

10th Circ. Ruling Could Gut Homeowners' Ch. 13 Safety Net

By **Catherine Bauer** (April 17, 2023, 1:37 PM EDT)

Like so many legal specializations, bankruptcy law is complex.

Many balls are in the air at the same time during almost every bankruptcy case. Unfortunately, the uninitiated don't usually see all those balls.

As one of my supervisors once told me, "You bankruptcy folks speak a language I don't understand; I went to bankruptcy court once, and I'll never go back."

In some ways bankruptcy practice is like joining a fraternal organization that has its own language, its own terms of art and its own common understanding of how things work.

This understanding is important because bankruptcy courts serve as hospitals for people and entities who are suffering financially. Bankruptcy courts are emotion-packed places, with debtors seeking breathing room and a fresh start while creditors are asking to be treated in an equitable manner.

Employees are hoping to stay employed while vendors are anticipating what will happen in the future. With so many stakeholders, each bankruptcy case can mean financial life or death for both debtors and nondebtors.

For individuals who are facing home foreclosures, bankruptcy court may serve as their only viable life support option.

Chapter 13 of the Bankruptcy Code can provide these debtors with much-needed time to reorganize and try to save their homes.[1] While not a perfect chapter by any means, Chapter 13 is an important and necessary part of the bankruptcy toolbox for some debtors.

Chapter 13 is, however, like a secret menu item. It's so specialized that few practitioners — yes, even bankruptcy attorneys — understand all its complex ins and outs. I freely admit that I'm one of them, even after years on the bench.

Often, while trying to persuade unrepresented individuals to hire attorneys, I would inform them that I myself would never try to navigate Chapter 13 on my own.

I said this for good reason. In the Central District of California, virtually no one makes it through the



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arduous process of confirming and performing under a Chapter 13 plan without assistance from a Chapter 13 attorney.

In some parts of the country, judges require that Chapter 13 debtors be represented by counsel.

Chapter 13's ongoing viability is especially critical at this juncture. During the COVID-19 pandemic, as millions struggled with illness, job loss and mounting debt, Chapter 13 provided a possible light at the end of the tunnel for homeowners behind on their payments.

Those who qualified for its protections and were fortunate enough to work with Chapter 13 experts could attempt to save their homes by agreeing to structured payment plans.

This is why a recent decision out of the U.S. Court of Appeals for the Tenth Circuit is so alarming that I added my name to an amicus brief filed by a distinguished list of retired bankruptcy judges from across the nation.[2]

The circuit court's opinion in *Doll v. Goodman* could, essentially, spell the end of Chapter 13 protection for consumers in Oklahoma, Kansas, New Mexico, Colorado, Wyoming and Utah, as well as portions of Montana and Idaho.[3]

If, heaven forbid, the decision is replicated in other circuits, homeowners across the country could lose their homes for lack of a viable Chapter 13 administration.

What Is Chapter 13?

Chapter 13, also known as the wage earner's plan, helps individuals save their homes from foreclosure by letting them cure delinquent mortgage payments over time.[4]

Under these plans, debtors make their regular monthly mortgage payments and are allowed to pay their past due mortgage payments, as well as other payments, over a period of three to five years, depending on their current monthly income and the applicable state median.[5]

During this time the law forbids creditors from starting or continuing collection efforts. This can be a godsend and save a family homestead that may have substantial equity.

The goal is for debtors to confirm their plans, make all their payments and then receive Chapter 13 discharges.[6] If plans are not confirmed, Chapter 13 cases are usually dismissed and foreclosure proceedings are reinstated.

Given the dire consequences of failed Chapter 13 cases, some basic understanding of how these cases work is important.

Who Is the Chapter 13 Trustee?

When a debtor files a petition under Chapter 13, a trustee is appointed to administer the case.[7]

The U.S. trustee or bankruptcy administrator appoints a standing trustee to serve in Chapter 13 cases. In all cases, the Chapter 13 trustee must be completely impartial.

Although Chapter 13 trustees are not judges, they are vested with quasi-judicial responsibilities. Like special masters or magistrates, they review the evidence, assess the merits of the case, and make recommendations to the court.

While not binding, their recommendations are given extreme deference and are often followed.

Confirmations of Chapter 13 plans are often fiercely litigated, and the trustees' role is critical. They are required by law to investigate the financial affairs of the debtor, and they preside over meetings of creditors where debtors are questioned about their plans, debts and assets.[8]

Even when no creditor objects to a proposed plan, the trustee must appear and be heard before the plan is confirmed. Courts rely to some extent upon the Chapter 13 trustee's recommendation regarding whether a plan should be approved.[9]

Trustees invest substantial time and resources making sure they understand all aspects of a debtor's situation, and can competently advise a judge on the merits of a petition and plan.

They manage offices and employ staff trained in the evaluation and analysis of debtors' circumstances, as well as the ongoing administration of approved plans.

Trustees' work does not end at confirmation. The trustee serves as a disbursing agent for the plan, collecting payments from the debtor and making distributions to creditors.

This often involves a massive accounting operation, with many thousands of checks being issued for millions of dollars annually by the trustee's office.[10] Trustees can and do spend years administering Chapter 13 plans.

Conducting these operations often requires a large staff but, unlike judges, trustees are not supported by tax dollars. Both the trustee and his or her staff are paid entirely from the percentage fees the trustee deducts from the payments debtors make to the estate.[11]

What Did the Tenth Circuit Decide?

A panel of the Tenth Circuit, clearly not conversant with the mechanics of Chapter 13, made a novel — and highly problematic — ruling in *Doll v. Goodman* in January.

The justices held that the trustee in a Chapter 13 bankruptcy case is not entitled to collect any fee unless the plan is confirmed.

If a plan is not confirmed, can the standing trustee deduct and keep his fee before returning the rest of the pre-confirmation payments to the debtor or must the trustee instead return the entire amount of pre-confirmation payments to the debtor without deducting his fee? We conclude that, read together, 28 U.S.C. § 586(e)(2) and 11 U.S.C. § 1326(a)(2) unambiguously require the trustee to return the pre-confirmation payments to the debtor without deducting the trustee's fee when a plan is not confirmed.

For the following reasons, the retired bankruptcy judges' amicus brief asked for en banc review of the issue and a different outcome.

Constitutional Challenge

As noted earlier, Chapter 13 trustees act in a quasi-judicial role in plan confirmation proceedings. To do their jobs, they must maintain an objective and impartial posture in those proceedings.

Under the panel's decision, however, many trustees will have a financial incentive to recommend confirmation of Chapter 13 plans, regardless of the merits of such plans.

It is a fundamental violation of constitutional due process for a quasi-judicial officer to have a pecuniary stake in his or her own decisions.

Almost a century ago, the U.S. Supreme Court stated in *Tumey v. Ohio* that "officers acting in a judicial or quasi judicial capacity are disqualified by their interest in the controversy to be decided."^[10]

When a trustee must choose between doing the right thing and getting paid, there can be no fair outcome. The court's decision basically pays trustees to support confirmation of plans that may be unfair or not in accordance with law.

Bankruptcy judges, who rely on trustees to do much of the work necessary for them to issue decisions, will end up second- and third-guessing those decisions.

In many districts, Chapter 13 revenue easily reaches the 10% revenue cap placed on Chapter 13 trustees, so trustees have little pecuniary interest in confirming individual plans.

But for trustees who don't reach their cap, the pressure to lower standards could be significant.

When underfunded trustees bow to economic reality, the result could be disparate treatment depending on whether a case is filed in a district with high or low revenue for Chapter 13 trustees.

Practical Challenge

Only about 70% of Chapter 13 plans are confirmed nationwide.

Without revenue from the cases that end without a confirmed plan, many Chapter 13 trustees will struggle to fund their offices. They will have a clear pecuniary incentive to support confirmation, regardless of the merits of a particular case.

Unless the Tenth Circuit's ruling is reversed, trustees stand to lose between a quarter and a third of the debtors currently funding their operations.

For those trustees who are unable to reach their revenue caps, the ruling appears to present a Hobson's choice: Continue to maintain standards, or keep the lights on and make payroll by pushing confirmation in as many cases as possible.

But a third option may also present itself. Chapter 13 trustees — knowledgeable, professional, impartial and invaluable — could find themselves relegated to a no man's land where their skills and expertise are devalued.

They may instead choose to leave the Chapter 13 trustee world altogether.

Should this happen, homeowners in the Tenth Circuit — and any other circuits following this route — will no longer have the Chapter 13 safe harbor that so many have looked to over the years when trying to save their homes.

Conclusion

Our amicus brief lays the dilemma out clearly:

Imagine a magistrate judge whose office only gets paid when cases go to trial, and who might have to lay off clerks if she recommends granting too many 12(b)(6) motions. The idea is absurd—but it is roughly the situation facing underfunded trustees if the Panel's decision stands.

When Chapter 13 trustees don't get paid for their work, they simply cannot do it. They provide a highly specialized work product that bankruptcy courts rely upon.

Unless the circuit court's ruling is reversed, everyone involved — but especially homeowners — will end up paying the price.

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[1] 11 U.S. Code Chapter 13.

[2] Retired Bankruptcy Judges' Motion for Permission to File Brief as Amici Curiae, Civil Action No. 21-cv-00731-RBJ Bankruptcy Case No. 17-20831-MER, Appellate Case: 22-1004 Document: 010110832593 Date Filed: 03/24/2023.

[3] Goodman v Doll, January 18, 2023 No. 22-1004 10th Circuit, <https://law.justia.com/cases/federal/appellate-courts/ca10/22-1004/22-1004-2023-01-18.html>.

[4] <https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-13-bankruptcy-basics>.

[5] 11 U.S.C. § 1322(d).

[6] 11 U.S.C. § 1328(a).

[7] 11 U.S.C. § 1302.

[8] 11 U.S.C. § 1302(b).

[9] Collier on Bankruptcy ¶ 6.14.

[10] Collier ¶ 6.14.

[11] 11 U.S.C. § 586(e).

[12] *Tumey v. Ohio*, 273 U.S. 510, 522 (1927).