

# Seventh Circuit Rules that Secured Creditors *Required* to File Timely Proofs of Claim in Chapter 13's. Otherwise, Adverse Consequences Could Follow – Ten Year Plans?

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## **Introduction**

This article deals with chapter 13 secured creditor proofs of claims. Chapter 13 of the Bankruptcy Code allows debtors to retain some assets and pay off their debts with future income. The debtor makes regular payments to a trustee pursuant to a Plan that the debtor must file. After the bankruptcy court confirms the Plan, the trustee begins to distribute payments to creditors, as specified in the debtor's Plan. Once the debtor makes all of the payments required by the Plan, the bankruptcy court discharges most of the debtor's remaining debts.

A proof of claim is a document filed by a creditor of a bankruptcy debtor to enable that creditor to participate in distribution of the debtor's bankruptcy estate or to participate under the debtor's Plan of reorganization. Usually, this participation involves curing pre-bankruptcy secured debt defaults through payments over the time of the debtor's chapter 13 Plan (usually, five years). There are two types of claims of concern here: (1) unsecured claims; and, (2) secured claims. Normally, a lender who is adequately secured by the debtor's real property will only be concerned with a secured claim. (Beyond the scope of this article are unsecured claims which may be possessed by a lender, such as underwater or undersecured claims, claims for deficiencies, and the like.)

It was most often thought that a fully secured creditor did not have to file a proof of claim to participate in a debtor's chapter 13 proceeding so long as the secured creditor's claim was provided for in the Plan. A new case from the 7<sup>th</sup> Circuit, *In re Pajian*<sup>1</sup>, has changed that view.

*Pajian* held that a secured creditor is obligated to file a proof of claim just like any other creditor, unsecured or otherwise. One reason for this is that a debtor must know what he/she is obligated to pay during the course of the chapter 13 Plan so he/she can come out on the other side of the bankruptcy with all of his/her debts resolved. In other words, the debtor must be able to Plan what is necessary to pay to satisfy his/her creditors under the Bankruptcy Code. And, the court and trustee must know these numbers as well in order to properly monitor and approve a Plan that has a reasonable chance for success. What would often happen in the past is that a debtor would finish a chapter 13 Plan, pay the "pre-petition" debt the debtor thought was owed to the secured creditor, only to have a secured creditor slap on a rash of unknown or unsuspected fees and costs, advances, or other items, leaving the debtor to struggle to pay these items after the conclusion of the Plan. This would sometimes result in another bankruptcy.

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<sup>1</sup> *In re Pajian* (7<sup>th</sup> Cir. 2015) 785 F.3<sup>rd</sup> 1151.

The 7<sup>th</sup> Circuit's interpretation of Rule 3002 (California is in the 9<sup>th</sup> Circuit, but it is likely the new case would be upheld here) makes it mandatory that secured creditors file their proofs of claims with all appropriate attachments (if any.) (Rule 3002 *also* requires that secured creditors holding deeds of trust secured by a debtor's personal residence take extra steps to comply with that rule. All secured creditors having liens secured by a debtor's personal residence should be aware of these different rules.)

### **The Case and the Court's Analysis**

So, what happened in this case? In *Pajian*, the secured creditor held a note secured by a deed of trust on the debtor's commercial real property. The bank missed the court's filing deadline for its proof of claim, ultimately filing the tardy proof of claim three months late. Previously (at least at the court of appeal level), such a secured creditor omission was not thought to be fatal, as long as the Plan properly provided for the secured creditor's secured claim. Here, however, the debtor objected to the late-filed claim, asserting that Rule 3002(c) required the proof of claim to be timely filed even though it was a secured claim. And, there was no objection to the validity of the note, or of the deed of trust, or even as to the amount claimed by the secured creditor. The debtor simply did not want to pay the Bank's arrearages during the course of the chapter 13 Plan.

The Court agreed with the debtor. What this meant was that the debtor did not have to pay *anything* on arrearages owed to the Bank during the course of the chapter 13 Plan (presumably five years). The debtor *only* had to pay the regular payments on the secured obligation that came due during the Plan.

*What does this all mean?* This means that the debtor could simply pay his regular payments over the course of the five years. Payments on arrearages would be unnecessary, because arrearages are normally dealt with in the Plan. But, because the secured creditor filed its proof of claim for arrearages late, that claim was objected to and need not be paid under the Plan. At the end of the Plan, the debtor would obtain his/her discharge. It should be noted that the failure of the secured creditor to file the proof of claim does not result in the secured creditor's lien being "voided". The lien still exists, but may not be fully enforceable during the debtor's chapter 13 proceedings unless the debtor defaults under the Plan. But, because the failure to file the proof of claim did not *void* the lien and the bank's secured creditor rights remained (but were postponed) regarding the defaulted arrearages, the bank would be able to pursue foreclosure for failure to pay when the debtor's chapter 13 concluded. But notice this: the debtor could theoretically *again* file a chapter 13 at the end of the first Plan and deal with the former arrearages that should have been dealt with in the first Plan in a new, second chapter 13 Plan. In other words, the debtor could theoretically get ten years of protection, just because the secured creditor did not file its proof of claim in a timely fashion in the first place (90 days from the date of the first meeting of creditors<sup>2</sup>).

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<sup>2</sup> *Caution:* It is proposed to reduce the 90 days to 60 days. Be aware of the actual filing requirements.

### What to do?

1. Always get any new bankruptcy filing to your bankruptcy counsel immediately. *Deadlines are very short in bankruptcy. Failure to timely take action can result in disastrous consequences.* All deadlines should be calendared and monitored.
2. Properly fill out, calendar and *timely* file the proof of claim, with *all* required information under Rule 3002. Start work on this duty promptly, as more information may be required than may be easily available. Time frames are very short. Make the proof of claim as accurate as possible. If totally accurate information cannot be obtained immediately, at least file an estimated proof of claim timely, then file an amended proof of claim as soon as the accurate information becomes available.
3. Check to see if the secured creditor's claim is provided for in the chapter 13 Plan. For example, are pre-bankruptcy arrearages proposed to be paid over the course of the Plan? Do the secured claim documents allow for interest on the arrearages? If so, are they provided for? If it is not, the Plan *should* be objected to. Also, see if the Plan attempts to infringe upon other secured creditor rights. For example, is the debtor attempting to "strip" the lien down just by using the device of the Plan? Is the Plan attempting to reduce the interest rate, or lower the payments? If so, object if adequate grounds exist to do so.

### Conclusion

Bankruptcy can be a bewildering maze of unfamiliar requirements. Competent legal counsel is most often required when dealing with even the most mundane of bankruptcy filings due to the plethora of bankruptcy requirements, most all of which have unrelenting and unwavering deadlines. But in addition, one should be familiar with the most common issues that arise in a bankruptcy so that these issues can be spotted and addressed promptly and effectively once the bankruptcy is recognized. Proofs of claims and chapter 13 Plans that impinge upon secured creditor rights are two areas rife with issues. Be aware of what they are, and address them promptly.



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