# COVID-19: HOW THE CARES ACT WILL IMPACT CHAPTER 7 AND CHAPTER 13 CONSUMER BANKRUPTCIES

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**U.S. Financial Institutions and Services Litigation Alert**

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On March 27, 2020, the President signed into law the historic Coronavirus Aid, Relief, and Economic Security Act ("CARES Act" or "Act"), a $2.2 trillion stimulus package designed to mitigate the widespread economic effects of the novel coronavirus ("COVID-19"). The Act includes several temporary modifications to chapter 7 and chapter 13 of the U.S. Bankruptcy Code.[1] This alert details these modifications as follows:

## CERTAIN FEDERAL PAYMENTS EXCLUDED FROM DEFINITION OF "INCOME"

For cases under chapter 7 and 13, the CARES Act modifies the definition of "current monthly income" in 11 U.S.C. § 101(10A)(B)(ii) to expressly exclude payments made under federal law relating to the national emergency declared by the President under the National Emergencies Act with respect to COVID-19. Similarly, the Act provides that any payments made to individuals under federal law relating to the COVID-19 pandemic do not constitute "disposable income" required to be committed to a chapter 13 debtor's plan pursuant to 11 U.S.C. § 1325(b)(2). The amended definition of "disposable income" will benefit both current chapter 13 debtors who did not have confirmed plans as of the date of enactment of the CARES Act, as well as future chapter 13 debtors.

## MOD

## IFICATIONS AND PLAN PERIOD EXTENSIONS FOR CHAPTER 13 DEBTORS WITH CONFIRMED PLANS

The CARES Act also permits chapter 13 debtors with plans that were confirmed as of the date of enactment of the CARES Act to seek modifications of their plan due to COVID-19-related hardships. Specifically, the Act adds subsection (d)(1) to 11 U.S.C. § 1329 to permit a debtor to modify a confirmed plan, after notice and a hearing, if such debtor is experiencing a "material financial hardship" due, "directly or indirectly," to the COVID-19 pandemic. Under the Act, a plan also may be modified to extend the plan period up to seven years after the first payment under the original confirmed plan became due.[2] A bankruptcy court may approve such a modification upon request of a debtor. Until the amendment sunsets one year from March 27, 2020, chapter 13 debtors with plans confirmed prior to the enactment date will be able to seek to modify their plans consistent with this provision.

The Act does not define the scope of an "indirect" hardship arising from the COVID-19 pandemic or what type of proof will be required of a debtor to show indirect hardship. Further, it is unclear what bankruptcy courts will deem to be "material financial hardship" sufficient to justify a plan modification. Given the uncertain and unprecedented

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times, it is likely that many debtors with confirmed plans will meet the qualifications for "material financial hardship" directly or indirectly arising from COVID-19, but how expansively bankruptcy courts interpret this requirement remains to be seen.

## IMPACT OF CARES ACT PROVISIONS ON CHAPTER 13 CREDITORS

At this juncture, it is still unclear what types of plan modifications chapter 13 debtors will propose pursuant to § 1329(d)(1), what types of modifications courts will ultimately permit, and the full extent of what types of consumer loans may be impacted. It is foreseeable that chapter 13 creditors will need to work with debtors and trustees to memorialize and seek court approval for a large volume of payment deferments and that they will need to do so on an expedited basis.

The Act specifically provides that 11 U.S.C. §§ 1322(b) and 1322(c) apply to any modifications pursuant to the § 1329(d)(1). Under § 1322(b)(2), a plan may not modify the rights of holders of claims secured only by real property that is the debtor's principal residence. However, § 1322(c)(1) permits a debtor to cure defaults with respect to liens on his or her principal residence, notwithstanding §1322(b)(2). It is unclear how courts will treat the interplay between these two subsections and a proposed deferment, but it is quite possible that courts may allow a deferment of ongoing payments in conjunction with a plan to repay post-petition arrearages over an extended plan term. On the other hand, if a debtor is paying his or her ongoing mortgage directly to the creditor outside of the plan, the new § 1329(d)(1) may not apply. Seemingly, the debtor could amend the plan to provide for ongoing payments to be made through the trustee or to propose that post-petition arrearages be paid through the plan. Otherwise, the debtor would appear to have to work directly with the creditor to secure a loan modification or other relief (e.g., secure a forbearance or deferment). Ultimately, what modifications debtors propose and what courts allow will likely involve fact-intensive considerations that will need to be addressed on a case-by-case basis.

We expect that the plan amendment provision permitted by the CARES Act will cause debtors to include requests for deferred payments on various types of consumer debt, such as mortgage loans, auto loans, credit cards, and student loans. Although payments may be deferred, there does not presently appear to be any reason why a chapter 13 creditor would be relieved of its obligation to file timely Notices of Mortgage Payment Change pursuant to Bankruptcy Rule 3002.1 in the event of a future payment change, since the rule does not carve out any exception for forbearance agreements or similar types of deferred payment agreements.

What is clear is that the impact of COVID-19 on consumer bankruptcies is expected to be widespread, notwithstanding the benefits afforded to consumers under the CARES Act. K&L Gates is advising clients on the parameters of the CARES Act and will continue to monitor COVID-19 developments with respect to consumer bankruptcies and other topics.

## ADDENDUM

(b) BANKRUPTCY RELIEF.—

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(1) IN GENERAL.—

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style="MARGIN-RIGHT: 0px" dir="ltr">

(A) EXCLUSION FROM CURRENT MONTHLY INCOME.—Section 101(10A)(B)(ii) of title 11, United States Code, is amended—

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(i) in subclause (III), by striking "; and" and inserting a semicolon;
(ii) in subclause (IV), by striking the period at the end and inserting "; and";
(iii) by adding at the end the following:

> "(V) Payments made under Federal law relating to the national emergency declared by the President under the National Emergencies Act (50 U.S.C. 1601 et seq.) with respect to the coronavirus disease 2019 (COVID–19).".

(B) CONFIRMATION OF PLAN.—Section 1325(b)(2) of title 11, United States Code, is amended by inserting "payments made under Federal law relating to the national emergency declared by the President under the National Emergencies Act (50 U.S.C. 1601 et seq.) with respect to the coronavirus disease 2019 (COVID–19)," after "other than".

(C) MODIFICATION OF PLAN AFTER CONFIRMATION.—Section 1329 of title 11, United States Code, is amended by adding at end the following:

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"(d) (1) Subject to paragraph (3), for a plan confirmed prior to the date of enactment of this subsection, the plan may be modified upon the request of the debtor if—

> "(A) the debtor is experiencing or has experienced a material financial hardship due, directly or indirectly, to the coronavirus disease 2019 (COVID–19) pandemic; and
> "(B) the modification is approved after notice and a hearing.

"(2) A plan modified under paragraph (1) may not provide for payments over a period that expires more than 7 years after the time that the first payment under the original confirmed plan was due.

"(3) Sections 1322(a), 1322(b), 1323(c), and the requirements of section 1325(a) shall apply to any modification under paragraph (1).".

(D) APPLICABILITY.—

> (i) The amendments made by subparagraphs (A) and (B) shall apply to any case commenced before, on, or after the date of enactment of this Act.
> (ii) The amendment made by subparagraph (C) shall apply to any case for which a plan has been

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> confirmed under section 1325 of title 11, United States Code, before the date of enactment of this Act.

(2) SUNSET.—

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(A) IN GENERAL.—

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(i) EXCLUSION FROM CURRENT MONTHLY INCOME.—Section 101(10A)(B)(ii) of title 11, United States Code, is amended—

> (I) in subclause (III), by striking the semicolon at the end and inserting “; and”;
> (II) in subclause (IV), by striking “; and” inserting a period; and
> (III) by striking subclause (V).

(ii) CONFIRMATION OF PLAN.—Section 1325(b)(2) of title 11, United States Code, is amended by striking "payments made under Federal law relating to the national emergency declared by the President under the National Emergencies Act (50 U.S.C. 1601 et seq.) with respect to the coronavirus disease 2019 (COVID–19),".

(iii) MODIFICATION OF PLAN AFTER CONFIRMATION.—Section 1329 of title 11, United States Code, is amended by striking subsection (d).

> (B) EFFECTIVE DATE.—The amendments made by subparagraph (A) shall take effect on the date that is 1 year after the date of enactment of this Act.

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## NOTES

[1] An excerpted copy of the bankruptcy-specific amendments is included as an addendum at the end of this alert.

[2] The modification must otherwise comply with the requirements of 11 U.S.C. §§ 1322(a), 1322(b), 1323(c), and 1325(a).

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