TAKE NOTICE OF THIS CHANGE: SUPREME COURT ADOPTS RECOMMENDED AMENDMENTS TO BANKRUPTCY NOTICE OF PAYMENT CHANGE RULE

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Restructuring & Insolvency Alert

Come December, the requirements surrounding notices of payment change ("PCNs") for certain mortgage loans in bankruptcy will change. The Supreme Court, on April 28, 2016, adopted various proposed amendments to the Federal Rules of Bankruptcy Procedure, including amendments to the language of Rule 3002.1 aimed at clarifying when a secured creditor must file a payment change notice ("PCN") in a Chapter 13 bankruptcy.[1] Amended Rule 3002.1 will require secured creditors to file PCNs on all claims secured by the Chapter 13 debtor's primary residence for which the debtor or Chapter 13 Trustee is making post-petition payments during the bankruptcy, without regard to whether the debtor is curing a pre-petition arrearage. The amendments to Rule 3002.1 further clarify that, absent a court order indicating otherwise, the obligation to file PCNs generally ceases once the creditor obtains relief from the automatic stay. The amendments take effect on December 1, 2016.

A. CURE AND MAINTAIN PLANS AND THE ADOPTION OF RULE 3002.1

Chapter 13 of the United States Bankruptcy Code allows a debtor to cure the default on long-term mortgage debt while maintaining regular post-petition payments during the course of the bankruptcy.[2] While debt that is cured and maintained under the debtor's plan is not discharged at plan completion,[3] the common expectation is that the debtor will exit bankruptcy current on her mortgage payments. In practice, however, this has not always proven to be the case with respect to mortgage loans. Interest rates can adjust, and annual escrow obligations often fluctuate on a yearly basis. If the monthly post-petition mortgage payment on the debtor's residence increased during the bankruptcy and the responsible party (the debtor or Chapter 13 Trustee) did not adjust the ongoing payment to reflect the increased payment amount, the debtor could find herself embroiled in a collection action within weeks of exiting bankruptcy. Consequently, debtors, Chapter 13 Trustees, mortgage servicers, and courts often grappled with post-discharge issues arising from debt that was ostensibly cured and maintained during the bankruptcy.

As cure and maintain provisions in Chapter 13 plans are the preferred method for reinstating delinquent mortgages, rulemaking at the local district level led to a system by which the creditor would file a notice of change to the ongoing mortgage payment in the bankruptcy proceeding, thereby making the parties aware of any decrease or increase in the payment obligations. Congress took this system national on December 1, 2011, the effective date of Bankruptcy Rule 3002.1. The current rule requires a creditor in a Chapter 13 case whose claim is secured by a security interest in the debtor's principal residence to file and serve a notice advising the Court, the debtor, and the Chapter 13 Trustee of (1) any change in the payment amount, including any change that

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results from an interest rate or escrow account adjustment, and (2) any fees, expenses, or charges incurred post-petition.[4] Rule 3002.1 was intended to provide greater transparency to debtors, trustees, and bankruptcy courts regarding the debtor's home mortgage obligations, by giving the party responsible for the ongoing payment obligation sufficient notice to adjust the plan payment in the event of a change.[5]

Following the completion of the plan, the Chapter 13 Trustee files a Notice of Final Cure ("NOFC"), contending that the debtor has made all payments required in the bankruptcy and that the Trustee considers the loan current. The creditor is permitted to respond to the NOFC and to indicate (1) whether it agrees that the debtor has paid in full the amount required to cure the default on the claim, and (2) whether the debtor is otherwise current on (i.e., has "maintained") all payments consistent with section 1322(b)(5) of the Bankruptcy Code.[6] A creditor that did not file timely PCNs or respond to the NOFC can be precluded from offering the information, in any form, as evidence in any contested matter or adversary proceeding.[7] Indeed, the failure to file PCNs on a timely basis can, in some circumstances, significantly impact the Chapter 13 debtor's reorganization effort, and the creditor's right to recover amounts that are contractually owed.

B. CONFLICTING PCN FILING STANDARDS FOLLOWING RULE 3002.1'S ENACTMENT

Rule 3002.1 was intended to ensure that correct loan payments are made during the pendency of the bankruptcy. As we explained in a prior Alert on this subject,[8] one reason for the amendment is that Rule 3002.1(a)'s current language requires PCNs to be filed for claims "provided for under § 1322(b)(5)," and this, in turn, has created conflicting case law. By way of background, post-petition maintenance payments are authorized under section 1322(b)(5) of the Bankruptcy Code, which also provides for the cure of any pre-petition default within a "reasonable" time.[9] Some courts have required PCNs only where there is a pre-petition default on the mortgage, thereby excusing creditors from filing PCNs for loans that are current as of the petition date.[10] Other courts have taken a different approach, requiring PCNs to be filed regardless of the pre-petition payment status of the loan.[11]

In addition, courts have disagreed over whether the phrase "provided for" under a Chapter 13 plan meant that a Chapter 13 Trustee must make the ongoing mortgage payments, or whether a claim is still treated under section 1332(b)(5) if the debtor pays the mortgage directly to the creditor.[12] There has also been some confusion over whether a creditor's obligation to comply with Rule 3002.1 should end once the Court enters an order granting relief from the automatic stay.[13]

C. THE SCOPE OF THE AMENDMENTS TO BANKRUPTCY RULE 3002.1

The amendments to Rule 3002.1 are intended to simplify and clarify the PCN requirement for cure and maintain plans. As amended, Rule 3002.1(a) reads:

> **In general.** This rule applies in a chapter 13 case to claims (1) that are secured by a security interest in the debtor's principal residence, and (2) for which the plan provides that either the trustee or the debtor will make contractual installment payments. Unless the court orders otherwise, the notice requirements of this

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> rule cease to apply when an order terminating or annulling the automatic stay becomes effective with respect to the residence that secures the claims.

This new language reflects a number of changes:

First, the current reference to claims "provided for under § 1322(b)(5) of the Code in the debtor's plan" has been eliminated to make clear that amended Rule 3002.1 applies even if there is no pre-petition arrearage to be cured.[14]

Second, amended Rule 3002.1 applies regardless of whether the debtor or Chapter 13 Trustee is making the post-petition maintenance payments to the creditor.[15]

Third, amended Rule 3002.1 clarifies that the PCN requirement ceases once the creditor obtains relief from stay, unless the court orders otherwise. As the Judicial Conference explained in its October 9, 2015 memorandum to the U.S. Supreme Court, while there is generally no need to notice ongoing payment changes after an order granting relief from stay has been entered, PCNs might continue to be useful in some circumstances:

> Debtors and trustees typically do not make payments on mortgages after the stay relief is granted, so there is generally no need for the holder of the claim to continue providing the notices required by this rule. Sometimes, however, there may be reasons for the debtor to continue receiving mortgage information after stay relief. For example, the debtor may intend to seek a mortgage modification or to cure the default. When the court determines that the debtor has a need for the information required by this rule, the court is authorized to order that the notice obligations remain in effect or be reinstated after the relief from stay is granted.[16]

Accordingly, effective December 1, 2016, a creditor must file a PCN on a mortgage loan that the debtor is paying directly and for which there is no pre-petition default being cured through the Chapter 13 plan.

But do the amendments to Rule 3002.1 go far enough? Although the amendments clarify when a PCN is required, they do not address the difficulties of calculating timely payment amounts for daily simple interest accounts and home equity lines of credit ("HELOCs"), and the burdens associated with filing PCNs for the often de minimis monthly changes on these types of accounts. The Advisory Committee considered Rule 3002.1's applicability to HELOCs at its fall 2014 meeting and has indicated that a proposed amendment to address these issues will be sought later as part of a larger package of related amendments. In the meantime, we have worked closely with clients on how best to address PCN/HELOC operations, and can assist should the need arise.

D. CONCLUSION

With the adoption of the amendments to Bankruptcy Rule 3002.1, effective December 1, 2016, secured creditors that have not been filing PCNs (1) where a debtor was current entering bankruptcy or (2) where the debtor was making post-petition payments directly to the creditor during the course of the bankruptcy, will have to adjust their filing practices in order to avoid the penal provisions of the rule. It should be noted, however, that Rule 3002.1

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sets the minimum noticing obligations at a national level. Some bankruptcy courts can—and do—promulgate local rules related to the cure and maintenance of secured debt in Chapter 13 bankruptcies, and impose additional PCN-related obligations in an effort to address what those courts perceive to be matters that are strictly local in nature.[17] For example, the bankruptcy courts for the Southern District of Florida, the Southern District of Illinois, the Southern District of Indiana, and Southern District of Ohio extend the PCN filing obligation to claims secured by a security interest in real property other than the debtor's principal residence.[18] Some bankruptcy courts require that PCNs be filed more than 21 days in advance of the payment change.[19] Absent amendment to the local rules, creditors will still be required to comply with those rules, following the effective date of amended Rule 3002.1. Accordingly, like the existing Rule 3002.1, amended Rule 3002.1 sets a floor, and not a ceiling, on a secured creditor's obligation to notice payment changes in Chapter 13 bankruptcies. K&L Gates LLP can assist mortgage servicers and other secured creditors in navigating the PCN filing requirements for each district.

Notes:

[1] *See* http://www.supremecourt.gov/orders/courtorders/frbk16_4h25.pdf.

[2] *See* 11 U.S.C. § 1322(b)(5) ("The plan . . . may . . . 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."); *see also Rake v. Wade*, 508 U.S. 464, 469 (1993).

[3] *See* 11 U.S.C. § 1328(a).

[4] *See* Fed. R. Bankr. P. 3002.1(b) and (c).

[5] *See* Memorandum of Advisory Committee to Supreme Court of United States dated Oct. 9, 2015 ("This rule was intended to ensure that debtors who attempt to maintain home mortgage payments while in chapter 13 have the information needed to do so.").

[6] *See* Fed. R. Bankr. P. 3002.1(f) and (g).

[7] *See* Fed. R. Bankr. P. 3002.1(i).

[8] *See* "Have You Noticed Your Payment Change," http://www.klgates.com/have-you-noticed-your-payment-change-advisory-rules-committee-proposes-amendments-to-bankruptcy-rule-30021.

[9] The Bankruptcy Code offers no guidance with respect to what period of time is considered "reasonable" for curing a pre-petition default, and courts look at the facts and circumstances of the case in rendering a decision. *See* 8 Collier on Bankruptcy ¶ 1322.09[6] (Alan N. Resnick & Henry J. Sommer eds., 16th ed.).

[10] *See In re Weigel*, 485 B.R. 327, 328 (Bankr. E.D. Va. 2012).

[11] *See In re Fitch*, 540 B.R. 13, 15 (Bankr. D. Me. 2015).

[12] *Compare In re Merino*, 2012 WL 2891112, at *1 (Bankr. M.D. Fla. July 16, 2012) (Rule 3002.1 does not apply) *with In re Heinzle*, 511 B.R. 69, 78 (Bankr. W.D. Tex. 2014) (Rule 3002.1 applies).

[13] *Compare In re Thongta*, 480 B.R. 317, 320-21 (Bankr. E.D. Wis. 2012) (reasoning that once stay relief entered, the claim was no longer provided for under the plan and, therefore compliance with Rule 3002.1 was no longer required) *with In re Holman*, 2013 WL 1100705, at *3 (Bankr. E.D. Ky. Mar. 15, 2013) (reasoning that an

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order granting relief from stay does not modify the cure and maintain provision in the plan and, therefore, the Rule 3002.1 obligation remains until the debtor no longer has title to the property).

[14] *See* Memorandum from Judicial Conference of the United States to the Chief Justice of the United States and Associate Justices of the Supreme Court, dated October 9, 2015 ("Judicial Conference Memorandum").

[15] *See* Memorandum from Advisory Committee on Bankruptcy Rules to Standing Committee on Rules of Practice and Procedure, dated May 6, 2015 ("Advisory Committee Memorandum").

[16] *See* Judicial Conference Memorandum.

[17] See Fed. R. Bank. P. 9029.

[18] *See* Bankr. S.D. Fla. Local Rule 3070-1(B); S.D. Ill. LBR 3002.1; S.D. Ind. L.R. 3002.1-2(a); Bankr. S.D. Ohio LBR 3015-1(e)(4).

[19] *See, e.g.*,Bankr. D. Ariz. Standing Order dated July 30, 2008 (requiring 60 days' notice); Bankr. W.D. La. Local Rule 3002-1(A) (requiring 35 days' notice).

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