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Barry Schermer: His Consumer Bankruptcy Greatest Hits

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INTRODUCTION

The following Article is an effort to encapsulate some of the more important consumer-related decisions rendered by Barry Schermer during his thirty-year tenure as bankruptcy judge. It is not meant to cover all of his body of consumer work, much less provide an exhaustive study of the issues he has addressed. Rather, it is a sampling of his more critical decisions that guide the day-to-day practice of bankruptcy law today.

I. *COPMAN* & SECTION 109(G)(2)

Can a person use repeated bankruptcy filings to thwart creditors or can creditors use a person's mistaken effort to rebuild without filing bankruptcy against them? These seemed to be the unappetizing alternatives facing the court in *In re Copman*.[1]

Vicki Copman filed Chapter 13 bankruptcy in October 1992. Soon thereafter, two secured creditors sought and were granted relief from the automatic stay in order to foreclose on their collateral.[2] These motions were not opposed by Copman.[3]

Subsequently in April 1993, Copman sought and was granted dismissal of her Chapter 13 proceeding. Less than five months later, she again sought relief in Chapter 13.[4] This time, an unsecured creditor, Southwestern Bell Company (SWB) asked the court to dismiss her case as a violation of section 109(g)(2).[5]

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1. *See* 161 B.R. 821 (Bankr. E.D. Mo. 1993).
2. *Id.* at 822.
3. *Id.*
4. *Id.*
5. Bankruptcy Code, 11 U.S.C. § 109(g)(2) (2012).

Section 109(g) provides, in pertinent part:

> Notwithstanding any other provision of this section, no individual or family farmer may be a debtor under this title who has been a debtor in a case pending under this title at any time in the preceding 180 days if . . .
>
> (2) the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title.

Section 109(g)(2) is generally recognized to be a legislative effort to curb abuses of a debtor's section 1307 absolute right to voluntarily dismiss a Chapter 13 proceeding and then to re-file bankruptcy in order to invoke the automatic stay, thwarting the efforts of creditors to pursue their rights.[6] By imposing a six-month moratorium on new filings, it would give conscientious creditors the opportunity to liquidate their collateral, for example.

At the time *Copman* was litigated, there were three rather different approaches to interpreting section 109(g)(2)'s command to bar re-filings.[7] One simple reading provided that the 180-day bar was only invoked if the voluntary dismissal was sought while the motion for relief from the automatic stay was still pending before the court, in the prior case.[8] As a motion for relief is often a relatively quick summary proceeding and a voluntary motion to dismiss is often considered and granted without a hearing at all, this interpretation rendered the 180-day bar a virtual nullity.

Other courts took a mechanical approach — urged by SWB in *Copman*

6. *In re* Patton, 49 B.R. 587, 589 (Bankr. M.D. Ga. 1985) ("The 1978 amendments generally eased a debtor'[s] access to bankruptcy to avoid excessive indebtedness. Title II [sic] contains over 30 substantive amendments to curb abuses of the bankruptcy code and make its use truly a last resort.").

7. *In re* Copman, 161 B.R. 821, 822 (Bankr. E.D. Mo. 1993) ("Section 109(g)(2), while seemingly unambiguous, is subject to several interpretations.").

8. *See, e.g.*, *In re* Patton, 49 B.R. 587 (Bankr. M.D. Ga. 1985); *In re* Milton, 82 B.R. 637 (Bankr. S.D. Ga. 1988).

— that provides that any voluntary dismissal occurring in a case where a motion for relief from stay had been filed at all would yield an automatic 180-day bar on refiling.[9] These courts treated the bar on re-filing as a virtually administrative act: if the prior case docket includes a motion for relief from the automatic stay then a bar is applied without further ado.

At the polar opposite end, other courts have taken a discretionary approach, concluding that the bankruptcy court must investigate the underlying purpose of the dismissal to thwart abusive dismissals and re-filings.[10] In doing so, such courts attempt to discern whether the debtor's goal is to "string out" a creditor seeking to foreclose on collateral without a meaningful intention (or perhaps ability) to reorganize under the protection of the bankruptcy court.[11] Some of these courts found that a mechanical approach to enforcement, while possibly justified by a plain reading of the statute, would lead to absurd results where the debtor did not appear to be pursuing a strategy of delay in lieu of reorganization.[12]

Judge Schermer declined to adopt any of these interpretive methods fully. Instead, he focused more precisely on the language of the statute in an effort to square it with the seemingly narrow purpose intended by Congress. He reasoned:

> Section 109(g)(2) applies if "the debtor *requested* and *obtained* the voluntary dismissal of the case *following* the filing of a request for relief . . ." (emphasis added). The word "following" in the statute requires some relationship between the timing of the [section] 362 request and the voluntary dismissal. Furthermore, by requiring that the debtor both "request" and "obtain" the dismissal after the request for relief, the statute requires a causal connection such that the request for relief triggers the dismissal. Had the statute been written to curb successive dismissals

9. *See, e.g.*, *In re* Keziah, 46 B.R. 551 (Bankr. W.D.N.C. 1985); *In re* Smith, 58 B.R. 603 (W.D. Pa. 1986).

10. *In re* Santana, 110 B.R. 819, 821 (Bankr. W.D. Mich. 1990); *see also In re* Luna, 122 B.R. 575 (B.A.P. 9th Cir. 1991); *In re* Jones, 99 B.R. 412 (Bankr. E.D. Ark. 1989).

11. *See, e.g., In re Santana*, 110 B.R. at 821-22.

12. *See, e.g., In re* Luna, 122 B.R. 575 (B.A.P. 9th Cir. 1991); *In re* Santana, 110 B.R. 819 (Bankr. W.D. Mich. 1990); *In re* Jones, 99 B.R. 412 (Bankr. E.D. Ark. 1989).

> generally, it would not have been so specific in requiring that both the request and the granting of dismissal follow the [section] 362 request. The plain language of [section] 109(g)(2) thus applies when the request for relief from stay results in the debtor requesting and obtaining a voluntary dismissal of the bankruptcy proceeding.[13]

By emphasizing the "causal connection" inherent in the language of section 109(g)(2), Schermer effectively *synthesized* the "mechanical" and the "discretionary" schools of thought. Thus, under *Copman* the court is not simply acting in a ministerial capacity. It must analyze whether dismissal of the prior case was *related to* the relief from stay motion. But, if the court finds such a connection, then it has no discretion to allow the new case to continue. On the other hand, where there is no such connection, as with Ms. Copman, then the court must allow the new case to proceed.

II. SECURED CLAIM INTEREST IN CHAPTER 13

Secured creditors — those holding a lien under non-bankruptcy law against property of the bankruptcy estate — are in a special position in Chapter 13 cases. They are entitled to better treatment than general unsecured creditors as a consequence of their lienhold interest in the collateral. In particular, they are entitled to have their contracts maintained,[14] their collateral surrendered to them,[15] or to be paid the present value of the collateral[16] under a bankruptcy plan.

Generally, paying the present value owed over time requires the payment of a "discount rate" (or, in laymen's terms, "interest") to compensate for the loss in time-value of money.[17] The controversy is that the Bankrupcty Code does not identify how the court should determine this discount rate.

In re Wilmsmeyer[18] brought this dilemma to Judge Schermer's

13. *Copman*, 161 B.R. at 823.
14. 11 U.S.C. §§ 1322(b)(2), (5) (2016).
15. 11 U.S.C. § 1325(a)(5)(c) (2016).
16. 11 U.S.C. § 1325(a)(5)(B)(ii) (2016).
17. *See generally*, Rake v. Wade, 508 U.S. 464, 472-474 (1993).
18. 171 B.R. 61 (Bankr. E.D. Mo. 1994).

courtroom in 1994 with an added twist. In *Wilmsmeyer,* the debtors sought to pay for their mobile home in deferred payments as part of the Chapter 13 plan at a lower rate of interest of 9.5% — provided in the bankruptcy court's local rules — than the underlying contract rate of 19.18%.[19] The secured creditor objected and asserted that it was entitled to the contract rate of interest under section 506(b) because it was an oversecured creditor.[20]

An "oversecured" creditor is one whose collateral exceeds the amount owed on the underlying loan obligation such that there is additional equity that, in such cases, may serve as additional protection for the creditor.[21] And, the Bankruptcy Code recognizes that oversecured creditors have additional protection from loss, as section 506(b) provides:

> To the extent that an allowed secured claim is secured by property the value of which . . . is greater than the amount of such claim, there shall be allowed to the holder of such claim, interest on such claim, and any reasonable fees, costs, or charges provided for under the agreement or state statute under which such claim arose.

The Wilmsmeyers' mobile home lender reasoned that section 506(b) required the debtors to pay "interest . . . provided for under the agreement[,]" rather than a lower rate designed simply to compensate for the time-value of money.[22] Indeed, the mobile home creditor could point to powerful authority in that the Supreme Court had concluded that under section 506(b), "[r]ecovery of postpetition interest is unqualified."[23]

However, the bankruptcy court had recently received more precise guidance on section 506(b) from the Supreme Court. In *Rake v. Wade*,[24] the Supreme Court noted that this provision provided interest only during the period between the date of filing and the confirmation of a plan.[25]

19. *In re* Wilmsmeyer, 171 B.R. 61, 62 (Bankr. E.D. Mo. 1994).
20. *Id.*
21. U.S. v. Ron Pair Enter., Inc., 489 U.S. 235, 241 (1989).
22. *In re* Bell, 171 B.R. 61, 62 (Bankr. E.D. Mo. 1994).
23. *Id.* at 241.
24. 508 U.S. 464 (1993).
25. *Id.* at 468.

While this resolved the dispute in favor of the creditor for the narrow period of time when a Chapter 13 case was pending but a plan was not approved by the court, the applicable *post-confirmation* discount rate required by section 1325(a)(5)(B)(ii) — which applied to all secured claims whether under or oversecured — remained unresolved.

The creditor next argued that the court was bound by the Eighth Circuit decision, *In re Monnier Brothers*.[26] The *Monniers Brothers* case involved the analogous Chapter 11 provision to an oversecured claim.[27]. In that case, the Eighth Circuit Court of Appeals approved the use of the interest rate in the underlying contract.[28]

Judge Schermer rejected the argument that *Monnier Brothers* dictated the use of contract rate generally.[29] He pointed out that the circuit panel had concluded on appeal that the district court had not erred in relying on the underlying contract because the debtor, when advocating for a lower rate, had failed to provide any evidence of an alternative rate that reflected the statutory requirements.[30] Failing to find evidence to support any other rate, the lower court was not incorrect to rely on the arm's-length negotiation that gave rise to the contract rate.[31]

Instead, Judge Schermer found that *Monnier Brothers* stood for the proposition that the discount rate in Chapter 13 must reflect the time value of the claim plus a risk factor adjustment to compensate for risk factors like the quality of the collateral and risk of default.[32] Noting that the underlying contract provided for not only those compensations, but a handsome profit margin, Judge Schermer concluded that the "local rule rate" was appropriate which was originally derived from the same factors announced in *Monnier Brothers*.[33]

A decade later, the *Wilmsmeyer* approach was vindicated when a plurality of the Supreme Court concluded that essentially the same "coerced loan" formula incorporated in local rules was presumptively an

26. 755 F.2d 1336 (8th Cir. 1985).
27. *Id.*; *and see* 11 U.S.C. § 1129(b)(2)(A)(iii) (2010).
28. *In re* Monniers Bros., 755 F.2d at 1339.
29. *In re* Wilmsmeyer, 171 B.R. 61,64 (Bankr. E.D. Mo. 1994).
30. *Id.*
31. *Id.*
32. *Id.*
33. *Id.* at 64.

appropriate discount rate, not the original contract interest rate bargained for between the parties.[34] The dissent argued for a contract rate presumption; Justice Thomas concurred, reasoning that, while the statute only required a risk-free time-value of money discount rate and did not *compel* adjustment for any risk factors, it did not prevent the use of a higher rate either.[35]

Only two years later, following congressional action in passing systemic amendments to the Bankruptcy Code, Judge Schermer was confronted with essentially the same issue all over again. In 2005, Congress passed the Bankruptcy Abuse and Consumer Protection Act (BAPCPA).[36] One element of BAPCPA was a provision, commonly referred to as the "hanging paragraph" because it appears in an unnumbered paragraph immediately following section 1325(a)(9), which states:

> Section 506 shall not apply to a claim described in that paragraph if the creditor has a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day period preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle . . . acquired for the personal use of the debtor, or if collateral for that debt consists of any other thing of value, if the debt was incurred during the 1-year period preceding that filing.[37]

The "hanging paragraph" prevents a court from confirming a Chapter 13 plan that attempts to modify the value of a secured claim to the value of the underlying collateral pursuant to section 1325(b)(5) — otherwise referred to as "cramdown" — if the underlying collateral meets specific qualifications. Essentially, the "hanging paragraph" compelled the payment of the full amount owed under a contract entered into during relatively recent periods.

34. *See* Till v. SCS Credit Corp., 541 U.S. 465 (2004).
35. *Id.* at 487 (Thomas, J., concurring).
36. Pub. L. No. 109-8, 118 Stat. 23.
37. 11 U.S.C. § 1325(a)(9) (2012).

In re Fleming consisted of a consolidation of cases in which the same issue was presented to Judges Schermer and Surratt-States (the co-author here): When the "hanging paragraph" applies, is the debtor compelled to propose a plan that provides for the contract rate of interest instead of the so-called *Till,* or local rule, rate?[38]

The less-than-ideal statutory construction of the amendments complicated *In re Fleming*'s issue. While the "hanging paragraph" took away the tool used to "cramdown" the value of an allowed secured claim to the value of the underlying collateral — section 506(a) — and other BAPCPA provisions protected such creditors[39] the statutory amendments did not change the language of section 1325(a)(5)(B)(ii). And, as noted above, this provision had been read in *Till* to reject the underlying contract rate as the required discount rate in a Chapter 13 plan.[40]

Further, BAPCPA did not amend the Bankruptcy Code's provision allowing the debtor to propose a plan that modifies a creditor's contractual rights. Section 1322(b)(2) provides that the Chapter 13 plan may:

> Modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims.[41]

This left intact the right of the debtor to "modify" the secured creditor's contractual rights, which typically include the amount and timing of payments as well as the interest rate. And BAPCPA did not alter section 502(b)(2), which provides that a creditor's claim may not include "unmatured" (or post-petition) interest, if challenged.

Thus, while BAPCPA had attempted to provide a dramatic increase in the recovery paid to certain secured creditors in Chapter 13, the court

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38. 339 B.R. 716 (Bankr. E.D. Mo. 2006).

39. *See, e.g.*, 11 U.S.C. § 1325(a)(5)(B)(i) (2016) (allowing lender to retain lien until full contract paid off or Chapter 13 discharge is granted); 11 U.S.C. § 1325(a)(B)(iii) (2016) (stating that periodic payments must provide "adequate protection"). This was particularly true for automobile lenders in the case of *In re Fleming*.

40. *See Till*, 541 U.S. at 277-78.

41. 11 U.S.C. § 1322(b)(2) (2012).

concluded that the core provision addressing the post-confirmation discount rate afforded such claims remained unchanged, therefore the *Till* formula approach also remained intact.[42]

III. JUNIOR MORTGAGE LIEN STRIP-OFF

Home mortgages often hold special rights within the bankruptcy process. For consumer purposes, the most critical of these is the anti-modification right embedded in section 1322(b)(2):

> (b) Subject to subsections (a) and (c) of this section, the plan may . . .
> (2) modify the rights of holders of secured claims, *other than a claim secured only by a security interest in real property that is the debtor's principal residence*, or of holders of unsecured claims, or leave unaffected the rights of holders of any class of claims (emphasis added).[43]

The exact contours of the anti-modification provision are a heavily-litigated issue, but in general, the provision stands for the proposition that, while the contractual or non-bankruptcy rights of a creditor are subject to change or "modification" in a Chapter 13 plan, those of a home mortgage lender are not.

On the other hand, the anti-modification provision itself is loaded with terms of art that are otherwise defined in the Bankruptcy Code.[44] For example, the protection extends to the holder of a "security interest" in a residence but not the holder of a non-consensual lien therein, as may occur with a judgment.[45]

Importantly, the phrase "a claim secured by a security interest"[46] implicates section 506's definition of a "secured claim" by defining a

42. *In re* Fleming, 339 B.R. 716, 724 (Bankr. E.D. Mo. 2006).
43. 11 U.S.C. § 1322(b)(2) (2012) (emphasis added).
44. *See, e.g*. 11 U.S.C. § 101(5) ("claim"); 11 U.S.C. § 506(a)(1) ("secured claim"); *and* 11U.S.C. § 101(51) ("security interest").
45. *Compare*, 11 U.S.C. § 101(51) ("security interest"), *with* 11 U.S.C. § 101(36) ("judicial lien").
46. 11 U.S.C. § 1322(b)(2).

claim as secured only to the extent of the value of collateral securing the obligation. In 1993, the Supreme Court attempted to clarify one aspect of section 506's limitation on the extent of a secured claim in the anti-modification language of section 1322(b)(2). In *Nobelman v. American Savings Bank*,[47] the Court concluded that a Chapter 13 plan may not seek to "cramdown," or modify, a claim that is undersecured by a security interest in the residence of the debtor.[48] The debtor could not attempt to treat the "in the money" portion of the loan — the portion for which there is sufficient equity in the property to satisfy the debt — differently than the part that lacked equity value underlying it.[49] In a critical part, the Court said it would,

> read "a claim secured only by a [homestead lien]" as referring to the lienholder's entire claim, including both the secured and the unsecured components of the claim. Indeed, [section] 506(a) itself uses the phrase "claim . . . secured by a lien" to encompass both portions of an undersecured claim.[50]

But, in 1994, Judge Schermer was confronted with a factual twist on the *Nobelman* scenario: What happens if the home mortgage is completely unsecured?[51] *In re Mitchell*[52] involved an elderly woman whose home was worth less than the debt owed on her first mortgage and statutory liens.[53] Despite this, there was a second mortgage against her home in favor of Green Tree Financial Corporation (Green Tree) as well.[54] She sought to treat Green Tree's claim as a general unsecured claim, to be paid pennies on the dollar, with her personal liability discharged and the recorded lien removed (that is, "stripped off") at the conclusion of her Chapter 13 plan.[55]

Green Tree naturally opposed this and argued that *Nobelman* controlled

47. 508 U.S. 324 (1993).
48. *Id.* at 331.
49. *Id.*
50. *Id*.
51. This scenario occurs most typically with "home equity" and junior, or second, mortgages.
52. 177 B.R. 900 (Bankr. E.D. Mo. 1994).
53. *Id.* at 901.
54. *Id.* at 902.
55. *Id.* at 901.

the outcome of the case. While it acknowledged that its loan was entirely unsecured under section 506(a), Green Tree pointed to the Supreme Court's instruction that the anti-modification provision applied to "both the secured and unsecured components of the claim."[56]

Ms. Mitchell was not the first debtor to pursue this strategy. Courts within the Eighth Circuit had concluded before and after *Nobelman* that the analysis should focus on the type of claimant — a creditor with a residential mortgage — and the section 506(a) determination of secured versus unsecured status was irrelevant.[57] An oversecured or undersecured or completely unsecured consensual mortgage interest was protected.[58]

Judge Schermer concluded that such an extension of *Nobelman* from undersecured claims to totally unsecured claims (that happen to be for a home mortgage) was unwarranted.[59] He pointed out that *Nobelman* only interpreted the specific language of section 1322(b)(2) in the context of a different factual scenario.[60] *Nobelman*'s creditor indisputably held a secured claim as well as an unsecured claim; as such, it was covered by the exception to the general rule allowing modification of a claimant's rights. In *Mitchell*, the creditor was not the "holder" of "a secured claim" at all. Its lien, at the time of filing, attached to no value in the property. Therefore, the creditor was only the holder of an *unsecured* claim in bankruptcy and section 1322(b)(2)'s clear language does not protect the rights of a holder of an unsecured claim from modification.[61]

Under the *Mitchell* logic, the rights of a junior mortgagee often hinge on valuation of the collateral property and senior liens. If only one dollar of equity exists after deducting senior liens, the mortgagee's rights are sacrosanct. If they are a dollar short, they are treated no better than an unsecured handshake loan between neighbors.

At the time, *Mitchell* was not the first case to reach this conclusion. A handful of other bankruptcy courts outside the Eighth Circuit provided

56. *Id.*
57. *In re* Mitchell, 177 B.R. 900, 901 (Bankr. E.D. Mo. 1994) *citing Nobleman* 508 U.S. 324, 331 (1993).
58. *See, e.g.*, *In re* Hussman, 133 B.R. 490 (Bankr. D. Minn. 1991); *In re* Hughes, 402 B.R. 325 (Bankr. D. Minn. 2009).
59. *Mitchell*, 177 B.R. at 902.
60. *Id.*
61. *Id.*

precedent in favor of Judge Schermer's conclusion.[62] But, no higher court had agreed. Within the Eighth Circuit, the bankruptcy judges of the District of Minnesota reached the opposite conclusion and the split remained unresolved.[63]

Following *Mitchell*, however, Judge Schermer's opinion has been adopted by every circuit court that has had occasion to review the matter.[64] This situation did not resolve the split within the Eighth Circuit as its circuit court had never confronted the issue.

In 2011, the situation came to a head when the District of Minnesota ruled that a debtor could not "strip off" his unsecured junior mortgage lien in Chapter 13.[65] To add a unique twist to the case, Mr. Fisette was not seeking to discharge his personal liability on the mortgage because he had, in fact, previously done so in a recent Chapter 7 proceeding.[66] In fact, pursuant to section 1328(f)(1), Mr. Fisette would not be entitled to a discharge at all at the conclusion of a successful Chapter 13 plan.

Mr. Fisette appealed this decision to the Bankruptcy Appellate Panel (BAP) for the Eighth Circuit.[67] The appellate panel, in an opinion written by Judge Schermer, reaffirmed the conclusion he first reached in the *Mitchell* case: that *Nobelman* did not hinder the modification of a fully unsecured mortgagee's rights.[68] As the BAP pointed out, "the *Nobelman* Court did not examine the rights protected by §1322(b)(2) until *after* it established that the creditor held a secured claim."[69] At this point, the BAP could rely on unanimous support in appellate authority for this proposition.[70]

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62. *See, e.g.,In re* Plouffe, 157 B.R. 198 (Bankr. D. Conn. 1993); *In re* Williams, 161 B.R. 27 (Bankr. E.D. Ky.1993); *In re* Lee, 161 B.R. 271 (Bankr. W.D. Okla. 1993); *In re* Sette, 164 B.R. 453 (Bankr. E.D.N.Y. 1994).

63. *In re* Hussman, 133 B.R. 490, 491-493 (Bankr.D.Minn. 1991); *In re* Hughes, 402 B.R. 325, 326 (Bankr.D.Minn. 2009).

64. *See, In re* MacDonald, 205 F.3d. 606 (3d Cir. 2000); *In re* Bartee, 212 F.3d 277 (5th Cir. 2000); *In re* Tanner, 217 F.3d 1357 (11th Cir. 2000); *In re* Pond, 252 F.3d 122 (2d Cir. 2001); *In re* Lane, 280 F.3d 663 (6th Cir. 2002); *In re* Zimmer, 313 F.3d 1220 (9th Cir. 2002).

65. *In re* Fisette*,* 455 B.R. 177, 180 (B.A.P. 8th Cir. 2011).

66. *Id.* at 179.

67. *Id.*

68. *Id.* at 177.

69. *Id.* at 183.

70. *In re* Zimmer*,* 313 F.3d 1220 (9th Cir. 2002); *In re* Lane, 280 F.3d 663 (6th Cir. 2002); *In re* Pond, 252 F.3d 122 (2d Cir. 2001); *In re* Tanner, 217 F.3d 1357 (11th Cir. 2000); *In re* Bartee, 212

Beyond an opportunity to reaffirm *Mitchell*, however, *Fisette* presented the more hotly-debated issue of what would happen in such "strip-off" scenarios where the debtor was not entitled to a discharge at the successful completion of the repayment plan. *Fisette* represents a relatively routine phenomena, colloquially referred to as a "Chapter 20 case," in which the debtor has previously obtained a discharge under Chapter 7 and later seeks relief in Chapter 13 to address either new financial issues or those which remain unresolved after the completion of Chapter 7. Due to the timing of the second case, the debtor would not be entitled to a discharge of any debt in this proceeding.[71]

In a typical recourse mortgage, the lender has the right to collect on its claim via two distinct rights: A recourse contract may be collected from the individual debtor as a personal obligation — the *in personam* liability — and from the property pledged as collateral for the loan — the *in rem* liability.[72] As in *Fisette*, the debtor may use a Chapter 7 discharge to eliminate his personal liability on a mortgage obligation pursuant to section 524. But, the discharge injunction alone does not eliminate the *in rem* liability — the lienhold interest in the property — owed to the lender.[73] In essence, the property continues to owe the debt while the individual does not.

The Supreme Court in *Johnson v. Home State Bank* held unanimously that this *in rem* liability of the debtor's property is a "claim" in a Chapter 13 proceeding that may be addressed in a plan.[74] *Johnson* has no wisdom to impart on the merits of unsecured junior mortgage strip-offs, much less where no discharge may be granted at the conclusion.

For many courts, the "no-discharge Chapter 20 strip-off" is a bridge too far.[75] In lay terms, the consumer bankruptcy discharge is traditionally the signature mark of finality to the process. Although there is much more to

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F.3d 277 (5th Cir. 2000); *In re* McDonald, 205 F.3d 606 (3d Cir. 2000); *In re* Griffey, 335 B.R. 166 (B.A.P. 10th Cir. 2005); *In re* Mann, 249 B.R. 831(B.A.P. 1st Cir. 2000).

71. The debtor was barred from receiving a discharge in this case as it had been filed within four-years of receiving a discharge in a prior Chapter 7 case. 11 U.S.C. § 1328(f)(1).

72. Johnson v. Home State Bank, 501 U.S. 78, 84 (1991).

73. 11 U.S.C. § 524(a)(2) (2010).

74. 501 U.S. 78 (1991).

75. *In re* Victorio, 454 B.R. (Bankr. S. D. Cal. 2011); *In re* Gerardin, 447 B.R. 342 (Bankr. S. D. Fla. 2011); *In re* Fenn, 428 B.R. 494 (Bankr.N.D.Ill. 2010); *In re* Jarvis, 390 B.R. 600 (Bankr. C. D. Ill. 2008).

the process than the discharge order, and it is possible to obtain many benefits from bankruptcy without a discharge, it represents the iconic "fresh start" that the consumer seeks in filing bankruptcy.

In general, if a debt is not discharged, then the collection of it is merely delayed during the pendency of the bankruptcy case.[76] By allowing a no-discharge plan to still eliminate a mortgage lien upon completion amounts to a "[*de facto*] discharge" of the *in rem* liability.[77] In particular, the Chapter 13 trustee in *Fisette* raised section 1325(a)(5) as an impediment.[78] This section provides, in pertinent part:

> (a) Except as provided in subsection (b), the court shall confirm a plan if —
> (5) with respect to each allowed secured claim provided for by the plan—
> (B)(i) the plan provides that—
> (I) the holder of such claim retain the lien securing such claim until the earlier of—
> (aa) the payment of the underlying debt determined under nonbankruptcy law; or
> (bb) discharge under section 1328.

Under this argument, the debtor could not confirm a plan that failed to provide for the creditor to "retain the lien securing the claim" until either the claim was paid in full under the contract or a discharge was granted. As neither was proposed, the plan could not be confirmed.

The *Fisette* panel concluded that this argument failed to give effect to all the words of the provision in that the creditor must hold "an allowed secured claim."[79] As they pointed out, *Nobelman* held that the bank was the holder of a secured claim "because petitioner's home retain[ed] $23,500 of value as collateral."[80] It also relied on the analysis of the Eighth Circuit in *Harmon v. U.S.*,[81] where the court reviewed the

76. 11 U.S.C. § 362(a) (2012).
77. *See, e.g.*, *In re* Fenn, 428 B.R. 494, 500 (Bankr. N.D. Ill. 2010).
78. *In re* Fisette, 455 B.R. 177,185-186 (B.A.P. 8th Cir. 2011).
79. *Id.* at 183.
80. *Id.* at 186 (quoting *Nobelman*, 508 U.S. at 329).
81. 101 F.3d 574 (8th Cir. 1996).

application of the same term "allowed secured claim" in section 1225(a)(5). The *Harmon* court taught as well that the definition of a secure claim must be found by referring "to the bifurcation of claims into secured and unsecure claims by section 506(a)."[82]

In *Fisette*, the court concluded by critiquing the conceptual framework that found that such a strip-off proceeding was tantamount to a discharge and therefore should not be approved.[83] The Bankruptcy Code itself defines the limitation created by a recent prior case in section 1328(f)(1), where a Chapter 20 debtor's right to an *in personam* discharge is limited.[84] But, none of the other provisions of Chapter 13 were restricted. In particular, the Bankruptcy Code does not limit the section 1322(b)(2) power to modify the rights of the holder of a fully unsecured claim.[85] Thus the court would not read into the Bankruptcy Code new restrictions that Congress had not created.

IV. THE *LONG* SAGA: STUDENT LOAN ISSUES

Judge Schermer has been particularly active and influential in the case of student loan hardship discharge appeals. Section 523(a)(8) allows a debtor to discharge student loan obligations if the debtor demonstrates that remaining liable for the loan will "impose an undue hardship on the debtor and the debtor's dependents."[86]

The Bankruptcy Code does not define "undue hardship" in this context, leaving the courts to define the term.[87] The Eighth Circuit has outlined a "totality of circumstances" test for determining undue hardship. The test requires the court to take into consideration: (1) the debtor's past, present, and reasonably reliable future financial resources; (2) calculate the debtor's and the debtor's dependent's reasonable and necessary living expenses; and (3) any other relevant facts and circumstances surrounding

82. *Fisette*, 455 B.R. at 186 (quoting *Harmon,* 101 F.3d at 583).
83. *Id.* at 186-187.
84. A Chapter 13 debtor may not be granted a discharge if the debtor has previously been granted a discharge in a Chapter 7 proceeding filed within four years. 11 U.S.C. § 1328(f)(1).
85. *Fisette*, 455 B.R. at 186.
86. 11 U.S.C. § 523(a)(8) (1978).
87. *In re* Reynolds*,* 425 F.3d 526, 531 (8th Cir. 2005).

the particular bankruptcy case.[88]

In one notable case, Judge Schermer succeeded in converting his initial dissent into the majority opinion after further appeal and remand from the circuit court.[89] Nanci Long filed bankruptcy in 2000 and sought, and received, a declaration that approximately $35,323.00 in consolidated student loans was an undue hardship.[90] Ms. Long was supporting her daughter on approximately $14,000.00 in annual income and suffered from mental health issues, which she testified limited her ability to seek higher income employment.[91] The student loan creditor argued that she would qualify for a $54.00 monthly payment at her existing income level, under an Income Contingent Repayment Plan (ICRP) under the William D. Ford Loan Consolidation program, which could lead to the cancellation of any further indebtedness after twenty-five years.[92] Ms. Long admitted she was aware of the ICRP option but argued that she had paid for over ten years on the loan until she could not continue to pay and needed more relief than what was offered under the ICRP.[93] The bankruptcy court, although anticipating that Ms. Long "will ultimately get herself out of this unfortunate situation," granted the hardship discharge because it was "highly unlikely that in the foreseeable future she is going to earn the kind of money that would ever be able to begin to dig herself out of these . . . loans."[94] This was particularly true in light of the non-dischargeability of other loans governed by an even more stringent standard.[95] The creditor appealed.[96]

On appeal, the creditor argued that the BAP should apply a *de novo*

88. *In* re Andrews, 661 F.2d 702 (8th Cir.1981); *In re* Andresen, 232 B.R. 127 (B.A.P. 8th Cir. 1999). The *Andrews* test conflicts with the more common *Brunner* test in that *Brunner* takes into account prior payment history on the student loan obligations in the good faith of the request for undue hardship determination. Brunner v. New York State Higher Educ. Serv. Corp., 831 F.2d 395, 396 (2d Cir. 1987).

89. *In re* Long, 271 B.R. 322 (B.A.P. 8th Cir. 2002).

90. *Id.* At 325-329.

91. *Id.* at 332.

92. *Id.* at 327.

93. *Id*.

94. *Id.* at 328.

95. *Id.* at 326-330. Discharge of Health Education Assistance Loans (HEAL) is governed by 42 U.S.C. § 294f(g), which, among other things, requires a finding that nondischarge would be "unconscionable." U.S. v. Wood, 925 F.2d 1580, 1582 (7th Cir. 1991).

96. *In re* Long, 271 B.R. 322, 326–30 (B.A.P. 8th Cir. 2002) [hereinafter "Long I"].

review of the facts of the case and that the lower court had clearly erred in finding an undue hardship.[97] The BAP majority declined to apply a different review standard; instead, pursuant to prior decisions, it applied a more deferential "clearly erroneous" standard.[98] The BAP went on to conclude it would "not go over [the debtor's] expenses dollar for dollar but rather agreed with the lower court that the debtor lived modestly, had reduced her expenses significantly and ultimately they could not find clear error in the lower court's conclusion that her expenses were reasonable."[99]

Judge Schermer dissented. His protest focused on the undisputed fact that the debtor would qualify for a $54.00 per month payment under the ICRP option, with forgiveness of the indebtedness after 25 years. He found that the record "amply" supported debtor's ability to pay $54.00 per month.[100]

This dissent references Judge Schermer's dissent in the *Cline* case from two years previously.[101] In *Cline*,[102] a similar scenario in which an extended repayment program would have yielded a $283.00 per month payment on over $53,522.00 of consolidated student loans used to obtain both a bachelor's and a master's degree.[103] The repayment program would extend for thirty-five years.[104] The majority panel had concluded that "this is a case that could be determined either way."[105] The majority found that her budget could yield as much as $320.00 per month sufficient to afford the reduced payment option.[106] Nevertheless, the majority declined to delve into the budget morass of examining her spending "dollar for dollar" and found that the lower court was not clearly erroneous in determining that the debt constituted an undue hardship.[107]

While agreeing with the majority in *Cline* that the review standard encompassed only clear error by the trial judge, Judge Schermer

97. *Id.* at 328.
98. *Id.* at 328.
99. *Id.* at 331-32.
100. *Id.* at 332.
101. *Id.*
102. *In re* Cline, 248 B.R. 347 (B.A.P. 8th Cir. 2000).
103. *Id.* at 353-54.
104. *Id.* at 352.
105. *Id.* at 349.
106. *Id.* at 351.
107. *Id.* at 353-54.

concluded that such a review did indeed require a nearly dollar for dollar re-examination of the budget.[108] In part this was warranted because the lower court had failed to review the debtor's paystubs, which showed the filed budget may have understated the debtor's net income by almost $296.00,[109] which would leave her with $240.00 month available to pay the loans. In addition, he identified several expenses — $30.00 for cable, $50.00 for recreation and $25.00 for charity contributions — which Ms. Cline could eliminate from her budget.[110] In doing so, in addition to the $240.00, it generated sufficient disposable income to fund the reduced payment option.[111]

In *Cline*, the trial court found that the debtor was employed as a social worker for a state agency earning approximately $25,000.00 annually.[112] The debtor had sought and obtained higher paying jobs within the government, but testified that the additional stress caused by the greater responsibilities caused her to voluntarily return to the lower-paying job.[113] The trial court concluded that the debtor was unable to perform tasks beyond minimal, repetitive jobs.[114] The BAP majority concluded that the trial court had applied the proper test: it had the opportunity to consider the candor and demeanor of witnesses and it "did not let Cline win an undue hardship discharge because she voluntarily limited her earning capacity. Instead, the court found that the [sic] Cline was *unable* to maintain a job that paid higher income."[115]

Judge Schermer argued instead that the debtor voluntarily limited her income and therefore should not receive an undue hardship discharge. Pointing out that she had not been diagnosed with learning or other disabilities, he held, "[t]he [d]ebtor is uncomfortable in a job other than one requiring simple repetitive tasks, and therefore has voluntarily left several jobs which did not fall within her *self-imposed comfort level*."[116] He went on to argue that the debtor had failed to take any other steps to

108. *Id.* at 352.
109. *Id.*
110. *Id.* at 354.
111. *Id.*
112. *Id.* at 348.
113. *Id.* at 349.
114. *Id.* at 350.
115. *Id.* at 351 (emphasis added).
116. *Id.* at 352-53, n.4 (emphasis added) (internal citations omitted).

increase her income "such as obtaining a second job of a menial nature which would fit within her self-imposed comfort level."[117]

While his dissent asserts a "clearly erroneous" standard of review, his detailed line-by-line budget analysis and dispute of the lower court's findings demonstrate a *de facto* application of a much less deferential standard of review.[118] It is difficult to conclude that he was doing anything other than reviewing the evidence as though he were the trial judge in the first instance and reaching a *de novo* conclusion about the relevance of the evidence presented.

Ironically, while Judge Schermer may have been applying a more stringent standard in the *Cline* and *Long* dissents *sub silentio*, it turned out he was not wrong in applying a more inquisitive standard of review. The creditor in the *Long* case appealed its BAP loss to the Eighth Circuit Court of Appeals, focusing this time on the standard of review.[119] It pointed out that the Eighth Circuit had not yet adopted a standard of review in "undue hardship" appeals and the lower courts had therefore applied the highly deferential "clearly erroneous" standard.[120] The creditor argued, and the Eighth Circuit agreed, it should adopt a more searching *de novo* review standard to bring it in line with the other circuits that had ruled on the issue.[121] The Eighth Circuit panel found that "undue hardship" is a question of law: "It requires a conclusion regarding the legal effect of the [b]ankruptcy [c]ourt's findings as to her circumstances. Questions of law are reviewed *de novo*."[122]

The creditor also sought to convince the Eighth Circuit to join the other circuits in applying the more restrictive *Brunner* test for "undue hardship" rather than its own "totality of circumstances" test.[123] This the Eighth Circuit declined to do, stating:

> We prefer a less restrictive approach . . . We are convinced that requiring our bankruptcy courts to adhere

117. *Id.* at 353.
118. *Id.* at 352-56.
119. *In re* Long, 322 F.3d 549, 553 (8th Cir 2003) [hereinafter "Long I"].
120. *Id.*
121. *Id.*
122. *Id.* (citing *In re* Papio Keno Club, Inc., 262 F.3d 725, 728 (8th Cir. 2001)).
123. *Id.* at 553-54.

> to the strict parameters of a particular test would diminish the inherent discretion contained in [section] 523(a)(8)(B) . . . We believe that fairness and equity require each undue hardship case to be examined on the unique facts and circumstances that surround the particular bankruptcy.[124]

As the BAP had applied the incorrect standard of review though, the Eighth Circuit remanded the case back to the BAP for review of the bankruptcy court's ruling under a *de novo* standard.[125]

Upon remand, the BAP hearing the case only retained one member from the previous panel, Barry Schermer.[126] In his opinion for a unanimous court, Judge Schermer made searching use of the *de novo* review standard.[127] He challenged the debtor's decision to work only part-time, reasoning that she "may incur additional child care expenses if she increased her work, but she has failed to demonstrate that the additional child care costs would exceed the additional income she could earn."[128] He reasoned that, as the debtor was pursuing additional degrees, "her income potential should increase in the future."[129] Ultimately, Judge Schermer focused on the option to pursue an income-based repayment plan.[130] He concluded that the debtor's budget reflected sufficient leftover funds to be able to afford the $54.00 monthly payment, concluding that this amount was affordable and comparing the twenty-five-year repayment commitment to a standard thirty-year mortgage.[131]

The reliance on income-based repayment plan options remains a cornerstone of Judge Schermer's undue hardship jurisprudence. It is featured, for example, in his opinion for the BAP in the *In re Parker* [132] case, where the lower court found that the debtor would have required payments of $152.00 monthly to service the debt and the reduced payment

124. *Id.* at 554.
125. *Id.* at 555.
126. *Long I*, 271 B.R. 322; *and In re* Long, 292 B.R. 635 (B.A.P. 8th Cir. 2003) [hereinafter "Long II"].
127. *Long II*, 292 B.R.b at 639.
128. *Id.* at 638.
129. *Id.*
130. *Id.* at 639.
131. *Id.* at 639.
132. 328 B.R. 548 (B.A.P. 8th Cir. 2005).

plan would require payments of $136.33, even though the contractual monthly amount was $564.09. In response, Judge Schermer later argued:

> The debtor must establish *undue* or *excessive* hardship before a student loan may be discharged. If the budget demonstrates that a debtor can afford payments under the ICRP, continued liability on the student loan does not create an undue hardship . . . . [A]bsent compelling evidence to the contrary, a debtor's ability to afford payments under the ICRP is determinative of the issue: continued liability for a student loan where a debtor can afford the payments does not create an undue hardship.[133]

Other members of the BAP have been less willing to view the ability to afford a reduced payment plan as decisive. As the *Lee* majority pointed out:

> Several bankruptcy courts have opined, and we agree, that the availability of the ICRP is "but one factor to be considered in determining undue hardship, but it is not determinative." Placing too much weight on the ICRP would have the effect in many cases of displacing the individualized determination of undue hardship mandated by Congress in [section] 523(a)(8) since the payments on a student loan will almost always be affordable, *i.e.,* not impose an undue hardship on a [d]ebtor.[134]

Initially, the Eighth Circuit seemed to be of different mind on the subject. For example, in *In re Reynolds*, a divided panel concluded that a

133. *In re* Lee, 352 B.R. 91, 97 (B.A.P. 8th Cir. 2006) (Schermer, J., concurring in result) (emphasis in original). Nonetheless, it should be noted that Judge Schermer went on to conclude that, "this case is distinguishable from the many cases where I have concluded that the student loan did not create an undue hardship in one important aspect. In each of those cases, the debtor's budget afforded the ability to make minimal payments toward the student loan debt under the ICRP. That is not the case in the present situation where the Debtor's budget does not permit payment of the amount which would be due under the ICRP, nor does the Debtor face any prospect which would permit repayment in the reasonably foreseeable future." *Id.* at 98.

134. *Id.* at 95-96 (internal citations and footnotes omitted).

student loan could be an undue hardship where the mental health of the debtor was impacted by the burden of carrying large amounts of debt and the obligation to make payments.[135] It granted the discharge despite the apparent ability to make a reduced monthly payment with the assistance of a spouse's income.[136]

Yet, a few years later, the Eighth Circuit Court of Appeals sounded a nearly-identical tone regarding the relevance of income-based repayment plan options in *Educational Credit Management Corp. v. Jesperson*.[137] It said,

> the [lower courts] rejected reliance on the ICRP because "it does not offer a fresh start" and "might even be viewed as inimical to the goals of the fresh start because the ICRP allows for negative amortization of the student loan debt and a potentially significant tax bill if the student loan is ultimately forgiven after 25 years . . . ." We disagree. In [section] 523(a)(8), Congress carved an exception to the "fresh start" permitted by discharge for unpaid, federally subsidized student loans. If the debtor with the help of an ICRP program can make student loan repayments while still maintaining a minimal standard of living, the absence of a fresh start is not undue hardship.[138]

It is important to note that the *Jesperson* court also stated that the income-based plan options were "a factor" as opposed to determinative.[139] Indeed, in concurrence, Judge Smith wrote separately "to emphasize that whether the debtor enrolled in the ICRP remains merely 'a factor' to consider when applying the totality-of-the-circumstances test."[140]

It is also instructive to note that *Jesperson* involved an attorney who had relatively substantial funds available to contribute to repayment (approximately $900 per month), while having made no prior effort to

135. 425 F.3d 526 (8th Cir. 2005).
136. *Id.* at 532-33.
137. 571 F.3d 775 (8th Cir. 2009).
138. *Id.* at 782 (internal citations omitted).
139. *Id.* at 781.
140. *Id.* at 783.

repay and who demonstrated no meaningful impairment that would make it difficult to maintain employment.[141] Indeed, the panel even went so far as to conclude the past history of non-payment was reflective of a lack of good faith in pursuing the undue hardship discharge at all, a factor that is more common to the *Brunner* test than the circuit's own "totality of circumstances" test.[142]

CONCLUSION

Over the past thirty years Judge Schermer's impact on jurisprudence in the area of consumer bankruptcy law has been undeniable. The sampling of issues presented in this Article demonstrates his critical impact on complex issues in an ever-changing niche within the bankruptcy field. The bankruptcy community in the Eastern District of Missouri is grateful for Judge Schermer's dedication to consumer bankruptcy law and for providing new and seasoned lawyers with a guide for practice before his court. We look forward to Judge Schermer's continued contributions to the legal community and wish him much success as he continues his tenure as a bankruptcy judge.

141. *Id.* at 779.
142. *Compare* Brunner v. New York Higher Educ. Svcs. 831 F.2d 395, 396 (2d Cir 1987), *with Long,* 322 F.3d at 554.