

BANKRUPTCY BY THE NUMBERS

CHAPTER 13: WHO PAYS THE MORTGAGE?^{1/}

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It should be uncontroversial that two major goals of chapter 13 are to repay creditors as much as the debtor reasonably can, and, when this is accomplished, to grant the debtor the benefits of a chapter 13 discharge.^{2/} It should also be uncontroversial that any feature of chapter 13 plan administration that demonstrably advances these goals without violating the Code, the Rules, ethical standards, or cost-benefit precepts, is worthy of consideration as part of any program of bankruptcy administration.

There are a number of administrative features of chapter 13 that deserve to be tested for their success in meeting this strict standard for national adoption. Among them is the practice of requiring debtors to pay non-delinquent (“ongoing”) mortgage payments through the trustee (“through the plan”) in cases where the trustee is also curing the accumulated pre-petition mortgage arrears.^{3/} This practice has been endorsed in the major treatise on chapter 13.^{4/} It has also been the subject of case law and a brief empirical test in one judicial district.^{5/}

^{1/}All views expressed in this article are those of the authors and do not necessarily represent the views of the Executive Office for U.S. Trustees or the Department of Justice.

^{2/} “By the second week of a basic course in bankruptcy, almost any law student can recite in his or her sleep the two competing goals of consumer bankruptcy: a ‘fresh start’ for debtors and equality of distributions for creditors. The two phrases are the twin stars of consumer bankruptcy, reflecting the need for relief and the need for fairness, the balanced objectives of the system.” Warren, Elizabeth, *A Principled Approach to Consumer Bankruptcy*, 71 *Amer. Bankr. L.J.* 483 (1997).

^{3/} We do not address, or have information about, instances in which the debtor may be required to pay non-delinquent mortgage payments when there are no arrears.

^{4/} Lundin, Keith M., *Chapter 13 Bankruptcy: Second Ed. Vol.1* §4.22(1991;1996 supplement).

^{5/} E.g. *Foster v. Heitkamp* 670 F.2d 478 (5th Cir. 1982)(chapter 13 permits a debtor to act as a disbursing agent in making current mortgage payments); *In re Aberegg*, 961 F.2d 1307, 1310 (7th Cir. 1992) (“It would serve little purpose to require the Debtors to disburse their mortgage payments through the Trustee....”); *In re Reid*, 179 B.R. 504 (E.D. TX 1995) (decision about who

This article presents our first effort to put the practice into a national perspective by identifying its locations among the corps of approximately 175 standing trustees and inquiring whether the practice is related to beneficial case outcomes. Our aspiration would be to assess the costs and benefits of this trustee practice in light of the goals of chapter 13. We face two major hurdles, however. First, this is an remarkably complicated problem because of the many variables affecting the costs and effectiveness of a standing trustee operation. Second, gaining consensus on the concept of success in chapter 13 is a difficult task. Like beauty, success lies in the eye of the beholder—including the eye of the beholden. Further, the interests of mortgagees and other creditors may be affected differentially by the details of the trustees' practices regarding ongoing mortgage payments. Our purpose here must therefore remain quite modest: to cast a little light on the practice in the hope that others might reflect on the practices prevailing in their own localities.

The comparisons here are based on information in the 1999 annual reports submitted by 175 standing trustees to the Executive Office for United States Trustees, supplemented by additional inquiries made through the regional U.S. Trustee offices.⁶

As shown in Table 1, in 1999 one third (58/175) of the standing trustees were making ongoing mortgage payments for at least some of their cases. These trustees were practicing in two-thirds of the federal circuits (excluded were circuits DC, 1, 2, and 10), and 31 districts within 18 states. The practice was most concentrated in a band running north to south through the mid-east of the country, including trustee operations in Illinois, Indiana, Kentucky, Michigan, Ohio, and Tennessee. Other areas of density included districts in Florida and Washington.

With only a couple of exceptions, both forms of practice could be found within the same circuit and state, and in some instances within the same district. Some trustees will plan for direct debtor payments in some cases and payments through the trustee in others. The administrative procedures supporting the mortgage payments also varied among the 58 trustee operations.⁷ As measured by the costs of the trustee operations as a percentage of their disbursements, the groups

will make disbursements is in the court's discretion); *In re Burkhardt*, 94 B.R. 724 (N.D. FL. 1988)(same); McManus, Michael S. and Meyer, Michael H., *Payment of Post-Petition Mortgage Installments Through the Chapter 13 Plan*. Presented to the Central California Bankruptcy Association, September, 2000.

⁶ We thank the USTP's standing trustee coordinators, and Debra Finan of the Executive Office Division of Review and Oversight, for their help.

⁷ There are two forms of practice: pay the mortgage without assessing a fee on it, or assess the trustee operations standard fee.

did not appear to differ meaningfully from each other.^{8/}

TABLE 1
DISTRIBUTION OF ONGOING MORTGAGE PAYMENT PRACTICES
(BASED ON FY 1999 DATA AND FOLLOW-UP)

TRUSTEE PRACTICE	TRUSTEE OPERATIONS (175)	DISTRICTS (80)	STATES (48)	UST REGIONS (21)	CIRCUITS (12)
DOES NOT PAY	113	62	42	18	12
PAYS ALWAYS OR SOMETIMES	58	31	18	10	8

The Relationship to Percentage of Completed Cases

One plausible benefit of moving the mortgage payments through the trustee operation is to increase the likelihood that the debtor will successfully complete the plan. The risks of default should be reduced, assuming the debtor remains regularly employed for the plan's duration.^{9/}

A thorough and valid test of this benefit would require following cohorts of equivalent cases forward from filing through termination, assigning some to direct payment by the debtor and the rest to payment through the trustee. Short of this degree of experimental rigor, we can try to find approximate tests which give us some idea of the extent to which the practice is beneficial. We are just beginning to understand how to do this, and in particular how to avoid making errors of inference arising from the many factors that can confound our understanding of what works and what doesn't .

We can compare the percentages of terminated cases within a year that were successfully completed in trustee operations that paid the ongoing mortgage versus those in which the debtor made payments directly. We recognize and emphasize that this not an ideal measure for a number of reasons—but it is a place to begin. If no difference is found at this relatively crude level, it may be that there is in fact no difference between the practices in supporting plan

^{8/} The median percentage of expense to receipts was approximately 6% for both groups. There are economies of scale in chapter 13 trustee operations. Because there were both very large and very small trustee operations in both groups, the costs of operations in both groups ranged from very small (approximately 3% of disbursements) to the maximum allowed (10%). Closer analysis might reveal useful differences within and between the two groups.

^{9/} The practice is further strengthened if combined with the use of wage orders. We recognize that there are often additional issues to be considered in respect to imposing wage orders in chapter 13 plans, but the principle remains valid.

completion; alternatively, the difference may be obscured by factors not controlled in our comparison.

TABLE 2
1999 COMPLETIONS AS A PERCENTAGE OF 1999 TERMINATIONS

TRUSTEE PRACTICE	MEAN PERCENTAGE OF COMPLETED CASES	MEDIAN PERCENTAGE OF COMPLETED CASES
DOES NOT PAY (113)	29.6%	29.7%
PAYS SOMETIMES OR ALWAYS (58)	31.5%	30.5%
ALL TRUSTEES (175)*	30.2%	30.0%

* We were unable to identify the practice of 4 trustees.

The comparison in table 2 does not support the conclusion that moving the ongoing mortgage payments through the trustee operation increases the rate of successful terminations. When we subdivide the group of 58 into smaller groups based on administrative differences between them, the result does not change markedly: the successful termination remains approximately 30%. The essential identity within each group of arithmetic average and median values shows that the tails of the distribution (extreme percentages) did not influence the average.

This finding is merely a snapshot of a single year's activity; it needs to be supplemented with more dynamic work that tracks cases over their lifetimes. One example of this approach was summarized in a paper by Judge Michael S. McManus (Eastern District of California) and standing trustee Michael H. Meyer, who changed the local practice in Modesto Calif., for a period of time in the mid-1990's to pay the mortgage through the plan. On the basis of their experience, they concluded: "The bottom line appears to be that requiring payment of post-petition mortgage installments through the plan makes it more likely that chapter 13 cases will remain pending and ultimately be concluded."¹⁰ The authors discontinued the practice, however, believing that the costs were greater than the trustee operation could bear in the long run.

Conclusion

As with everything else that is interesting about chapter 13, this practice has its strong adherents and equally strong detractors. Of course it is always embedded in the context of all the other features of the local bankruptcy environment: the financial profiles of typical debtors, expectations for percentages to be repaid to unsecured creditors, budget details, standards of feasibility, numbers of repeat filers, and so on. There is no way to intuit or declare by fiat what

¹⁰ McManus and Meyer, *supra* n. 4, at 12.

the most the cost-effective practices are. Those answers can only come through more detailed observations and studies.