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Post-Confirmation Appreciation of Assets and After-Acquired Assets in Chapter 13: A Tale of Two Issues

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A Chapter 13 debtor owns a home worth $300,000.00 at the date of filing, which after accounting for secured liens, liquidation costs, priority debt, and hypothetical Chapter 7 Trustee commission, would result in non-exempt equity in the amount of $20,000.00. Accordingly, the debtor's confirmed Chapter 13 Plan provides a Chapter 7 liquidation amount of $20,000.00. After confirmation, due to the high real estate market, the debtor sells the same house for $400,000.00 but refuses to remit any net proceeds from the sale above the $20,000.00 Chapter 7 liquidation amount, arguing that the property vested to him upon confirmation. Additionally, after confirmation, this same debtor unexpectedly received an inheritance as a result of his father's passing worth $100,000.00. Again, Debtor refuses to turn over the inheritance to his Chapter 13 estate, arguing that all property vested to him upon confirmation. These two related, yet distinct, issues have perplexed courts for decades, and some courts have erroneously treated these two issues as interchangeable. The ultimate question for courts in such a case is whether post-confirmation appreciation of or proceeds related to a pre-petition asset and a post-confirmation acquired asset are property of a Chapter 13 estate and thus required to be turned over to a Chapter 13 Trustee.

At first glance, it would appear as though this question turns on the interplay between 11 U.S.C. §§1306(a) and 1327(b) and (c). 11 U.S.C. § 1306(a)(1) provides that "property of the estate includes, in addition to the property specified in section 541 of this title – 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." The question then becomes "how can the language of 11 U.S.C. § 1327(b) and (c) be reconciled with the plain language of 11 U.S.C. § 1306(a)(1)? 11 U.S.C. § 1327(b) clearly states that "[e]xcept as otherwise provided in the plan or order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor." 11 U.S.C. § 1327(c) elaborates even further by stating that "[e]xcept 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."

In trying to reconcile the provisions of 11 U.S.C. §§ 1306 and 1327, courts in the past have adopted one of four approaches. The first approach is regarded as the "estate termination approach," and courts adopting this approach have held that, by virtue of 11 U.S.C. § 1327(b), upon confirmation property of the estate vests in the debtor and is no longer property of the estate unless the order of confirmation or plan provides otherwise. *See In re Petruccelli,* 113 B.R. 5 (Bankr. S.D. Cal. 1990); *in re Jones,* 657 F.3d 921 (9th Cir. 2011); *Black v. Leavitt (in re Black),* 609 B.R. 518 (BAP 9th Cir. 2019). Courts adopting the "estate termination approach" give the broadest definition to the term "vest" and regards "vesting" as absolute ownership and not just mere possession. *In re Black,* 609 B.R. at 528. Other courts have criticized the reasoning of these courts adopting the "estate termination approach" for failing to apply the plain language of 11 U.S.C. § 1306 and interjecting the term "confirmation" into the terms of 11 U.S.C. § 1306. *See, e.g, in re Kolenda,* 212 B.R. 851, 853 (W.D. Mich. 1997). As these critics argue, by attempting to interpret what these courts viewed as the plain language of 11 U.S.C. §

1327, they in essence were rewriting the plain language of 11 U.S.C. § 1306 while at the same time rendering the stated conditions of dismissal, closing, or conversion of the case in 11 U.S.C. § 1306 meaningless insofar as they interjected the condition of "confirmation" into that provision.

The second approach adopted by some courts is called the "estate transformation approach," and courts adopting this approach have determined that upon confirmation estate property vests in the debtor but that the estate retains property that is necessary for the execution of the plan. *See Black v. U.S. Postal Svc. (in re Heath),* 115 F.3d 521 (7th Cir. 1997); *Telfair v. First Union Mtg. Corp.*, 216 F.3d 1333 (11th Cir. 2000); *in re Waldron,* 536 F.3d 1239 (11th Cir. 2008). Over twenty years after its decision in *Heath,* the Seventh Circuit later seemed to adopt a variation of the "estate transformation approach" when it held that property vests in the debtor unless the court finds a good reason to keep an asset as part of the estate. *Matter of Steenes,* 918 F.3d 554 (7th Cir. 2019). The reasoning of these courts has been rejected by other courts on the basis that these courts arguably have inserted a subjective standard into both 11 U.S.C. §§ 1306 and 1327 in determining what property is necessary and what property is not necessary for fulfillment and execution of a plan. *See, e.g., in re Kolenda*, 212 B.R. 851, 855 (W.D. Mich. 1997) ("no textual basis exists for distinguishing between post-confirmation property that is "necessary" and that which is "not necessary" to funding the confirmation plan, and courts have differed widely concerning how broadly "necessary" should be construed").

The third approach adopted by some courts has been called the "estate preservation approach," and courts adopting this approach have ruled that, while property "vests" upon debtor at confirmation pursuant to 11 U.S.C. § 1327, the property still remains property of the Chapter 13 estate until the case is closed, dismissed, or converted. *See In re Kolenda,* 212 B.R. 851 (W.D. Mich. 1997); *Security Bank of Marshalltown, Iowa v. Neiman,* 1 F.3d 687 (8th Cir. 1993). In attempting to give meaning to the terms used in both 11 U.S.C. §§ 1306 and 1327 in a consistent manner with one another, these courts construe the term "vesting" in a more restrictive manner than the courts adopting the "estate termination approach." These courts view the term "vesting" as meaning more than mere possession and including, at minimum, an immediate right to property but less than full ownership rights in the property.

There has been what some courts have regarded as a fourth approach, and it is this approach that seems to muddy the waters. Some courts have construed the "modified estate preservation approach" as a distinct fourth approach to determining whether an asset that exists at the time of the commencement of a case or proceeds from such an asset remains property of the estate. However, as poignantly implied by the recent Ninth Circuit Bankruptcy Appellate Panel decision in *Berkley,* the "modified estate preservation approach" should not be regarded as a separate approach when dealing with property that existed at the time of a commencement of a case and at confirmation. There was a decision rendered by the First Circuit in *Barbosa v. Soloman,* 235 F.3d 31, 36 (1st Cir. 2000) that was later regarded by the Ninth Circuit in *in re Jones,* 657 F.3d 921, 927-28 (9th Cir. 2011) as a decision adopting the "modified estate preservation approach" insofar as it determined that "estate property vests in the debtor upon plan confirmation, but property acquired after confirmation becomes property of the estate pursuant to § 1306(a)" *see also, Fritz Fire Prot Co. v. Wei-Fung Chang (in re Wei-Fung Chang),* 438 B.R. 77 (Bankr. M.D. Pa. 2010); *in re Zisumbo,* 519 B.R. 851 (Bankr. Utah 2014); *in re Wetzel,* 381 B.R. 247 (Bankr. E.D. Wis. 2008). These courts' reliance upon the distinction between property acquired post confirmation and property existing at the time of confirmation is misplaced since such a distinction is non-existent based upon the plain language of 11 U.S.C. § 1306(a). Section 1306(a) reads, in pertinent part: "Property of the estate includes, *in addition to the property specified in section 541 of this title . . .*

" (emphasis added). Section 1306(a) does in fact capture property that was acquired post confirmation but that property is "in addition" to property that exists at the commencement of the case under 11 U.S.C. § 541. Hence, the "modified estate preservation approach" espoused by the First Circuit in *Barbosa* and other courts should not be regarded as a separate approach to reconciling the language between 11 U.S.C. §§ 1306 and 1327 with regard to property existing at the time of confirmation. The Ninth Circuit Bankruptcy Appellate Panel essentially recognized this particular point when it dealt with a debtor's post-confirmation increase in income when the debtor received $3.8 million in a stock option buyout. The Bankruptcy Appellate Panel ultimately held that the debtor's post-confirmation wages should be committed to the debtor's Plan. *Berkley v. Burchard (in re Berkley)*, BAP No. NC-19-1197 at *13 (April 17, 2020). In its reasoning, the Panel acknowledged that the Panel had previously adopted the so-called "estate termination approach" which is relevant when dealing with property in existence at the time of confirmation, and the Panel did not intend to disturb its previous adaptation of the "estate termination approach." *Id.* at *10. However, as noted by the Panel, the case before it did not pertain to property the debtor owned on the petition date but rather pertained to post-confirmation wages. *Id.* at *13.

As the Ninth Circuit Bankruptcy Appellate Panel's decision in *Berkley* illustrates, the key distinction between post-confirmation appreciation of or proceeds related to assets that existed at the commencement of a Chapter 13 case and assets acquired by a debtor after confirmation of a Chapter 13 Plan should not be lost on bankruptcy practitioners and courts. With regard to appreciation of or proceeds related to assets that existed at the commencement of a Chapter 13 case, courts should utilize the estate termination approach, the estate transformation approach, or the estate preservation approach since courts will be faced with the challenge of reconciling both 11 U.S.C. §§ 1306 and 1327. However, if a court is faced with an asset that is acquired by the debtor after confirmation of a Chapter 13 Plan, there is no apparent conflict between 11 U.S.C. §§ 1306 and 1327, and thus there isn't anything for the court to *per se* reconcile. 11 U.S.C. § 1306 clearly controls in such an instance and dictates that such an after-acquired asset should be considered property of the Chapter 13 estate and should be committed to repayment of creditors in the Chapter 13 estate.

Exploring the Limitations of Fulton

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The automatic stay is arguably one of the strongest protections for debtors under the Bankruptcy Code, halting actions by creditors against debtors upon the bankruptcy filing. Whether a creditor violates the automatic stay by merely retaining collateral that was repossessed pre-bankruptcy is a question that many federal circuit courts have grappled with in recent years. Many bankruptcy courts impose an affirmative duty on creditors to turn over repossessed property after a bankruptcy filing upon demand by the debtor, without any conditions. Other courts held that the retention of property by the creditor only maintains the status quo, and that a creditor simply holding property repossessed pre-petition does not violate the automatic stay.

On January 14, 2021, the U.S. Supreme Court decided *City of Chicago v. Fulton*, holding that the creditor's mere retention of a debtor's property after the filing of a bankruptcy petition does not violate the automatic stay under Section 362(a)(3) of the Bankruptcy Code. The Supreme Court, in an 8-0 opinion, held that creditors are permitted to retain possession of the collateral repossessed pre-petition and are not obligated to return the collateral due to the debtor's filing of a bankruptcy petition. The Court interpreted the language of the statute, with Justice Samuel Alito writing the opinion, finding that Section 362(a)(3) prohibits "affirmative acts that would disturb the status quo of the estate property as of the time when the bankruptcy petition was filed."

In reaching its creditor-friendly decision, the Supreme Court focused on Section 362(a)(3) of the Bankruptcy Code. Section 362(a)(3) prohibits "any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate." The Supreme Court determined that merely maintaining the status quo does not constitute an affirmative act that would violate Section 362(a)(3). The Court remanded the case to the Seventh Circuit Court of Appeals for further proceedings consistent with the decision.

On remand, the Seventh Circuit Court of Appeals highlighted other subsections of Section 362, namely 362(a)(4) and (a)(6), that could require a creditor to return a debtor's property after the filing of a bankruptcy petition. The Seventh Circuit Court of Appeals alluded to certain language in the concurrence written by Justice Sonya Sotomayor, leaving the door open to the possibility of a creditor being required to return a debtor's property under other subsections of Section 362, noting "that the Court has not decided whether and when § 362(a)'s other provisions may require a creditor to return a debtor's property." The Seventh Circuit Court held that "the question of whether or not the City's conduct was impermissible on grounds other than § 362(a)(3) remains unresolved."

While the U.S. Supreme Court held that retaining a repossessed car does not constitute an act to obtain possession of estate property or an exercise of control under section 362(a)(3), the Court of Appeals' decision warns that the analysis does not end there, as retaining a repossessed car could constitute a violation of the Automatic Stay under section 362(a)(4) or under section 362(a)(6). Section 362(a)(4) prohibits acts to perfect a lien against estate property and section 362(a)(6) prohibits acts to collect, assess, or recover a claim against a debtor that arose before the filing of a bankruptcy petition.

Given the uncertainty surrounding the interpretation of stay violations, the best practice is to communicate with your bankruptcy counsel if and when a debtor files bankruptcy.