \*7 (10th Cir. Nov. 14, 1996) (barring consideration of issues that could have been raised in bankruptcy proceeding on grounds of res judicata).

431. *In re Turner-Mayo*, No. 05-44726, 2007 Bankr. LEXIS 466, at \*5, \*12 (Bankr. S.D. Tex. Feb. 8, 2007); *Miller v. Countrywide Home Loans (In re Miller)*, No. 99-25616JAD, 2007 Bankr. LEXIS 31, at \*14–15 (Bankr. W.D. Pa. Jan. 9, 2007); *In re Thaxton*, 335 B.R. 372, 375 (Bankr. N.D. Ohio 2005); *In re Coss*, No. 02-65893, 2005 Bankr. LEXIS 3182, at \*7–10 (Bankr. N.D.N.Y. July 14, 2005); *In re Bryant*, 323 B.R. 635, 645 (Bankr. E.D. Pa. 2005); *In re Stiller*, 323 B.R. 199, 2015 (Bankr. W.D. Mich. 2005).

432. *E.g.*, *In re Carr*, 318 B.R. 517, 520–21 (Bankr. W.D. Wis. 2004) (analogizing facts in § 1322(b)(2) case to those in *Escobedo*).

433. 331 F.3d 821 (11th Cir. 2003).

434. *In re Bateman*, F.3d at 823.

435. *Id.* at 834.

436. *Id.*

437. *See* 11 U.S.C. § 362(a)(6) (2006) (barring “any act to collect . . . a claim against the debtor that arose before the commencement of the case”).

438. For a contrary view, see *Litton Loan Servicing, L.P. v. Ephraim*, No. 07-c-2605, 2008 U.S. Dist. LEXIS 62308, at \*4–5 (N.D. Ill. Aug. 14, 2008).

439. §§ 1124, 1322(b)(3).

mortgages (which cannot be crammed down) are surely the most common type of reinstatement. The price of reinstating a contract going forward is to pay back arrears under § 1322(b)(5), one of the “permissive” provisions of § 1322(b).

Before the meaning of § 1322(b)(5) can be apprehended, a predicate must first be discussed. With regard to secured creditors, a Chapter 13 debtor can either cram down a secured creditor or reinstate the agreement going forward after curing defaults. Cramdown occurs under § 1325(a)(5). It constitutes a modification of the secured claim within the meaning of § 1322(b)(2). Here we learn that “a claim secured only by a security interest in real property that is the debtor’s principal residence” may not be modified.<sup>440</sup>

Alternatively, an agreement (whether a mortgage, an unsecured loan agreement, or a lease) may be reinstated.<sup>441</sup> A reinstatement<sup>442</sup> implies no discharge. By definition, a discharge without payment in full would be a violation of the very agreement that is to be reinstated.

What in the Bankruptcy Code institutes the debtor’s unilateral right to reinstate an agreement over the opposition of the creditor? In Chapter 11, reinstatement is authorized by § 1124, which characterizes the creditor as “not impaired” when cure and reinstatement occur. A creditor who is not impaired is deemed to have accepted the plan.<sup>443</sup> Meanwhile, only nonvoting creditors are entitled to cramdown protections in Chapter 11.<sup>444</sup> It is easy to see that in Chapter 11, reinstatement is an alternative to cramdown protections. The source of the debtor’s reinstatement power in Chapter 13 is more vaguely identified. Section 1322(b)(3) permits a plan to “provide for the curing or waiving of any default.”<sup>445</sup> By implication, if a plan cures or waives a default, the creditor is disentitled to seek remedies for breach of the agreement. Hence, in effect, the agreement is reinstated.

What is a cure? After an obtuse and unsatisfactory intervention by the Supreme Court,<sup>446</sup> Congress acted in 1994 to define a cure: “if it is proposed in a plan to cure a default, the amount necessary to cure the default, shall be determined in accordance with the underlying agreement and applicable nonbankruptcy

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440. § 1322(b)(2).

441. *But see* *Rake v. Wade*, 508 U.S. 464, 472–73 (1993) (holding that reinstatement must meet criteria of § 1325(a)(5) cramdown with regard to cures), *superseded by statute*, Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106. Congress has arguably overruled this category mistake by the Supreme Court by adding § 1322(e), which defines “cure” to mean whatever the contract defines it to be.

442. A reinstated agreement is not to be confused with a reaffirmation agreement under § 524(c). A reaffirmation is an agreement about an otherwise discharged debt. These are unenforceable unless a heavy procedural burden is met. A reinstatement does not involve a new postpetition agreement, but is instead the imposition of an agreement even if the creditor opposes it.

443. § 1126(f).

444. § 1129(b).

445. § 1322(b)(3).

446. *Rake*, 508 U.S. at 471. On the difficulties created by this decision, see generally David Gray Carlson, *Rake’s Progress: Cure and Reinstatement of Secured Claims in Bankruptcy Reorganization*, 13 EMORY BANKR. DEV. J. 273 (1997).

law.”<sup>447</sup> So the idea of the cure is to make the creditor whole for past defaults. Cure is the price for reinstating the agreement going forward. Absurdly, § 1322(b)(3) permits cure *or waiver*. Presumably this means a plan could *fail* to cure past defaults and nevertheless prevent the creditor from seeking remedies on any past default. But no debtor has so far been tempted to take up this invitation to reinstate by “waiving” the cure.

This finally brings us to § 1322(b)(5), which states that a plan may, notwithstanding paragraph (2) of this subsection, provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any unsecured claim or secured claim on which the last payment is due after the date on which the final payment under the plan is due.<sup>448</sup>

This subsection permits a debtor to cure over a reasonable time (usually interpreted to mean the entire length of a Chapter 13 plan)<sup>449</sup> and to maintain payments going forward during the plan. It actually says nothing about the agreement after the plan. Nothing in Chapter 13 addresses the effectiveness of a reinstated agreement after the plan is concluded.<sup>450</sup>

Meanwhile, a Chapter 13 discharge occurs at the end of the plan, but it cannot affect any debt “provided for under section 1322(b)(5).”<sup>451</sup>

This finally brings us to our *res judicata* point about cures. Suppose a confirmed plan declares that certain payments described in the plan are payment in full of past defaults. Suppose a creditor subject to the cure thinks the cure to be incomplete. Is the plan binding on the creditor?

In *Padilla v. GMAC Mortgage Corp. (In re Padilla)*,<sup>452</sup> a debtor cured a home mortgage in a confirmed plan and won a discharge.<sup>453</sup> Later, the lender attempted to collect unpaid preconfirmation attorneys’ fees, which the contract required the debtor to pay.<sup>454</sup> In an adversary proceeding, the debtor claimed that the cure

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447. § 1322(e). This provision applies only to transactions entered into after Oct. 22, 1994. *In re Jones*, 188 B.R. 281, 282 (Bankr. D. Or. 1995).

448. § 1322(b)(5).

449. *In re Capps*, 836 F.2d 773, 774 (3d Cir. 1987), *abrogated by* *Rake v. Wade*, 508 U.S. 464 (1993).

450. Often agreements make bankruptcy itself an event of default. These are called *ipso facto* clauses. *Bonneville Power Admin. v. Mirant Corp. (In re Mirant Corp.)*, 440 F.3d 238, 242 (5th Cir. 2006). *Ipso facto* clauses are ineffective to terminate executory contracts, but loan agreements are not executory contracts. *See Kash & Karry Wholesale, Inc. v. Citizens & S. Nat’l Bank of S.C. (In re Kash & Karry Wholesale, Inc.)*, 28 B.R. 66, 69 (Bankr. D.S.C. 1982) (distinguishing loan agreements from executory contracts). In Chapter 11 cases, § 1124(2)(A) makes clear that a cure of past defaults renders a creditor unimpaired. § 1124(2)(A). It also makes clear, by a cross-reference to § 365(b)(2), that cure of an *ipso facto* clause is not required. *Id.* No similar cross-reference exists in Chapter 13, though courts seem to take it for granted that a home mortgage that is cured and reinstated cannot be declared in default the minute the automatic stay lapses (i.e., when the debtor’s discharge is final).

451. § 1328(a)(1).

452. 389 B.R. 409 (Bankr. E.D. Pa. 2008).

453. *In re Padilla*, 389 B.R. at 415–16.

454. *Id.*

amount was paid in full and that therefore the lender was in violation of the discharge injunction of § 524(a).<sup>455</sup>

Judge Eric L. Frank dismissed this claim because any claim for cure falls under § 1322(b)(5), and such claims are expressly not discharged under § 1328(a)(1).<sup>456</sup> In this, Judge Frank is correct if we read Chapter 13 literally. In truth, I actually think § 1328(a)(1) contains a heretofore undiscovered drafting glitch. What § 1328(a)(1) probably meant to say is that a reinstated agreement is not to be discharged at the end of the plan. In fact, § 1328(a)(1) fails to say anything about the reinstated agreement after the plan because § 1322(b)(5) says nothing about this. Section 1322(b)(5) speaks only to curing the past defaults. If in fact the defaults were not cured, the debtor was not discharged.<sup>457</sup>

Nevertheless, Judge Frank gave the plan res judicata effect.<sup>458</sup> The cure was achieved, and the debtor owed nothing. Accordingly, the debtor was entitled to an injunction going forward. The attempts to collect the cure deficit, however, did not violate the § 524(a) injunction, since claims for cure are never discharged under § 1328(a)(1).<sup>459</sup> Rather, the plan proclaimed the cure price paid, and this statement was entitled to res judicata respect.<sup>460</sup>

Similarly, in *Ruhl v. HSBC Mortgage Services, Inc.*,<sup>461</sup> various debtors wrote plans that cured mortgage defaults.<sup>462</sup> After confirmation, these debtors found that they had paid too much—cure amounts not actually required by the mortgage agreements they had signed.<sup>463</sup> The court held that res judicata barred the debtors' action.<sup>464</sup> The amount needed to cure, the court thought, was a minimal requirement.<sup>465</sup> Nothing prohibited overpaying for a cure.<sup>466</sup>

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455. Section 1328(a) does not mention the § 524(a) injunction. But § 524(a) applies to any discharge "under this title," which includes discharges in Chapter 13. *Id.* at 419 (quoting § 524(a)).

456. *Id.* at 409.

457. Because this was so, the lender could not be held in contempt. If an injunction adheres to the discharge, it does not adhere to plan confirmation. *In re Padilla*, 389 B.R. at 421.

458. *Id.* at 423–24.

459. On further reflection, § 1328(a)(1) may seem absurd. The plan states what the cure price is. The discharge is at the end of the plan. So if the plan is successfully completed, the cure claim is discharged by payment, without the aid of § 1328(a). Therefore, the reference to § 1328(a)(1) is superfluous. But hardship discharges are sometimes available even if the plan is not completed. 11 U.S.C. § 1328(b) (2006). If the hardship discharge encompasses the exceptions to the regular discharge in § 1328(a) (which is not entirely clear), then the reference to § 1322(b)(5) is not superfluous; it has bite in hardship cases.

460. *In re Padilla*, 389 B.R. at 422.

461. 399 B.R. 49 (E.D. Wis. 2008).

462. *Ruhl*, 399 B.R. at 53.

463. *Id.*

464. *Id.* at 58–59.

465. *Id.* at 60.

466. To be contrasted is *Century Indemnity Co. v. National Gypsum Co. Settlement Trust (In re National Gypsum Co.)*, where the bankruptcy court confirmed a Chapter 11 plan in which an executory contract was assumed and the cure amount was zero. 208 F.3d 498, 501 (5th Cir. 2000). Later, the nondebtor party claimed that \$5 million was due under the debtor's obligation to cure. *In re Nat'l Gypsum*, 208 F.3d at 502. The court denied summary judgment on the debtor's defense of res judicata because it was possible that the nondebtor party received constitutionally defective notice. *Id.* at 510.



### 3. Leases Under § 1322(b)(7)

Whether inside or outside reorganization proceedings, a bankruptcy trustee can assume a lease agreement going forward.<sup>467</sup> Debtors in Chapter 13 can do so as well.<sup>468</sup> According to the permissive rule in § 1322(b)(7), a plan may,

subject to section 365 of this title, provide for the assumption, rejection, or assignment of any executory contract or unexpired lease of the debtor not previously rejected under such section . . . .

Under § 365(a), only the *trustee* can assume a lease. In Chapter 13, thanks to § 1322(b)(7), a debtor can as well, even though the § 365(a) power is not listed in § 1303 as a trustee power delegated to the debtor.<sup>469</sup> Since the debtor can and indeed must write the plan, the plan itself can assume the lease.<sup>470</sup>

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Presumably, if notice had been adequate, the plan's statement that the cure price was zero would have bound the parties. The debtor also claimed that, even if the cure amount was an affirmative claim, it was discharged under § 1141(d) which (unlike Chapter 13's analog) is effective upon confirmation. *Id.* at 504. The court held that a cure amount is not a "debt that arose before the date of such confirmation." *Id.* (quoting 11 U.S.C. § 1141(d)(1)(A) (1994)). In contrast, § 1328(a) provides a discharge of "all debts provided for by the plan," except (among other things) any debt "provided for under section 1322(b)(5)." § 1328(a). In *In re Chappell*, a Chapter 13 plan paid out an oversecured nonresidential mortgage over five years. 984 F.2d 775, 781 (7th Cir. 1993). The mortgage lender filed a proof of claim just prior to confirmation of the plan, claiming more than what the plan provided. *Id.* at 777. The plan was confirmed with no objection. *Id.* The plan carried through to conclusion, culminating in a discharge order pursuant to § 1328(a). *Id.* at 793. After the discharge order, the lender commenced a mortgage foreclosure proceeding. *Id.* at 778. The debtors then responded by reopening the bankruptcy case to determine whether the lender still had a mortgage for unpaid arrearages. *In re Chappell*, 984 F.2d at 778. Properly, the issue should have been whether the plan was res judicata as to the amount of the debt, even though the plan contradicted the proof of claim. The result reached favored res judicata over the proof of claim. Instead of relying on res judicata of the plan, the court thought that the § 1328(a) discharge order was the reason the secured creditor must lose. *Id.* at 782–83. The debtor had argued that its claim for arrearage fell under § 1322(b)(5) and therefore could not be discharged because of § 1328(a)(2). *Id.* at 779. The court rightly pointed out that no arrearage claim falls under § 1322(b)(5) unless associated with a reinstated agreement where the last payment was due after the Chapter 13 plan ended. *Id.* at 781. But since the lender was to be paid in full over the life of the plan, § 1322(b)(5) did not apply. In fact, the court could have more simply relied on the res judicata worth of the plan. A discharge order affects only unsecured claims. It cannot affect the existence of liens. *In re Hudson*, 260 B.R. 421, 438 (Bankr. W.D. Mich. 2001). Even if the mortgage debt was discharged, the lender properly had a nonrecourse lien. *Id.* Only the res judicata effect of the plan could have protected the debtor. *See id.* at 428 (describing res judicata effect as precluding larger payment on secured portion of claim). The plan proclaimed that the secured claim was paid in full; res judicata gets the credit, not the discharge order. *See id.* at 444–45 (holding that creditor's failure to object to debtor's plan before confirmation prevented creditor from increasing debt owed).

467. 11 U.S.C. § 365(a) (2006).

468. *See In re Brewer*, 233 B.R. 825, 828 (Bankr. E.D. Ark. 1999) (finding that Chapter 13 debtors may reject or assume any unexpired lease under § 365(a)); *In re DiCamillo*, 206 B.R. 64, 66 (Bankr. D.N.J. 1997) (stating that § 365(a) and § 1322(b)(7) provide authority for Chapter 13 debtor to assume or reject unexpired debtor leases); *In re Hall*, 202 B.R. 929, 932 (Bankr. W.D. Tenn. 1996) (stating that under § 365(a), debtors may assume or reject unexpired leases). Rule 6006 refers to actions against Chapter 13 trustees or *debtors* to assume or reject a lease. FED. R. BANKR. P. 6006(b).

469. An assumption of a lease is subject to the rules of contested motions, "*other than as part of a plan.*" FED. R. BANKR. P. 6006(a) (emphasis added). A plan confirmation, as we have seen, is not a contested motion unless someone objects to confirmation. *See supra* text accompanying notes 412–20 for a discussion of contested motions. Meanwhile, the advisory notes to Rule 6006 affirm that the rule

Suppose a debtor assumes a lease, and so the lessor is receiving payments under the plan. Under these circumstances, so long as the debtor continues to make the plan payments, the lease cannot possibly be in default, because the Chapter 13 trustee is in charge of the wages the debtor actually pays in.<sup>471</sup>

But suppose the debtor is to make lease payments “outside the plan”—i.e., not through the Chapter 13 trustee.<sup>472</sup> Under these circumstances, the debtor might continue to make plan payments to the trustee but be in default to the lessor.

Breach of an assumed lease gives rise to damages that are administrative claims.<sup>473</sup> A Chapter 13 plan is supposed to pay administrative claimants “[b]efore or at the time of each payment to creditors under the plan.”<sup>474</sup> Can the lessee now intrude upon the plan (under which the lessee is to receive nothing) and seize for itself a high priority? In *Ford Motor Credit Co. v. Bankruptcy Estate of Parmenter (In re Parmenter)*,<sup>475</sup> the court answered no.<sup>476</sup> The plan was res judicata as to the lessor, and according to the plan, the lessor was entitled to receive nothing *through* the plan.<sup>477</sup>

The contrary view rests on the fact that res judicata presupposes that facts were actually litigated. Where a lease is assumed but nothing is said about the consequences of a breach, the matter is supposedly not litigated and not subject to

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“does not apply to . . . the assumption or rejection of contracts in a plan pursuant to § 1123(b)(2) or § 1322(b)(7).” FED. R. BANKR. P. 6006 advisory committee’s note. An open question, however, is whether the onerous reaffirmation rules of § 524(c) have been met, or if § 1322(b)(7) overrides § 524(c). On this controversy, see Hillinger & Hillinger, *supra* note 21, at 383–92.

470. *But see* § 365(d)(2) (indicating that Chapter 13 trustee is one who assumes lease).

471. *In re Masek*, 301 B.R. 336, 337–38 (Bankr. D. Neb. 2003).

472. Of course, the plan will provide for payments “outside the plan,” and therefore these are really payments “under the plan.” What “outside the plan” really means is *not* through the Chapter 13 trustee. *Foster v. Heitkamp (In re Foster)*, 670 F.2d 478, 485 (5th Cir. 1982); *In re Venuto*, 343 B.R. 120, 133 n.21 (Bankr. E.D. Pa. 2006); *In re Perez*, 339 B.R. 385, 390 n.4 (Bankr. S.D. Tex. 2006).

473. There is a dissenting view: damages for breach of an assumed lease do not benefit the bankruptcy estate and therefore are not entitled to administrative priority. *See Ford Motor Credit Co. v. Bankr. Estate of Benn*, 362 B.R. 1, 6 (E.D. Mich. 2007) (indicating administrative priority would be manifestly unfair), *aff’d sub nom. Ford Motor Credit Co. v. Bankr. Estate of Parmenter (In re Parmenter)*, 527 F.3d 606, 613 (6th Cir. 2008).

474. § 1326(b).

475. 527 F.3d 606 (6th Cir. 2008).

476. *In re Parmenter*, 527 F.3d at 608.

477. *Id.* An unanswered question in *Parmenter* is how the lessor shall recover damages. The automatic stay protects only property of the estate (which is now revested in the debtor, following confirmation), or it protects the debtor only if the claim is a prepetition claim. § 362(a). Section 362(a) nowhere protects the debtor from enforcement of a postconfirmation claim. But the discharge provision threatens the lessor. According to § 1328(a), “as soon as practicable after completion by the debtor of all payments *under the plan* . . . , the court shall grant the debtor a discharge of all debts provided for by the plan or disallowed under section 502.” § 1328(a) (emphasis added). Properly, the lessor should never be discharged. *Under the plan*, the debtor was to have paid the lessor *outside the plan*. Since these payments were never completed, the debtor is disentitled to any discharge order. At best the debtor can try for the hardship discharge in § 1328(b), which potentially applies when the debtor does not complete the plan. *But see First Am. Title Ins. Co. v. Nation (In re Nation)*, 352 B.R. 656, 668–69 (Bankr. E.D. Tenn. 2006) (holding that debtor was discharged even though debtor did not make balloon payment outside of plan to mortgage lender).

the harsh rule of res judicata.<sup>478</sup> Yet res judicata is *claim preclusion*. Whatever *could* have been litigated is barred.<sup>479</sup> Since the parties *could* have written default rules into the plan and did not, under *Parmenter*, the lessor is barred from claiming an administrative priority over the Chapter 13 estate.<sup>480</sup>

The *Parmenter* court thought that, with regard to a default on a lease (which had previously been assumed), Chapter 13 cases are inherently different from Chapter 11 cases. According to the court:

[T]here is a material difference between the two settings: Whereas a Chapter 11 debtor-in-possession acts on behalf of the estate when it assumes a lease and thus creates a legal obligation on the estate, a Chapter 13 debtor who assumes and pays for a lease outside of the plan does not.<sup>481</sup>

Although the result of *Parmenter* is defensible, this particular piece of metaphysics is not. In both Chapters 11 and 13, breach of the lease creates a postconfirmation obligation that the reorganized debtor must pay. In both chapters, the plan itself can bind the debtor to the lease (though in both chapters the trustee, prior to confirmation, can assume the lease on behalf of the postconfirmation debtor). In both chapters, confirmation vests *all* property of the estate in the debtor.<sup>482</sup> So there does not seem to be any real difference between the chapters. Chapter 13 does add something that Chapter 11 does not have. In Chapter 13, a debtor creates a fund over which the trustee is a fiduciary.<sup>483</sup>

This concept does not exist in Chapter 11. So, properly, in both chapters the debtor owes the lessor for breach of the lease. In Chapter 13, however, the trust administered by the trustee is simply not for the benefit of any party not provided for in the plan.<sup>484</sup>

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478. *In re Wells*, 378 B.R. 557, 560–61 (Bankr. S.D. Ohio 2007).

479. *Wallis v. Justice Oaks II, Ltd.* (*In re Justice Oaks II, Ltd.*), 898 F.2d 1544, 1552 (11th Cir. 1990) (stating that “any” claims that “were actually made, *or could have been made*,” are barred by plan confirmation).

480. *In re Parmenter*, 527 F.3d at 608.

481. *Id.* at 610 (citation omitted).

482. §§ 1144(b), 1327(b).

483. § 1326(a).

484. How is it that breach of a lease can be an administrative expense in a Chapter 11 case? This is quite impossible when the breach is postconfirmation. Rather, the debtor is simply liable for the breach. If the Chapter 11 case is converted to a Chapter 7 liquidation, the matter is different. Here the landlord is entitled to an administrative claim under § 503(b) that would outrank any prepetition claim allowable under § 502(a). Furthermore, a claim under § 503(a) is not subject to the cap on landlord damages under § 502(a)(6). See *Nostas Assocs. v. Costich* (*In re Klein Sleep Prods., Inc.*), 78 F.3d 18, 28 (2d Cir. 1996) (limiting cap on damages under § 502(a) to claims brought under § 501). *Klein Sleep* had an unusual posture. A Chapter 11 trustee had been appointed and ordered to liquidate. *Id.* at 22. A lessor moved for allowance of an administrative claim for breach of an assumed lease. *Id.* The Second Circuit upheld the motion. *Id.* at 30. But Chapter 11 trustees cannot make distributions. Either the case would have to be converted to Chapter 7 where the administrative priority could be vindicated, or some party in interest would have to write a plan where distributions could be provided for. Under a Chapter 11 plan, the administrative priority would have to be cashed out under the effective date of the plan. § 1129(a)(9)(A).

*D. Discharge Issues*

## 1. Student Loans

Students have been a bankruptcy worry ever since they obtained easy credit to fund tuition. Such persons graduate wealthy in knowledge but bereft of net worth. For such students, bankruptcy discharge looms as a sore temptation.

As enacted in 1978, the Bankruptcy Code prohibited Chapter 7 discharge of student loans for the first five years after a student loan became due.<sup>485</sup> Later, the period was extended to seven years, and finally the time limit was entirely omitted.<sup>486</sup> Throughout this history, however, it was always possible to obtain a discharge if the student showed “undue hardship.”<sup>487</sup> This finding, however, must, according to some courts, be achieved in the course of an adversary proceeding.<sup>488</sup>

Meanwhile, discharge was entirely possible in Chapter 13.<sup>489</sup> This invitation was slammed shut in 1990 with an amendment to § 1328(a)(2).<sup>490</sup> In modern times, only undue hardship justifies a student loan discharge, even in Chapter 13.

But what if the plan itself announces that, upon completion, the student loan will be discharged? To be sure, a creditor objecting to a “discharge by declaration” can object to confirmation of the plan on the grounds that the hardship discharge requires an adversary proceeding. Where the creditor does not object to confirmation but seeks to enforce the student loan as if it were never discharged, is the plan worthy of res judicata respect?

In *Espinosa v. United Student Aid Funds, Inc.*,<sup>491</sup> a bankruptcy court confirmed a plan that called for a student loan to be discharged at the end of the plan (even though discharge is prohibited by § 1328(a)(2)).<sup>492</sup> When the plan ended successfully, the bankruptcy court issued a discharge order that included the student loan.<sup>493</sup> The creditor then intercepted the debtor’s tax refunds.<sup>494</sup> The debtor claimed this to be a violation of the discharge injunction,<sup>495</sup> and the Ninth Circuit Court of Appeals agreed.<sup>496</sup>

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485. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, 2590 (codified as amended at 11 U.S.C. § 523 (2006)).

486. Higher Education Amendments of 1998, Pub. L. No. 105-244, § 971, 112 Stat. 1581, 1837 (codified as amended at 11 U.S.C. § 523 (2006)) (eliminating seven-year rule).

487. § 523(a)(8).

488. See FED. R. BANKR. P. 7001(6) (listing “a proceeding to determine the dischargeability of a debt” as type of adversarial proceeding).

489. See *Educ. Assistance Corp. v. Zellner*, 827 F.2d 1222, 1224 (8th Cir. 1987) (noting that though loan might not be dischargeable under Chapter 7, it may be under Chapter 13).

490. Student Loan Default Prevention Initiative Act of 1990, Pub. L. No. 101-508, § 3007(b)(7), 104 Stat. 1388-25, 1388-28 (codified as amended at 11 U.S.C. § 1328(a)(2) (2006)).

491. 553 F.3d 1193 (9th Cir. 2008), *cert. granted*, 129 S. Ct. 2791 (2009).

492. *Espinosa*, 553 F.3d at 1205.

493. *Id.* at 1197.

494. *Id.*

495. *Id.*

496. *Id.* at 1205.

Chief Judge Alex Kozinski denied that the case turned on res judicata of the confirmation order.<sup>497</sup> Rather, the case concerned a violation of the discharge injunction.<sup>498</sup> This may be questioned. According to § 1328,

as soon as practicable after completion by the debtor of all payments under the plan . . . the court shall grant the debtor a discharge of all debts provided

for by the plan or disallowed under section 502 . . . except any debt . . .

...

(2) of the kind specified . . . in paragraph . . . (8) . . . of section 523(a).<sup>499</sup>

Any attempt to order discharge of a student loan would seem to be ultra vires. If the plan proclaims the student loan extinguished, it does not mean it was discharged. Discharge gives rise to an injunction.<sup>500</sup>

Extinguishment of a claim pursuant to a plan simply means that the student loan creditor has no cause of action once the plan is complete. This would have been the case even if a court refused to issue a discharge order pursuant to § 1328(a). Therefore, contrary to the Ninth Circuit's opinion, the case turned on res judicata of the plan after all. The plan itself does not give rise to the discharge injunction.<sup>501</sup> Only a discharge order could do so.

Under Rule 7001(6), "a proceeding to determine the dischargeability of a debt" must be commenced as an adversary proceeding.<sup>502</sup> Yet, in *Espinosa*, no adversary proceeding was commenced. According to the *Espinosa* court, the requirement of an adversary proceeding does not conflict with the finality provision of § 1327(a).<sup>503</sup> Judge Kozinski thought that the creditor had a valid objection to the plan—that it discharged the student loan without a finding of hardship (pursuant to an adversary proceeding).<sup>504</sup> Having failed to make that objection, the creditor was bound by the terms of the plan.<sup>505</sup>

The Tenth Circuit had once held this position. But over the years, it has been rolling back its prodebtor position. At first the court ruled that a discharge provision was enforceable as written if the plan was confirmed without objection of the student lender.<sup>506</sup> Then it emphasized that res judicata has bite only if the

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497. *Espinosa*, 553 F.3d at 1200–01.

498. *Id.*; see also 11 U.S.C. § 523(a) (2006) (outlining exceptions to discharge).

499. § 1328(a).

500. § 524(a)(2).

501. See *id.* (stating that discharge of Chapter 7 case has effect of injunction).

502. FED. R. BANKR. P. 7001(6).

503. *Espinosa*, 553 F.3d at 1198 (9th Cir. 2008).

504. *Id.*

505. The *Espinosa* court went so far as to hold that bankruptcy courts do not even have discretion to refuse to confirm a plan when a creditor does not object to discharge by declaration. See *id.* at 1205 (noting that creditor's failure to object was likely due to calculated strategy expected to recover part of debt and that courts, therefore, should not stand in creditor's way).

506. See *Andersen v. UNIPAC-NEBHELP (In re Andersen)*, 179 F.3d 1253, 1258 (10th Cir. 1999) (finding that creditors must protect their interests by timely objection), *overruled by* Educ. Credit

plan itself sets forth an explicit finding that a hardship exists.<sup>507</sup> Finally, in *Educational Credit Management Corp. v. Mersmann (In re Mersmann)*,<sup>508</sup> a plan that discharges student loans without an adversary proceeding was deemed to have no res judicata effect whatsoever.<sup>509</sup>

Today, outside the Ninth Circuit, the majority view is that Chapter 13 plans have no ability to discharge student loans in the absence of an adversary proceeding.<sup>510</sup> The *Espinosa* opinion has caught the attention of the Supreme Court, which has granted a petition of certiorari in the case. The Supreme Court may therefore have an opportunity to describe precisely what due process requires in the context of bankruptcy litigation.<sup>511</sup>

## 2. Tax Debt

Tax debts are not generally dischargeable.<sup>512</sup> Tax debt is therefore different from student loan debt, which *is* dischargeable if the student loan constitutes an undue hardship.<sup>513</sup> What if a plan illegally discharges a tax debt and the taxing authority has not objected to the confirmation of the plan? Some courts have ruled that the plan is not entitled to res judicata effect.<sup>514</sup> Others disagree; if the plan indicates

Mgmt. Corp. v. Mersmann (*In re Mersmann*), 505 F.3d 1033, 1038 (10th Cir. 2007). In *Andersen*, the creditor filed an untimely objection to the confirmation plan. *In re Andersen*, 179 F.3d at 1254. The bankruptcy court ruled that the plan was incompetent to make the student loan claim dischargeable in violation of § 1328(a)(2). *Id.* at 1256. The appellate courts reversed. *Id.* at 1255, 1260.

507. *Poland v. Educ. Credit Mgmt. Corp. (In re Poland)*, 382 F.3d 1185, 1186 (10th Cir. 2004). *Andersen* had involved an explicit plan reference to hardship. *In re Andersen*, 179 F.3d at 1256. No such reference existed in *Poland*. The court in *Poland* also said that “*Andersen* was wrongly decided and should be reconsidered.” *In re Poland*, 382 F.3d at 1189 n.2.

508. 505 F.3d 1033 (10th Cir. 2007).

509. The holding was made prospective only. *In re Mersmann*, 505 F.3d at 1052.

510. See, e.g., *Whelton v. Educ. Credit Mgmt. Corp.*, 432 F.3d 150, 153 (2d Cir. 2005) (noting that student loan discharge requires adversary proceeding to establish undue hardship); *Ruehle v. Educ. Credit Mgmt. Corp. (In re Ruehle)*, 412 F.3d 679, 684 (6th Cir. 2005) (noting that federal rules and Code require adversary proceeding to discharge student loan); *In re Hanson*, 397 F.3d 482, 486–87 (7th Cir. 2005) (finding that although plan made no reference to hardship, discharge by declaration is void); *Banks v. Sallie Mae Servicing Corp. (In re Banks)*, 299 F.3d 296, 300 (4th Cir. 2002) (finding that under Bankruptcy Code and rules, student loans cannot be discharged without adversary proceeding).

511. In *Espinosa*, Judge Kozinski details his own theory of due process, which is discussed *infra* in the text accompanying notes 634–37.

512. 11 U.S.C. § 523(a)(1) (2006).

513. *Andersen v. UNIPAC-NEBHELP (In re Andersen)*, 179 F.3d 1253, 1259–60 (10th Cir. 1999).

514. In *DePaolo v. United States (In re DePaolo)*, the IRS had filed a proof of claim, and a Chapter 11 plan provided for the full payment of that amount (as § 1129(a)(9) requires). 45 F.3d 373, 374 (10th Cir. 1995). The confirmation order stated that the debtor was discharged from all preconfirmation debts, subject to the exceptions in § 1141(d) (which do not permit discharges of any claim listed in § 523(a)). *In re DePaolo*, 45 F.3d at 375. Later, the IRS did an audit and claimed further taxes from the petition period. *Id.* It was able to disregard the confirmed plan and collect additional tax. *Id.* at 377.

that the tax claim has been paid, the taxing authority cannot later dispute the conclusion.<sup>515</sup>

In *Internal Revenue Service v. Taylor (In re Taylor)*,<sup>516</sup> a Chapter 11 debtor failed to pay withholding taxes from his company, thereby triggering control person liability.<sup>517</sup> The plan proposed to pay the IRS nothing for these claims.<sup>518</sup> The IRS filed a proof of claim.<sup>519</sup> The debtor objected.<sup>520</sup> After an audit, the IRS withdrew its claim.<sup>521</sup> The plan was confirmed.<sup>522</sup> The IRS had received a copy of the plan but did not participate in the confirmation hearing.<sup>523</sup> When the IRS started proceedings to collect the tax penalty from the debtor, the debtor sought relief that the claim was discharged under the plan.<sup>524</sup>

The court ruled that, because the tax penalty was nondischargeable, the IRS was privileged to stand aloof from the plan and seek recovery later, no matter what the plan provided.<sup>525</sup> The court stated that the debtor should have filed a proof of claim for the IRS and then objected to it.<sup>526</sup> This holding, of course, applies not only to tax claims but to any claim that is never dischargeable.<sup>527</sup>

How does *Taylor* compare to *In re Escobedo*?<sup>528</sup> In *Escobedo*, the IRS was not subject to res judicata of a Chapter 13 plan, because the plan did not conform to § 1322(a)(2).<sup>529</sup> In *Taylor*, the IRS was not subject to res judicata because its claim was nondischargeable.<sup>530</sup> *Taylor* therefore wreaks broader damage upon res judicata than does *Escobedo*.

Both cases are highly questionable. If a plan states what a tax debt *is*, and if the tax authority is fairly notified of the confirmation hearing, why shouldn't § 1327(a) apply, if no due process violation is entailed?

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515. See *IRS v. DiPasquale*, No. 06-106 (MLC), 2006 U.S. Dist. LEXIS 24068, at \*16–21 (D.N.J. Apr. 28, 2006) (noting that plan provided for IRS lien and that discharge order terminated debtors' liability on IRS's claim because it made no secured claim); *Meyer v. Pagano*, No. C 01-0848 MMC, 2002 U.S. Dist. LEXIS 18187, at \*18 (N.D. Cal. Sept. 25, 2002) (finding that discharge was properly granted where debtor completed plan's requirements, which did not mandate repayment of priority claims in full).

516. 132 F.3d 256 (5th Cir. 1998).

517. *In re Taylor*, 132 F.3d at 258; see also 26 U.S.C. § 6672 (2006) (providing that any person required to pay tax under this title who willfully fails to do so is liable for total amount of tax evaded).

518. *In re Taylor*, 132 F.3d at 259.

519. *Id.*

520. *Id.*

521. *Id.*

522. *Id.*

523. *In re Taylor*, 132 F.3d at 259.

524. *Id.*

525. *Id.* at 261.

526. *Id.* at 263.

527. *Id.* at 261; accord *Pacana v. Pacana-Siler (In re Pacana)*, 125 B.R. 19, 25 (B.A.P. 9th Cir. 1991) (holding nondischargeable child support obligation to be "insulated from mandatory inclusion in a Chapter 13 plan").

528. 28 F.3d 34 (7th Cir. 1994).

529. *In re Escobedo*, 28 F.3d at 35.

530. *In re Taylor*, 132 F.3d at 261.

### 3. Fraud and Willful and Malicious Injury

If student loans are not dischargeable unless the debtor shows undue hardship in an adversary proceeding, there is a class of claims which is the mirror image: some claims are dischargeable unless the creditor steps forward to protest the discharge. There are three types of claims: (a) claims based on the inducement of credit through fraud,<sup>531</sup> (b) claims based on breach of fiduciary duty,<sup>532</sup> and (c) claims based on “willful and malicious injury.”<sup>533</sup> These claims are “of a kind specified in paragraph (2), (4), or (6).”<sup>534</sup> These types of claims are subject to the rule of Bankruptcy Code § 523(c)(1):

Except as provided in subsection (a)(3)(B) of this section,<sup>[535]</sup> the debtor shall be discharged from a debt of a kind specified in paragraph (2), (4), or (6) of subsection (a) of this section, unless, on request of the creditor to whom such debt is owed, and after notice and a hearing, the court determines such debt to be excepted from discharge under paragraph (2), (4), or (6) . . . .<sup>536</sup>

Suppose a plan calls for the discharge of an embezzlement claim. The plan is confirmed without objection. Can the creditor thereafter bring an adversary proceeding to prevent the discharge?

The Ninth Circuit has ruled that the plan is *res judicata* on the issue of whether the claim falls within (2), (4) or (6). In *Lawrence Tractor Co. v. Gregory (In re Gregory)*,<sup>537</sup> the debtor embezzled money and then filed in Chapter 13.<sup>538</sup> The plan listed the embezzlement claim as among those to be paid zero payment.<sup>539</sup> The creditor commenced an adversary proceeding before the plan was completed, but confirmation of the plan precluded pursuit of this cause of action.<sup>540</sup> *Gregory*, therefore, anticipates the Ninth Circuit’s holding in *Espinosa*, soon to be reviewed by the Supreme Court. In the Ninth Circuit, at least for the moment, the plan is capable of settling discharge issues. Most circuits think otherwise and require an adversary proceeding.

#### E. Third-Party Releases

Sometimes, debtors use reorganization plans to discharge guarantors of creditors with claims against the debtors. Courts disagree about whether such plan

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531 . 11 U.S.C. § 523(a)(2) (2006).

532 . § 523(a)(4).

533 . § 523(a)(6).

534 . § 523(a)(3)(B), (c)(1).

535 . Subsection 523(a)(3)(B) exempts from discharge claims known to the debtor if not scheduled in time for a creditor with a (2), (4), or (6) claim to make a timely proof of claim and a “timely request for a determination of dischargeability . . . unless such creditor had notice or actual knowledge of the case in time for such timely filing and request.” § 523(a)(3)(B).

536 . § 523(c)(1).

537 . 705 F.2d 1118 (9th Cir. 1983).

538 . *In re Gregory*, 705 F.2d at 1119.

539 . *Id.* at 1120.

540 . *Id.* at 1120–21.



terms are illegal.<sup>541</sup> Where legally possible, even if provisionally,<sup>542</sup> res judicata is irrelevant.<sup>543</sup> If such a term is within the discretion of the court, it is by definition permitted by the Bankruptcy Code.

Some courts think such terms are ultra vires as violations of § 524(e).<sup>544</sup> When courts take this position, the issue becomes whether plans in violation of § 524(e) are worthy of res judicata respect. The classic res judicata case in this vein is *Republic Supply Co. v. Shoaf*,<sup>545</sup> where a creditor failed to appeal confirmation of a plan discharging a guarantor.<sup>546</sup> Later, res judicata was accepted as a defense to the claim against the guarantor.<sup>547</sup> In upholding the defense, Judge E. Grady Jolly was not certain that the release term was barred by § 524(e).

[T]he statute does not by its specific words preclude the discharge of a guaranty when it has been accepted and confirmed as an integral part of a plan of reorganization. *Regardless of whether that provision is inconsistent with the bankruptcy laws* or within the authority of the bankruptcy court, it is nonetheless included in the Plan, which was confirmed by the bankruptcy court without objection and was not appealed. Republic, in effect, is now seeking to appeal the confirmed Plan and asking us to review it on its merits. Questions of the propriety or legality of the bankruptcy court confirmation order are indeed properly addressable on direct appeal. Republic . . . is now foreclosed from that avenue of review because it chose not to pursue it. The issue before us in this appeal is the application, not the interpretation, of the Plan.<sup>548</sup>

To date, no court has denied res judicata respect to a third-party discharge.<sup>549</sup> But courts have yet to confront the argument presented in the student loan cases. In some of these cases, courts have refused to honor the res judicata effect of a

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541. See generally Joshua M. Silverstein, *Hiding in Plain View: A Neglected Supreme Court Decision Resolves the Debate over Non-debtor Releases in Chapter 11 Reorganizations*, 23 EMORY BANKR. DEV. J. 13 (2006).

542. See SEC v. Drexel Burnham Lambert Group, Inc. (*In re Drexel Burnham Lambert Group, Inc.*), 960 F.2d 285, 293 (2d Cir. 1992) (stating that creditor can be enjoined from suing third party if injunction plays important role in debtor's reorganization plan); MacArthur Co. v. Johns-Manville Corp., 837 F.2d 89, 91 (2d Cir. 1988) (upholding discharge of third-party insurance company).

543. See Corbett v. MacDonald Moving Servs., Inc., 124 F.3d 82, 92 (2d Cir. 1997) (recognizing that decision denying res judicata to third-party debtor would render reorganization plan unenforceable).

544. See Resorts Int'l, Inc. v. Lowenschuss (*In re Lowenschuss*), 67 F.3d 1394, 1401 (9th Cir. 1995) (holding that § 524(e) precludes bankruptcy courts from discharging nondebtors' liabilities); Landsing Diversified Props.-II v. First Nat'l Bank & Trust Co. (*In re W. Real Estate Fund, Inc.*), 922 F.2d 592, 600 (10th Cir. 1990) (stating that Congress did not intend to extend bankruptcy protection to nondebtors).

545. 815 F.2d 1046 (5th Cir. 1987).

546. *Shoaf*, 815 F.2d at 1049.

547. *Id.* at 1050.

548. *Id.* (emphasis added).

549. See, e.g., Pratt v. Ventas, Inc., 365 F.3d 514, 521–22 (6th Cir. 2004) (noting that preclusive effect is given to jurisdictional decisions and third-party discharge is upheld); Monarch Life Ins. Co. v. Ropes & Gray, 65 F.3d 973, 983 (1st Cir. 1995) (holding that failure to appeal confirmation order had preclusive effect). Even worse, courts have claimed that the original appeal is forfeited under the disgraceful doctrine of equitable mootness. *In re Specialty Equip. Cos.*, 3 F.3d 1043, 1047–49 (7th Cir. 1993).

discharge of a student loan because Federal Rule 7001(6) requires an adversary proceeding for “a proceeding to determine the dischargeability of a debt.”<sup>550</sup> Does Rule 7001(6) also require an adversary proceeding to effectuate a third-party release? If so, failure to bring the adversary proceeding destroys the *res judicata* effect of plans that discharge third parties.

Such a possibility must be rejected. First, it may be noted that some claims are never discharged—priority taxes and claims for domestic support obligations, for example.<sup>551</sup> Certainly a creditor need not bring an adversary proceeding to determine the nondischargeability of such claims. They are simply, by their nature, not dischargeable. Surely the adversary proceeding requirement is limited to student loan claims, which are provisionally nondischargeable, or to willful and malicious tort claims and the like, which are dischargeable unless the creditor comes forward in a timely manner to prevent the discharge.<sup>552</sup>

But what is a “discharge” under the Bankruptcy Code? Whatever it is, the *consequences* of discharge “under this title” are described in § 524(a). There we learn that enforcement is enjoined, prepetition judgments are voided, etc. Each of these terms refers to discharge *of the debtor*.<sup>553</sup> We also know *when* a discharge is effective. In Chapter 7, it is when the court grants it.<sup>554</sup> The discharge at that time is granted to *the debtor*. In Chapter 11, discharge happens when the plan is confirmed.<sup>555</sup> It is the *debtor* who is discharged. In Chapter 13, the court grants it after the debtor has made all payments required by the plan.<sup>556</sup> Once again, the *debtor* is discharged. None of these provisions refers to the discharge of third parties. It says that, whatever a discharge is, a discharge of the *debtor* “does not affect the liability of any other entity on . . . such debt.”<sup>557</sup> Section 524(e) provides another clue. This leads to the inference that a discharge of a nondebtor in a reorganization plan is not what § 523(a) means by “discharge under . . . this title.”<sup>558</sup> Accordingly, no adversary proceeding is required to achieve a third-party discharge by means of plan confirmation. Perhaps the plan term in question is a *release*, not a discharge within the meaning of Rule 7001(6).<sup>559</sup> Indeed, many

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550. FED. R. BANKR. P. 7001(6). See *supra* Part III.D.1 for a discussion of cases where courts have refused to honor the *res judicata* effects of discharges of student loans.

551. 11 U.S.C. § 523(a)(1), (5) (2006).

552. § 523(c).

553. In the case of the injunction, § 524(a)(2) does not mention the debtor, but it refers to acts to collect “such debt.” § 524(a)(2). “Such debt” refers back to § 524(a)(1) which refers to “the personal liability of the debtor.” § 524(a)(1).

554. § 727(a).

555. § 1141(d)(1)(A). BAPCPA has changed the rule for individuals in Chapter 11. Inspired by Chapter 13, Congress has directed that the discharge be granted at the end of the plan, “unless after notice and a hearing the court orders otherwise.” § 1141(d)(5)(A).

556. § 1328(a); see also § 1328(b) (providing for discharge even if plan is not completed).

557. § 524(e).

558. § 523(a).

559. One commentator remarks, “Section 524(e) does not expressly prohibit releases; it merely provides that the discharge of a debtor does not, ‘by itself, affect the liability of other parties.’” Silverstein, *supra* note 541, at 61 (quoting *In re Transit Group, Inc.*, 286 B.R. 811, 816 (Bankr. M.D. Fla. 2002)).

courts think releases are barred by § 523(e) because *they purport to be discharges*, which can only affect the debtor.<sup>560</sup> Accordingly, for courts that disagree, it must also be true that releases are *not* discharges, and the adversary proceeding is not required.

#### F. Setoffs

Suppose a confirmed plan treats a creditor as unsecured, when that creditor actually has a setoff opportunity. Can the creditor later assert the setoff?

Setoff opportunities are equated with security interests by the Bankruptcy Code.<sup>561</sup> So, if a plan cannot avoid a security interest without an adversary proceeding, one would certainly expect that the plan cannot end the setoff opportunity without a like procedure. This expectation is considerably strengthened by the wording of § 553(a), which provides:

Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case . . . .<sup>562</sup>

This section is “in direct conflict” with the finality provisions in the reorganization chapters.<sup>563</sup>

The issue is important in Chapter 13 cases, where debtors owe prepetition taxes from prior years and where they are overwithheld for current taxes. In *United States v. Munson (In re Munson)*,<sup>564</sup> the court insinuated that the IRS does not even need to assert a setoff to cancel the refund.<sup>565</sup> Rather, the IRS’s right was in the nature of a recoupment or a netting; the refund figures in calculating the debtor’s tax debt.<sup>566</sup> According to this view, there are not two countervailing claims in this situation.<sup>567</sup> But just in case the IRS had a setoff opportunity, the court went on to rule that § 553(a) outranks the res judicata effect of a plan; a court is not competent to deprive a setoff opportunist of her right.<sup>568</sup>

The contrary view was taken early by the Third Circuit in *United States ex rel. Internal Revenue Service v. Norton*.<sup>569</sup> The IRS was held to have a setoff right, and, where the confirmed plan did not confirm this right, the debtor’s right to a

560. See *Resorts Int’l, Inc. v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1401–02 (9th Cir. 1995) (discussing cases where courts have found that discharge of nondebtors violates § 524(e)).

561. § 506(a).

562. § 553(a).

563. *Carolco Television Inc. v. Nat’l Broad. Co. (In re De Laurentiis Entm’t Group Inc.)*, 963 F.2d 1269, 1274 (9th Cir. 1992).

564. 248 B.R. 343 (C.D. Ill. 2000).

565. *In re Munson*, 248 B.R. at 345.

566. *Id.* at 346.

567. *Id.*

568. *Id.*; accord *In re Bare*, 284 B.R. 870, 874 (Bankr. N.D. Ill. 2002) (finding that Title 11 does not extinguish IRS’s setoff rights).

569. 717 F.2d 767 (3d Cir. 1983), *superseded by statute*, 11 U.S.C. § 362(h), Pub. L. No. 109-390, 120 Stat. 2692 (2006).

refund was returned to the debtor free and clear of the setoff pursuant to § 1327(c).<sup>570</sup> Mitigating the loss of the setoff right, of course, is the fact that the IRS was entitled to be paid in full under the plan (to the extent that its claims are entitled to priority under § 507).<sup>571</sup>

The circuits are split as to whether § 553(a) outranks § 1141(a). In *United States v. Continental Airlines (In re Continental Airlines)*,<sup>572</sup> the government owed \$4.8 million to the debtor, and the debtor owed the government \$14.5 million.<sup>573</sup> The proofs of claim did not assert a setoff right.<sup>574</sup> The plan gave the government a 4.8% dividend on its unsecured claims.<sup>575</sup> Later, the government sought permission from the bankruptcy court to set off the amount the debtor owed against the government's obligation to the debtor.<sup>576</sup> The court held that, under Bankruptcy Code § 1141(a), the plan was res judicata against the government's setoff right.<sup>577</sup> In so ruling, the court gave no weight to § 553(a).<sup>578</sup>

By way of contrast, in *Carolco Television Inc. v. National Broadcasting Co. (In re De Laurentiis Entertainment Group Inc.)*,<sup>579</sup> a debtor had bought advertising time from a television network.<sup>580</sup> Simultaneously, the network bought the rights to televise a made-for-TV film.<sup>581</sup> As a result, a setoff opportunity existed.<sup>582</sup> The debtor then filed in Chapter 11.<sup>583</sup> In the bankruptcy, the network filed a proof of claim featuring an assertion of the setoff opportunity.<sup>584</sup> Under the plan, all of the debtor's assets were sold to a buyer, including the payment intangible against the network.<sup>585</sup> These assets were sold "free and clear" of all interests not mentioned in the plan.<sup>586</sup> The network's setoff right was nowhere mentioned.

Meanwhile, the debtor-in-possession had filed an adversary proceeding against the network to recover the film fee, which continued after confirmation.<sup>587</sup>

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570. *Norton*, 717 F.2d at 774.

571. 11 U.S.C. § 1322(a)(2) (2006).

572. 134 F.3d 536 (3d Cir. 1998).

573. *In re Cont'l Airlines*, 134 F.3d at 538.

574. *Id.*

575. *Id.*

576. *Id.*

577. *Id.* at 541.

578. *In re Cont'l Airlines*, 134 F.3d at 541.

579. 963 F.2d 1269 (9th Cir. 1992).

580. *In re De Laurentiis Entm't Group*, 963 F.2d at 1271.

581. *Id.* The film was *Manhunter*—a prequel to *Silence of the Lambs* and featuring the psychotic jailed psychiatrist, Hannibal Lecter. LEONARD MALTIN'S 2009 MOVIE GUIDE 867 (Leonard Maltin et al. eds., 2009). The film gets three stars from Leonard Maltin. *Id.*

582. *In re De Laurentiis Entm't Group*, 963 F.2d at 1271.

583. *Id.*

584. *Id.*

585. *Id.*

586. *Id.* (internal quotation marks omitted).

587. *In re De Laurentiis Entm't Group*, 963 F.2d at 1271.

This adversary proceeding was inherited by the buyer of the debtor's assets.<sup>588</sup> After confirmation, the network asserted the right to set off its advertising claim against its debt.<sup>589</sup> All levels of courts agreed that the network's setoff right was preserved.<sup>590</sup> The Ninth Circuit relied heavily on § 553(a)'s promise that nothing in the Bankruptcy Code could affect a setoff right.<sup>591</sup>

In exalting § 553(a) over § 1141(a), the Ninth Circuit overlooked the fact that, by its terms, § 553(a) gives way to § 363. Section 363(f) directly authorizes sales free and clear of *liens*, if "the price at which such property is to be sold is greater than the aggregate value of all liens on such property."<sup>592</sup> The definition of lien is broad enough to encompass a setoff right.<sup>593</sup> To be sure, a court is invited to condition a sale on adequate protection of the lien. But, in *De Laurentiis*, the court that confirmed the Chapter 11 plan obviously did not affirmatively provide adequate protection.<sup>594</sup> The *sale* is consistent with § 553(a), even if § 1141(a) is not. Perhaps the Bankruptcy Code was not as contradictory as the Ninth Circuit thought.

The Third Circuit in *Continental* viewed its opinion as distinguishable from *De Laurentiis*,<sup>595</sup> and it can only be distinguishable on the basis that the setoff in *De Laurentiis* was mentioned in the proof of claim. Setoffs were not mentioned in *Continental*, and so perhaps the government was estopped from claiming the setoff later, after the plan was confirmed in reliance on the proof of claim. Yet in *SLW Capital, LLC v. Mansaray-Ruffin (In re Mansaray-Ruffin)*,<sup>596</sup> the Third Circuit held that a plan cannot terminate the lien of a creditor who filed no proof of claim.<sup>597</sup> Since setoffs and liens are equated in the Bankruptcy Code, *Mansaray-Ruffin* arguably overruled *Continental* and *Norton*. This depends on whether avoiding a setoff requires an adversary proceeding.

#### G. Eligibility

According to Bankruptcy Code § 109(e), debtors with too much debt are ineligible for Chapter 13.<sup>598</sup> What if the debtor nevertheless files for Chapter 13 and, before anyone notices, obtains confirmation of a plan? In *Ekeke v. United States*,<sup>599</sup> the court held that § 109(e) was jurisdictional.<sup>600</sup> Accordingly, the plan

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588. *Id.*

589. *Id.*

590. *Id.* at 1274, 1278.

591. *Id.* at 1276–77.

592. 11 U.S.C. § 363(f)(3) (2006).

593. See § 101(37) (defining "lien" as "charge against . . . property to secure payment of a debt").

594. See *In re De Laurentiis Entm't Group*, 963 F.2d at 1277 (finding Chapter 11 would allow setoffs only when written into reorganization plan).

595. *United States v. Cont'l Airlines (In re Cont'l Airlines)*, 134 F.3d 536, 541 (3d Cir. 1998).

596. 530 F.3d 230 (3d Cir. 2008).

597. *In re Mansaray-Ruffin*, 530 F.3d at 235.

598. § 109(e).

599. 133 B.R. 450 (S.D. Ill. 1991). The court also noted that the plan is not binding on the IRS where the IRS is not paid in full. *Ekeke*, 133 B.R. at 452–53.

600. *Id.* at 452.

had no res judicata worth at all.<sup>601</sup> This justified dismissing the case under § 1307(c).<sup>602</sup> Other courts, however, have disagreed and found plans worthy of res judicata respect where the debtor was ineligible for Chapter 13.<sup>603</sup>

#### IV. DUE PROCESS

Res judicata has no bite if a litigant has been denied due process of law.<sup>604</sup> In the context of bankruptcy reorganization, therefore, any showing that notice of the confirmation hearing was unfair will destroy the res judicata worth of the plan.<sup>605</sup> In *Piedmont Trust Bank v. Linkous (In re Linkous)*,<sup>606</sup> a secured creditor claiming a lien on a car and mobile home was notified of a confirmation hearing, but the car loan was not referenced in the notice, and no clear statement that the mobile home loan would be bifurcated appeared in the notice.<sup>607</sup> The plan was confirmed without the creditor objecting.<sup>608</sup> Later, the creditor moved to vacate the confirmation order for lack of notice.<sup>609</sup> The bankruptcy court denied the motion, but the appellate courts vacated the dismissal and ordered the bankruptcy court to revoke the confirmation order.<sup>610</sup> Res judicata can apply only if due process rights are met.<sup>611</sup> Vagueness of the plan is therefore a reason to negate res judicata.<sup>612</sup>

With regard to confirmation as such, notice is required.<sup>613</sup> Creditors are entitled to twenty-five days' notice.<sup>614</sup> The Rules require that a copy of the plan be

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601. *Id.*

602. *Id.*

603. *See Jones v. United States (In re Jones)*, 134 B.R. 274, 277 (N.D. Ill. 1991) (holding that discharge of debtors as to IRS was proper, even though debtor would be ineligible for Chapter 13 relief if IRS contested in timely fashion); *United States v. Edmonston*, 99 B.R. 995, 998 (E.D. Cal. 1989) (stating that res judicata effect precludes challenge to debtors' eligibility); *In re Pitts*, No. 04-81133, 2005 Bankr. LEXIS 490, at \*6 (Bankr. C.D. Ill. Mar. 30, 2005) (stating that eligibility for Chapter 12 is not jurisdictional); *In re Toronto*, 165 B.R. 746, 756 (Bankr. D. Conn. 1994) (recognizing power of court to convert Chapter 13 claim to Chapter 7 claim if debtor does not meet Chapter 13 requirements).

604. *Mullane v. Cent. Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950) ("An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all the circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections.").

605. *See Foremost Fin. Servs. Corp. v. White (In re White)*, 908 F.2d 691, 694 (11th Cir. 1990) (finding denial of appeal rights improper when secured creditor had received inadequate notice for confirmation hearing).

606. 990 F.2d 160 (4th Cir. 1993).

607. *In re Linkous*, 990 F.2d at 161.

608. *Id.*

609. *Id.*

610. *Id.* at 162.

611. *Id.* Judge Robert Foster Chapman, in dissent, complained that the creditor admitted "that the only reason it failed to appear at the hearing or object to the confirmation of [the] proposed plan was because it misplaced its notice." *In re Linkous*, 990 F.2d at 164 (Chapman, J., dissenting).

612. *Brawders v. County of Ventura (In re Brawders)*, 503 F.3d 856, 867 (9th Cir. 2007).

613. 11 U.S.C. § 1324(a) (2006).

614. FED. R. BANKR. P. 2002(b); *see also In re Hudson*, 260 B.R. 421, 430 (Bankr. W.D. Mich. 2001) (stating that Chapter 13 creditors must have twenty-five days' notice of confirmation hearing date and deadlines for objections).

sent along with that notice.<sup>615</sup> But many courts believe that, for any of the items listed in Rule 7001 as requiring an adversary proceeding, the adversary proceeding is itself a constitutional requirement.

In *SLW Capital, LLC v. Mansaray-Ruffin (In re Mansaray-Ruffin)*,<sup>616</sup> Judge Rendell held due process to mean the commencement of an adversary proceeding with regard to lien avoidance.<sup>617</sup> This would seem rather to go beyond the classic minimum set in *Mullane v. Central Hanover Bank & Trust Co.*,<sup>618</sup> but in favor of this view is the Supreme Court's statement in *City of New York v. New York, New Haven & Hartford Railroad Co.*,<sup>619</sup> about due process in the context of bankruptcy. In this case, a new entity was set up for the purpose of buying debtor assets pursuant to a confirmed plan. The entity sought a declaration that a creditor had forfeited liens by not filing a proof of claim by the bar date.<sup>620</sup> At that time the railroad reorganization statute authorized a tough bar date that could destroy liens.<sup>621</sup> The Bankruptcy Act required that "[t]he judge shall cause *reasonable* notice of the period in which claims may be filed . . . by publication or otherwise."<sup>622</sup> Meanwhile, the court was supposed to have caused "proper persons to file in the court a list of all known creditors,"<sup>623</sup> but this was never done. When it came time to notify creditors of the bar date, the court relied on publication of a notice in the *Wall Street Journal*.<sup>624</sup> The Court ruled that the creditor was not on inquiry notice to discover what was occurring in the proceeding that could affect its rights: "But even creditors who have knowledge of a reorganization have a right to assume that the *statutory* 'reasonable notice' will be given them before their claims are forever barred."<sup>625</sup> So the Supreme Court itself equated meeting the bankruptcy procedural rules with proper minimal due process.<sup>626</sup>

615. FED. R. BANKR. P. 3015(d).

616. 530 F.3d 230 (3d Cir. 2008).

617. *In re Mansaray-Ruffin*, 530 F.3d at 238 (holding that adversary proceeding is mandatory due process right that trumps finality); *accord* Whelton v. Educ. Credit Mgmt. Corp., 432 F.3d 150, 156 (2d Cir. 2005) (dismissing debtor for failing to initiate adversary proceeding).

618. 339 U.S. 306 (1950).

619. 344 U.S. 293 (1953). Judge Rendell does not cite *City of New York*. Rather, she relies on *In re Harbor Tank Storage Co.*, 385 F.2d 111, 115–16 (3d Cir. 1967), which reads *City of New York* as supplying the constitutional standard. *In re Mansaray-Ruffin*, 530 F.3d at 239–40.

620. *City of New York*, 344 U.S. at 294–95.

621. *In re New York, N.H. & H.R. Co.*, 105 F. Supp. 413, 417 (D. Conn. 1951) ("The judge shall promptly determine and fix a reasonable time within which the claims of creditors may be filed or evidenced and after which no claim not so filed or evidenced may participate except on order for cause shown . . . ." (quoting 11 U.S.C. § 205(c)(7) (1946))), *aff'd sub nom.* *City of New York v. New York, N.H. & H.R. Co. (In re New York, N.H. & H.R. Co.)*, 197 F.2d 428 (2d Cir. 1952), *rev'd*, 344 U.S. 293 (1953).

622. *City of New York*, 344 U.S. at 296 (emphasis added) (quoting 11 U.S.C. § 205(c)(8) (1946)) (internal quotation marks omitted).

623. *Id.* (citing § 205(c)(4)).

624. *Id.* at 294.

625. *Id.* at 297 (emphasis added).

626. *See* *Banks v. Sallie Mae Servicing Corp. (In re Banks)*, 299 F.3d 296, 302 (4th Cir. 2002) (stating that where Bankruptcy Code and Bankruptcy Rules specify that notice is required before entry of order, order does not have preclusive effect if notice was not given under due process). *But see In re*

But is *City of New York* really a due process case?<sup>627</sup> Some courts have thought so.<sup>628</sup> Other courts have asserted that governmental entities do not have due process rights.<sup>629</sup> The assumption is that the City of New York is the government. Some courts have held that, while *City of New York* is not technically a constitutional case, “courts have construed the notice requirements of the bankruptcy code to apply to ‘all creditors,’ vesting the government ‘with a right akin to due process.’”<sup>630</sup> This warrants borrowing the rule of *City of New York* as the constitutional standard for bankruptcy cases.

If *City of New York* is not a constitutional case, then it is open for courts to hold that following the bankruptcy rules is not constitutionally required. In *Mansaray-Ruffin*, Judge Morton Greenberg dissented on the ground that, under the minimum standard of *Mullane*, all that was required was notice reasonably calculated to apprise interested parties of the proceedings.<sup>631</sup> As the creditor had received notice of the confirmation hearing and the plan was clear as to its treatment of the lien, due process was satisfied, Judge Greenberg opined.<sup>632</sup> But this view cannot be sustained in light of what the Supreme Court has said about due process in the bankruptcy context. There, meeting the statutory procedures is what due process requires. And the rules (as authorized by enabling statutes) require the adversary proceeding in cases of lien avoidance.<sup>633</sup>

This dissenting view won the day in the Ninth Circuit in a discharge case where an adversary proceeding was also required. In *Espinosa v. United Student Aid Funds, Inc.*,<sup>634</sup> Judge Kozinski thought that due process did not require the adversary proceeding:

[W]e find it both wrong and dangerous to hold that the standard for what amounts to constitutionally adequate notice can be changed by legislation. The constitutional standard, as we understand it, requires

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Pence, 905 F.2d 1107, 1109–10 (7th Cir. 1990) (suggesting that sophisticated creditors are on inquiry notice; confirmed plans are binding even in absence of notice). For criticism of *Pence* on constitutional grounds, see Eric S. Richards, *Due Process Limitations on the Modification of Liens Through Bankruptcy Reorganization*, 71 AM. BANKR. L.J. 43, 73–74 (1997).

627. See Richards, *supra* note 626, at 49 (arguing that as *Mullane* was constitutional due process decision, citation to *Mullane* in *City of New York* makes latter case due process opinion).

628. See, e.g., *Arch Wireless, Inc. v. Nationwide Paging, Inc.* (*In re Arch Wireless, Inc.*), 534 F.3d 76, 84–85 (1st Cir. 2008) (holding that plan was not binding because no one notified creditor about confirmation hearing); Kennedy & Smith, *supra* note 14, at 656–64 (discussing cases in which courts have found that *City of New York* is due process case).

629. E.g., *United States v. Cardinal Mine Supply, Inc.*, 916 F.2d 1087, 1090 (6th Cir. 1990).

630. *United States ex rel. IRS v. Hairopoulos* (*In re Hairopoulos*), 118 F.3d 1240, 1244 n.3 (8th Cir. 1997) (quoting *In re Interstate Cigar Co.*, 150 B.R. 305, 309 (Bankr. E.D.N.Y. 1993)).

631. *SLW Capital, LLC v. Mansaray-Ruffin* (*In re Mansaray-Ruffin*), 530 F.3d 230, 245–46 (3d Cir. 2008) (Greenberg, J., dissenting).

632. *Id.* at 247.

633. Failure to follow the rules can also be a violation of a debtor’s due process rights, thereby spoiling res judicata in the creditor’s favor. In *Sanchez v. Ameriquet Mortgage Co.* (*In re Sanchez*), a mortgage lender inflated its proper secured claim, but it did not file a proper Rule 2016 application for fees. 372 B.R. 289, 302, 304 (Bankr. S.D. Tex. 2007). The plan was held to have no res judicata effect, and the debtor could seek a refund. *In re Sanchez*, 372 B.R. at 320–21.

634. 553 F.3d 1193 (9th Cir. 2008), *cert. granted*, 129 S. Ct. 2791 (2009).



that a party affected by the litigation obtain sufficient notice so that it is able to take steps to defend its interests. Congress can, of course, give rights to additional notice, but we find it difficult to see how this can affect the floor provided by due process—either to increase or diminish it.<sup>635</sup>

In Judge Kozinski's opinion, the purpose of the adversary proceeding requirement is to provide grounds for a creditor to object to confirmation.<sup>636</sup> Had the creditor objected at the confirmation hearing, failure to obtain an adversary proceeding would require the bankruptcy court to deny confirmation.<sup>637</sup> Due process, however, was satisfied by conforming to the notice provisions required for confirmation of a plan.

This view, however, does not account for *City of New York*, which arguably equates due process with such notice as actually required by the rules. Only if *City of New York* is not a due process case can the view of Judges Greenberg and Kozinski be sustained. Yet why should the City of New York, for all its grandeur and *haute cuisine*, have more rights than a humble American citizen?

## V. REVOCATION

A reorganization plan might be worthy of *res judicata*, but perhaps, under the Bankruptcy Code or some other provision, the confirmation order is revocable. Obviously *res judicata* must give way to revocability.

Both Chapters 11 and 13 have rules that apply to revocation of a reorganization plan. Section 1144 provides:

On request of a party in interest at any time before 180 days after the date of the entry of the order of confirmation, and after notice and a hearing, the court may revoke such order *if and only if* such order was procured by fraud.<sup>638</sup>

Similarly, § 1330(a) provides:

On request of a party in interest at any time within 180 days after the date of the entry of an order of confirmation under section 1325 of this title, and after notice and a hearing, the court may revoke such order if such order was procured by fraud.<sup>639</sup>

Section 1330(b) goes on to command a dismissal of the Chapter 13 case or conversion to Chapter 7 unless, within the time fixed by the court, the debtor

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635. *Espinosa*, 553 F.3d at 1204. In its earlier opinion in *Fireman's Fund Mortgage Corp. v. Hobdy (In re Hobdy)*, the appellate panel ruled that failure of a debtor to object to the arrearage claim of a mortgage lender was a due process violation. 130 B.R. 318, 320 (B.A.P. 9th Cir. 1991). Presumably, if *Espinosa* is constitutionally sound, *Hobdy* is not good law. On Judge Kozinski's reasoning, however, failure to object to an arrearage claim per Rule 3007 becomes a reason for the court to deny confirmation of the plan, pending resolution of the objection procedure.

636. *Espinosa*, 553 F.3d at 1204.

637. *Id.* at 1200–01.

638. 11 U.S.C. § 1144 (2006) (emphasis added).

639. § 1330(a).

proposes an acceptable modification of the plan (which, oddly, has earlier been entirely revoked).<sup>640</sup> No similar provision exists in Chapter 11.

Notice that § 1144 contains the stern words “if and only if”—the language of necessary *and* sufficient conditions. Section 1330(a) uses the word “if” only—feeble language of sufficiency but not necessity. It does not so clearly state that fraud is the *only* grounds for revocation. Furthermore, “if and only if” stems from a 1984 amendment to § 1144.<sup>641</sup> Congress therefore chose to clarify the rule in Chapter 11, leaving intact whatever the Chapter 13 rule was supposed to be.

Meanwhile, Federal Rule of Bankruptcy Procedure 9024 makes Federal Rule of Civil Procedure 60 applicable in bankruptcy proceedings.<sup>642</sup> According to Rule 60(b):

On motion and just terms, the court may relieve a party . . . from a final judgment, order, or proceeding for the following reasons:

- (1) mistake, inadvertence, surprise, or excusable neglect;
- (2) newly discovered evidence that, with reasonable diligence, could not have been discovered in time to move for a new trial under Rule 59(b);
- (3) fraud (whether previously called intrinsic or extrinsic), misrepresentation, or misconduct by an opposing party;
- (4) the judgment is void;
- (5) the judgment has been satisfied, released or discharged; it is based on an earlier judgment that has been reversed or vacated; or applying it prospectively is no longer equitable; or
- (6) any other reason that justifies relief.<sup>643</sup>

Rule 60(b) has a time restriction. The motion must be in a “reasonable time,” and, in any case, relief under subparagraphs (1)–(3) must be within a year of the judgment or order.<sup>644</sup> But Rule 9024(3) makes clear that, in bankruptcy cases, the relevant time limit is the 180 days mentioned in § 1144 and § 1330(a).<sup>645</sup> In

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640. Section 1330(b) is also ambiguous on the question of whether a court *must* afford an opportunity to modify the revoked plan.

641. Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 515, 98 Stat. 333.

642. According to Federal Rule of Bankruptcy Procedure 9024, Federal Rule of Civil Procedure 60:

applies in cases under the Code except that (1) a motion to reopen a case under the Code or for the reconsideration of an order allowing or disallowing a claim against the estate entered without a contest is not subject to the one year limitation prescribed in Rule 60(c), (2) a complaint to revoke a discharge in a chapter 7 liquidation case may be filed only within the time allowed by § 727(e) of the Code, and (3) a complaint to revoke an order confirming a plan may be filed only within the time allowed by § 1144, § 1230, or § 1330.

FED. R. BANKR. P. 9024.

643. FED. R. CIV. P. 60(b); *see also* Johnson v. Stemple (*In re Stemple*), 361 B.R. 778, 799–800 (Bankr. E.D. Va. 2007) (applying Rule 60(b) to claim that debtor procured confirmation plan through fraud).

644. FED. R. CIV. P. 60(c).

645. FED. R. BANKR. P. 9024(3).

addition, although Rule 60(b) can be invoked by motion, a revocation order requires an adversary proceeding.<sup>646</sup>

Many courts hold that § 1144 and § 1330(a) preempt Rule 60(b), once the confirmation order is final.<sup>647</sup> Accordingly, only fraud will justify revocation of the confirmation order, and, even in the case of fraud, the required adversary proceeding must be commenced within 180 days of confirmation.<sup>648</sup> Such a holding seems compelling in Chapter 11 cases, because § 1144 intones “*if and only if*.”<sup>649</sup> It is less compelling in Chapter 13 cases, where § 1330(a) invites revocation for, but does not limit it to, incidents of fraud.<sup>650</sup>

In *Branchburg Plaza Associates, L.P. v. Fesq (In re Fesq)*,<sup>651</sup> the Third Circuit nevertheless ruled that § 1330(a) preempts Rule 60(b). In *Fesq*, a creditor had a judgment lien for \$69,000 on the debtor’s house.<sup>652</sup> The court confirmed a plan that provided for satisfaction of the lien upon payment of a lump sum of \$7,050.<sup>653</sup> The creditor did not object to confirmation.<sup>654</sup> Later the creditor moved for revocation under Rule 60(b)(1) because of the creditor’s excusable neglect in not objecting to confirmation.<sup>655</sup> A majority of the court held that § 1330(a) provided the exclusive grounds for revoking an otherwise valid confirmation order.<sup>656</sup> Judge Milton I. Shadur, for the majority, thought that, if fraud was *not* the only grounds for revocation, statutory language would be reduced to mere surplusage.<sup>657</sup> Indeed, fraud is one of the items listed in Rule 60(b).<sup>658</sup> If Rule 60(b)

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646 . FED. R. BANKR. P. 7001(5).

647 . According to Rule 8002(b)(4), the time for filing an appeal of a confirmation order is extended beyond the usual ten days if a creditor makes a Rule 60(b) motion prior to the ten days after the confirmation order. FED. R. BANKR. P. 8002(b)(4). It has been held that § 1330(a) does not preempt Rule 60(b) if the motion is made in this fashion. *In re Briley*, No. 01-10691-RLJ-13, 2003 Bankr. LEXIS 2279, at \*6 (Bankr. N.D. Tex. 2003) (holding § 1330(a) provides that fraud is only basis for revocation of order of confirmation).

648 . *Duplessis v. Valenti (In re Valenti)*, 310 B.R. 138, 152 (B.A.P. 9th Cir. 2004) (holding that creditors could not evade 180-day bar even if Chapter 13 confirmation order was obtained by fraud). In *Valenti*, the court ruled that the 180-day period is not tolled if the debtor conceals the fraud. *Id.* at 150. It also held open the possibility that debtor fraud could lead to a dismissal for cause under § 1307(c). *Id.* at 151. If this is the case, the 180-day deadline means little.

649 . *In re Longardner & Assocs., Inc.*, 855 F.2d 455, 460 n.5 (7th Cir. 1988) (quoting § 1144) (internal quotation marks omitted).

650 . 11 U.S.C. § 1330(a) (2006); *see also* *Mason v. Young (In re Young)*, 237 B.R. 791, 803 (B.A.P. 10th Cir. 1999) (holding that § 1330 provides “complete substantive basis” for all revocation motions), *aff’d* 237 F.3d 1168 (10th Cir. 2001); *Educ. Credit Mgmt. Corp. v. Robinson (In re Robinson)*, 293 B.R. 59, 63 (Bankr. D. Or. 2002) (stating that § 1330(a) makes more sense as substantive limitation than as permissive reminder).

651 . 153 F.3d 113 (3d Cir. 1998).

652 . *In re Fesq*, 153 F.3d at 114.

653 . *Id.* Could this be done without the aid of an adversary proceeding? Probably the case must be viewed as one in which the secured claim was determined in amount or by value of collateral (rather than a case in which avoidance was attempted by means of the plan). *See supra* Part III.A.1 for a discussion of avoidance without an adversary proceeding.

654 . *In re Fesq*, 153 F.3d at 114.

655 . *Id.* at 116.

656 . *Id.* at 120.

657 . *Id.* at 115.

is not somehow limited, the statutory language in § 1330(a) could properly have been omitted.

In dissent, Judge Walter King Stapleton pointed to the 1984 amendment to the Bankruptcy Code, which established that revocation in Chapter 11 could occur “if and only if” confirmation was procured by fraud. Congress could have, but did not, make the same amendment in Chapter 13.<sup>659</sup> This led Judge Stapleton to opine that Congress intended the Chapter 13 rule to be nonexclusive.

Why should we, in the absence of an unambiguous directive of Congress, tie the hands of bankruptcy judges in situations where justice cries out for review of a previously entered judgment. Why, for example, should we render a bankruptcy court powerless to grant relief when an objecting creditor’s attorney has a heart attack on his way to a confirmation hearing at which a final order is entered?<sup>660</sup>

Contrary to *Fesq*, in a way, is *Cisneros v. United States (In re Cisneros)*.<sup>661</sup> This case is ostensibly a discharge case, but arguably it rests on the premise that a Chapter 13 plan has no res judicata worth where a creditor timely files a proof of claim after confirmation. In *Cisneros*, a plan was confirmed, paying the IRS at a relatively low amount.<sup>662</sup> The IRS then filed a proof of claim in excess of the plan amount.<sup>663</sup> The Chapter 13 trustee never received notice of the proof of claim (as he should have).<sup>664</sup> He therefore recommended a discharge order be entered.<sup>665</sup> The court complied.<sup>666</sup> Later, the IRS sought to reverse the discharge order using Rule 60(b).<sup>667</sup> This motion, eventually successful, logically depends on the plan *not* being res judicata to the IRS proof of claim.

Discharge is subject to a rule that resembles § 1330(a). According to § 1328(e):

[T]he court may revoke such discharge only if—

- (1) such discharge was obtained by the debtor through fraud; and
- (2) the requesting party did not know of such fraud until after such discharge was granted.<sup>668</sup>

Notice that, unlike § 1330(a), § 1328(e) does use the language of necessary and sufficient conditions. Nevertheless, the *Cisneros* court ruled that Congress could

658 . FED. R. CIV. P. 60(b).

659 . This is what is called a “knew how to” argument. See Charles Jordan Tabb, *The Bankruptcy Reform Act in the Supreme Court*, 49 U. PITT. L. REV. 477, 518 n.259 (1988) (explaining how Justice Rehnquist used “knew how to” argument to interpret 11 U.S.C. § 1167 (1982) in *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 521–23 (1984)). Since Congress “knew how to” set necessary and sufficient conditions for revocation of confirmation in Chapter 11, it intended a different rule for Chapter 13.

660 . *In re Fesq*, 153 F.3d at 123 (Stapleton, J., dissenting).

661 . 994 F.2d 1462 (9th Cir. 1993).

662 . *In re Cisneros*, 994 F.2d at 1464.

663 . *Id.*

664 . *Id.*

665 . *Id.*

666 . *Id.*

667 . *In re Cisneros*, 994 F.2d at 1464–65.

668 . 11 U.S.C. § 1328(e) (2006) (emphasis added).

not have intended to deny courts the power to correct their own mistakes.<sup>669</sup> It did so, even though § 1328(e), like § 1144, says “only if.”<sup>670</sup> If Rule 60(b) can flourish in the § 1328(e) environment, should it not likewise thrive in the healthier § 1330(a) environment, where fraud is a sufficient but not an explicitly necessary ground for revocation?

Nevertheless, it cannot be the case that fraud is the only grounds for revocation. What if the order is void for failure to accord the creditor due process protection? Rule 60(b)(4) indicates that the revocation is still possible, so long as the motion is made in a reasonable time. Yet denial of due process may not be fraudulent. So Rule 60(b)(4), which articulates a constitutional principle, outranks the Bankruptcy Code, at least on this one point.<sup>671</sup>

Consistent with *Cisneros*, some courts simply deny that § 1330(a) was intended to limit Rule 60(b) revocations. Said one court,

[I]t is difficult to believe that Congress, in drafting § 1330, or the Supreme Court, in adopting Rule 9024, intended to prevent bankruptcy courts from granting relief from confirmation orders for any of the various weighty reasons for which a federal court may set aside a final judgment in a civil action. While the matter is not wholly free from doubt, the court concludes that Rule 9024 may be used to grant relief from a confirmation order on grounds other than fraud.”<sup>672</sup>

In support of this view, one court held that § 1330(a) applies to *revocation* of the confirmation order.<sup>673</sup> Rule 60(b), however, provides for “[r]elief.”<sup>674</sup> The two remedies are supposedly different, and therefore a court has the full access and passage to remorse via Rule 60(b).<sup>675</sup>

What is fraud for the purposes of § 1144 and § 1330(a)? It might include falsely understating debt to achieve Chapter 13 eligibility under § 109(e),<sup>676</sup>

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669. *In re Cisneros*, 994 F.2d at 1466.

670. §§ 1328, 1144.

671. See *In re Swanson*, 312 B.R. 153, 158 (Bankr. N.D. Ill. 2004) (holding that relief from confirmation order pursuant to Rule 60 can be granted only when party has been deprived of constitutional right); *Educ. Credit Mgmt. Corp. v. Whelton* (*In re Whelton*), 312 B.R. 508, 520 (D. Vt. 2004) (holding that part of confirmation and discharge orders was void when creditor's due process right was not sufficiently satisfied), *aff'd*, 432 F.3d 150 (2d Cir. 2005); *In re Hudson*, 260 B.R. 421, 444 (Bankr. W.D. Mich. 2001) (holding that court can set aside Chapter 13 confirmation order when notice is not constitutionally adequate).

672. *In re Joseph*, No. 97-16155-SSM, 1998 WL 939694, at \*6 (Bankr. E.D. Va. Nov. 4, 1998).

673. *Branchburg Plaza Assocs., L.P. v. Fesq* (*In re Fesq*), 153 F.3d 113, 116–17 (3d Cir. 1998).

674. FED. R. CIV. P. 60(b).

675. See *In re Joseph*, 1998 WL 939694, at \*6 (finding that Rule 60(b) allows for relief from confirmation orders for reasons other than fraud); cf. *Johnson v. Stemple* (*In re Stemple*), 361 B.R. 778, 810–11 (Bankr. E.D. Va. 2007) (allowing creditor to seek § 1330(a) revocation of confirmation plan that debtor obtained through fraud).

676. *Nikoloutsos v. Nikoloutsos* (*In re Nikoloutsos*), 199 F.3d 233, 238 (5th Cir. 2000); *In re Stemple*, 361 B.R. at 784–85.

failing to send notice to a creditor whose address was known,<sup>677</sup> concealing assets or income,<sup>678</sup> misvaluing assets,<sup>679</sup> or deliberately misstating tax debt.<sup>680</sup>

What if creditors do not find out about the fraud during the 180-day period? In *Duplessis v. Valenti (In re Valenti)*,<sup>681</sup> the court held that the period is not tolled.<sup>682</sup> This can be questioned. In *Young v. United States*,<sup>683</sup> the Supreme Court held that equitable tolling principles are to be read into statutes of limitation whenever “nothing in the Bankruptcy Code precludes equitable tolling of the lookback period.”<sup>684</sup> There is no reason to suppose that the “discovery rule” could not be used to extend the 180-day period, where the debtor is concealing grounds for the revocation order.

The *Valenti* court also suggested that, even if the 180-day period has lapsed, a court might still dismiss the entire Chapter 13 case or convert the case to Chapter 7 for “cause” under § 1307(c).<sup>685</sup> Cause is not exclusively defined, but eleven examples of cause are given.<sup>686</sup> One of them is “revocation of the order of confirmation under section 1330 . . . and denial of confirmation of a modified plan under section 1329.”<sup>687</sup> So the *Valenti* court must be assuming that, even where § 1330 revocation is no longer possible, the same grounds for revoking might nevertheless be grounds for dismissing, as an unenumerated cause. One may fairly ask if there is any difference between revocation under § 1330 and dismissal or conversion under § 1307(c).<sup>688</sup> If not, no harm was done by the *Valenti* court in ruling that the discovery rule cannot apply to plan revocation.

Incidentally, revocation of a confirmation order requires an adversary proceeding,<sup>689</sup> but dismissals or conversions under § 1307(c) do not. Perhaps § 1307(c) entirely undercuts the careful restrictions of § 1330(a).

A different idea for undermining res judicata of the plan on grounds of fraud (where the 180-day period of § 1330(a) has not been met) is to proclaim that the fraud gives rise to a due process violation. In *United States v. Trembath (In re Trembath)*,<sup>690</sup> two different debtors failed to pay a withholding tax, thereby

677. *In re Scott*, 77 B.R. 636, 637 (Bankr. N.D. Ohio 1987).

678. *Duplessis v. Valenti (In re Valenti)*, 310 B.R. 138, 142 (B.A.P. 9th Cir. 2004).

679. *In re Powers*, 48 B.R. 120, 120 (Bankr. M.D. La. 1985).

680. *In re Moseley*, 74 B.R. 791, 804 (Bankr. C.D. Cal. 1987), *vacated as moot*, 101 B.R. 608 (B.A.P. 9th Cir. 1989).

681. 310 B.R. 138 (B.A.P. 9th Cir. 2004).

682. *In re Valenti*, 310 B.R. at 145.

683. 535 U.S. 43 (2002).

684. *Young*, 535 U.S. at 47.

685. *In re Valenti*, 310 B.R. at 151 (observing that motions based on preconfirmation misconduct by debtor, under § 1307(c), may not be barred by res judicata because debtor's misconduct could bar defense of res judicata by estoppel).

686. 11 U.S.C. § 1307(c) (2006).

687. § 1307(c)(7).

688. *See United States v. Trembath (In re Trembath)*, 205 B.R. 909, 914–15 (Bankr. N.D. Ill. 1997) (asserting but not explicating difference between dismissing and revoking plans).

689. FED. R. BANKR. P. 7001(5).

690. 205 B.R. 909 (Bankr. N.D. Ill. 1997).

triggering control person liability.<sup>691</sup> They filed for Chapter 13 protection.<sup>692</sup> One falsely listed his tax debt at zero; the other did likewise but also falsely indicated that he did not run a business.<sup>693</sup> The court confirmed plans that gave the IRS nothing.<sup>694</sup> After the plans were completed, the IRS began processes for collecting taxes which, according to the plan, had been paid in full.<sup>695</sup> And of course, under § 1322(a)(2), such claims *must* be paid in full as a condition to confirmation.<sup>696</sup> The court ruled that the plan had no res judicata worth because the fraud committed by the debtors constituted a due process violation.<sup>697</sup> Ironically, the IRS, being the government, *owes* due process. It does not *have* due process rights. Nevertheless, bankruptcy courts paper over this embarrassment by saying the government has “right[s] akin to due process”<sup>698</sup> (i.e., they simply ignore the fact that the IRS has no due process rights and proceed accordingly). A due process violation serves to destroy the res judicata worth of plans, and so the IRS was permitted to collect from the debtors.

Some courts have held that simple failure to disclose facts is a due process violation, spoiling the res judicata worth of a plan. In *In re Friedman*,<sup>699</sup> the debtor failed to list his employer identification number and *nom de commerce* in the caption to court papers, as required in Rule 1005.<sup>700</sup> A confirmed plan allocated zero to a taxing authority, which claimed a lien.<sup>701</sup> The court held the plan unworthy of res judicata because of the defective caption.<sup>702</sup>

Some courts hold that conversion of a case to Chapter 7 has the effect of revoking a Chapter 13 plan.<sup>703</sup> In *Hutchinson v. Delaware Savings Bank FSB*,<sup>704</sup> a plan had reinstated home mortgages, the case converted to Chapter 7, and the debtor then brought an adversary proceeding against the mortgage lender for lender liability.<sup>705</sup> The lender claimed that res judicata from the plan barred this cause of action; the debtors had had an opportunity to assert setoffs against the lender prior to the plan but did not.<sup>706</sup> Therefore the countervailing claim was

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691. *In re Trembath*, 205 B.R. at 911.

692. *Id.* at 910–11.

693. *Id.* at 911–12.

694. *Id.*

695. *Id.*

696. *In re Trembath*, 205 B.R. at 912.

697. *Id.* at 915.

698. *United States ex rel. IRS v. Haiopoulos (In re Haiopoulos)*, 118 F.3d 1240, 1244 n.3 (8th Cir. 1997) (quoting *In re Interstate Cigar Co.*, 150 B.R. 305, 309 (Bankr. E.D.N.Y. 1993)) (internal quotation marks omitted).

699. 184 B.R. 883 (Bankr. N.D.N.Y. 1994).

700. *In re Friedman*, 184 B.R. at 886.

701. *Id.*

702. *Id.* at 889–90.

703. *Friendly Fin. Serv.–Eastgate Inc. v. Dorsey (In re Dorsey)*, 505 F.3d 395, 400 (5th Cir. 2007); *Nash v. Kester (In re Nash)*, 765 F.2d 1410, 1413 (9th Cir. 1985).

704. 410 F. Supp. 2d 374 (D.N.J. 2006).

705. *Hutchinson*, 410 F. Supp. 2d at 376.

706. *Id.* at 377–78.

precluded.<sup>707</sup> The court denied the res judicata defense and noted that the debtors' cause of action properly belonged to the Chapter 7 trustee.<sup>708</sup> Accordingly, the court ordered that the trustee be added as a plaintiff in the action.<sup>709</sup>

Similarly, in *In re Shaffer*,<sup>710</sup> a Chapter 13 plan proclaimed security interests void.<sup>711</sup> In later times, many courts would have said that such a plan term is ultra vires absent an adversary proceeding. Be that as it may, the case converted to Chapter 7, and the secured parties sought to assert their liens in the Chapter 7 case.<sup>712</sup> The court ruled that plan confirmation "[a]t best . . . operates as only a provisional determination of [the debtors' and creditors'] rights."<sup>713</sup> Only a discharge order can have res judicata effect, the court thought.<sup>714</sup> Plans never do. Such a view flies in the face of § 1327(a) and therefore cannot be endorsed.

Finally, one court has gone so far as to hold that mere plan default revokes the plan. In *In re Miano*,<sup>715</sup> a plan was in default when the secured creditor moved to lift the automatic stay to permit foreclosure of a mortgage.<sup>716</sup> Although the court found that lifting the stay was appropriate relief, it held that bifurcation in the confirmed plan had no res judicata worth whatsoever.<sup>717</sup>

Other courts disagree and hold res judicata applies even if the case is converted or dismissed. In *Adair v. Sherman*,<sup>718</sup> the debtor proposed a plan that never valued collateral, but it promised to pay the secured claim 100 cents on the dollar.<sup>719</sup> Before confirmation, the secured creditor filed a proof of claim reflecting that the collateral was worth more than its original purchase price.<sup>720</sup> The court confirmed the plan, but at the high amount.<sup>721</sup> The debtor did not object.<sup>722</sup> Later, the Chapter 13 proceeding was dismissed.<sup>723</sup> The debtor then sought to recover damages against the secured creditor's attorneys under the Fair Debt Collection Practices Act.<sup>724</sup> The court held this action to be precluded by confirmation of the

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707. *Id.* at 378.

708. *Id.* at 380–82.

709. *Id.* at 382; *cf. Elliott v. ITT Corp.*, 150 B.R. 36, 40 (N.D. Ill. 1992) (holding that debtor's failure to disclose to creditors her consumer fraud and related claims did not bar her from subsequently asserting such claims).

710. 48 B.R. 952 (Bankr. N.D. Ohio 1985).

711. *In re Shaffer*, 48 B.R. at 953.

712. *Id.*

713. *Id.* at 956.

714. *Id.* at 956–57.

715. 261 B.R. 391 (Bankr. D.N.J. 2001).

716. *In re Miano*, 261 B.R. at 392.

717. *Id.* at 392–93.

718. 230 F.3d 890 (7th Cir. 2000).

719. *Adair*, 230 F.3d at 893.

720. *Id.*

721. *Id.*

722. *Id.*

723. *Id.*

724. *Adair*, 230 F.3d at 893.



plan, even though the plan was never completed.<sup>725</sup> Meanwhile, in *Carvalho v. Federal National Mortgage Association (In re Carvalho)*,<sup>726</sup> the First Circuit held that plan default does not spell the end of res judicata for the plan.<sup>727</sup>

Nor should conversion or dismissal. Nothing in § 348 or § 349 says the plan is undone. Courts have held that *discharges* cannot be undone by dismissals.<sup>728</sup> Why should determinations of liability in the plan be undone? One might also observe that BAPCPA undoes bifurcations of undersecured creditors in Chapter 13 cases. Presumably, in all other cases, a confirmed plan *is* entitled to res judicata respect in a converted Chapter 7 case.

## VI. MODIFICATION

Suppose a plan is confirmed. Under narrow circumstances it can be revoked. May it in general be modified?

In Chapter 11, where the debtor is not an individual, it cannot be modified after “substantial consummation” of the plan.<sup>729</sup> Not so in individual Chapter 11 cases or in Chapter 13. Bankruptcy Code § 1329(a) invites modification of a Chapter 13 plan, provided the payments thereunder have not been completed.<sup>730</sup> BAPCPA introduces a similar rule in Chapter 11 cases where the debtor is an individual.<sup>731</sup>

To the extent modification is possible, the plan obviously cannot have res judicata effect.<sup>732</sup> Suppose an illegal plan is confirmed. Unsecured creditors and the Chapter 13 trustee have standing to seek modification.<sup>733</sup> Can one of these characters seek to modify the plan in order to conform the plan to what the law requires? Can modification undo the res judicata that is promised by § 1327(a)?

725. *Id.* at 894–96. *Adair* should not be read to mean that a valuation in a preconfirmation proof of claim is binding at the confirmation hearing, unless objected to. *See In re Duggins*, 263 B.R. 233, 241–42 (Bankr. C.D. Ill. 2001) (noting *Adair* court’s finding that preconfirmation proof of claim valuation became effective when plan was confirmed without competing value). Rather, the case indicates that the value stipulated in the confirmation order is binding on the debtor, even though the plan is never completed. *See id.* (stating that once secured claim is determined it cannot be subsequently attacked).

726. 335 F.3d 45 (1st Cir. 2003).

727. *In re Carvalho*, 335 F.3d at 52.

728. *In re Puckett*, 193 B.R. 842, 845 (Bankr. N.D. Ill. 1996).

729. 11 U.S.C. § 1127(b) (2006). Substantial consummation is defined to mean:

(A) transfer of all or substantially all of the property proposed by the plan to be transferred;  
(B) assumption by the debtor or by the successor to the debtor under the plan of the business or of the management of all or substantially all of the property dealt with by the plan; and  
(C) commencement of distribution under the plan.

§ 1101(2).

730. Section 1329(a) is a codification of a pre-Code bankruptcy rule. *See In re Moore*, 247 B.R. 677, 683 (Bankr. W.D. Mich. 2000) (comparing former Bankruptcy Rule of Procedure with § 1329(a)).

731. *See* § 1127(e) (providing that individual debtor’s plan may be modified after plan confirmation but before payments under plan are completed).

732. *See In re Solis*, 172 B.R. 530, 533 (Bankr. S.D.N.Y. 1994) (granting creditor’s motion for postconfirmation modification where debtor received large sum of money after confirmation of plan).

733. In the Chapter 11 rule, the United States has standing. § 1127(e).

Section 1329(a) is categorical. A plan may be modified “[a]t any time.”<sup>734</sup> Nevertheless courts add a nonstatutory requirement. The plan can only be modified if the moving party demonstrates that the debtor experienced a substantial and unanticipated postconfirmation change in financial situation.<sup>735</sup> “Absent this salutary policy, there is no readily available brake on the filing of motions under § 1329 by creditors and debtors simply hoping to produce a more favorable plan based on the same facts presented at the original confirmation hearing.”<sup>736</sup> When courts insist on this rule, there is some residual res judicata effect allocated to confirmation of the plan.<sup>737</sup> Nevertheless, some courts declare that res judicata does not apply to Chapter 13 plans and that no change in circumstances need be shown at all.<sup>738</sup>

In *In re Witkowski*,<sup>739</sup> the court submitted a “percentage plan”—now illegal by BAPCPA.<sup>740</sup> Confirmation occurred before the bar date.<sup>741</sup> Many creditors failed to file proofs of claim by the bar date, and so the debtor looked forward to ending the plan earlier than expected.<sup>742</sup> Fearing res judicata of the plan, the trustee moved to modify to increase the percentage each of the surviving creditors would receive, thereby keeping the debtor in the plan for the original time conceived.<sup>743</sup> The debtor objected on the ground that the res judicata rule prohibits modification in the absence of “unanticipated, substantial changes in the debtor’s financial situation.”<sup>744</sup> Although the court could have found that having fewer creditors was a change in the debtor’s financial situation, it ruled instead that res judicata was no bar to a motion to modify.<sup>745</sup>

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734. § 1329(a).

735. *Arnold v. Weast (In re Arnold)*, 869 F.2d 240, 243 (4th Cir. 1989); *Coastal Credit, L.L.C. v. Mellors (In re Mellors)*, 372 B.R. 763, 771 (Bankr. W.D. Pa. 2007); *see also Storey v. Pees (In re Storey)*, 392 B.R. 266, 272 (B.A.P. 6th Cir. 2008) (precluding issues that were or could have been decided at confirmation); *In re Belcher*, 369 B.R. 465, 467 (Bankr. E.D. Ark. 2007) (arguing that modifications should be necessitated by “unanticipated” and “substantial” changes).

736. *In re Butler*, 174 B.R. 44, 47 (Bankr. M.D.N.C. 1994).

737. *See In re Storey*, 392 B.R. at 273 (finding res judicata blocked modification where trustee claimed mere error in calculation).

738. *E.g., Barbosa v. Soloman*, 235 F.3d 31, 39–41 (1st Cir. 2000); *In re Witkowski*, 16 F.3d 739, 746 (7th Cir. 1994); *Max Recovery, Inc. v. Than (In re Than)*, 215 B.R. 430, 435 (B.A.P. 9th Cir. 1997); *In re Meeks*, 237 B.R. 856, 859 (Bankr. M.D. Fla. 1999); *see also In re Jourdan*, 108 B.R. 1020, 1022–23 (Bankr. N.D. Iowa 1989) (finding that creditors are subject to res judicata but debtors are not); *In re Davis*, 34 B.R. 319, 319–20 (Bankr. E.D. Va. 1983) (finding no requirement of “grievous change in circumstances”).

739. 16 F.3d 739 (7th Cir. 1994).

740. *In re Witkowski*, 16 F.3d at 746. In a percentage plan, the debtor would pay until all creditors received the stipulated percentage (here, 10%). At that point, the plan would terminate. Today a mandatory “applicable commitment period” is required. 11 U.S.C. § 1325(b)(1)(B) (2006). The period is three years for debtors below the median income; five years for those above. § 1325(b)(4).

741. *In re Witkowski*, 16 F.3d at 741.

742. *Id.*

743. *Id.*

744. *Id.* at 744 (quoting *Arnold v. Weast (In re Arnold)*, 869 F.2d 240, 243 (4th Cir. 1989)).

745. *Id.* at 745; *accord Meza v. Truman (In re Meza)*, 467 F.3d 874, 877–78 (5th Cir. 2006) (finding plain language of § 1329 provides no requirement of unanticipated or substantial change); *In re*

The First Circuit in *Barbosa v. Soloman*<sup>746</sup> also ruled that res judicata was not a bar to modifications,<sup>747</sup> but the court could not help equivocating. In approving some remarks made by the bankruptcy court, it reintroduced the same concept under a different name.

However, the bankruptcy judge was careful to note that “motions to modify cannot be used to circumvent the appeals process for those creditors who have failed to object confirmation [sic] of a Chapter 13 plan or whose objections to confirmation have been overruled.” . . . Accordingly, the court concluded that “while [res judicata is not required], as a practical matter, parties requesting modifications of Chapter 13 plans must advance a legitimate reason for doing so . . . .”<sup>748</sup>

This reeks of the claim that Homer did not write the *Odyssey*, but surely it was written by a blind poet of the same name. Some level of change is undoubtedly required before a court will entertain a motion to modify, notwithstanding rhetoric to the contrary.

Modification, then, might spoil res judicata in the Seventh and perhaps the First Circuit, but elsewhere the court-introduced res judicata bar preserves the illegality of a plan for the benefit of the undeserving debtor.

A final distinction, however, must be made, as it is presumably relevant in all the circuits. Modifications must conform to the requirements of §§ 1322, 1323(c), and 1325(a).<sup>749</sup> Suppose the original plan was confirmed in spite of violating one of these provisions. And now suppose a debtor moves to modify a plan that was illegally confirmed, perhaps to change the amount<sup>750</sup> or timing<sup>751</sup> of payments, without in any way affecting the illegal plan term. The creditor harmed by the illegal plan term may not hold up the debtor’s motion by insisting that the unmodified portion of the plan be made to conform to § 1322, etc.<sup>752</sup> Only the *modified term* need comply. The unmodified terms cannot be challenged by a creditor who did not raise the point at the original confirmation hearing.

Presumably this rule would apply in the Seventh Circuit, where the *Witkowski* court scotched res judicata for modification motions.<sup>753</sup> In *Witkowski*, the Chapter 13 trustee moved to modify.<sup>754</sup> The merits of the to-be-modified term

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Sutton, 303 B.R. 510, 516 (Bankr. S.D. Ala. 2003) (finding res judicata does not require substantial change in circumstances).

746. 235 F.3d 31 (1st Cir. 2000).

747. *Barbosa*, 235 F.3d at 38–41.

748. *Id.* at 41 (citations omitted) (quoting *In re Barbosa*, 236 B.R. 540, 547–48 (Bankr. D. Mass. 1999)).

749. 11 U.S.C. § 1329(b)(1) (2006).

750. § 1329(a)(1).

751. § 1329(a)(2).

752. *In re Ambuhl*, No. 99-10698, 2001 Bankr. LEXIS 2128, at \*2 (Bankr. D. Vt. Nov. 30, 2001), *overruled in part by* Educ. Credit Mgmt. Corp. v. Whelton (*In re Whelton*), 299 B.R. 306 (Bankr. D. Vt. 2003), *aff’d*, 432 F.3d 150 (2d Cir. 2005); *In re Eason*, 178 B.R. 908, 913–14 (Bankr. M.D. Ga. 1994).

753. See *supra* notes 739–45 and accompanying text for a discussion of the *Witkowski* court’s ruling that res judicata does not bar motions to modify.

754. *In re Witkowski*, 16 F.3d 739, 741 (7th Cir. 1994).

could not be tarnished by res judicata. But, where the debtor moves to modify, and the trustee or the creditors have some side issue they wish to relitigate, *Witkowski* would not authorize a relitigation of some nonmodified portion of the plan.

## VII. CONCLUSION

In this Article, I surveyed the res judicata worth of reorganization plans. In spite of the extremely broad statements demanding finality and bindingness in Bankruptcy Code § 1141(a) and § 1327(a), courts have found plenty of exceptions. Some are not surprising. The jaws of res judicata never maul the tender neck of justice where the victim has been denied due process of law. Other exceptions are based on conflicts between some Bankruptcy Code provision and the finality provisions in Chapters 11 or 13.

At least some of what I have written here is obvious and uncontroversial. But I have made a great many propositions that might possibly spawn controversy. These include:

1. Holdings in the Third and Seventh Circuit to the effect that § 1325(a) is not a mandatory provision governing confirmation of the plan are surely wrong. The Third Circuit's assertion of this questionable proposition certainly looks as if it was overruled in *SLW Capital, LLC v. Mansaray-Ruffin (In re Mansaray-Ruffin)*.<sup>755</sup> This case holds that a lien creditor has a constitutional right to an adversary proceeding before a plan eliminates the lien, but since the rights of the lien creditor depend entirely on § 1325(a)(5), it is surely the case that the Third Circuit has reversed its former position (despite its denials to the contrary).

2. If there is a constitutional right to an adversary proceeding (which seems plausible, given the Supreme Court's holding in *City of New York v. New York, New Haven & Hartford Railroad Co.*),<sup>756</sup> then this right exists both in Chapter 11 and Chapter 13. Yet the Fourth Circuit, at least, implies that somehow the Constitution changes its pallor when we move from Chapter 13 to Chapter 11, as if Chapter 11 were on par with Guantanamo. Though I am no constitutional scholar, this seems rather impossible, to my eye. Surely the Constitution means the same thing in Chapter 11 as it means in Chapter 13.

3. Even if lien creditors have the right to an adversary proceeding before a plan kills off their liens, this is not so where the theory of lien termination stems from the strong-arm power in Bankruptcy Code § 544(a). That section gives bankruptcy trustees the "rights and powers" of lien creditors and bona fide purchasers of real property. Under state law, unperfected security interests and mortgages are doomed without a trial. This must also be the rule in bankruptcy. So, for example, a Chapter 7 trustee has an inherent right to sell personal property free and clear of unperfected security interests because, under the UCC, judicial lien creditors have that right. If we recognize that plan confirmation *is* a sale, then lien creditors cannot claim that their liens survive confirmation of sale (unless the plan *affirms* that the unperfected liens survive this process).

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755. 530 F.3d 230 (3d Cir. 2008).

756. 344 U.S. 293 (1953).

4. When a confirmed plan conflicts with a proof of claim (which, in Chapter 13, might be filed *after* confirmation of the plan), courts take every conceivable position on the res judicata worth of the plan. But why shouldn't we take § 1327(a) at its word and simply proclaim that creditors treated thereunder are entitled to rely on the plan, whether or not they ever filed proofs of claim? Section 1111(a) makes this the rule for Chapter 11, and there is no statutory impediment to devising the same rule for Chapter 13.

5. In *In re Escobedo*,<sup>757</sup> the Seventh Circuit held that a court has no jurisdiction to confirm a plan in violation of § 1322(a), which stipulates what a plan *shall* do. This holding has been expanded to include other provisions. But, as this holding is not grounded in the constitutional notion of due process, there is no justification for not following the plain meaning of § 1327(a), which insists that confirmed plans are binding according to their terms.

6. In *Espinosa v. United Student Aid Funds, Inc.*,<sup>758</sup> the Ninth Circuit adhered to its increasingly lonely position that plans might discharge student loans. But since discharge matters must be resolved in adversary proceedings, the court countenances due process violations, if the Supreme Court was correct in *City of New York v. New York, New Haven & Hartford Railroad Co.*

These are a few of my controversial findings. But one thing is not controversial. Bankruptcy is an unusually chaotic theater for the application of the ethically dubious doctrine of res judicata. In general, the doctrine remains largely untheorized and unsystematized, perhaps just because it is ethically dubious.

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757. 28 F.3d 34 (7th Cir. 1994).

758. 553 F.3d 1193 (9th Cir. 2008), *cert. granted*, 129 S. Ct. 2791 (2009).