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TO OBJECT, OR NOT TO OBJECT? (THAT IS THE CHAPTER 13 QUESTION)

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When a borrower files chapter 13 bankruptcy, it is often the case that the borrower seeks to repay his or her mortgage arrears. This is commonly done over 36 to 60 months through a chapter 13 repayment plan. In these chapter 13 plans, a borrower will list the amount of mortgage arrears to be repaid; it is rarely the case that such borrower will get the amount correct, however. In fact, it is *almost* universal that the borrower will 'understate' the amount of arrears owed, whether out of a good faith but mistaken belief as to the amount, or due to 'clever' accounting maneuvers that attempt to make a repayment plan seem capable of success.

In any event, a creditor can object to confirmation of such a plan in order to address any perceived legal or factual deficiencies. There are a multitude of bases upon which to object to a plan (as mainly set forth in 11 U.S.C. §§ 1322 and 1325 but with other possible bases located throughout Title 11). For example, a creditor may object on the basis that a plan impermissibly modifies its rights [11 U.S.C. § 1322(b)(2)], does not repay its mortgage arrears in a reasonable amount of time [11 U.S.C. § 1322(b)(5)], or is not financially feasible due to insufficient borrower income [11 U.S.C. § 1325(a)(6)]. Sometimes, a borrower will play fast and loose with the bankruptcy system and so Title 11 allows a creditor to object to a plan based on a lack of good faith. [11 U.S.C. § 1325(a)(3), (a)(7)].

There is another objection that creditors routinely make: that a plan 'understates' the arrears owed to the creditor. These 'understated arrears' objections are ostensibly made in order to preserve a creditor's rights and prevent the creditor from being bound to an incorrect, lower arrearage amount; after all, a confirmed plan is binding on a creditor under 11 U.S.C. § 1327. Seemingly, it appears prudent to object to a plan that 'understate arrears.'

This is especially true where a creditor's proof of claim, the document whereby creditor formally asserts what it is owed, and to which a borrower can object is he or she believes it to be incorrect, is to be filed after a creditor's deadline to object to borrower's plan.

But, are these types of objections proper?

Bankruptcy Rule 9011(b)(2) requires that any claims or legal contentions presented to the Court be warranted by existing law or by a nonfrivolous argument for the extension, modification, or reversal of existing law or the establishment of new law.

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While a plan's 'understated arrearage' is certainly relevant to many other objectionable bases, such as where a creditor's higher arrearage renders the plan financially infeasible or results in the arrearage repayment period being unreasonably long, there is no specific code section in Title 11 that deems a plan non-confirmable *ipso facto* an understated arrearage. A creditor could argue that an incorrect arrearage amount impermissibly modifies its rights under 11 U.S.C. § 1322(b)(2) (provided the creditor's lien is secured by only borrower's principal residence). However, what if the plan states that the arrears are 'estimated only' or that a creditor's proof of claim controls the amount of arrears to be repaid under the plan?

In California, creditors face this exact situation. In all four California districts, the respective form chapter 13 plans all contain language to the effect that a creditor's proof of claim will control the amount of the arrears over what is listed in the plan.

Therefore, in California, an objection based *solely* on 'understated arrears' would not be warranted by existing law; the plan, by its terms, does not control the amount of the arrears but rather the creditor's proof of claim. For an objection to be warranted by existing law, the creditor must point to some other basis other than 'understated arrears.'

In fact, a class action was filed in the United States District Court for the Northern District of California entitled *Torres v. PHH Mortgage Corp. et al*. that alleged the impropriety of these 'understated arrears-only' objections, where the chapter 13 plans at issue stated that the creditors' proofs of claim control the arrearage amounts. Notably, the plaintiff also alleged that the defendants were assessing attorney fees to borrowers' loans for these allegedly meritless objections, which might have been a large factor in bringing the suit.

The action was dismissed with prejudice upon the parties' resolution, with plaintiff apparently receiving no compensation or value from defendants. The District Court had no opportunity to provide any substantive ruling to shed light on the merits of the plaintiff's claims. But such a case still serves as a cautionary tale for creditors regarding 'understated arrears' objections.

What is this cautionary tale's lesson?

For California, my advice has generally been to not recommend an objection solely due to understated arrears. Of course, all possible objection arguments are analyzed for a client; often, a borrower's plan that understates arrears will be rendered financially infeasible when accounting for a client's higher arrearage, which helps avoid the propriety issue altogether. However, there are still chapter 13 plans that understate arrears, but which are not reasonably subject to any objection otherwise.

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Some clients will nonetheless want to file objections for understated arrears where we cannot reasonably make any other argument for objection. This is to assert the claim amount out of caution, as proofs of claim are often filed later than the client's plan objection deadline in California. There might be some legal wiggle-room to this course of action: in the 9th Circuit, an objection could be considered an informal proof of claim and might protect a creditor if its proof of claim is filed late[1]. This rationale could *possibly* provide some basis in law to justify the 'understated arrears' objection. Although, best practice is to not rely on this untested rationale and simply ensure a timely proof of claim is filed.

For clients that do insist on an objection for only understated arrears, I advise them of the risk that the objection could be overruled by the Court and that a debtor could try to seek attorney fees if the objection is so overruled. For the objections themselves, I file limited objections that state that the objection is cautionary, and the arrears are set forth in case the higher arrearage amount is relevant to confirmation. Also, I advise clients that they should not recover or assess to the loan attorney fees for the objections if they choose to file them.

There is one district that can be difficult: The Eastern District of California. In general, a creditor must have its proof of claim on file if an objection relates to its arrears. If the proof of claim is already on file, then there is no reason to file a cautionary objection for understated arrears. In this situation, I recommend that a client just escalate its proof of claim to ensure it is timely filed.

So, to answer the question: 'to object or not to object?' Well, the answer is, as always, it depends…

The End.

[1] ***Spokane Law Enf't Fed. Credit Union v. Barker (In re Barker)*, 839 F.3d 1189, 1196 (9th Cir. 2016)**