In Chapter 13, you gotta stake your claim

By Lauren Rode

The 9th U.S. Circuit Court of Appeals' recent decision in *Spokane Law Enforcement Federal Credit Union v. Barker*, 2016 DJDAR 10687 (Oct. 27, 2016), may pose some issues for creditors but will not be extremely detrimental. Rather, the ruling underscores the importance of creditors making their claims known in a Chapter 13 bankruptcy.

Chapter 13 is a mechanism for debtors to reorganize by proposing a repayment plan and having the payment plan confirmed (approved), usually within a few months of the case being filed. The whole purpose of Chapter 13 is to have the repayment plan finalized *early on*. The bankruptcy rule requiring creditors to file a timely proof of claim in a Chapter 13 case is clearly stated and well-known to financial lending institutions — and especially their bankruptcy attorneys. Moreover, at the commencement of each Chapter 13 case, a notice goes out to all creditors listed by the debtor informing them of the requirement to file a proof of claim by a specified deadline.


RODE

In this case, the creditor, Spokane Federal Credit Union, appealed a decision disallowing their late-filed proof of claim in Barker's Chapter 13 bankruptcy. The credit union argued that since Barker listed the credit union on her schedules, the court should allow the late claims.

I agree with the court in that the Barker's schedules are not dispositive. If the court ruled differently, that would set the trend of creditors deciding what to do or what not to do in a case based on the debtor's schedules. Yet the bankruptcy rules provide that debtors *must* file their schedules with the court *and* creditors *must* file a proof of claim with the court by a certain deadline. The rules contain no language relieving a creditor from its obligation to file a claim if the debtor lists the creditor in his or her schedules.

The credit union also offered the court the excuse that they failed to file their proof of claim due to a "disgruntled employee." This is simply not an excuse the courts should accept for late-filed claims to be allowed. Creditors are well aware of the rigid requirement to file a proof of claim within the prescribed deadline. Failure to do so will very likely forfeit a creditor's right to being paid on its claim.

If the court had allowed the credit union's late-filed claims, it would have created precedent where a debtor's plan could never be finalized because creditors could continuously add late-filed claims with no end. If courts were to allow late-filed claims all the time, there would be no urgency for creditors to file a proof of claim by the deadline and, even more complicating, debtors would continuously have to modify their Chapter 13 plans. This would mean the debtor would likely have to expend more money on an attorney to file motions to modify and the court and trustee would have to use judicial resources to hear and process these motions.

The implications of *Spokane Law Enforcement* are different for secured creditors versus unsecured creditors. Secured creditors will always retain liens on property securing debt, regardless whether a proof claim is filed and/or paid on in a debtor's Chapter 13. Secured creditors do not have to worry about the deadline to file a proof of claim unless they want to make sure they are paid *in a debtor's Chapter 13* — they will retain their liens either way. If a court disallows a secured creditor's late-filed proof of claim, that creditor still retains the right to foreclose or repossess the property the debt is secured by. This means secured creditors will likely still collect down the line.


Shutterstock

> If courts were to allow late-filed claims all the time, there would be no urgency for creditors to file a proof of claim by the deadline and, even more complicating, debtors would continuously have to modify their Chapter 13 plans.

The decision will have the greatest effect on unsecured creditors who do not retain a secured lien on any property of the debtor. If they file their claim late, unsecured creditors will never be paid on their claim, unless, of course, the debtor's case is dismissed without a discharge for one reason or another.

Another important takeaway concerns a court's finding of an "informal proof of claim." Sometimes, even if a proof of claim is filed after the deadline, the court will still allow the proof of claim because the creditor took some affirmative action during the case to make their claim known. For example, if a creditor frequently confers with the trustee regarding their claim or makes their intentions to file a claim known to the debtor's attorney or to the court. This sets a low threshold for creditors that, at the very least, creditors must make their intentions to file a claim in a debtor's case known to the parties involved — the trustee, the debtor and/or the court.

If the creditor does not at least do this, the *Spokane Law Enforcement* court ruled it cannot just allow for every single late-filed claim. The effect of this discussion in the decision will push creditors to at least make their claim known in the beginning stages of a Chapter 13 regardless whether the creditor ever files a formal claim in the case.

Overall, the 9th Circuit's decision reinforces Federal Rule of Bankruptcy Procedure 3002, requiring creditors to file a timely proof of claim. It sends the message to creditors that the full-proof way to make sure they are paid on their claim is to file their proof of claim on time.

Lauren Rode *is a bankruptcy attorney with Consumer Action Law Group of Panzarella, G. R., P.C.*

9th Circuit limits a borrower's ability to 'cure' in Chapter 11

By David Kupetz and Asa Hami

Default rate interest provisions are standard language in business loan agreements. A borrower's default on a loan triggers consequences, including higher default rate interest. A borrower can generally "cure" the default and reinstate the loan to its original terms. Disputes over claims for default rate interest arise in the context of bankruptcy cases filed by financially distressed borrowers.

Chapter 11 of the Bankruptcy Code provides a framework for business reorganization. The primary goals of Chapter 11 are rehabilitation of the debtor, equality of treatment of creditors holding claims of the same priority, and maximization of the value of the estate. A plan of reorganization is generally the vehicle for achieving the goal of rehabilitation. Moreover, the Bankruptcy Code incorporates the concept of "cure" under a plan. Section 1123(a)(5)(G) provides that means for implementing a plan may include the "curing" of any default. The 9th U.S. Circuit Court of Appeals has explained that this "means that a plan of reorganization may include a provision authorizing the debtor to remedy any breach of a loan agreement with a creditor and return to pre-default conditions." *Pacifica L 51 LLC v. New Investments, Inc. (In re New Investments, Inc.)*, 2016 DJDAR 11072 (9th Cir. Nov. 4, 2016), citing *Great W. Bank & Tr. v. Entz-White Lumber & Supply, Inc. (In re Entz-White, Inc.)*, 850 F.2d 1338 (9th Cir. 1988).

Chapter 11 plans place creditor claims into classes. Each class that is impaired is entitled to vote on the plan. A class that is not impaired under a plan is deemed to have accepted the plan. Bankruptcy Code Section 1124 sets forth two ways a claim can be left unimpaired under a plan. The first exception to impairment requires that there be no alteration of the creditor's legal, equitable or contractual rights. The second exception allows a Chapter 11 plan to cure defaults, reverse acceleration and reinstate the agreement, compensate the creditor for any damages incurred as a result of the default, and not otherwise alter the creditor's legal, equitable or contractual rights.

In 1988, in *Entz-White*, the 9th Circuit held that a debtor who cures a default under a plan "is entitled to avoid all consequences of the default — including higher post default interest rates." The *Entz-White* court concluded that "the power to cure under the Bankruptcy Code authorizes a plan to nullify all consequences of default, including avoidance of default penalties such as higher interest," even when the terms of the loan agreement called for a higher interest rate upon default.

> The 9th Circuit addressed 'whether *Entz-White*'s rule that a debtor may nullify a loan agreement's requirement of post-default interest remains good law in light of [Section 1123(d)].'

In 1994, however, the Bankruptcy Code was amended by enacting Section 1123(d), which provides that, if a plan proposes to cure a default, "the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law." Until this month, the 9th Circuit had not revisited the merits of *Entz-White*.

In *New Investments*, a borrower executed a promissory note for $3 million, secured by real property. The note bore an interest rate of 8 percent. It also provided that in the event of default, the interest rate would increase by 5 percent. The borrower filed a Chapter 11 bankruptcy petition and proposed a plan that offered to cure its default by paying off the loan at the pre-default interest rate. The secured creditor objected to the plan on the ground that it was entitled to be paid at the higher post-default interest rate. Overruling that objection, the bankruptcy court confirmed the plan. The creditor appealed.

The 9th Circuit addressed "whether *Entz-White*'s rule that a debtor may nullify a loan agreement's requirement of post-default interest remains good law in light of [Section 1123(d)]." A three-judge panel, with one dissent, held that the rule is not. Among other things, the dissent asserts that stare decisis requires the continued application of *Entz-White*, stating that *Entz-White* had not been undermined by any en banc decision of the 9th Circuit, Supreme Court decision, or subsequent legislation.

The 9th Circuit's rejection of *Entz-White* is grounded in both the plain language of Section 1123(d) and its legislative history. The court said the plaint language "compels the holding that a debtor cannot nullify a preexisting obligation in a loan agreement to pay post-default interest solely by proposing a cure." Further, the court explained that the legislative history reveals that Section 1123(d) was designed to overrule the Supreme Court decision in *Rake v. Wade*, 508 U.S. 464 (1993) (requiring payment of interest to cure even if the underlying agreement did not provide for it), and to limit the secured creditor to "the benefit of the initial bargain with no court contrived windfall," as well as "to put the debtor in the same position as if the default had never occurred."

The 9th Circuit found that this primary target underlying the legislation does not limit the impact of Section 1123(d) on other scenarios, stating: "The fact that Congress had a particular purpose in mind when enacting a statute does not limit the effect of the statute's text. … Rather, '[t]he fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning.' By its terms, § 1123(d) tells us to look to the promissory note and Washington law to determine what amount New Investments must pay to cure its default. Here, that analysis requires the payment of post-default interest."

The court found this result to be consistent with the intent of Section 1123(d) because it holds the parties to the benefit of their bargain. The 9th Circuit explained that Section 1123(d) governs how a debtor returns to pre-default conditions. In order to effectuate a cure, in addition to arrearages be paid, obligations under the agreement for interest, late charges, fees and costs must be satisfied. Further, the court emphasized that Section 1123(d) looks to the entire underlying agreement and not only to the pre-default interest provisions of the agreement. The 9th Circuit stated that "[h]ere the note provided that upon default, the interest rate on the loan would increase by 5 percent. Unfortunately for New Investments, the increased rate applies to the entirety of the note and not just to arrearages."

The court also found Section 1123(d) and its ruling in *New Investments* is consistent with the traditional concept of "cure," the concept of impairment under Section 1124, and the balance Chapter 11 was designed to strike between a debtor's interest in a reorganization and a fresh start and creditor rights. Moreover, if the agreement did not contain a higher post-default interest rate, such interest would not have to be paid. The 9th Circuit found that it was holding the debtor to its bargain by applying the terms of the loan agreement as required by Section 1123(d). Having bargained for a higher interest rate upon default, the secured creditor was entitled to receive payment of the loan at the post-default interest rate.

David Kupetz *and* **Asa Hami** *are attorneys with SulmeyerKupetz, P.C. They are experts in restructuring, business reorganization, bankruptcy, assignments for the benefit of creditors, and other insolvency solutions. You can reach them at dkupetz@sulmeyerlaw.com and ahami@sulmeyerlaw.com.*

SUBMIT A COLUMN
The Daily Journal accepts opinion pieces, practice pieces, book reviews and excerpts and personal essays. These articles typically should run about 1,000 words but can run longer if the content warrants it. For guidelines, email legal editor Ben Armistead at ben_armistead@dailyjournal.com.

WRITE TO US
The Daily Journal welcomes your feedback on news articles, commentaries and other issues. Please submit letters to the editor by email to ben_armistead@dailyjournal.com. Letters should be no more than 500 words and, if referencing a particular article, should include the date of the article and its headline. Letters may not reference a previous letter to the editor.

LETTER TO THE EDITOR

Ruling on immigration status isn't dead yet

The case of *Rodriguez v. Kline*, 186 Cal. App. 3d 1145 (1986), stands for the proposition that someone who enters this country illegally and is subject to deportation (8 U.S.C. Section 1251) is only entitled to future lost earnings based upon their potential future earnings in their home country. ["Justice for noncitizen plaintiffs," Nov. 9].

Under *Rodriguez*, when a defendant challenges a personal injury plaintiff's right to be legally in the U.S., the court is to set a hearing that will afford the plaintiff an opportunity to present proof regarding his or her legal status. If the plaintiff's status is illegal and subject to deportation, it would be abundantly unfair to subject a defendant to the payment of future earnings that the injured plaintiff would in all probability never be entitled. The court in *Rodriguez* stated the obvious: "A contrary rule ... would allow someone who is not lawfully available for future work in the United States to receive compensation to which he is not entitled."

Now the California Legislature and governor have abrogated that sound rule with newly minted Evidence code Section 351.2(a) prohibiting the both the discovery and the admission into evidence of a person's immigration status in any civil action for personal injury or wrongful death. Presumably defendants now in personal injury cases may be assessed future lost earnings based upon speculative evidence given that the Trump administration may deport the plaintiff at any time. A law that allows a jury to speculate as to an injured plaintiff's future earnings is abundantly unfair and a violation of due process. The rule in *Rodriguez v. Kline* is not dead yet.

— Paul A. de Lorimier
Los Angeles