

Secured Creditors Entitled to Contract Interest Rate in Chapter 13 Plans

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Recently, a bankruptcy judge in the United States Bankruptcy Court for the Middle District of North Carolina issued a ruling that should help lenders dealing with borrowers who file for Chapter 13 bankruptcy protection, at least in the Middle District.

In a bankruptcy case entitled In re Varner, the judge ruled that where a lender has a loan secured by a principal residence and the loan matures before, or will mature during, the life of the Chapter 13 plan, the borrower cannot modify the interest rate on the loan as a part of the debtor's plan. The borrower will have to repay the lender's claim at the contract interest rate. As a result of In re Varner, lenders may have more protection (and leverage) with borrowers who are contemplating filing, or who file, Chapter 13.

Background

In a Chapter 13 bankruptcy proceeding, a debtor files a repayment plan with the bankruptcy court that requires the debtor to pay back all or a portion of the debtor's debts over time. The amount to be repaid depends on how much the debtor earns, the amount and types of debt owed, and how much property the debtor owns. This is in contrast to a Chapter 7 bankruptcy proceeding, in which the debtor asks the bankruptcy court to discharge most of the debtor's debts. In exchange for a Chapter 7 discharge, the bankruptcy trustee can take any of the debtor's property that is not exempt from collection, sell it, and distribute the proceeds to the debtor's creditors.

Modifying Secured Claims in Chapter 13

In any bankruptcy proceeding, creditors are generally classified as having either a "secured" or "unsecured" claim. A secured claim is supported by collateral securing repayment of the claim, while an unsecured claim is not supported by collateral. The ability of a debtor to modify a lender's secured claim in Chapter 13 is limited, especially when the security is the debtor's primary residence.

In In re Varner, the debtors had executed a note in 2003 that was secured by their primary residence. They filed for Chapter 13 bankruptcy protection in 2014. Their note was scheduled to mature in 2018. Since the typical Chapter 13 plan runs for five years, the note would mature during the life of the plan. At the time of filing, the note had an interest rate of 9.08%. The debtors' Chapter 13 plan proposed to repay the lender at a rate of 5.25%. The Chapter 13 Trustee objected to the plan and the bankruptcy judge denied confirmation of the plan. The judge held that a debtor can modify the payments under a note by stretching payments out over the life of the plan, but the debtor cannot modify the contractual interest rate.

The judge in In re Varner recognized that other bankruptcy judges from other districts, including the Eastern District of North Carolina, have allowed modification of a secured creditor's interest rate. But the Middle District bankruptcy judge rejected the reasoning of those judges. For now, at least, In re Varner is arguably the guiding decision in the Middle District. It remains to be seen if other bankruptcy judges in the Middle District or the other two districts in North Carolina will follow In re Varner when called upon to rule on the issue.

Conclusion

Secured lenders who want to protect their rights to obtain their contract interest rate in Chapter 13 need to understand the In re Varner decision and the reasoning behind it, and also be cognizant of the district in which the bankruptcy proceeding is filed.

If you need guidance with this or other bankruptcy issues, please contact our Creditors' Rights Practice Group for more information.

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