By Charissa Potts

The State of the Chapter 13 Estate: Miseducation of §§ 1306 and 1327

The inquiry into the proper composition of a chapter 13 estate property is vexing, as the Bankruptcy Code appears to provide contradictory instruction. The attempts to harmonize the contradictions fail by selectively weighting one Code provision over another, or by creating theory unsupported by textual analysis. Further, the lifespan of a chapter 13 case provides ample opportunity for these views to play out in ways that are illogical, or worse, logical but absurd.

Section 541 is the starting point for determining estate property for all chapters: Pre-petition property is part of the debtor's estate, while post-petition property is not. A relevant exception is found in § 541(a)(5), which brings into the estate inheritances, life insurance payouts and divorce property settlements obtained within 180 days after the petition filing date. Section 1306 expands the composition of the chapter 13 estate to include any post-petition property obtained by the debtor:

> Property of the estate includes, in addition to the property specified in section 541 ... —
>
> (1) all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first; and
>
> (2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first.[1]

The chapter 13 estate is subject to an additional provision in § 1327, effective upon a chapter 13 plan's confirmation:

> (b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.
>
> (c) Except as otherwise provided in the plan or in the order confirming the plan, the property vesting in the debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan.[2]

Courts have read the provisions of §§ 1306 and 1327 as being contradictory. The author's position is that they are not contradictory when the language of these provisions is logically dissected.

Conflicting Theories and the Impact of § 1322(b)(9)

A survey of various courts' approaches to resolving the tension between §§ 1306 and 1327 indicates that there are nearly as many approaches to the issue as there are courts. To further complicate matters, § 1322(b)(9) allows debtors to propose a plan that nullifies § 1327(b) entirely by "provid[ing] for the vesting of property of the estate, on confirmation of the plan or at a later time, in the debtor or in any other entity."[3]

Section 1322(b)(9) is a powerful but often overlooked provision that appears to give debtors complete latitude in determining how property of the estate is vested, when vesting occurs, and to whom property is vested. The flexibility allowed by chapter 13 to craft a plan specifying the nature of the chapter 13 estate arguably makes any discussion on the "correct theory" of the chapter 13 estate trivial or, at best, academic.

The patchwork of court opinions on this issue indicates that local practice and custom heavily influence the outcome of the decisions. The search for a "correct" prevailing theory that brings harmony to the contradictory Code provisions might never reach a conclusive result, but a robust discussion can develop one's practice or provide a *grundnorm* in the absence of specific plan language. As in so many other enterprises, the journey might be more important than the destination.

Disclaimer notwithstanding, the harmonization theories enunciated by various courts tend to fall into roughly three different camps, each placing a different emphasis on § 1306 or § 1327 to the detriment of the other. In the first interpretation, the bankruptcy estate is extinguished at confirmation and estate property is vested in the debtor; post-petition assets are the property of the debtor. The second interpretation is a middle ground in that only property necessary for the fulfillment of the plan vests with the estate and all other assets vest back to the debtor upon confirmation. The majority view

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1 11 U.S.C. § 1306(a).
2 11 U.S.C. § 1327(b), (c).
3 11 U.S.C. § 1322(b)(9).

is the third interpretation, which states that property of the estate vests in the debtor at the time of confirmation, while any post-petition property is brought into the estate pursuant to § 1306 but is not vested in the debtor.

All Property Vests Back to the Debtor

This interpretation puts heavy emphasis on § 1327(b) and its language that "confirmation of a plan vests all of the property of the estate in the debtor." This theory is commonly referred to as the "estate termination" approach, since it asserts that the estate ceases to exist at confirmation. Any property acquired post-confirmation is the property of the debtor. One perceived drawback for the debtor is that he/she is subject to post-petition creditor pursuit, and this lack of protection is entirely intentional. Courts have reasoned that debtors should not be entitled to protection from post-petition creditors and that allowing post-petition collections is entirely consistent with the "fresh start" policy provided by bankruptcy.[4] At least three courts have used this approach to rule in favor of Internal Revenue Service garnishment of post-confirmation wages.[5] The biggest issue with this approach is that it completely ignores § 1306(a), which plainly extinguishes the bankruptcy estate upon a chapter 13's closing, dismissal or conversion, but does not mention confirmation at all.

Only Property Necessary for the Fulfillment of the Plan Should Vest Through Discharge, with Non-Necessary Property Vesting Back to Debtor

The so-called "middle of the road" approach,[6] this interpretation heavily relies on § 1322(a)(1) and that the debtor's plan must provide earnings or other funds to the trustee "as is necessary for the execution of the plan." Under this theory, property vests in the debtor at confirmation, but the estate continues to exist with respect to property that is necessary to fund the plan. "Necessary" for plan execution is determined by some courts on a case-by-case basis,[7] while others have determined that wages not committed to the payment plan, including property acquired post-petition, vest with the debtor free and clear of all claims of pre-petition creditors upon confirmation.[8] The weakness of this approach is its inherent subjectivity and that it abrogates both §§ 1306(a) and 1327(b) by not properly honoring either.

Property Vests to Debtor at Confirmation, but Post-Petition Assets Are Property of the Estate and Do Not Vest

The majority of courts espouse this interpretation. The theory goes like this: Property existing at the time of the filing and up to confirmation may become vested in the debtor at confirmation pursuant to § 1327; property acquired post-confirmation comes into the bankruptcy estate pursuant to § 1306, but this post-confirmation property cannot vest in the debtor because confirmation has already passed, and because confirmation provides the only mechanism by which a debtor can be vested of estate property. Because a debtor can only be vested with estate property at confirmation, property acquired after confirmation cannot become vested in the debtor. The hallmark case is the Eleventh Circuit's *In re Waldron*, which involved the question of whether post-confirmation assets needed to be disclosed in amended schedules. The *Waldron* court held that the new assets came into the estate by virtue of § 1306(a) but did not exist at confirmation and therefore could not be returned to the debtor under § 1327(b).[9]

> **The word "*all*" is not qualified in any respect in § 1327.**

The drawback to this theory is the violence it renders to § 1327 by diminishing its most meaningful aspects to meaninglessness. It also creates a complicated mythology to overcome a perceived dissonance between §§ 1306 and 1327 by creating something that otherwise has no support in the Bankruptcy Code: two separate bankruptcy estates, one that is extinguished at confirmation and controlled by the debtor, and another that is not.

Much is discussed in the literature and at bankruptcy conference cocktail receptions about the so-called inherent conflict between §§ 1306 and 1327 and ways to find harmony (notwithstanding the torpedo effect of § 1322(b)(9)). As **Thomas D. DeCarlo** (Chapter 13 Trustee Office; Southfield, Mich.) recently said about the matter at a golf outing while hunting for the author's ball in the weeds, "It is a question for which there is no answer." Perhaps.

Section 1327(b) and the Meaning of "All": An Analytical Approach

So much of the conflict on chapter 13 estate property is due to a lack of clarity on what the term "vest" means in § 1327. The word "vest" is not defined in the Code. It cannot mean "possession," because the debtor already retains possession of all property of the bankruptcy estate pursuant to § 1307(b). Thus, courts have interpreted "vest" to mean the fixing of right to title in the debtor.[10] It does not follow from this, however, that vesting necessarily extinguishes the bankruptcy estate.

Section 1306 does two very important things. First, it defines chapter 13's "property of the bankruptcy estate." Second, it places existential limits on the bankruptcy estate — specifically, that the bankruptcy estate exists *from* commencement of the case *until* the case is closed, dismissed or converted.

4 *In re Toth*, 193 B.R. 992 (Bankr. N.D. Ga. 1996).
5 *Shell Oil Co. v. Capital Fin. Servs.*, 170 B.R. 903, 905 (S.D. Tex. 1994); *In re Lambright*, 125 B.R. 733, 735 (Bankr. N.D. Tex. 1991); *In re Petruccelli*, 113 B.R. 5 (Bankr. S.D. Cal. 1990).
6 David B. Wheeler, "Whose Property Is It, Anyway? Evaluating the Rights and Obligation of Post-Confirmation Debtors and Creditors in Chapter 13," *ABI Journal* (November 1999), *available at* abi.org/abi-journal.
7 *In re Powell*, 223 B.R. 225 (N.D. Ala. 1998); *In re Adams*, 12 B.R. 540 (Bankr. D. Utah 1981).
8 *Telfair v. First Union Mortg. Corp.*, 216 F.3d 1333 (11th Cir. 2000); *Black v. United States Postal Serv. (In re Heath)*, 115 F.3d 521, 524 (7th Cir. 1997); *In re Ziegler*, 136 B.R. 497, 501-02 (Bankr. N.D. Ill. 1992).
9 *In re Waldron*, 536 F.3d 1239 (11th Cir. 2008).
10 *Security Bank of Marshalltown v. Neiman*, 1 F.3d 687, 690-91 (8th Cir. 1993).

continued on page 72

from page 33

Section 1327(b) then vests "*all* property of the estate in the debtor,"[11] not just the property of the estate existing prior to confirmation. It would have been nice if Congress had written § 1327(b) to read that confirmation "vests all property of the estate in the debtor, except for property acquired by the estate after confirmation," but it did not.

If Congress had added the qualifier "except for property acquired by the estate after confirmation" after the phrase including *all*, then it would be clear that the debtor was not entitled to exercise control over this newly acquired property, and that control belonged presumably to the chapter 13 trustee for the benefit of creditors. However, Congress did not qualify the word "*all*" this way. A more logical conclusion is that Congress wrote § 1306 to define the chapter 13 estate, then it wrote § 1327 to give control of *all* that property of the estate to the debtor at confirmation. The word "*all*" is not qualified in any respect in § 1327. Section 1327, with its use of the word "*all*," therefore, should be read in conjunction with § 1306 and its definitional and existential qualifiers. Thus, § 1327(b) ought to be read as follows:

> (b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of the plan vests [property specified in section 541 of this title, in addition to (1) all property of the kind specified in such section that the debtor acquires after the commencement of the case but before the case is closed, dismissed, or converted under chapter 7, 11, or 12 of this title, whichever occurs first; and (2) earnings from services performed by the debtor after the commencement of the case but before the case is closed, dismissed, or converted to a case under chapter 7, 11, or 12 of this title, whichever occurs first] in the debtor.

Further, there is no indication that the bankruptcy estate was meant to be bifurcated at confirmation into the pre-confirmation extinguished estate that is vested in the debtor, and the post-bankruptcy estate that is not. Section 1327 unequivocally says *all*.

When read this way, § 1306 now appears to exist to provide an extra layer of protection to the debtor by making it clear that any new property acquired by the debtor during the case is property of the estate protected by the automatic stay, and pre-petition creditors have no right or interest to it. It also vests this property in the debtor, who may now control this property as he/she sees fit, provided that payments are completed under the plan and pursuant to the confirmation order. Post-petition creditors are unaffected by this theory because § 1327(c) only includes creditors provided for by the plan, the implication being that property of the estate is *not* free and clear of claims by creditors who are *not* provided for by the plan. It draws a line in the sand from where a debtor can start anew, and that line appears to be confirmation.

The result of this theory is one that is simpler, hews closely to a plain reading, and is cohesive with the overarching principles of bankruptcy, specifically that of a fresh start. Under this theory, if the debtor inherits a home or settles a cause of action after confirmation, those funds are property of the bankruptcy estate, controlled by the debtor and "free and clear" from creditors provided for in the plan. Those funds might be used by the debtor to start a business or send a child to college. Finally, this theory is consistent with what happens in the event of a conversion to chapter 7 filed pursuant to § 348(f)(1)(A), where income and earnings acquired during a debtor's chapter 13 case do not become property of chapter 7 estate upon conversion.[12] abi

11 Emphasis added.

12 *Harris v. Viegelahn*, 135 S. Ct. 1829 (2015).