

BY ROBERT V. SCHALLER

## Proof of Claim Filing Deadline Applies to Secured Creditors

In a ruling of first impression at the circuit court level, the U.S. Court of Appeals for the Seventh Circuit in *In re Pajian*<sup>1</sup> held that the proof-of-claim filing deadline under Fed. R. Bankr. P. 3002(c) applies to *all* claims, including those of secured creditors. This ruling rocked the conventional thinking<sup>2</sup> of both the debtor and creditor bar that a secured creditor need not file a proof of claim as long as that creditor's claim was included in the proposed chapter 13 plan prior to confirmation.<sup>3</sup> This ruling could provide a strategic advantage to a debtor's efforts to confirm a more favorable plan.

### Creditor Wrongly Relied Upon Unconfirmed Plan Terms

As is often the case, the *Pajian* debtor suffered significant financial hardship pre-petition. A secured creditor was on the cusp of foreclosing on the debtor's commercial property when the debtor stayed the sale by filing for chapter 13 relief. The debtor's plan filed prior to the proof-of-claim deadline offered to pay the secured creditor the monthly post-petition mortgage payment required by the mortgage note, plus an amount that was equal to what the debtor believed was the pre-petition mortgage arrearage in accordance with § 1322(b)(5).<sup>4</sup>

Subsequently, the proof-of-claim deadline passed without the secured creditor filing a claim or objecting to the plan. At the same time, the debtor discovered that the true amount of the pre-petition mortgage arrearage was vastly greater than originally estimated and substantially greater than the debtor could afford to repay over the 60-month plan term. The debtor filed a modified plan<sup>5</sup> that elimi-

nated all payments to the secured creditor on behalf of the pre-petition mortgage arrearage. Instead, the modified plan simply proposed to pay to the secured creditor the monthly post-petition mortgage payments, as required by the mortgage note, and nothing more.

In response, the secured creditor filed a late proof of claim and an objection to the modified plan. The bankruptcy court sustained the secured creditor's objection, holding that the creditor's proof of claim was timely because it was filed prior to confirmation of the modified plan.<sup>6</sup> The bankruptcy court focused on the Seventh Circuit's belief in the sanctity of a confirmed plan<sup>7</sup> and the previous rejection of a collateral attack upon a confirmed plan.<sup>8</sup> Lacking Seventh Circuit or any circuit court guidance, the bankruptcy court extrapolated that confirmation must be the deadline for secured creditors. The debtor took a direct appeal to the Seventh Circuit.

### Seventh Circuit Clarifies Fed. R. Bankr. P. 3002(c)'s Applicability

The *Pajian* court reversed the bankruptcy court and held that the secured creditor's claim was late and thus subject to disallowance because the proof-of-claim filing deadline applies to *all* claims, including those of secured creditors. The Seventh Circuit began its analysis by noting that creditors must file a proof of claim in accordance with § 501 in order to participate in chapter 13 distributions because chapter 13 trustees can only pay creditors whose claims have been "allowed."<sup>9</sup>

Proofs of claim are deemed allowed without notice or a hearing unless a party in interest objects.<sup>10</sup> A creditor's failure to file a timely proof of claim as required by § 502(b)(9)<sup>11</sup> is a basis for objection and disallowance of a late claim to object. Fed. R. Bankr. P. 3002(c) provides that a nongovernmental proof of claim is timely filed in chapter 13 if it is filed no later than 90 days after the first date set for the meeting of creditors under § 341.<sup>12</sup>



**Robert V. Schaller**  
Schaller Law Firm, PC  
Oak Brook, Ill.

Robert Schaller is  
president of Schaller  
Law Firm, PC in  
Oak Brook, Ill.

1 *In re Pajian*, No. 14-2052 (7th Cir. May 11, 2015). The author served as prevailing counsel.

2 For cases in which courts have allowed secured creditors to file claims after the Fed. R. Bankr. P. 3002(c) deadline, see, e.g., *In re Pajian*, 508 B.R. 708 (Bankr. N.D. Ill. 2014); *In re Mehl*, No. 04-85570, 2005 WL 2806676 (Bankr. C.D. Ill. 2005); *In re Hudson*, 260 B.R. 421 (Bankr. W.D. Mich. 2001); *Strong v. U.S. Dep't of Treasury, IRS*, 203 B.R. 105 (Bankr. N.D. Ill. 1996); *In re Harris*, 64 B.R. 717 (Bankr. D. Conn. 1986). Courts have allowed secured creditors to file proofs of claim after the Fed. R. Bankr. P. 3002(c) deadline by finding the deadline applicable only to unsecured creditors. These courts read Fed. R. Bankr. P. 3002(c)'s deadline in conjunction with Fed. R. Bankr. P. 3002(a)'s mandate requiring only unsecured creditors to file proofs of claim. Plus, these courts note that the rehabilitative purpose of chapter 13 is promoted by allowing secured creditors to file proofs of claim at any time.

3 For cases in which courts have applied the Fed. R. Bankr. P. 3002(c) deadline to all creditors, see, e.g., *In re Dumain*, 492 B.R. 140 (Bankr. S.D.N.Y. 2013); *In re Dennis*, 230 B.R. 244 (Bankr. D.N.J. 1999); *In re Brisco*, 486 B.R. 429 (Bankr. N.D. Ill. 2013). Courts applying the deadline to both unsecured and secured creditors contrast the Code's restrictive language of Fed. R. Bankr. P. 3002(a) identifying *who* must file a claim (i.e., unsecured creditors) to the expansive language of Fed. R. Bankr. P. 3002(c) identifying *when* the claim must be filed (i.e., creditors).

4 11 U.S.C. § 1322(b)(5).

5 11 U.S.C. § 1323(a).

6 *In re Pajian*, 508 B.R. 708 (Bankr. N.D. Ill. 2014).

7 See *Ernst & Young LLP v. Baker O'Neal Holdings Inc.*, 304 F.3d 753, 755 (7th Cir. 2002).

8 See *Adair v. Sherman*, 230 F.3d 890, 894 (7th Cir. 2000).

9 Fed. R. Bankr. P. 3021.

10 11 U.S.C. § 502(a).

11 11 U.S.C. § 502(b)(9).

12 Fed. R. Bankr. P. 3002(c)(1)-(6) also provide six exceptions to the 90-day rule, but none were relevant to the case at bar.

The court initially focused on the purpose of Fed. R. Bankr. P. 3002 as a whole and considered the interplay of each subsection. It noted that Fed. R. Bankr. P. 3002(a) related to the topic of *who* must file proofs of claim, while Fed. R. Bankr. P. 3002(c) related to the topic of *when* those claims must be filed. Fed. R. Bankr. P. 3002(a)'s mandate requiring unsecured creditors to file proofs of claim applies specifically and only to unsecured creditors. In fact, the court noted that Fed. R. Bankr. P. 3002 never expressly refers to "secured creditors" and speculated that this omission had led some bankruptcy courts to conclude that Fed. R. Bankr. P. 3002, in its entirety, applies only to unsecured creditors.

The Seventh Circuit thought the better interpretation was that all creditors, unsecured and secured alike, are bound by Fed. R. Bankr. P. 3002(c)'s filing deadline because the subsection uses the phrase "proof of claim" and does not distinguish between the claims of secured and unsecured creditors. The Bankruptcy Code also defines "claim" as including both secured and unsecured claims,<sup>13</sup> and the Federal Rules of Bankruptcy Procedure adopted this definition.<sup>14</sup> Furthermore, Fed. R. Bankr. P. 3002(c) mentions both a "claim" and "unsecured claim."<sup>15</sup> This interpretation is consistent with the use of subsets of the term "claim" in the Code<sup>16</sup> and Rules.<sup>17</sup>

The *Pajian* court found that the use of both of the terms in Fed. R. Bankr. P. 3002 suggested that the drafters knew how to distinguish between *all* claims and *unsecured* claims. The fact that Congress did not specifically mention *unsecured* claims when establishing the 90-day deadline in Fed. R. Bankr. P. 3002(c) strongly implied that the deadline encompasses all claims.

Notwithstanding, the Seventh Circuit reminded the bar that while all creditors (secured and unsecured) must file a proof of claim in order to receive plan distributions, a secured creditor who fails to do so can still enforce its lien through a foreclosure action after the debtor receives a discharge.<sup>18</sup> In other words, a secured creditor's lien is largely unaffected by the bankruptcy discharge, regardless of whether the secured creditor filed a proof of claim.<sup>19</sup>

## Ramifications of *Pajian* Debtor Strategies

The Seventh Circuit's ruling offers debtors a potent tool to use against secured creditors. First, if the secured creditor does not file a claim, debtors could pressure secured creditors into modifying the terms of existing mortgage

<sup>13</sup> 11 U.S.C. § 101(5)(A) ("claim" includes "right to payment, whether or not such right is ... secured, or unsecured").

<sup>14</sup> Fed. R. Bankr. P. 9001.

<sup>15</sup> Compare Fed. R. Bankr. P. 3002(c)(3) (excepting from the 90-day deadline "[a]n unsecured claim which arises in favor of an entity..."), with Fed. R. Bankr. P. 3002(c)(4) (excepting from the deadline "[a] claim arising from the rejection of an executory contract").

<sup>16</sup> See 11 U.S.C. § 506 (secured claim), 11 U.S.C. § 507 (priority claim), 11 U.S.C. § 1325(a)(4) (unsecured claim) and 11 U.S.C. § 1325(a)(5) (secured claim).

<sup>17</sup> Fed. R. Bankr. P. 3012 (secured claim).

<sup>18</sup> *In re Penrod*, 50 F.3d 459, 461-62 (7th Cir. 1995).

<sup>19</sup> See *Dewsnup v. Timm*, 502 U.S. 410 (1992).

notes. Debtors could also offer to pay the otherwise late claim during the plan term to entice the secured creditor into agreeing to modify the mortgage note by extending the maturity date, relaxing certain loan covenants, changing the interest rate from variable to fixed, or reducing the monthly mortgage payment.

Second, debtors could prevent foreclosure of defaulted real estate loans by proposing a plan that merely pays the monthly post-petition mortgage payments required by the mortgage note and nothing more. This strategy could afford debtors an additional 60 months to develop an end-game strategy to save real estate. While enjoying the automatic stay protections, debtors could restructure debtors' financial circumstances to better manage debt obligations after the completion of the plan.

Third, debtors who successfully complete their chapter 13 plans and receive their discharge could conceivably file a subsequent chapter 13 petition. The only debts to be included in the subsequent plan would be debts not discharged in the previous case. A debtor could propose a new 60-month repayment plan to pay the mortgage arrearage not paid in the prior case if the facts prove that the debtor's income had changed and the debtor now has the ability to cure the mortgage default within a reasonable amount of time.<sup>20</sup>

## Creditor Strategies

First, a creditor should promptly file a proof of claim. A proof of claim identifying the exact pre-petition debt would be best, but one that only estimates the debt can serve as a "placeholder" — although the proof of claim should expressly describe the debt balance as being only an estimate to avoid an underestimate being deemed as an admission. Later, creditors could amend the proof of claim *after* the filing deadline and still have an allowed claim.

Second, a secured creditor should file an objection to any plan providing inadequate payment provisions. An objection to the plan could be considered an "informal" proof of claim if no timely proof of claim is filed. Debtors have as much interest in the accuracy of claims, so they can emerge from bankruptcy current on their secured obligations.

## Conclusion

The Seventh Circuit's *Pajian* ruling created a strategic opportunity for a debtor to confirm a plan on terms more favorable to a debtor. The court simultaneously created a trap for unwary creditors' counsel who may be unfamiliar with Rule 3002(c) or more seasoned counsel stuck in a routine of not filing proofs of claims when their clients' claims are provided for in unconfirmed plans. **abi**

<sup>20</sup> The subsequent case would not be deemed "presumptively filed not in good faith" because the prior case was successfully completed and not dismissed. See 11 U.S.C. § 362(c)(3)(C). The automatic stay would not expire after 30 days, and the debtor would not need to file a motion to extend the automatic stay. Such a chapter 26 strategy would give a debtor 10 years to cure the mortgage default by paying the mortgage arrearage.

Copyright 2015  
American Bankruptcy Institute.  
Please contact ABI at (703) 739-0800 for reprint permission.