

**IN THE UNITED STATES DISTRICT COURT FOR THE
EASTERN DISTRICT OF VIRGINIA
Alexandria Division**

EMILIO MARTINEZ, JR.)	
Appellant,)	
)	
v.)	Civil Action No. 1:21-cv-1077
)	
THOMAS P. GORMAN,)	
Appellee.)	

ORDER

At issue in this bankruptcy appeal is whether the Bankruptcy Court abused its discretion in granting Appellee-Trustee Thomas P. Gorman’s (“Trustee”) motion to modify Debtor-Appellant Emilio Martinez, Jr.’s (“Debtor”) Chapter 13 bankruptcy plan. This matter has been fully briefed and oral argument was conducted telephonically on May 25, 2022. The matter is therefore ripe for disposition.

I.

On January 27, 2020, Debtor filed for Chapter 13 bankruptcy protection. A Chapter 13 bankruptcy, also called a “wage earner’s plan,” allows the debtor to keep his assets while in bankruptcy provided the debtor agrees to a plan to pay a portion of his disposable income to his unsecured creditors over a period of several years. *In re Murphy*, 474 F.3d 143 (4th Cir. 2007). In the course of a Chapter 13 bankruptcy, the debtor’s unsecured creditors typically receive only a portion of the full amount of the debt owed to them.

To this end, Debtor in this case submitted a proposed plan to the Bankruptcy Court to pay a portion of his disposable income to his creditors. The plan Debtor submitted included a monthly budget and a set of schedules detailing, *inter alia*, (i) the property owned by Debtor, (ii) Debtor’s income, and (iii) the secured and unsecured debts owed by Debtor. Debtor’s budget

indicated monthly gross earnings of \$12,809. Debtor's proposed bankruptcy plan indicated that Debtor, along with Debtor's ex-wife, possessed a joint tenant ownership interest in a property located at 14385 Gulliver Road, Centreville, Virginia (hereinafter referred to as the "Gulliver Road property"). Debtor does not reside at the Gulliver Road property; only Debtor's ex-wife continues to live there.

Debtor's proposed plan, which included the budget and schedules described above, was reviewed and confirmed by the Bankruptcy Court on July 27, 2020. This Confirmed Plan required Debtor to make monthly payments of \$1,700 to his unsecured creditors over the course of five years, for a total of \$102,000. The Confirmed Plan also required Debtor to surrender his interest in the Gulliver Road property in order to satisfy partially a secured debt to mortgagor Shellpoint Mortgage Servicing. *See* Dkt. 1 at 19–20. The Confirmed Plan also provided that, in addition to the \$1,700 monthly payment to his unsecured creditors, Debtor would continue to make a monthly payment on the mortgage of \$3,710, although this payment, probably for federal tax purposes, was scheduled as an alimony-type payment.

On June 3, 2021, Debtor filed a motion with the Bankruptcy Court, seeking permission to refinance the mortgage on the Gulliver Road property in order to take advantage of lower interest rates then in effect and thus presumably save \$300 per month on the \$3,710 mortgage payments, styled as alimony, Debtor was required to make under the Confirmed Plan. *See* Dkt. 44. The motion to refinance the mortgage was not opposed by the Trustee, and the Bankruptcy Court held a hearing on the motion to refinance. Following this hearing, on June 21, 2021, the Bankruptcy Court entered an Order granting Debtor's motion to refinance the mortgage on the Gulliver Road property. *See* Dkt. 51.¹ The Order granting the motion to refinance the mortgage

¹ Not addressed or decided here is whether Debtor was properly permitted to refinance a

on the Gulliver Road property did not acknowledge that Debtor's refinancing was arguably inconsistent with Debtor's obligation, under the Confirmed Plan, to surrender his interest in the Gulliver Road property. Presumably, Debtor would have no right to refinance the mortgage unless Debtor retained an interest in the Gulliver Road property. Yet the Confirmed Plan required Debtor to surrender that property interest. The Debtor's retention of his interest in the Gulliver Road property was not addressed by the Bankruptcy Court.

The following day, June 22, 2021, the Trustee filed a motion to modify the Confirmed Plan under 11 U.S.C. § 1329(a), seeking to increase Debtor's plan payments by \$300 per month. *See* Dkt. 52. In the motion to modify, the Trustee noted that the mortgage refinancing approved by the Bankruptcy Court reduced Debtor's monthly expenses by \$300, and accordingly the Trustee sought to increase the Debtor's monthly plan payments to unsecured creditors from \$1,700 to \$2,000 in order to account for the refinancing savings. The Bankruptcy Court heard oral argument and granted the Trustee's motion to modify, thus increasing Debtor's monthly plan payments to \$2,000. *See* Dkt. 62.

Debtor appealed the Bankruptcy Court's Order granting the Trustee's motion to modify the Confirmed Plan. Jurisdiction to hear this bankruptcy appeal arises under 28 U.S.C. § 158(a).

II.

District courts review a bankruptcy court's factual findings for clear error and its legal conclusions de novo. *See In re Taneja*, 743 F.3d 423, 429 (4th Cir. 2014). The Fourth Circuit has made clear that "[m]ixed questions of law and fact are also reviewed de novo." *In re J.A. Jones, Inc.*, 492 F.3d 242, 249 (4th Cir. 2007). Importantly for this case, bankruptcy courts are afforded discretion in deciding motions to modify a confirmed bankruptcy plan under 11 U.S.C. § 1329,

mortgage for a property which the Confirmed Plan required Debtor to surrender.

and thus a bankruptcy court's ruling on a motion to modify a Confirmed Plan is reviewed for abuse of discretion. *See In re Murphy*, 474 F.3d 143, 149 (4th Cir. 2007). A bankruptcy court abuses its discretion when its conclusion is "guided by erroneous legal principles" or "rests upon a clearly erroneous factual finding." *Westberry v. Gislaved Gummi AB*, 178 F.3d 257, 261 (4th Cir. 1999).

III.

Debtor appeals the Bankruptcy Court's order granting the Trustee's motion to modify conditions of Debtor's confirmed Chapter 13 bankruptcy plan. As the Fourth Circuit has instructed, a confirmed Chapter 13 bankruptcy plan "is a new and binding contract, sanctioned by the court, between the debtors and their pre-confirmation creditors." *In re Murphy*, 474 at 148 (citing *Matter of Penrod*, 169 B.R. 910, 916 (Bankr. N.D. Ind.1994)) (internal quotations omitted). A Confirmed Plan is therefore binding on the debtor, the trustee, and the creditors, and accordingly "the doctrine of res judicata prevents modification of a confirmed plan" in the absence of compelling circumstances. *Id.* Res judicata "ensures that confirmation orders will be accorded the necessary degree of finality, preventing parties from seeking to modify plans when minor and anticipated changes in the debtor's financial condition take place." *In re Murphy*, 474 F.3d 143, 149 (4th Cir. 2007). Thus, res judicata sensibly prevents the parties to a confirmed bankruptcy plan from relitigating that plan every time the debtor experiences a minor, modest, or anticipated change to his financial condition. Yet, the doctrine of res judicata is not absolute in this context, and res judicata may be overcome and a Confirmed Plan may be modified, if "the party seeking modification demonstrates that the debtor experienced a *substantial and unanticipated* post-confirmation change in his financial condition." *Id.* at 149 (emphasis added).

Thus, the first step in the analysis is to determine what changes, if any, have occurred in

the Debtor's financial condition since the Confirmed Plan was approved.² With those changes in mind, the next step is to determine whether those changes are (i) an unanticipated change and (ii) a substantial change in Debtor's financial condition since the Confirmed Plan was approved. The question whether a change is substantial must be assessed vis a vis the financial situation of the Debtor. If the changes in the Debtor's financial situation were both unanticipated and substantial, then the doctrine of res judicata does not apply and the Confirmed Plan may be modified.

The Bankruptcy Court in this matter correctly found that the change in Debtor's financial condition was unanticipated at the time the Confirmed Plan was approved. In this respect, the Fourth Circuit has instructed bankruptcy courts to assess "whether a debtor's altered financial circumstances could have been *reasonably anticipated* at the time of confirmation by the parties seeking modification." *In re Arnold*, 869 F.2d 240, 243 (4th Cir. 1989) (emphasis in original). As discussed above, the Confirmed Plan contemplated that Debtor would surrender his interest in the Gulliver Road property. Yet importantly Debtor retained his interest in the Gulliver Road property, an outcome that was clearly not reasonably anticipated at the time the Confirmed Plan was approved. Thus, Debtor's subsequent refinancing of the mortgage was an unanticipated change in Debtor's financial circumstances.

This does not end the analysis, however, as it remains to be determined whether these changes, (i) Debtor's retention of his interest in the Gulliver Road property and (ii) Debtor's

² The Bankruptcy Court did not specifically identify what changes had occurred in Debtor's financial condition. Importantly, and as discussed below, the Debtor experienced at least two changes in his financial condition after the Confirmed Plan was approved. First, Debtor retained his interest in the Gulliver Road property, which the Confirmed Plan had required Debtor to surrender. Second, Debtor saved \$300 a month in mortgage payments due to a refinancing of his mortgage on the Gulliver Road property. In evaluating the Trustee's motion to modify the Confirmed Plan, the Bankruptcy Court evaluated only the impact of the second change (i.e. the \$300 monthly savings) on Debtor's financial condition, but did not consider the impact of the first change (i.e. Debtor's retention of his interest in the Gulliver Road property) on Debtor's financial condition.

monthly savings of \$300 due to refinancing the mortgage on the Gulliver Road property, amounted to a substantial change in Debtor's financial condition. In this respect, the Bankruptcy Court concluded that the \$300 monthly savings was a substantial change in Debtor's financial situation, but as explained below, this conclusion rested on erroneous legal principles.³ In reaching this conclusion, the Bankruptcy Court remarked that "300 dollars is 300 dollars. 300 dollars over the next four years times, what -- four years times 3,600, that's 12,000 dollars plus. I think that's substantial. That's substantial in my book." September 8, 2021 Hearing Transcript, p. 12. This explanation is no more than an *ipse dixit* and is insufficient to explain why a \$300 monthly savings constituted a substantial change in Debtor's financial circumstances that warranted modification of the Confirmed Plan. The Bankruptcy Court's Order granting the motion to modify contained no reasoning explaining why the \$300 change in the Debtor's monthly cash flow was substantial so as to warrant a modification notwithstanding *res judicata*. Neither the Order nor the hearing transcript indicate that the Bankruptcy Court considered any changes apart from the \$300 monthly savings, in the Debtor's financial position. *See* Dkt. 2-1 at 256. A review of applicable caselaw demonstrates that the Bankruptcy Court's conclusion that the Debtor's \$300 monthly refinancing savings amounted to a substantial change in the Debtor's financial condition was contrary to law, as the \$300 savings, considered in isolation, is not a substantial change to the Debtor's financial condition. Thus, the Bankruptcy Court abused its discretion in concluding otherwise.

The analysis of substantiality properly begins with the Fourth Circuit decision in *In re Murphy*, which, like this case, involved a motion to modify a confirmed Chapter 13 plan after a

³ Entirely missing from the Bankruptcy Court's analysis is consideration of the effect of Debtor retaining his interest in the Gulliver Road property. If Debtor has retained equity in the property that he can now access, his financial condition may have substantially improved.

debtor refinanced a home mortgage. Like the instant case, *Murphy* involved the issue whether a debtor's decision to refinance a home mortgage qualified as a substantial and unanticipated change in the debtor's financial circumstance that would provide a basis for modification of the debtor's confirmed bankruptcy plan. In *Murphy*, the Fourth Circuit held that "[a] debtor's proposal of an early payoff [of a bankruptcy plan] through the refinancing of a mortgage simply does not alter the financial condition of the debtor and, therefore, cannot provide a basis for the modification of a confirmed plan." 474 F.3d at 151

To be sure, the facts of *Murphy* are not an exact match with the instant case. First, the debtor couple in *Murphy* refinanced their home largely due to a decline in income; Debtor in this case has not experienced a decline in their income, and instead sought refinancing solely to take advantage of lower mortgage rates. Second, the refinancing in *Murphy* involved not only a lower interest rate (as occurred here), but also involved a debt-for-equity swap, under which the *Murphy* debtors received a cash payout in exchange assuming a larger mortgage on their home. No such lump sum payout occurred in this case. Notwithstanding these factual distinctions, the Fourth Circuit in *Murphy* commented on the exact issue in this case, explaining that "although the [debtors] obtained a lower interest rate on their new loan, this fact alone did not substantially improve their financial condition..." *Id.* at 150. It clear from *Murphy*, therefore, that the mortgage refinancing in this case, which solely involved a lower interest rate on the refinanced mortgage, did not constitute as a substantial improvement in Debtor's financial condition and thus the Trustee's request to modify the Confirmed Plan should have been barred by the doctrine of res judicata.

A review of caselaw involving motions to modify confirmed bankruptcy plans confirms the conclusion that the Debtor's modest savings from refinancing did not amount to a substantial

improvement in Debtor's financial circumstances.⁴ In *In re Arnold*, the Fourth Circuit held that an increase in the debtor's annual income from \$80,000 at the time of plan confirmation to \$200,000 at the time of modification, a 150% increase in the debtor's income, constituted a substantial increase. *See In re Arnold*, 869 F.3d 240, 241–43 (4th Cir. 1989). Other bankruptcy courts in the Fourth Circuit have interpreted *Arnold* to hold “that increases or decreases in income of approximately 50% are substantial.” *In re Matusak*, 571 B.R. 176, 179–80 (Bankr. E.D.N.C. 2017); *see also In re Swain*, 509 B.R. 22 (Bankr. E.D. Va. 2014 (holding that an increase of nearly 50% in debtor's income was substantial).

Given the fifty percent benchmark suggested by these cases, it is clear that Debtor's \$300 monthly savings in this case does not qualify as substantial to overcome res judicata and modify the Confirmed Plan. The Debtor's income schedule, filed as part of the Confirmed Plan, showed that Debtor had gross monthly earnings of \$12,809. *See* Dkt. 2 at 7–10. A monthly savings of \$300 a month amounts to less than a three percent increase in Debtor's monthly income; this is a modest increase, not a substantial change.

The doctrine of res judicata prevents modifications of the Confirmed Plan unless the Debtor has experienced an unexpected and substantial change to his finances after the plan was confirmed. Here, the \$300 monthly savings that the Debtor experienced, when considered alone, did not amount to a substantial change in the Debtor's finances, and thus res judicata bars modification of the Confirmed Plan. In concluding otherwise, the Bankruptcy Court ignored binding Fourth Circuit precedent and persuasive caselaw, and therefore abused its discretion in granting the Trustee's motion to modify the Confirmed Plan. Thus, the Order granting the

⁴ As another court in this District has observed, “the Fourth Circuit has not defined the term substantial.” *Goodman v. Gorman*, 534 B.R. 656 (E.D. Va. 2015).

Trustee's motion to modify the Confirmed Plan must be vacated.

The conclusion that the Bankruptcy Court abused its discretion does not end the analysis, however, as it appears from the record that Debtor's financial position has changed in two ways since the Confirmed Plan was approved. First, the Debtor has retained his interest in the Gulliver Road property. Second, the Debtor has saved \$300 in monthly mortgage payments as a result of refinancing the mortgage on the Gulliver Road property. The Bankruptcy Court considered the latter change, but did not consider the former. The Confirmed Plan required Debtor to surrender his interest in the Gulliver Road property in order to pay a secured debt to mortgagor Shellpoint Mortgaging Service, *see* Dkt. 2 at 3, but Debtor has since been permitted to retain that interest and refinance the mortgage on that property. It is unclear from the record what effect this change has had on Debtor's financial position. For example, now that Debtor has been permitted to retain his interest in the Gulliver Road property, Debtor may have access to additional equity in that property. It is also unclear whether Debtor is obligated to pay any additional alimony to his ex-wife, as the mortgage payments, which were lowered by \$300 as a result of the refinancing, were classified as alimony-type payments to Debtor's ex-wife under the Confirmed Plan. The record does not explain, and it is therefore unknown, whether Debtor's \$3,700 monthly mortgage payments, which were classified as alimony-type payments, were reduced to \$3,400 monthly payments as a result of the refinancing.

It is therefore appropriate to remand this matter to the Bankruptcy Court to determine in the first instance whether Debtor's financial circumstances have undergone a substantial improvement which warrants modification of the Confirmed Plan to increase the Debtor's monthly plan payments. Although it is clear that the \$300 savings from the mortgage refinancing, when considered in isolation, does not constitute a substantial change in the


Debtor's financial circumstances, it well may be that the effects of changes in the Debtor's financial condition, when considered in the aggregate, constitute a substantial change in the Debtor's financial condition. On remand, the Bankruptcy Court should assess the aggregate effect of these financial changes to determine whether the Debtor has experienced an unanticipated and substantial change in Debtor's financial position which would permit modification of the Confirmed Plan as an exception to the doctrine of res judicata.

Accordingly,

It is hereby **ORDERED** that the Bankruptcy Court's Order granting the Trustee's motion to modify the confirmed Chapter 13 bankruptcy plan is **VACATED**. This matter is **REMANDED** to the Bankruptcy Court for further proceedings consistent with this opinion.

The Clerk of Court is directed to send a copy of this Order to all counsel of record.

Alexandria, Virginia
June 16, 2022



T. S. Ellis, III
United States District Judge