In the United States Bankruptcy Court

for the Northern District of Iowa

DANIEL RAY OLSON
RHONDA JEAN OLSON
Debtor(s).

Bankruptcy No. L90-00423W

Chapter 13

RULING ON MOTION TO DISMISS AND CONFIRMATION OF MODIFIED PLAN

On September 21, 1994, the above-captioned matter came on for hearing pursuant to assignment in Waterloo, Iowa. Debtors appeared by Attorney Barton Schwieger. The Chapter 13 Trustee, Carol Dunbar, was present. The Internal Revenue Service (IRS) appeared by Assistant U.S. Attorney Ana Maria Martel.

Two matters were before the Court for hearing; namely (1) the Chapter 13 Trustee's objection to confirmation of Debtors' Third Amended Chapter 13 Plan, and (2) the Internal Revenue Service's objection to the proposed Plan and a Motion to Dismiss the existing Chapter 13 case. Debtors filed an Answer resisting these Motions.

STATEMENT OF THE CASE

Debtors filed their Chapter 13 Petition on March 13, 1990. The Plan was confirmed on May 23, 1990. It provided for payment of Debtors' IRS debt as a priority claim in the amount of $39,577.83. Subsequently, the IRS filed a Proof of Claim for taxes in the total amount of $41,733.74. This amount included secured claims totaling $35,228.48, unsecured priority claims totaling $5,550.78, and an unsecured nonpriority claim of $954.48.

The IRS has received $10,710.59. It asserts that there is still due on the secured claims of the IRS a total amount of $29,755.45, and $1,259.78 on the unsecured priority claims. The increase from $954.00 to $1,259.78 is due to additional penalties. Additionally, the IRS asserts that Debtors have failed to pay postpetition federal taxes, penalties and interest in the approximate amount of $56,000.00.

The original plan was confirmed with a 60-month term payable in the amount of $750.00 per month. The last payment made by Debtors for the full amount was October 21, 1993. The only payment of any kind since that time was in the amount of $300.00 on July 5, 1994. On July 22, 1994, Debtors filed the pending Third Amended Plan in which they propose to pay the amended amount of $300.00 per month for 60 months, with a total payout of $18,000.00 over the course of the plan. These payments do not include Trustee's fees.

Trustee objects to this plan. She states that the plan, as proposed, fails to pay priority claims in full. She asserts that, although the original plan proposed to pay the IRS as a priority creditor when, in fact, it was a secured creditor, there remains a balance due of $29,817.00 to the IRS. The Trustee objects to confirmation because the IRS will not be paid in full under the amended plan and, additionally, the amended plan fails to address the $14,050.00 which has been received by the Trustee and disbursed to allowed priority creditors, secured creditors and administrative claimants in accordance with the plan.

Debtors have filed an Answer to Motion to Dismiss Chapter 13 Case. Debtors state that they were running a small business, did the best they could under the circumstances, and are now proposing a new plan to continue paying the IRS.

At hearing, Debtors' attorney Barton Schwieger raised an additional issue concerning the fact that Mr. Stephen Rapp, who was Debtors' original attorney, is now the U.S. Attorney for the Northern District of Iowa. Mr. Schwieger suggests that a conflict of interest exists pursuant to the governmental connection between the U.S. Attorney's office and counsel

for the IRS, Ms. Martel, who is an Assistant U.S. Attorney. Consequently, he implies that Ms. Martel should not be allowed to represent the IRS in this matter. Ms. Martel stated that the U.S. Attorney's office is careful to insulate Mr. Rapp from those cases where he previously represented a party. She said that she has not consulted with Mr. Rapp about this case, and that she is acting independently on behalf of the IRS.

ISSUES

Five separate issues are presented for determination by the Court. These issues are:

1. Does the current U.S. Attorney's previous representation of Debtors create an impermissible conflict of interest when an Assistant U.S. Attorney appears as counsel for the Internal Revenue Service?

2. Is Debtors absence from this hearing on the Motion to Dismiss and Confirmation of the Modified Plan critical to a determination of the issues presented at hearing?

3. Can Debtors' Third Amended Chapter 13 Plan be confirmed despite the fact that its duration exceeds the 5-year limit specified in 11 U.S.C. §§ 1322(c) and 1329(c)?

4. Regardless of duration of the Plan, is the Third Amended Chapter 13 Plan presented by Debtors feasible in this case?

5. Regardless of acceptance or denial of the Third Amended Chapter 13 Plan, should the Court allow Debtors original Plan to continue, or should the IRS' Motion to Dismiss be granted at this time?

The Court will address each of the foregoing issues separately.

CONFLICT OF INTEREST

The first issue concerns U.S. Attorney Stephen J. Rapp's previous representation of Debtors and Assistant U.S. Attorney Martel's current representation of the IRS in this matter. Although Mr. Rapp no longer represents Debtors, Debtors suggest an impermissible conflict of interest exists due to Ms. Martel's representation of the IRS and her office's connection to Mr. Rapp.

A similar situation was addressed in United States v. Weiner, 578 F.2d 757 (9th Cir. 1978), cert. denied, 439 U.S. 981 (1978). An attorney, formerly a member of the firm currently representing defendant, left the firm and began working for the Securities Exchange Commission (SEC). Defendant claimed the SEC and the Department of Justice work in close cooperation and, therefore, the U.S. Attorney's office should be disqualified from the case.

The court denied the defendant's request. Weiner, 578 F.2d at 767. To disqualify the entire U.S. Attorney's office, the court stated, knowledge gained by the firm representing defendant would have to be imputed to the attorney who transferred to the SEC. Id. Second, the court would have to impute that same knowledge to the other attorneys in the SEC office. Id. Finally, that same knowledge would somehow have to be imputed to the entire U.S. Attorney's office, by virtue of alleged cooperation between the Department of Justice and the SEC. Id. The court declined to make such imputations, stating that the logic after step (1) was "tenuous." Weiner, 578 F.2d at 767. The court further stated that, although it is possible to impute knowledge to members within a private firm due to the free flow of information, "the size and diversity of many government agencies makes similar assumptions about agencies wholly unrealistic." Id.. The court noted there was no showing that the named SEC attorney had ever investigated or acquired any information about the case.

Here, Mr. Rapp did represent Debtors and does have actual knowledge of the case. The second step, imputed knowledge to the other members of the U.S. Attorney's office, specifically, Ms. Martel, however, is illogical based on the rationale expressed by the Weiner court. Finally, imputing knowledge to the Internal Revenue Service, through the U.S. Attorney's office, is inappropriate for the same reasons. Debtors' argument presupposes some discussion between Mr. Rapp and Ms. Martel about this case. As the Weiner court held, such a conclusion is tenuous, especially in light of the lack of supporting evidence as to this allegation. Here, Ms. Martel affirmatively stated that there was in fact no cooperation or communication between herself and Mr. Rapp, and that the U.S. Attorney's office was careful to screen

Mr. Rapp from the cases in which he previously represented someone. Although the Weiner court noted a lack of evidence indicating that the named attorney had actual knowledge concerning the case, even so, this fact was not critical to the decision. The court focused primarily on the tenuous connection between and within governmental agencies and stressed their size and diversity. Such is the case here, and the allegation that an impermissible conflict of interest exists is unfounded.

In addition, the court in Caggiano held that "the government's ability to function properly would be unreasonably impaired" if entire agencies were to be disqualified due to former representation conflicts. United States v. Caggiano, 660 F.2d 184, 191 (6th Cir. 1981), cert. denied, 455 U.S. 945 (1982) (citing ABA Comm. on Professional Ethics, Formal Op. 342, 62 A.B.A.J. 517 (1976)). The ABA Opinion distinguished the government attorney from the private attorney: (1) government attorneys do not have the same financial interests in the outcome of the case as private attorneys; and (2) government attorneys are governed by Canon 7 of the ABA Code of Professional Responsibility which compels the public prosecutor to seek justice, not merely convictions. Id. The court noted that if the attorney was separated from participation in the matters, no disqualification would be necessary. Id. Because Mr. Rapp is separated from cases where he formerly represented a party, the U.S. Attorney's office should not be disqualified from the case. Further, Ms. Martel's representation of the IRS is proper, and Debtors' claim of an impermissible conflict of interest is without merit.

DEBTORS' ABSENCE

A second threshold issue is whether the absence of Debtors from the hearing on the Motion to Dismiss and the Confirmation of Modified Plan is critical to a determination of the issues presented. Debtors' presence is required at discharge hearings (11 U.S.C. §§ 521(5), 524(d)); reaffirmation hearings (11 U.S.C. § 524(d)), and the meeting of creditors (11 U.S.C. § 343). In addition, Rule 4002 requires the debtor to attend and submit to examination when ordered by the court. Fed. R. Bankr. P. 4002. However, there is no absolute requirement that a debtor attend dismissal or confirmation hearings. In re Perskin, 9 B.R. 626, 630 (Bankr. N.D. Tex. 1981). The Court did not order Debtors to appear at the September 21, 1994, hearing. The matters at issue were more than adequately presented by Debtors' counsel. It is, therefore, the conclusion of this Court that Debtors' absence was not of significant consequence to a determination of the issues presented. The presence of Debtors' attorney was sufficient. See Fed. R.Bankr.P. 9010; Perskin, 9 B.R. at 630; 2 William L. Norton, Jr., Norton Bankruptcy Law and Practice 2d § 45:6 (1994).

LENGTH OF CHAPTER 13 PLAN

The core issue in dispute is whether Debtors' modified plan may extend payments an additional five years when the original plan has been in effect for four years and four months. Section 1322(c) states: "The plan may not provide for payments over a period that is longer than three years, unless the court, for cause, approves a longer period, but the court may not approve a period that is longer than five years." 11 U.S.C. § 1322(c). This section applies to the Chapter 13 Plan. Section 1329(c), which applies to modified or amended plans, states that the court may not approve a modified Chapter 13 plan that expires after five years after the time that the first payment under the original confirmed plan was due. See In re White, 126 B.R. 542, 547 (Bankr. N.D. Ill. 1991).

Congress justified the time limits of §§ 1322(c) and 1329(c) by reasoning that lengthy repayment periods fly in the face of the bankruptcy policies entitling the debtor to a fresh start and relief from debt. H.R. Rep. No. 595, 95th Cong., 1st Sess. 117 (1977) reprinted in 1978 U.S. Code Cong. & Admin. News 5787, 6078. Payment periods extending beyond these limits places the Chapter 13 debtor in danger of becoming a "wage slave" and facing the prospect of lifelong Chapter 13 obligations. In re Woodall, 81 B.R. 17, 18 (Bankr. E.D. Ark. 1987). In essence, the five-year limit serves as a check on Debtors' eagerness to pay back their debts and a check on the overreaching of creditors in pressuring Debtors to do so. 2 David G. Epstein et al., Bankruptcy, § 9-12, at 647 (1992).

The payment period of a Chapter 13 plan is determined from the day the first payment is due under the original plan. In re Eves, 67 B.R. 964, 967 (Bankr. N.D. Ohio 1986). Payments under Debtors' original plan were to commence upon receipt of the Notice to Begin Payments dated March 12, 1990. Debtors' Third Amended Plan, if confirmed, would expire sometime in late 1999, nearly ten years after the date the first payment under the original plan was due. Therefore, Debtors' Third Amended Plan violates the provisions of §§ 1322(c) and 1329(c), and cannot be confirmed.

FEASIBILITY OF CHAPTER 13 PLAN

Regardless of the §§ 1322(c) and 1329(c) issues, the Court will also consider whether Debtors' Third Amended Plan is feasible. In order to be confirmed, a plan or amended plan must meet the requirements of § 1325(a). 11 U.S.C. § 1329(b)(1). Section 1325(a)(6) requires that, in order for the plan to be confirmed, debtor must have the ability to make all payments under the plan and to comply with the plan. 11 U.S.C. § 1325(a)(6). Debtors must have a sufficiently stable income to regularly make payments under the plan. 5 William L. Norton, Jr., Norton Bankruptcy Law and Practice 2d § 115:4 (1994). In addition, if debtor is unable to meet living expenses, the plan fails the feasibility test of § 1325(a)(6) and cannot be confirmed. In re Wilson, 117 B.R. 714, 714 (Bankr. M.D. Fla. 1990).

Debtors are currently looking for employment. When Debtors are unemployed at the time of confirmation of the plan, they need only have a realistic expectation of income; their future income stream need not be a certainty. In re Compton, 88 B.R. 166, 167 (Bankr. S.D. Ohio 1988). Thus, the fact that Debtors are currently unemployed is not necessarily fatal to the feasibility of the proposed modified plan. However, § 1325(a)(1) encompasses all other applicable provisions of the Code, including § 1322(a)(2), which states that the Chapter 13 plan must provide for full payment of priority claims. 11 U.S.C. § 1325(a)(1).

The IRS claims for postpetition taxes are priority claims pursuant to §§ 1305 and 507. Debtors have proposed a 60-month plan, at $300 per month, for total payments of $18,000. The IRS' remaining prepetition claims amount to approximately $30,000, while its claims for postpetition taxes amount to approximately $56,000. Debtors have the burden of proving that the confirmation requirements are satisfied. In re Lindsey, 122 B.R. 157, 159 (Bankr. M.D. Fla. 1991). The amounts presented, on their face, fail to satisfy § 1322(a)(2). Debtors' Third Amended Plan cannot be confirmed.

Several factors affect the feasibility of a plan. Factors include: the future earning capacity of the debtor, the future disposable income of the debtor, whether the plan provides for payment of interest to secured creditors, whether the plan provides significant payment to secured creditors, (In re Brunson, 87 B.R. 304, 312 (Bankr. D. N.J. 1988)), the debtor's perseverance and motivation to execute the plan successfully (In re Ryals, 3 B.R. 522, 524-25 (Bankr. E.D. Tenn. 1980)), the type of employment the debtor is engaged in or may be engaged in (In re Goodavage, 41 B.R. 742, 746 (Bankr. E.D. Va. 1984)), whether the plan includes a cushion for unexpected expenses (Id.), and whether the plan considers the possibility of inflation (In re Perskin, 9 B.R. 626, 633 (Bankr. N.D. Tex.. 1981)). 9B Am. Jur. 2d *Bankruptcy* § 2642 (1991). In light of the circumstances of this case, these factors compel the conclusion that Debtors' amended plan is not feasible.

MOTION TO DISMISS

Finally, the Court must determine whether the case should be dismissed immediately or whether the original plan should be allowed to run its course. Section 1307(c)(6) states that the court may dismiss the Chapter 13 case, "for cause, including . . . [a] material default by the debtor with respect to a term of a confirmed plan."

Failure to make payments to the trustee under a confirmed plan may be considered a material default. In re Belanger, 60 B.R. 656, 656-57 (Bankr. D.R.I. 1986). The Belanger debtor failed to make payments as provided by the confirmed plan for over a year, and took no affirmative actions to seek relief. Id. at 657. The court dismissed the case for cause pursuant to § 1307(c)(6). Id. In the case at hand, Debtors have not made a full $750.00 payment to the trustee since October 1993. Some authorities do not consider simple failure to make payments under the plan an automatic ground for dismissal. In re Howell, 76 B.R. 793, 795 (Bankr. D. Or. 1986); In re Ford, 78 B.R. 729, 762 (Bankr. E.D. Pa. 1987); In re Black, 78 B.R. 840, 842 (Bankr. S.D. Ohio 1987). Whether missed payments constitute a "material default" must be determined on a case-by-case basis. Black, 78 B.R. at 842; In re Green, 64 B.R. 530, 530 (Bankr. 9th Cir. 1986). In Black, debtor's plan was substantially completed at the time of default, and debtor had a valid reason for the default. The court, therefore, denied the requested dismissal of the case. Black, 78 B.R. at 842. Debtors' Answer to Motion to Dismiss Chapter 13 Case asserts that Debtors have done the best they can to fulfill their obligations under the plan, and cite the failure of their small business as the cause of their payment default. This Court concludes that the plan should not be dismissed solely because Debtors have failed to

make payments.

Sometimes, if Debtors are allowed to continue making payments under their original plan, the original plan can exceed the five-year limit of §§ 1322(c) and 1329(c) if the extra time is necessary to make up for partial or missed payment, as long as the plan as originally proposed complied with the time limits. In re Black, 78 B.R. 840, 842 (Bankr. S.D. Ohio 1987). Debtors' last complete payment was made in October 1993. Since that time, Debtors have made one $300 payment in July 1994. While Black provides some authority that Debtors may exceed the five-year time limits, the court may not confirm a plan such as Debtors' Third Amended Plan if it violates the five-year limitation at the outset. Id. Additionally, the Black court noted that the extension would be of short duration as debtors had only six payments to complete. Id. Here, even if Debtors pay the full $750.00 per month as originally proposed under the plan, the payments must be extended well beyond one year. Also, the Black debtors' plan provided 100% payment to all unsecured creditors, while Debtors' plan does not.

Debtors' employment situation suggests strongly that they will be unable to continue making $750.00 per month payment under the original plan. 11 U.S.C. § 1325(a)(6). Debtors' original plan seems impossible for Debtors to complete. While a plan need only be feasible at the time of confirmation, and sometimes should be upheld until it fails, here, Debtors' failure to make a full payment in over a year and their current unemployment situation establishes that continuation of this plan would be to no avail. In re Anderson, 18 B.R. 763, 765 (Bankr. S.D. Ohio 1982), aff'd 28 B.R. 628 (Bankr. S.D. Ohio 1982). It is the conclusion of this Court that immediate dismissal is most appropriate.

WHEREFORE, for all of the reasons set forth herein, the Chapter 13 Trustee's objections to Debtors' Third Amended Chapter 13 Plan are SUSTAINED.

FURTHER, for the reasons set forth herein, the Internal Revenue Service's objections to Debtors' Third Amended Chapter 13 Plan are SUSTAINED.

FURTHER, as the objections of the Chapter 13 Trustee and the Internal Revenue Service are sustained, confirmation of Debtors' Third Amended Chapter 13 Plan is DENIED.

FURTHER, for all of the reasons set forth herein, the Motion to Dismiss the Chapter 13 case filed by the Internal Revenue Service is GRANTED and Debtors' Chapter 13 case is DISMISSED.

SO ORDERED this 14th day of October, 1994.

Paul J. Kilburg
U.S. Bankruptcy Judge