Bankruptcy: Chapter 7 Plus Chapter 12 Equals Chapter 19

By Larry D. Lahman

With the passage of the Bankruptcy Judges, United States Trustees and Family Farmer Bankruptcy Act of 1986[1] many bankruptcy practitioners thought new Chapter 12 of the Code,[2] would allow them to reorganize the debts of all of their farmer clients in financial distress. Those lawyers who did not realize the tremendous amount of money required to farm, rapidly became aware of the $1,500,000 upper debt limit[3] imposed by Chapter 12. The large number of farmers in trouble who have debts in excess of that amount.

A possible solution which may indirectly expand the eligibility of Chapter 12 to farmers with much greater indebtedness is a "Chapter 19"—a Chapter 7 followed by a Chapter 12. Lest the reader think the author has taken leave of his senses, there is authority, or at least a ray of authority, for a Chapter 19 referred to in the literature as a "Chapter 20"—a Chapter 7 followed by a Chapter 13.

This article assumes a basic understanding of the Bankruptcy Code and in particular Chapter 12. The author commends a recent OBJ article entitled "The New Family Farmer Bankruptcy Act" for those unschooled in new Chapter 12.[4]

There are several basic issues which must be explained to justify a Chapter 19.

I. IN RE METZ

Numerous Chapter 20 cases appear in the literature; however, one of the most recent and perhaps the most informative is *In re Metz*[5] which provides a solid foundation for Chapter 19.

On October 9, 1984, Metz filed a petition for relief under Chapter 7 of the Code. Downey Savings and Loan Association held a note and deed of trust on Metz's principal asset—his home. Metz was discharged under Chapter 7 on February 19, 1985, and all debts and judgment liens were extinguished pursuant to Section 524.[6] On that same date, Metz filed a Chapter 13 petition. This initial Chapter 13 was dismissed by the Bankruptcy Court on April 19, 1985, because it did not provide a market rate of interest and a timely cure of Downey's arrearages.

Two weeks later on May 3, 1985, Metz filed a second petition under Chapter 13 on the same day that Downey had scheduled a foreclosure sale of Metz's house which presumably was stayed by Section 362(a) of the Code.

The second Chapter 13 plan differed materially from the first providing the market interest rate to Downey as well as curing its arrearages over 36 months as contrasted with the earlier 60 month plan. Downey objected to the second Plan under Section 1325(a)(3) asserting that the filing of a Chapter 13 so quickly after a Chapter 7 discharge was bad faith. The Court confirmed the second Chapter 13 Plan on July 22, 1985, over Downey's objection reasoning that the Plan was in good faith as well as meeting the other statutory requirements for confirmation. The Bankruptcy Court held that the Code ". . . does not prohibit a debtor from bringing a Chapter 13 case shortly after receiving a discharge in a Chapter 7 case . . ." An an increase in the debtors wages of $350 per month also justified confirming the second Chapter 13 after the first was dismissed.

The Bankruptcy Panel of the 9th Circuit citing *Goeb v. Heid*[7] stated that:

> ". . . [in] this circuit, the test of good faith in proposing a Chapter 13 Plan is made on a case-by-case basis, with the court reviewing the 'totality of the circumstances'. Most circuits followed *Goeb* and adopted a flexible, totality-of-the-circumstances test . . . *Flygare v. Boulden* (In re Flygare), 709 F.2d 1344, 1346-48 (10th Cir. 1983) . . . No circuit level decision has rejected the *Goeb* approach in favor of a *per se* rule . . . "

Importantly, the appellate court also tells us that:

> "[while] Chapter 20 cases are clearly undesirable, Downey's approach to Chapter 20's runs contrary to the totality-of-the-circumstances test of *Goeb*. Because each Chapter 13 Plan should be tailored to the specific needs and obligations of the individual debtor, a case-by-case analysis of the good faith underlying the Plan is logical and appropriate. As recent bankruptcy court opinions in this [Ninth] circuit have emphasized, potentials for abuse can be stemmed by a case-by-case inquiry as to whether debtors are engaging in improper manipulations of the Bankruptcy Code . . . "

The court in *Metz* cites several impermissible Chapter 20 cases: one included an attempt solely to delay creditors and another involved an attempt to use the more liberal discharge provisions of Chapter 13 to eliminate a debt founded on embezzlement.[8]

II. A PETITION CAN BE FILED UNDER THE BANKRUPTCY CODE MORE OFTEN THAN EVERY SIX YEARS

The non-bankruptcy practitioner often labors under the misconception that a debtor can only file for bankruptcy once every six years. No such prohibition exists under the law. What does exist, however, is a prohibition against **discharge** pursuant to Section 727 of the Code only once in six years.[9] A similar prohibition appears in Chapter 11[10] of the Code. Obviously, if one cannot receive a discharge, there is little reason for filing the Petition; however, the constraints on discharge found in Section 727 relate only to earlier discharges under Chapter 7, under the companion provision of Chapter 11 or under similar provisions located in the old Bankruptcy Act.

Likewise, there is no prohibition against repeated filings under Chapter 12 or Chapter 13 of the Code and these Chapters have significantly different requirements for discharge. Generally, Chapter 12 and 13 discharges[11] are granted so long as the required payments are made and the terms of the confirmed plans are met under the appropriate sections **without reference to earlier discharges under Chapter 7.**

III. REPETITIVE DISCHARGES ARE PERMITTED

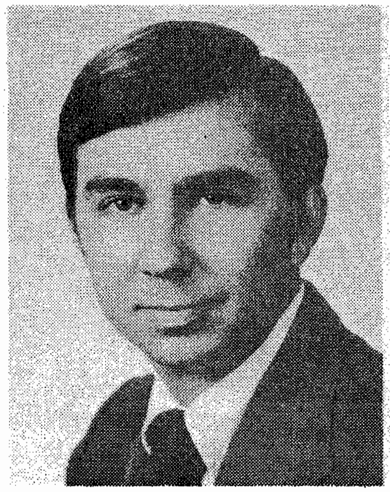
It is possible for repeated discharges to be granted under Chapter 7 so long as they occur no more frequently than every six years.[12] It is also possible for a debtor to file for Chapter 7, be discharged, file for Chapter 13 and similarly receive a discharge under that Chapter 13.[13] While no similar case under Chapter 12 has been found in the literature because of its recent birth, it appears clear that a debtor who has previously been discharged under Chapter 7 can be granted a discharge under Chapter 12.[14] Section 1228 and 1328 are almost identical. Simply, no limit exists on filing, but what is controlled is the frequency of discharge.

Conversely, certain discharges in Chapters 12 or 13 pursuant to plans with **less than 100 percent** payout to unsecured creditors preclude the **subsequent** discharge of the debtor under Chapter 7 within six years.[15]

IV. GOOD FAITH REQUIREMENT

The most difficult obstacle to surmount in a Chapter 19 is the pervasive requirement for "good faith" imposed throughout the Code.[16] Creditor lawyers will immediately be heard to say that a Chapter 19 is *per se* not in "good faith;" however, good faith like beauty is often in the eyes of the beholder. *Metz* categorically refutes this logic.[17] The availability of Chapter 19 will no doubt vary from district to district, from judge to judge and especially from debtor to debtor—who will each bring unique circumstances before the Court.

Nevertheless, it seems that had Congress wanted to preclude Chapter 19's, it could have easily inserted a similar provision limiting discharge into Section 1228 as it had in Section 727 and Section 1141. Chapter 20's have been with us for some time and significantly *Metz* was handed down in September of 1986 prior to the last major revision



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of the Code and the effective date of Chapter 12 on Thanksgiving Day 1986. The presumption exists that Congress acted with full knowledge of Chapter 20's and arguably of Chapter 19's.

A family farmer attempting to save his farm who is foresighted enough to utilize the provisions of Chapter 7 to discharge all of his debt certainly can act in good faith. If he then utilizes Chapter 12 to restructure the *in rem* debt which remains on his assets, he surely is not **automatically** guilty of bad faith by merely following the provisions of lawfully enacted statutes that allow and do not preclude his actions. A Chapter 19 is not presumptively in bad faith.

V. EXAMPLES

A farmer with a "pure heart" and $3,000,000 in mortgages on land worth $1,400,000 can file a Chapter 7 and have all $3,000,000 of his indebtedness discharged pursuant to Section 727. If he starts far enough in advance so that the mortgage holders are not able to lift the automatic stay[18] and compete a foreclosure before the farmer is discharged under Section 727, the farmer should then be able to obtain relief under Chapter 12. Chapter 12 would then authorize our pure hearted farmer to confirm a Plan to pay the $1,400,000 in claims secured by land over 30 years at an acceptable rate of interest.

Conversely, consider an "evil minded" farmer with the same land debt who also owes $5,000,000 on cattle, has sold all of the livestock and attempted to divert the proceeds beyond the reach of his creditors and the bankruptcy trustee. He ought not to be able to use a Chapter 19 to continue to farm restructuring real estate debt similar to our pure hearted farmer. The *Metz* case which forms the foundation for a Chapter 19 also supports this result with its case by case approach to ascertaining good faith.[19]

VI. CONCLUSION

Many creditors argue that the simple act **of filing bankruptcy itself** is bad faith but where the debtor otherwise has "clean hands," it seems as though a Chapter 19 should not be deemed in and of itself to be in bad faith as born out by the rationale of *Metz*. The author does not suggest that the Chapter 12 portion of a Chapter 19 would be, or even should be, automatically confirmed; however, it is equally clear that authority exists which would allow confirmation under appropriate circumstances.

For the heavily indebted farmer this may be yet another ray of light at the end of the tunnel. Unfortunately for agriculture lenders that light at the end of the tunnel may be the headlight on yet another locomotive.

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1. Pub. L. No. 99-554, 100 Stat. 3088
2. All references to Chapters 7, 11, 12 and 13 herein are of Title 11 U.S.C. 11 U.S.C. §101 *et seq.* is also referred to as the "Code" throughout this article.
3. 11 U.S.C. Section 101(17)
4. 58 OBJ 1505.
5. *In Re John Joseph Metz, Downey Savings and Loan Association vs. John Joseph Metz.* 67 B.R. 462 (9th Cir. 1986)
6. All references to Sections in this article are of the Code unless otherwise specified.
7. *In Re Goeb, Goeb v. Heid,* 675 F.2d 1386 (9th Cir. 1982).
8. *In re Metz, supra.*
9. 11 U.S.C. §727 "(a) the Court shall grant the debtor

a discharge unless . . . . (8) the debtor has been granted a discharge under this section, under section 1141 of this title, or under section 14,371 or 476 of the Bankruptcy Act, in a case commenced within six years before the date of the filing of the petition . . . . "

10. 11 U.S.C. §1141(d)(3)(C)
11. 11 U.S.C. §1328 and 1228
12. 11 U.S.C. §727
13. *In re Metz, supra.*
14. 11 U.S.C. §1228
15. 11 U.S.C. §727(9)
16. 11 U.S.C. 1225(a) " . . . . the Court shall confirm a plan if . . . . the plan has been proposed in good faith . . . . . " (emphasis added)
17. *In re Metz, supra.*
18. 11 U.S.C. §362(a)
19. *In re Metz, supra.*

Reinstatement of Members Suspended For Nonpayment of Dues

The following members of the Oklahoma Bar Association suspended for nonpayment of dues by Supreme Court Order entered on July 6, 1987, in S.C.B.D. No. 3423, has complied with the requirements of Title 5, O.S. Ch. 1, App. 1, Article VIII, §4, Rules Creating and Controlling the Oklahoma Bar Association, for reinstatement, and notice is hereby given of such reinstatement:

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