Consumer Bankruptcy Panel, June 3, 2023
Judge Tamara O. Mitchell
Career law clerk Donna G. McGee
United States Bankruptcy Court
Northern District of Alabama, Southern Division

GOOD FAITH IN CHAPTER 13

One of the most cited principles of bankruptcy is that bankruptcy is intended for "honest but unfortunate" debtors. Unfortunately, there may be now and then a debtor who does not have the best intentions when it comes to resolving his or her debts; thus, the concept of good faith is important in bankruptcy to ensure debtors' compliance with the principles of the Code.

I. GOOD FAITH

A. The Bankruptcy Code

The Bankruptcy Code imposes on debtors in Chapter 13 a good faith obligation. As set out in § 1325:

> (a) Except as provided in subsection (b), the court shall confirm a plan if –
> . . . .
> (3) the plan has been proposed in good faith and not by any means forbidden by law;
> . . . .
> (7) the action of the debtor in filing the petition was in good faith[.]

11 U.S.C. §1325(a)(3), (a)(7). Thus, a debtor must pass the good faith hurdle twice – when filing the case and when getting a plan confirmed.

B. Role of the courts

Courts, including the Supreme Court, have made clear that bankruptcy courts themselves have a significant role when it comes to ensuring a Chapter 13 debtor complies with the good faith requirements.

1. "[T]he Code makes plain that bankruptcy courts have the authority—indeed, the obligation—to direct a debtor to conform his plan to the requirements of §§ 1328(a)(2) and 523(a)(8)." *United Student Aid Funds, Inc. v. Espinosa*, 559 U.S. 260, 130 S. Ct. 1367, 1381, 176 L. Ed. 2d 158.

2. "[E]ven in the absence of objections by creditors or a trustee, a bankruptcy court has an independent duty to determine that all prerequisites for plan confirmation have been satisfied." *In re Jackson*, No. 11–42528–JJR–13, 2012 WL 909782 (Bankr. N.D. Ala. Mar. 16, 2012) (Robinson, J.).

3. The bankruptcy court's role was emphasized by the Eleventh Circuit Court of Appeals when it found "[w]e hold that with section 1325(a)(3) Congress intended to provide bankruptcy courts with a discretionary means to preserve the bankruptcy process for its intended purpose." *Shell Oil Co. v. Waldron (In re Waldron)*, 785 F.2d 936, 941 (11th Cir. 1996).

C. What is good faith?

1. The Bankruptcy Code does not define what is, or what is not, good faith. *Brown v. Gore (In re Brown)*, 742 F.3d 1309, 1316 (11th Cir. 2014).

2. Legislative history

As one court examining legislative history noted:

> "Good faith" is not defined in the Bankruptcy Code with respect to filing a Chapter 13 plan. Congressional intent, in relation to 11 U.S.C. § 1325(a)(3):
>
> > . . . as amended, neither prescribes nor authorizes the imposition by the court of a requirement that a chapter 13 plan propose any arbitrary minimum percentage or amount to creditors. Instead, it contemplates that the court determine whether the plan proposed in

> the particular case represents a good-faith effort to settle the claim of creditors to the extent feasible ... during the pendency of the proposed extension period as permitted under subsection 1325 . . . .

In re Britt, 211 B.R. 74, 77-78 (Bankr. M.D. Fla. 1997) (Briskman, J.) (quoting H.R.Rep. No. 1195, 95th Cong., 2d Sess. pt. 1, at 24–26 (1980)).

3. *Kitchens* factors

One case handed down by the Eleventh Circuit Court of Appeals just a few years after the passage of the Bankruptcy Reform Act of 1978 is still the prominent authority in guiding courts in the Eleventh Circuit on the subject of good faith. This case, *Kitchens v. Georgia Railroad Bank & Trust Company (In re Kitchens)*, 702 F.2d 885 (11th Cir. 1983), sets out fourteen non-exclusive factors which bankruptcy courts are to consider in determining whether a plan was proposed in good faith. These factors are:

(1) the amount of the debtor's income from all sources;
(2) the living expenses of the debtor and his dependents;
(3) the amount of attorney's fees;
(4) the probable or expected duration of the debtor's Chapter 13 plan;
(5) the motivations of the debtor and his sincerity in seeking relief under provisions of Chapter 13;
(6) the debtor's degree of effort;
(7) the debtor's ability to earn and the likelihood of fluctuation in his earnings;
(8) special circumstances such as inordinate medical expense;
(9) the frequency with which the debtor has sought relief under the Bankruptcy Reform Act and its predecessors;
(10) the circumstances under which the debtor has contracted his debts and has demonstrated bona fides, or lack of same, in dealings with his creditors;
(11) the burden which the plan's administration would place on the trustee;

(12) the substantiality of the payment to unsecured creditors;
(13) the type of debt to be discharged and whether these debts would be dischargeable under a Chapter 7 case;
(14) the accuracy of the schedules filed and whether any inaccuracies are an attempt to mislead the court.

Kitchens, 702 F.2d at 888-89. Since the *Kitchens* case was decided in 1981 the Bankruptcy Code has been amended numerous times, most notably in 1994 and 2005; however, courts within the Eleventh Circuit still cite to *Kitchens*.[1]

4. A court determining whether or not a plan has been filed by good faith must consider all of the *Kitchens* factors, but the court's inquiry is not limited to those. *Britt*, 211 B.R. at 78 (citing *Jim Walter Homes, Inc. v. Saylors (In re Saylors)*, 869 F.2d 1434, 1438 (11th Cir. 1989)).

5. Good faith will be determined "on a case by case basis using a 'totality of the circumstances' approach . . . ." *In re Major*, No. 20-11723, 2020 WL 10730051, at *2 (Bankr. S.D. Ala. Nov. 23, 2020) (Callaway, Chief J.).

6. "[U]ltimately, it is a debtor's burden to prove their good faith by a preponderance of the evidence." *In re Roby*, No. 21-30731-BPC, 2023 WL 2542365, at *9 (Bankr. M.D. Ala. Mar. 16, 2023) (Cresswell, J.) (citing *Matter of Ogden*, 570 B.R. 432, 435 (Bankr. N.D. Ga. 2017, amended No. 16-12280-WHD, 2017 WL 2124413 (Bankr. N.D. Ga. May 15, 2017))).

7. "The appropriate weight [of the factors] depends on the credibility of the debtor." *Britt*, 211 B.R. at 78 (citing *Saylors*, 869 F.2d at 1438).

[1] For a recent detailed analysis of many of the *Kitchens* factors see Judge Cresswell's case *In re Roby*, Case No. 21-30731-BPC, 2023 WL 2542365, -- B.R. -- (Bankr. M.D. Ala. Mar. 16, 2023).

8. "In deciding if a debtor has met their burden, '[t]he bottom line is whether the debtor is attempting to thwart his creditors, or is making an honest effort to repay them to the best of his ability.'" *Roby*, 2023 WL 2542365, at *9 (citing *In re Verden*, 279 B.R. 401, 409 (Bankr. D. Mass. 2002)). *See also In re Dekom*, Case No. 19-30082-KKS, 2020 WL 4001044, at *6 (Bankr. N.D. Fla. Apr. 6, 2020) (Specie, C.J.) (quoting *Tina Livestock Sales, Inc. v. Schachtele (In re Schachtele)*, 341 B.R. 650, 658 (S.D. Fla. 2003)) ("In the context of Chapter 13 cases, factors such as the debtor's motivation and sincerity in seeking Chapter 13 relief, are particularly relevant . . . .").

D. Is this bad faith?

1. Under-withholding taxes

a. Some debtors come into bankruptcy court with a large tax debt from failure to have enough taxes withheld from their wages year to year. It is not uncommon for Chapter 13 debtors in this situation to propose paying little to unsecured creditors because much of their disposable income goes toward paying the IRS or other taxing authorities. Could such a Chapter 13 plan be proposed in good faith?

b. Similarly, should a debtor who customarily has too little tax withheld from her wages change her practice in order to stay in Chapter 13? In one case, the bankruptcy court recognized that the debtor's problems with the IRS stemmed from years of "unpaid income tax obligations on an annual, incremental basis . . . ." *In re*

Rowell, 421 B.R. 524, 536 (Bankr. D. Minn. 2009). The court went on to say:

> The most likely explanation for the regular accrual of these obligations is a systematic, and knowing, under-withholding for income taxes from the Debtor's wages, probably to maximize the take-home from her modest gross income. If that has been her program, it has only deferred her day of reckoning to the taxing authorities. Beyond the legal matter of doing that in this case, the Debtor must take a belated, hard look at how she structures her personal cash flow, and must make some choices.

Rowell, 421 B.R. at 536.

2. Eve of bankruptcy

    1. "The debtor's good faith is often put at issue when she incurs a debt on the eve of bankruptcy." *In re Crittendon*, No. 09-10462, 2009 WL 2424331, at *3 (Bankr. M.D. Ala. Aug. 6, 2009) (Williams, J.).

    2. What is considered to be the "eve of bankruptcy"? Certainly the day before filing, or even a week before, should be. What about three months or even one year before filing? Will the answer change depending on the circumstances?

II. A FEW CASES OF INTEREST:

A. ***Shell Oil Co. v. Waldron (In re Waldron)***, 785 F.2d 936 (11th Cir. 1986)

In 1964 the debtors gave Shell Oil an option to purchase land for $40,000 almost 20 years into the future. It was apparent when the option period began that the property value had increased. The debtors, who owed no debts and were financially stable, admittedly filed bankruptcy for no reason other than to reject the option contract. In allowing the debtors to reject the option contract the bankruptcy court (subsequently affirmed by the district court)

looked at cases holding "'that it is not an abuse of the bankruptcy process to file a petition under Chapter 7 or Chapter 11 solely to reject an executory contract.'" *Shell Oil Co. v. Waldron,* 785 F.2d at 940 (quoting *In re Waldron*, 36 B.R. 633, 635 (Bankr. S.D. Fla. 1984)). The Eleventh Circuit Court of Appeals noted that the bankruptcy court did not make the distinction between the cases it relied upon, in which the the debtors were in financial trouble, and the case at bar, in which there debtors were financially sound. After remarking that the debtors' "only motive [in filing bankruptcy] was to enhance their financial coffers," the court went on to say:

> "The bankruptcy laws are intended as a shield, not as a sword." *In re Penn Central Transportation Co.*, 458 F. Supp. 1346, 1356 (E.D. Pa. 1978). Congress could not have intended that the debt-free, financially secure Waldrons be permitted to engage the bankruptcy machinery solely to avoid an enforceable option contract. From all that appears, the contract was negotiated at arms length; if the Waldrons now feel that it is less attractive than it should be, the difference is attributable to changes in the economic climate not to the Waldrons' financial situation. *See id*. The bankruptcy laws were simply not intended to be used as a sword by the rapacious.
> . . . .
> The Waldrons' plan was thus proposed in a bad faith attempt to use and abuse Chapter 13 for a greedy and unworthy purpose. . . . Permitting the financially secure Waldrons to avoid the option agreement with Shell Oil would prompt a flood of litigaton: any business that proves it miscalculated could avoid unprofitable deals through the bankruptcy process. This result makes a travesty of the bankruptcy process.

Shell Oil Co. v. Waldron, 785 F.2d at 939-41. Furthermore, the court noted "[g]ood faith or basic honesty is the very antithesis of attempting to circumvent a legal obligation through a technicality of the law." *Id*. at 941. The court reversed and remanded the district court decision with instructions to dismiss the debtors' petition.

B. ***In re Ogden*****,** 570 B.R. 432 (Bankr. N.D. Ga. 2017) (Drake, J.) (amended by Case No. 16–12280–WHD, 2017 WL 2124413 (Bank. N.D. Ga. May 15, 2017)).

The Chapter 13 Trustee objected to confirmation of the debtor's plan for lack of good faith because (1) the debtor did not disclose how she planned to use $920 in Social Security income that she saved every month, (2) the debtor would continue to save those funds while paying unsecured creditors approximately 20% of their claims, and (3) the debtor planned to fully pay a secured home improvement loan that she obtained around seven months before filing despite only paying $8,000 total to her unsecured creditors. The court noted that in the Bankruptcy Code, Social Security benefits are excluded from the definition of "current monthly income" and thus are not used to calculate Chapter 13 plan payments.[2] Because the Bankruptcy Code "show[s] a clear intention to protect Social Security income from the bankruptcy process" it was not a lack of good faith that the debtor did not disclose how she planned to use the money, nor was it a lack of good faith for the debtor to pay the home loan while paying only 20% to her unsecureds (although the court did recognize that the optics were not "pleasant"). *Ogden*, 570 B.R. at 436-38. However, citing the tenth *Kitchens* factor, "the circumstances under which the debtor has contracted his debts and demonstrated his bona fides, or lack of same, in dealing with his creditors," the court had a different take. According to the court, "[i]t is suggestive of a lack of good faith that the Debtor had work done to her home and acquired a loan less than a year before filing her case, and now proposes to pay that loan off in full while paying so little to unsecured creditors." *Id*. at 438-49. Because the court did not have a "sufficient basis" to determine if the debtor's proposed treatment of the loan was in good faith, it reset the confirmation hearing.

[2] Not all courts are in agreement about how to treat Social Security income in a good faith analysis. *See In re Meehean*, 611 B.R. 575, 586-92 (Bank. E.D. Mich. 2020) (examining cases both for and against considering Social Security income in a Chapter 13 good faith analysis) (*aff'd,* 619 B.R. 371 (E.D. Mich. 2020)).

C. ***In re Holifield***, No. 20-12097, 2020 WL 10731234 (Bankr. S.D. Ala. Dec. 11, 2020) (Callaway, C.J.).

The self-employed debtor proposed in his plan to keep two fairly expensive vehicles, although he did not list any dependents on his schedules. He used one to pull a trailer used in his business, and the second was used by his girlfriend and his dauagher. Because he had no dependents the expense associated with the second vehicle was not "reasonably necessary to be expended for the maintenance and support of a dependant under § 1325(b)(2)" nor was it "reasonably necessary for his own maintenance and support." *Holifield*, 2020 WL 10731234, at *1-2. Examining the *Kitchens* factors, the court concluded that the plan was not proposed in good faith as the debtor planned to keep the two vehicles, worth less than the amounts of debts they secured, without attempting fo find a less expensive vehicle. Furthermore, it appeared on the other hand that unsecured claimants would receive little in the case. The court gave the debtor an opportunity to propose an amended plan providing that he give up one vehicle of his choice; otherwise, the case could be dismissed, perhaps with a bar against refiling.

D. ***In re Tarver***, Case No. 20-12219-JCO, 2023 WL 1971607 (Bankr. S.D. Ala. Feb. 13, 2023) (Oldshue, C.J.)

The debtor had a significant monthly income from various sources, and while his disposable monthly income equaled $7,224.40 he proposed to pay only $586.01 to the trustee. His plan did not provide to pay for a large judgment owed to his ex-wife despite years of litigation over the amount owed and a few contempt orders against him. The court noted several ways in which the debtor's plan had not been filed in good faith:

> Tarver's financial situation and actions are not indicative of an "honest but unfortunate debtor." Like the debtors in *Waldron*,

> Tarver seems to have availed himself of the bankruptcy court solely to avoid honoring a pre-petition agreement and evading related state court orders. An assessment of the *Kitchen* factors supports finding that Tarver has not acted in good faith because: (1) even though his income greatly exceeds his expenses, he has made essentially no effort to pay the amounts due to Davis under the Divorce Decree and has purposefully accumulated substantial arrearage; (2) he has not proposed to pay all of his disposable income into the plan; (3) his living expenses include a large payment on a luxury vehicle that was purchased within thirty days of the bankruptcy; (4) his motivation for filing bankruptcy was not due to unfortunate circumstances beyond his control such as illness, loss of employment, or unexpected expenses but by his own desire to avoid paying his ex-wife agreed upon and court ordered amounts; and (5) the general manner in which he has conducted himself over the course of the past decade including, but not limited to, his flagrant disregard of the Domestic Court orders, flippant removal of state court contempt proceedings to the lower federal courts; unfounded, duplicative institution of proceedings, and failure to turnover the funds from the state court supersedeas bond. Considering the totality of the circumstances, denial of confirmation is required under 11 U.S.C. § 1325(a)(3), (a)(7), and (b)(1)(B) and dismissal would be justified.

Tarver, 2023 WL 1971607, at *8-9. Despite determining that confirmation was due to be denied and dismissal would be appropriate, the court noted that the debtor had been making his payments to the trustee and that the case was the only thing keeping the debtor out of jail. The court concluded that "it may be mutually beneficial to allow the parties an opportunity to discuss a potential resolution to the pending matters. Therefore, this court will allow Tarver an opportunity to attempt to resolve Davis' objection, file an amended plan, and seek to overcome the indicia of bad faith." *Id*. at *9.

E. ***In re Major***, Case No. 20-11723, 2020 WL 10730051 (Bankr. S.D. Ala. Nov. 23, 2020) (Callaway, C.J.)

A creditor of the debtor objected to confirmation on the grounds that the debtor had undervalued its collateral. The debtor had refinanced a signature loan with the creditor,

giving several household items as collateral. The main dispute between the parties involved a shed listed as collateral on the loan documents; the debtor contended she never had the shed and that she did not include the shed on the loan documents, while the creditor's representative testified that the debtor represented she did have a shed. Because of this the creditor argued that debtor had not proposed her plan in good faith. Examining the *Kitchens* factors, the court noted that the creditor focused only on the factor regarding dealings with creditors. Given the totality of the circumstances, the court determined that the debtor had proposed her plan in good faith. On another note, the court stated:

> [T]he court is reluctant to allow a § 523(a)(2) claim of a single creditor to proceed under the disguise of a § 1325(a)(3) objection to confirmation. If the court were to rule in Republic's favor in this respect, it would essentially be allowing Republic a secured claim of $3,587.82 based on collateral (a shed) that no one disputes does not exist for an extension of credit of $1,001.27.

Major, 2020 WL 10730051, at *3.

F. ***In re Katzel*****,** Case No. 8:21-bk-06184-CED, 2022 WL 16959271 (Bankr. M.D. Fla. Nov. 16, 2022) (Delano, C.J.).

The debtor and his ex-wife had entered into a "marital settlement agreement" providing that the debtor could keep four of five properties they owned together and in exchange the ex-wife would receive $700,000 from the debtor. After the divorce the debtor did not pay his ex-wife as required but did sell three properties to a company owned by his son. After the ex-wife filed a motion to enforce the settlememt agreement and received a state court judgment, the debtor paid her $149,296 and later $155,000; the debtor filed his bankruptcy case three days later. The ex-wife was the only creditor listed at the time of filing, although creditors added in a subsequent amendment filed claims totaling $360. While the debtor stated in an affidavit that he owed $446,613.03 to his son, the son was never added as a

creditor. Under the debtor's proposed plan, he would pay $202 per month for five years, amounting to the ex-wife receiving around 3% of her outstanding claim, to which he also objected. The ex-wife moved for dismissal for bad faith, alleging, among other things, that to keep his debts below the Chapter 13 limit, the debtor had his son waive the debt owed to him and the debtor paid her just enough prior to his bankruptcy filing to bring him under the limit, which was important – in a Chapter 7 or Chapter 11 case the debt owed to her could not be discharged. The debtor countered by arguing he used the bulk of proceeds from the sale of some properties to pay a portion of the debt owed to his ex-wife, and while he planned to mortgage one property to obtain the remainder of the funds, he could not get a loan due to the condition of the property. The court noted that an attempt to discharge in Chapter 13 an otherwise non-dischargeable debt is not necessarily bad faith by itself, but it is to be considered under the totality of the circumstances. The court had other considerations under the totality of the circumstances test. As the court pointed out, "[t]he Debtor has no need of a Chapter 13 case other than to circumvent his obligations to Gail under the [settlement agreement] and to avoid collection of the State Court Judgment." *Katzel*, 2022 WL 16959271, at *5. Also, "the Debtor's intent to manipulate the use of Chapter 13 to discharge his otherwise nondischargeable debt" was evidenced by the manner in which he reduced his debts to fall within the limits of Chapter 13. *Id*. The court also identified two *Kitchens* factors that were particularly relevant in the case: the debtor's motivation and sincerity in seeking relief under Chapter 13, and the circumstances under which the debtor incurred his debt and his prior dealings with creditors. As to the first factor, the court pointed out that when he negotiated the terms of the settlement agreement he knew the condition of the property he planned to mortgage, he had paid down debt just

enough to qualify for a Chapter 13 case, and he transferred property to his son before filing his case. As to the second, the debtor agreed to pay the settlement to his ex-wife then transferred property to his son and filed his case for the purpose of discharging the debt to her. The court determined both of those factors weighed in favor of dismissing the case.