

# In the United States Bankruptcy Court

## for the Northern District of Iowa

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RONALD O'BRIEN  
PHYLLIS O'BRIEN  
*Debtor(s).*

Bankruptcy No. 98-00545-C

Chapter 13

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### ORDER RE CONFIRMATION OF DEBTOR'S FIRST AMENDED PLAN AND CREDITORS' MOTION

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This matter came before the undersigned for hearing on April 15, 1999 pursuant to assignment. Debtors Ronald and Phyllis O'Brien appeared with attorneys Thomas McCuskey and Larry Thorson. Carol Dunbar appeared as Chapter 13 Trustee. Creditors Brian and Dana Capouch ("Creditors") appeared with attorney Michael McDonough. After the presentation of evidence and argument, the Court took the matter under advisement. The time for filing briefs has now passed and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(A), (L).

#### STATEMENT OF THE CASE

The matters scheduled for hearing were confirmation of Debtor's First Amended Chapter 13 Bankruptcy Plan and Creditors' Motion to Convert Proceeding to Chapter 7. Trustee filed an objection to confirmation which now appears to be largely resolved. In response to Trustee's objection, Debtors have agreed to sell their boat and to dedicate all disposable income to the plan. Creditors object to Debtors' treatment of their secured claim in the Amended Plan. They assert the 15-year amortization of their claim is impermissible. Creditors also argue the interest rate is unreasonably low and the plan fails to make provision for default or for insurance. Trustee and Creditors also raise the issue of feasibility of the plan. Creditors request the Court convert this case to Chapter 7.

#### FINDINGS OF FACT

Debtors filed their Chapter 13 petition and original plan on February 26, 1998. They have made \$500 monthly payments under the original plan since filing. Debtors objected to the claim filed by Custom Creations, Inc., Brian Capouch and Dana Capouch. The Court ruled on October 1, 1998 that Creditors hold a claim for \$12,500, plus attorney fees of \$10,000, secured by Debtors' homestead and further secured by Debtors' non-homestead real estate to the extent of the principle debt of \$12,500. This debt arises from judgment in an action by Creditors to enforce their mechanic's lien. The underlying debt became due in the fall of 1995. Creditors' judgment for \$12,500 was entered September 23, 1997 by the Linn County District Court. The judgment provided that "[i]nterest shall be on the judgment as provided by law." The court entertained the issue of attorney fees and entered judgment on that issue postpetition on September 10, 1998 in the amount of \$10,000.

Debtors' amended plan proposes to pay Creditors' judgment of \$22,500 with interest at the Noe rate of 7.02% over 15 years. If Debtors sell their homestead, the proceeds will be paid on Creditors' claim after payment of taxes, costs of sale and liens senior to Creditors' judgment lien. Creditors object to payment over 15 years. They also object to payment of interest at the Noe rate. Debtors' plan proposes monthly payments of \$500 to Trustee for three years. At the hearing, Debtors requested the opportunity to amend the plan if necessary after the Court decides whether the plan treatment of Creditors' claim is acceptable.

Debtor Ronald O'Brien testified at the hearing. He stated he has income from his job at Penford Products, as well as from his car rebuilding business. Mrs. O'Brien has income from her housekeeping business. Mr. O'Brien testified they have made all payments under the plan and can continue to do so, as well as making payments of \$202 per month to Creditors under the plan. He stated unsecured creditors are receiving more under the plan than they would in a Chapter 7 liquidation.

Creditor Brian Capouch testified that he provided services and materials during the building of Debtors' residence through the fall of 1995. He has received no payment from Debtors. Under his normal business practices, payment is due within 30 days of finishing the work. He does not provide for long-term financing of amounts due for his work.

### TERM OF PAYMENT

To qualify for confirmation under Chapter 13, Debtors' plan must satisfy the requirements set forth in § 1325(a) of the Code. Debtors' treatment of Creditors' secured claim is governed by subsection (a) (5).

Under this provision, a plan's proposed treatment of secured claims can be confirmed if one of three conditions is satisfied: the secured creditor accepts the plan, see 11 U.S.C. §1325(a)(5)(A); the debtor surrenders the property securing the claim to the creditor, see § 1325(a)(5)(C); or the debtor invokes the so-called "cram down" power, see § 1325(a) (5)(B). Under the cram down option, the debtor is permitted to keep the property over the objection of the creditor; the creditor retains the lien securing the claim, see §1325(a)(5) (B)(i), and the debtor is required to provide the creditor with payments, over the life of the plan, that will total the present value of the allowed secured claim . . . , see § 1325(a) (5)(B)(ii).

Associates Commercial Corp. v. Rash, 117 S. Ct. 1879, 1882-83 (1997). Creditors do not accept the plan and Debtors are not offering to surrender the collateral. Therefore, Debtors must provide Creditors with payments over the life of the plan that will total the present value of their allowed secured claim. The permissible life of the plan is three years, and may be extended to five years for cause. 11 U.S.C. §1322(d).

One method of complying with the cram down provision is to maintain regular payments under §1322 (b)(5). In re Gordon, 217 B.R. 973, 975 (Bankr. S.D. Ga. 1997). Under that section, a Chapter 13 debtor 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.

This permits the debtor to take advantage of a payment period which is longer than the life of the chapter 13 plan. In re Chappell, 984 F.2d 774, 780 (7th Cir. 1993). It applies only to long-term debts which by their own terms extend beyond the life of the plan. In re Ford, 221 B.R. 749, 753 (Bankr. W.D. Tenn. 1998); In re Dinsmore, 141 B.R. 499, 504 (Bankr. W.D. Mich. 1992). Long-term debt provided for in a Chapter 13 plan under §1322(b)(5) is excepted from discharge under §1328(a)(1). Dinsmore, 141 B.R. at 504.

If the debt in question is currently due and owing or will become due prior to the final plan payment, it is short term in nature and treatment under §1322(b)(5) is not permitted. Id.; In re Sabec, 137 B.R. 659, 668 (Bankr. W.D. Mich. 1992); In re Molitor, 133 B.R. 1020, 1021 (Bankr. D.N.D. 1991). If a claim does not qualify for treatment under §1322(b)(5) as long term debt, it is subject to the term restriction under §1322(d). In re Scott, 121 B.R. 605, 608 (Bankr. E.D. Okla. 1990).

Courts have allowed debtors to treat claims under §1322(b)(5) where an installment contract with the IRS provided for payments beyond the life of the plan, Gordon, 217 B.R. at 975; and where an agreement provided for 194 monthly payments for the debtor to reimburse an insurance company, Ford, 221 B.R. at 751. The section has been applied to student loans, mortgages and auto installment contracts. Id. at 752. Courts have refused to allow debtors to stretch payments beyond the life of the plan where a debtor's personal guaranty of business debt, with no fixed date of termination, was short term in nature, Dinsmore, 141 B.R. at 504; a tax lien debt obligation was currently due and owing and the tax act did not permit installment payments, Sabec, 137 B.R. at 668; final payments on contracts for deed of farmland were due well in advance of the final Chapter 13 plan payment, Molitor, 133 B.R. at 1021; and a five-year mortgage with a balloon payment became due preconfirmation, In re Schafer, 99 B.R. 352, 354 (W.D. Mich. 1989).

The statutory limit on the repayment period under a Chapter 13 plan is five years. Debtors' plan provides for payments on Creditors' claim over fifteen years. The debt to Creditors was due and payable in the fall of 1995. The judgment foreclosing their mechanics' lien is effective on the date it was rendered. See Andrew v. Winegarden, 219 N.W. 326, 328 (Iowa 1928). The Iowa District Court finalized its judgment for attorney fees in September 1998. Because these dates occurred before the end of the 36-month term of Debtors' plan, Creditors' claim does not qualify for §1322(b)(5) treatment of long-term debt. See Grundy Nat'l Bank v. Johnson, 106 B.R. 95, 96 (W.D. Va. 1989). Debtors may not stretch out payment on Creditors' claim beyond the five year limit of §1322(d). See Dinsmore, 141 B.R. at 505.

### INTEREST RATE

Chapter 13 allows for modification of the rights of holders of secured claims. 11 U.S.C. §1322(b)(2). Such modification cannot, however, violate the five year time limit. Id.; Molitor, 133 B.R. at 1022. A claim secured only by a security interest in real property that is the debtor's principal residence is excepted from the provision allowing modification of secured claims. 11 U.S.C. §1322(b)(2). A security interest under this section must be created as the result of a consensual agreement between the debtor and the creditor. First Nat'l Fidelity Corp. v. Perry, 945 F.2d 61, 64 (3d Cir. 1991). Because Creditors' claim is not a product of a consensual agreement, it may be modified under §1322(b)(2).

Pursuant to the Court's ruling of October 1, 1998, Creditors hold an allowed secured claim of \$22,500, plus interest as provided in their judgment which had accrued as of the date Debtors filed their bankruptcy petition. Under Iowa Code section 535.3 (1995), for actions filed prior to July 1, 1997, interest shall be allowed on all money due on judgments and decrees of courts at the rate of ten percent per year, accruing from the date of the commencement of the action. The Court assumes

Creditors filed their mechanics lien action prior to July 1, 1997 and are entitled to ten percent interest on their judgment under section 535.3. Therefore, Creditors' allowed secured claim includes the \$22,500 judgment plus prepetition interest at the rate of ten percent per annum.

It is undisputed that Creditors' are oversecured by the equity in Debtors' homestead and other real estate. As oversecured creditors, they are also entitled to postpetition interest until confirmation under §506(b) as part of their allowed secured claim. Rake v. Wade, 508 U.S. 464, 467 (1993). The correct interest rate of postpetition, preconfirmation interest to oversecured creditors is subject to some discretion on the part of the court. In re DeMaggio, 175 B.R. 144, 148 (Bankr. D.N.H. 1994). Absent any strong and unique countervailing factors, however, the prepetition rate is normally enforced. Id. at 148 (rejecting statutory rate of 18 percent for tax debt, in favor of federal judgment rate, in light of current economic conditions). In the absence of proof of countervailing factors, Creditors are entitled to statutory ten percent interest on their judgment postpetition until the date of confirmation.

After confirmation, Creditors are entitled to interest under §1325(a)(5)(B) to realize the present value of their allowed secured claim. The interest rate that will return present value under the plan under §1325(a)(5)(B) is not necessarily the same interest rate used to determine the allowed amount of the claim under §506(b). DeMaggio, 175 B.R. at 150. Debtor proposes to pay interest on Creditors' claim at the Noe rate. In this district, an acceptable interest rate for payments to secured creditors in a plan of reorganization is the current interest rate on treasury bonds with analogous maturity dates, plus 2 percent to provide for the risk factor. In re Noe, 76 B.R. 675, 678 (Bankr. N.D. Iowa 1987). According to Debtor, the applicable Noe rate is currently approximately 7.02%.

Debtors' plan treatment of Creditors' claim is not acceptable. Creditors' claim may be modified. Debtors must, however, pay the present value of Creditors' claim, including interest, over the life of the plan. The plan treatment proposed fails to comply with this mandate because the present value of Creditors' claim includes prepetition and preconfirmation interest at ten percent. Debtors must provide for payment of Creditors judgment plus ten percent interest to the date of confirmation. Debtors' proposal to only pay interest at the Noe rate preconfirmation violates Chapter 13 confirmation requirements because it fails to provide for Creditors' allowed claim in full. The Noe rate is only applicable postconfirmation.

### MOTION TO CONVERT

Creditors assert Debtors' case should be converted to Chapter 7. Pursuant to §1307(c), the Court may convert this case to a case under Chapter 7 for cause, including unreasonable delay that is prejudicial to creditors or denial of confirmation and denial of a request for additional time for filing another plan. Creditors state this case has been pending for over one year. They note Debtors' original plan was not confirmable and argue the Amended Plan also fails to comply with Chapter 13 requirements. Debtors request time to amend their plan if confirmation is denied.

A decision to dismiss or convert under §1307 is committed to the discretion of the bankruptcy court. In re Blaise, 219 B.R. 946, 950 (B.A.P. 2d Cir. 1998). In Blaise, the court found cause to convert or dismiss under §1307(c) as the case had been filed 11 months prior to the conversion hearing, the debtor's plan was fraught with problems and the debtor had not yet made any plan payments or adequate protection payments. Id. Furthermore, the court found the debtor had not "played by the rules" in failing to schedule assets and sale of estate property. Id. at 951. In In re Gale, 8 B.R. 960, 963-64 (Bankr. D. Md. 1981), the court sua sponte converted a case to Chapter 7 where "any modified plan proposed by the debtors must necessarily be non-confirmable under the feasibility test imposed by §1325(a)(6) because the debtor's budget will not permit payments to be made from future

earnings." Further grounds for conversion existed because the petition was filed more than nine months prior to the confirmation hearing and "further delay . . . would be unconscionable in view of the already ample period of protection that the debtors have availed themselves of." Id. at 964.

Creditors also assert Debtors are using Chapter 13 for purposes of delay and are not acting in good faith. Cause for conversion under §1307(c) includes filing the petition in bad faith. In re Molitor, 76 F.3d 218, 220 (8th Cir. 1996). A bad faith determination focuses on the totality of the circumstances, with consideration of the following factors: (1) whether debts and expenses are stated accurately, (2) whether the debtor made any fraudulent representations to mislead the court and (3) whether the debtor's filing unfairly manipulates the Bankruptcy Code. Id. Other factors can include the nature of the debt, the timing of the petition, the debtor's motive in filing, how the debtor's actions have affected creditors, the debtor's treatment of creditors both pre- and post-petition, and whether the debtor has been forthcoming with the court and creditors. In re Love, 957 F.2d 1350, 1357 (7th Cir. 1992).

As Trustee and Creditors point out, Debtors' Schedules I and J reflect disposable income available for plan payments of \$97 per month. Paradoxically, Debtors propose monthly plan payments of \$500 and have remained current in these \$500 payments since they filed their petition 14 months ago. Debtors have not amended their income or expense schedules to disclose the source of the additional income which has been allowing them to make their plan payments.

At the hearing, Debtors presented a copy of their 1998 tax return as an exhibit. After being examined regarding the income disclosed in the tax return, Debtor Ronald O'Brien indicated there must be some error in the return. Subsequent to the hearing, Debtor's counsel presented the Court with a copy of Debtors' amended return which indeed corrects an error in reporting income.

Copies of income tax returns are not substitutes for accurate Schedules I and J required in a bankruptcy case. Some allowed expenses and deductions for income tax purposes are non-cash which prevents a tax return from accurately reflecting a debtor's cash flow for purposes of determining disposable income in a Chapter 13 case. By backing out the non-cash expenses and deductions, it is possible to determine that Debtors' proposed plan payments of \$500 per month are feasible based on the income and expenses shown in the tax return. However, the plan as proposed mistreats Creditors' claim and cannot be confirmed. Neither the income tax return nor Debtors' schedules support Debtors' capability of also paying Creditors over the life of the plan.

Creditors estimate their claim as of the time of hearing totals approximately \$27,037 and amortizing this amount over five years, the longest length of a Chapter 13 plan under §1322(d), would require monthly payments of approximately \$561. Debtors have failed to show their disposable income is sufficient to make both the proposed plan payments of \$500 and this additional payment to Creditors of \$561 to provide them the present value of their allowed secured claim during the life of the plan. This is even more evident if the life of the plan remains three years as Debtors' amended plan proposes.

Debtors are unable to propose a feasible plan which pays Creditors as required by the Code. Their request for additional time to amend their plan is denied. Debtors' budget does not allow the required payment under a Chapter 13 plan, even if the term of the plan is extended to 5 years. This case has been pending for more than 14 months. Debtors have avoided paying Creditors on their mechanics' lien since 1995. This failure to pay on a secured debt has been aided by the automatic stay since February, 1998. Further delay will continue to be prejudicial to Creditors and are unwarranted. The Court finds good cause exists to convert this case to Chapter 7.

**WHEREFORE**, confirmation of Debtor's First Amended Chapter 13 Bankruptcy Plan is DENIED.

**FURTHER**, Creditors' Motion to Convert Proceeding to Chapter 7 is GRANTED.

**SO ORDERED** this 4th day of May, 1999.

Paul J. Kilburg  
U.S. Bankruptcy Judge