

CHAPTER 7 & 13 POST BAPCPA
CONSUMER CASES

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CONVERSION AND DISMISSAL**I. 11 U.S.C. § 706(a)**

- a. Provides that: “The debtor may convert a case under this chapter to a case under chapter 11, 12, or 13 of this title at any time, if the case has not been converted under section 1112, 1208, or 1307 of this title. Any waiver of the right to convert a case under this subsection is unenforceable.”

Marrama v. Citizens Bank of Massachusetts, 127 S. Ct. 1105 (2007)

The Debtor held real property in the state of Maine. In his bankruptcy schedules, the Debtor misrepresented the value of the real property and concealed the fact that he had recently transferred the property to a trust to protect it from creditors. The Chapter 7 Trustee attempted to recover the property, and the Debtor moved to convert the case to a case under Chapter 13. The Massachusetts Bankruptcy Court denied the conversion motion due to bad faith. The First Circuit Bankruptcy Appellate Panel (BAP) affirmed the Bankruptcy Court, rejecting the argument that the Debtor had an absolute right to convert to Chapter 13 under § 706(a). The BAP also held that the court has the right to dismiss a Chapter 13 case for bad faith, and that a motion to convert to Chapter 13 should be evaluated in the same manner as an initial Chapter 13 petition.

On certiorari, the Supreme Court held that there is an express limitation in § 706(d) that a case may not be converted to a case under another chapter unless the debtor may be a debtor under that chapter. In this case, the Debtor committed bad faith, and had he filed a Chapter 13 petition initially, the court could dismiss the case or convert it to Chapter 7 for cause, including bad faith conduct. The Court held that Congress intended to protect honest debtors from waiving the right to convert, but a Court still may take appropriate action against the bad faith conduct of a debtor who is not entitled to the relief available to a typical debtor. The Court further held that bankruptcy courts have broad discretion to prevent abuse of process, and that discretion is adequate to authorize an immediate denial of conversion.

In re Piccoli, 2007 U.S. Dist. LEXIS 72533, 2007 WL 2822001 (E.D. Pa. 2007)

The Debtor sought to convert her case from Chapter 7 to Chapter 13 after she learned the Trustee intended to liquidate her alleged interest in her residence, which she had transferred to her daughter and son-in-law for little or no consideration 16 months prior to filing her petition.

In Marrama v. Citizens Bank of Massachusetts, 127 S. Ct. 1105 (2007), the Supreme Court held there is no absolute right to convert a Chapter 7 case to Chapter 13, and that bad faith conduct is sufficient to deny conversion. While the court did not expressly identify what conduct qualifies as bad faith, the court emphasized that the debtor’s conduct must, in fact, be atypical. The good faith analysis is performed case-by-case based upon the totality of the circumstances.

In assessing the totality of the circumstances, the *Piccoli* court considered:

- a) whether the debtor is seeking to convert to Chapter 13 in good faith (including a review of facts such as the timing of the motion to convert; the debtor’s motive in filing the motion; and whether the debtor has been forthcoming with the bankruptcy court and creditors);
- b) whether the debtor can propose a confirmable Chapter 13 plan;
- c) the impact on the debtor of denying conversion weighed against the prejudice to creditors caused by allowing conversion;
- d) the effect of conversion on the efficient administration of the bankruptcy estate; and
- e) whether conversion would further an abuse of the bankruptcy process. In re Pakuris, 262 B.R. 330 at 335-36 (Bankr. E.D. Pa. 2001).

The good faith inquiry is a fact-intensive determination better left to the discretion of the bankruptcy court. The same good faith analysis performed when evaluating dismissal of a Chapter 13 case should be performed when evaluating conversion of a case from Chapter 7 to Chapter 13.

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In this case, the court found the Debtor's behavior "atypical," and not consistent with that of an "honest but unfortunate debtor." Her timing and lack of consideration for the transfer of ownership, her understatement of debt during settlement negotiations, and her acknowledgment that a Chapter 13 trustee was less likely to pursue the fraudulent conveyance to her family, all supported the finding that the Debtor sought to avoid the consequences of Chapter 7 by converting to Chapter 13.

Condon v. Brady (In re Condon), 358 B.R. 317 (6th. Cir. 2007)

Bankruptcy courts apply the same good faith standard whether evaluating conversion from Chapter 7 to Chapter 13 or dismissal under § 1307(c). Courts exhibit the same reluctance to deny a motion to convert as encountered when reviewing a petition for lack of good faith for the purpose of dismissal. In this case, the Debtor, a professional photographer, sought conversion to Chapter 13 primarily to discharge potential tort liability in a pending class action, which resulted from photographs of dead bodies in the county coroner's office.

The court considered these twelve factors (first iterated in In re Kull, 12 B.R. 654 (Bankr. S.D. Ga. 1981)) in determining whether the motion to convert the case from Chapter 7 to Chapter 13 had been filed in good faith:

- a) the debtor's income;
- b) the debtor's living expenses;
- c) the debtor's attorney's fees;
- d) the expected duration of the Chapter 13 plan;
- e) the sincerity with which the debtor has petitioned for relief under Chapter 13;
- f) the debtor's potential for future earning;
- g) any special circumstances, such as unusually high medical expenses;
- h) the frequency with which the debtor has sought relief before in bankruptcy;
- i) the circumstances under which the debt was incurred;
- j) the amount of payment offered by the debtor as indicative of the debtor's sincerity to repay the debt;
- k) the burden which administration would place on the trustee; and
- l) the statutorily mandated policy that bankruptcy provisions be construed liberally in favor of the debtor.

Finally, the court considers the debtor's motive in seeking conversion. This case was remanded for further consideration based on the appropriate good faith factors.

In re George Love Farming, LC, 366 B.R. 170 (Bankr. N.D. Utah 2007)

The Debtor was one of five entities operated by Mr. Love which were substantively consolidated in a separate Chapter 11 case. While the Chapter 11 case was still pending, the Debtor commenced this Chapter 7 case, and then sought to convert it to Chapter 11. The U.S. Trustee, the Chapter 7 Trustee, and two secured creditors objected, arguing that the Debtor was attempting to convert the case in bad faith.

Courts in the Tenth Circuit review the following factors (first discussed in In re Little Creek Dev. Co., 779 F.2d 1068 (5th Cir. 1986)) when considering conversion to Chapter 11 or dismissal of a Chapter 7 case due to bad faith:

- a) whether the debtor has one asset;
- b) whether the debtor's pre-petition conduct has been improper;
- c) whether there are only a few unsecured creditors;
- d) whether the debtor's property has been posted for foreclosure, and the debtor has been unsuccessful in defending against the foreclosure in state court;
- e) whether the debtor and one creditor have proceeded to a standstill in a prior forum, and the debtor has lost;
- f) whether the filing of the petition effectively allows the debtor to evade court orders;
- g) whether the debtor has no ongoing business or employees; and

- h) whether there is a lack of possibility for reorganization.

The court applied these factors, and in addition considered the Debtor's motivation and sincerity, a ninth factor, which led to the conclusion that the Debtor acted in bad faith.

The court found that the Debtor had manipulated the provisions of the Bankruptcy Code and hindered the rights of secured creditors in an effort to retain its farming property at any cost. Further, the court did not believe the Debtor was likely to be successful in another Chapter 11 case when it was unsuccessful in the former Chapter 11 case with the same principal.

In re Murray, 377 B.R. 464 (Bankr. E.D. Del. 2007) relies of *Marrama* in upholding conversion from Chapter 7 to Chapter 13, and **In re Broad Creek Edgewater, LP, 371 B.R. 752 (Bankr. S. Car. 2007)** relies on *Marrama* in denying conversion from Chapter 7 to Chapter 11.

II. Section 707(b)(3): Dismissal

- A. The amended §707(b)(3) allows the court to review “the totality of the circumstances” when considering a motion to dismiss.
- i. While the phrase “totality of the circumstances” is new to §707(b)(3), the courts have developed an extensive body of case law while using the phrase in other contexts;
 - ii. In *In re Krohn*, 886 F.2d 123 (6th Cir. 1989), the Krohn Court set forth various factors to be considered in evaluating the “totality of the circumstances”:
 1. the ability to repay the debts from future earnings;
 2. whether the debtor has stable sources of income;
 3. whether the debtor is eligible for Chapter 13;
 4. whether the debt has state remedies available to ease his financial predicament,
 5. the degree of relief obtainable through private negotiations with the creditors;
 6. whether the debtors' expenses can be reduced significantly without depriving the debtor of the basic necessities.

In re Zaporski, Case No. 06-51617 (Bankr. E.D. Mich. April 2007)

In deciding to grant the United States Trustee Motion to Dismiss pursuant to §707(b)(3) and the “totality of the circumstances”, the court evaluated the factors outlined in *In re Krohn*. The debtor argued that his ability to pay should not be considered as the means test is the exclusive factor in determining if he has the ability to repay his creditors. The court found that the amended §707(b)(3), “instructs the court to consider the totality of circumstances ‘of the debtor’s financial situation. This plain language is broad enough to encompass, indeed require, consideration of those facts that are probative of a debtor’s ability to repay his or her creditors.”

See also, *In re Goble*, 2009 Bankr. LEXIS 227 (Bankr. S.D.Ohio 2009); *In re Calhoun*, 396 B.R. 270, 2008 Bankr. LEXIS 3134 (Bankr. S.C. 2008); *In re Parada*, 391 B.R. 492, 2008 WL 126626 (Bankr. S.D.Fla. 2008); *In re Pak*, 343 B.R. 239 (Bankr. N.D.Cal. 2006); *In re Simmons*, 357 B.R. 480 (Bankr. N.D.Ohio 2006)

In re James, 345 B.R. 664 (Bankr. N.D. Iowa 2006)

The Debtor, shortly before filing bankruptcy, received large bonuses from work. Knowing he would file bankruptcy, the Debtor used his bonuses to treat himself with frivolous purchases. The Debtor testified that instead of paying on his debts, he chose to enjoy the bonus money as a reward. The court held that this was abuse under § 707(b)(3) using the bad faith and totality of circumstances tests, as the Debtor could have used the bonuses to pay down his \$24,165.22 in unsecured debts.

The court noted that at the time the Debtor received his bonuses, his finances were not beyond repair, but he made them so by being recklessly wasteful, at the expense of his creditors. The court concluded that spending significant cash assets on unnecessary luxury items with the intent to file bankruptcy and discharge existing indebtedness was bad faith within the meaning of 11 U.S.C § 707(b). The court ruled that the Debtor must convert the case to Chapter 13 to avoid dismissal.

In re Pak, 343 B.R. 239 (Bankr. N.D. Cal. 2006)

A Chapter 7 case filed by an individual debtor with primarily consumer debts must be dismissed if the court finds that the filing was an abuse of the Bankruptcy Code. Under the means test of § 707(b)(1), there is a rebuttable presumption of abuse. In this case, the Debtor was unemployed during the six months prior to filing for bankruptcy and had below-median income, thus passing the means test. However, a case also can be dismissed under §707(b)(3) based on bad faith or the totality of the debtor's circumstances. The U.S. Trustee argued that while there was no bad faith, the Debtor became employed and began to earn over \$100,000 annually.

The court held that the Chapter 7 filing was an "abuse." The debtor's actual ability to repay his debts is to be considered in the "totality of the circumstances" test. The court examined the provisions of Chapter 13 to analyze the Debtor's ability to repay his debts. Following the reasoning in *In re Jass, 340 B.R. 411 (Bankr. D. Utah 2006)*, the court looked at the Debtor's "actual and anticipated future income" and not just "current monthly income" to determine his ability to repay. After expenses, the Debtor's projected disposable income was \$1,117.20 per month, which would repay only 19% of his unsecured debt in a Chapter 13 case. The court held that although 19% was a small percentage payment, the total dollar amount repaid in a Chapter 13 case would be high. In addition, the court held that the Debtor's expenses were excessive, and ruled that the case must be dismissed or converted to Chapter 13.

The Debtor subsequently converted the case to Chapter 13, and appealed the denial of confirmation the Chapter 13 plan in *Pak v. eCast Settlement Corp. (In re Pak), 378 B.R. 257 (9th. Cir. BAP 2007)*. The Bankruptcy Appellate Panel affirmed the denial of confirmation because the Chapter 13 plan did not provide that all of the Debtor's "projected disposable income to be received in the applicable commitment period" would be applied to make payments to unsecured creditors, as required by 11 U.S.C § 1325(b)(1)(B).

In re Toney, 2007 Bankr. LEXIS 2889 (Bankr. D. Ohio 2007)

Prior to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCA), a Court could dismiss a case for "substantial abuse" based on the "totality of the circumstances." Under BAPCA, a court shall determine whether granting relief would be abuse by considering whether the petition was filed in bad faith or by evaluating the totality of the circumstances of a debtor's finances. 11 U.S.C. § 707(b). Congress lowered the standard for dismissal from "substantial abuse" to "abuse." A court may consider the pre-petition and post-petition circumstances when using the totality of circumstances test to find abuse.

The Court considered changes in the debtor's financial situation after the filing of amended schedules. The Court found that purchasing a new vehicle so the family could have one reliable vehicle was not unreasonable. Further, with only \$68 left at the end of the month, the debtor could only pay 3% of the unsecured claims. In light of these conditions, dismissal was not proper and the Court granted the Debtor relief under Chapter 7 of the Bankruptcy Code.

Haney v. Clippard, 2007 U.S. Dist. LEXIS 17295 (W.D. Ky. 2007)

The court echoed the Sixth Circuit stating that “a court should ascertain from the totality of the circumstances whether [a debtor] is merely seeking an advantage over his creditors, or instead is “honest,” in the sense that his relationship with his creditors has been marked by essentially honorable and undeceptive dealings, and whether he is “needy” in the sense that his financial predicament warrants the discharge of his debts in exchange for liquidation of his assets.” *In re Behlke*, 358 F.3d 429, 433 (6th Cir. 2004) (quoting from *In re Krohn*, 886 F.2d 123, 126 (6th Cir. 1989)). A debtor’s need is determined by her ability to repay her debts, and that analysis may include the consideration of the stability of her source of future income, including the income of a non-filing spouse. *In re Wilkinson*, 168 B.R. 626 (N.D. Ohio 1994); *In re Deandria Smith*, 157 B.R. 348 (N.D. Ohio 1993). The court held that it will reverse a finding of abuse only if the bankruptcy court committed a clear error in judgment. In this case, the district court agreed with the bankruptcy court based on evidence of the Debtor's lack of candor in her sworn statements and testimony, and the significant financial resources of her non-filing husband with whom she shared both income and expenses. In short, the Debtor lacked honesty and need.

In re Campbell, 2007 Bankr. LEXIS 4159 (Bankr. N.D. W. Va. 2007)

On April 10, 2007, the Debtor filed a Chapter 13 petition. Before the Chapter 13 plan could be confirmed, the Debtor found a purchaser for real property. Instead of selling the real property through the Chapter 13 case, the Debtor on August 29, 2007, filed a motion to voluntarily dismiss the case. On August 31, 2007, the Debtor sold the real property to a third-party purchaser. A creditor had a prior agreement with the Debtor to purchase the real property, and sought to set aside the sale because it occurred before the court entered an order of dismissal, and did not comply with 11 U.S.C. §363(b) and (f).

The court held that a debtor’s right to voluntarily dismiss a Chapter 13 case under 11 U.S.C. §1307(b) is absolute and is not conditioned by §1307(c), which allows other parties in interest to request conversion to Chapter 7 for cause. *Barbieri v. RAJ Acquisition Corp. (In re Barbieri)*, 199 F.3d 616, 619-622 (2d. Cir. 1999). Although creditors cannot compel conversion of a Chapter 13 case to one under Chapter 7, they are entitled to request that a Chapter 13 debtor’s motion to dismiss be conditioned upon “cause” pursuant to 11 U.S.C. § 349. For example, §349 may be invoked to prohibit the debtor from filing future cases to allow creditors time to pursue non-bankruptcy remedies against the debtor. Before a court may condition the dismissal of a case under § 349, some evidence of bad faith and prejudice to creditors must be present, and the debtor should be given notice and the opportunity for a hearing. The district court overruled the creditor’s objection to the motion to dismiss and denied the motion to set aside the sale.

Smith v. Geltzer, 507 F.3d 64 (2d. Cir. 2007)

The principal asset of the Chapter 7 estate was a personal injury action. The Debtor sought to pay all her debts in full (with a loan) and dismiss her petition, retaining special counsel to prosecute the personal injury action. The special counsel attempted several times to circumvent the requirements of the Bankruptcy Code and was cited for contempt. The bankruptcy court denied the motion to dismiss and, upon the request of the Trustee, ordered removal of her chosen special counsel.

Under § 707(a), a debtor has no absolute right to dismiss a Chapter 7 case. Rather, a debtor seeking dismissal must show “cause.” When, as in this case, a debtor moves for dismissal, courts in the Second Circuit have determined whether cause exists by examining “whether dismissal would be in the best interest of all parties in interest.” The best interest of the debtor “lies generally in securing an effective fresh start upon discharge and in the reduction of administrative expenses leaving him with resources to work out his debts.”

The circuit court affirmed the removal of the attorney as special counsel, because the special counsel ultimately works for the Trustee, and interference with the Trustee’s discretion is only warranted in “the rarest of cases.” However, the record was insufficiently developed to support denial of the Debtor’s motion to dismiss, and the court remanded the case for further proceedings on that issue.

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Reaffirmation Agreements

I. Reaffirmation Agreements Generally

- a. Section 524 as amended requires compliance with of §524(c), which was largely left unaltered. §524(c) provides the general requirements that must be met for a reaffirmation agreement to be enforceable.
 - i. §524(c)(1): the Reaffirmation Agreement must be made prior to discharge

The plain language of U.S.C. §524 (c)(1) provides that in order for a reaffirmation agreement to be valid, it must be made before the granting of discharge. There is a debate among the courts as to if “made” refers to entering into the agreements and signing the document or actually filing the document with the Court.
- b. Section 524(c)(2): the debtor received the disclosures described in subsection §524(k) at or before the time at which the debtor signed the agreement
 - i. §524(c)(2) prior to BAPCPA mandated the disclosures for reaffirmation agreements.
 - ii. Under §524(c), the question remains whether, a debtor not represented by counsel throughout the negotiation of a reaffirmation agreement at the time it was entered into had the advantage of an arms length negotiation of the agreement.
- c. Section 524(c)(3): Reaffirmation Agreement must have been filed with the court and, accompanied by a declaration or an affidavit of the attorney that represented the debtor during the course of negotiating an agreement under this subsection, which states that (a) such agreement represents a fully informed and voluntary agreement by the debtor; (b) such agreement does not impose an undue hardship on the debtor or a dependent of the debtor; and (c) the attorney fully advised the debtor of the legal effect and consequences of (i) an agreement of the kind specified in this subsection; and (ii) any default under such an agreement;
 - i. §524(c)(3) requires debtor’s attorney to certify that the agreement does not impose an undue hardship on the debtor and that the debtor is fully advised of the legal consequences of the agreement for the reaffirmation agreement for be enforceable.
- d. Section 524(c)(4): the debtor has not rescinded such agreement at any time prior to discharge or within sixty days after such agreement is filed with the court, whichever occurs later, by giving notice of rescission to the holder of such claim
 - i. §524(c) gives a debtor the right to rescind a reaffirmation agreement prior to discharge or within sixty days after filing the agreement, whichever is later.
- e. Section 524(c)(5): Requires compliance with subsection (d)
- f. Section 524(c)(6): (A) in a case concerning an individual who was not represented by an attorney during the course of negotiating an agreement under this subsection, the court approves such agreement as

- i. not imposing an undue hardship on the debtor or a dependent of the debtor; and
- ii. in the best interest of the debtor.
 (B) Subparagraph (A) shall not apply to the extent that such debt is a consumer debt secured by real property.

II. Agreement Must Be Made Prior To Discharge

- a. For a reaffirmation agreement to be enforceable, §524(d) provides that if the debtor is not represented by counsel during the negotiation of the agreement, the court must hold a discharge hearing.
- b. In *In re Cottrill*, 2007 Bankr. LEXIS 2009 (N.D. W.V 2007) the debtors filed statement of intention reflecting their intent to reaffirm the debt; however, they failed to execute a reaffirmation agreement. Subsequent to entry of their discharge, the debtors sought to file a reaffirmation agreement. The debtors suggested that §524(c) is subject to waiver since they agreed to reaffirm the debts prior to discharge or in the alternative, set aside the discharge so that the agreement could be filed. The court found that pursuant to 28 U.S.C. §1334(b), it no longer had jurisdiction over the matter. The court went on to state that the untimely filed reaffirmation agreement and the request to waive §524(c)(1) do not “arises under”, “arises in” and is not “related to” the debtor’s bankruptcy proceeding. §524(c)(1) creates strict time requirements for filing reaffirmation agreements. Failure to abide by §524(a)(1) renders §524(c) inapplicable to the proceeding. A reaffirmation agreement is valid only if all elements of the statute are satisfied and they cannot be waived or extended after discharge otherwise §524(c)(1) would not protect a debtor from bad judgment or making ill-advised decisions after the debt has been discharged.

See also:

- a. In *In re Herrera*, 18 CBN 271 (Bankr. W.D. Tex 2007) Judge Leif M. Clark ruled that the deadline for entering into a reaffirmation agreement is a hard deadline that cannot be altered even by setting aside the discharge;
- b. In *In re Young* 2007 Bankr. LEXIS 2007 (Bankr. S.D. CA 2007) the court determined that after a discharge has been granted the court no longer has power to validate a reaffirmation agreement;
- c. In *In re Stewart* 2006 Bankr. LEXIS 2959 (Bankr. N.D. Ohio 2006) the court decided that the discharge cannot be set aside for the purpose of filing a reaffirmation agreement entered into after discharge;
- d. In *In re Carrillo*, 2007 Bankr. LEXIS 2786 (Bankr. Utah 2007), the Court held that the debtor must enter into reaffirmation agreement prior to discharge; once discharge has been granted, it cannot be set aside for the entry of a reaffirmation agreement;
- e. In *In re Wilhelm*, 369 B.R. 882, (Bankr. M. D. N. C. 2007); the court held that a reaffirmation agreement must be made prior to the entry of the order of discharge to be enforceable and that an agreement entered into after the granting of a debtor's discharge have no legal significance.

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III. Mandatory Disclosures

- a. §524(k)(2) states that the “disclosures made shall be made clearly and conspicuously and in writing.” It further provides that the terms “Amount Reaffirmed” and “Annual Percentage Rate” shall be disclosed more conspicuously than other terms. The requisite disclosure must also contain language that states “before agreeing to reaffirm a debt, review these important disclosures.”
- b. Under Summary of Reaffirmation Agreement, the agreement must state “this summary is made pursuant to the requirements of the Bankruptcy Code.”
- c. §524(k)(3) requires that Reaffirmation Agreements:
 - i. Outline the rights of the debtor;
 - ii. Specify the amount of the debt being reaffirmed;
 1. The agreement must contain the term “amount reaffirmed” and must state “this amount is the total amount of the debt you have agreed to reaffirm by entering into this agreement . . . your credit agreement may obligate you to pay additional amounts which may come due after the date of this disclosure. Consult your credit agreement.”
 - iii. Specify additional charges or costs imposed upon the debtor;
 - iv. Specify the annual percentage rate, and simple interest rate. As stated previously, this term must be more conspicuous than the other terms of the agreement;
 - v. Provide a statement of the repayment schedule, if elected by the creditor;
 - vi. Provide a description of the property to which the lien is attached in the case of a secured debt;
 - vii. Specify the original purchase price of the items;
 - viii. Provide a statement that the debtor has the right to consult an attorney;
 - ix. Provide a statement that the reaffirmation agreement must be filed with the court before it becomes effective;
 - x. Provide a statement that the debtor has the right to rescind the reaffirmation within 60 days of filing.

In re Reardon, 2006 Bankr. LEXIS 1238 (Bankr. D. N.H., 2006)

The debtor signed a reaffirmation agreement; however, the agreement did not comply with §524(k)(3) because it failed to identify the creditor to whom notice of rescission should be given or any address to which the debtor should mail such notice. Additionally, the court held that the agreement was invalid as the agreement was not “accompanied by the best available evidence of the claim and, as appropriate, copies of the underlying contractual agreement” as set forth in a local Administrative Order. The Installment Contract was attached to the reaffirmation agreement; however, that contract was not an agreement between the debtor and the lienholder but between the debtor and the dealer. The court held that there was not enough evidence supporting any claim or agreement between the parties. The court held that the agreement was improperly completed and “too vague,

uncertain, and contradictory to constitute an enforceable agreement.” The court disapproved the reaffirmation agreement.

In re Lee, 2006 Bankr. LEXIS 2895

The debtor signed a reaffirmation agreement to reaffirm a debt secured by a motor vehicle. The reaffirmation agreement consisted of two pages that failed to disclose the amount reaffirmed and annual percentage rate more conspicuously than the other terms as required by §524(k)(3)(A). The agreement also failed to contain a summary of the reaffirmation agreement as required by §524(k)(3)(B) as well as the total fees and costs accrued as of the date of the disclosure pursuant to §524(k)(3)(C). The court deemed the reaffirmation agreement unenforceable and “pervasively defective”. The court acknowledged that the debtor may have entered into the reaffirmation agreement even if they were aware of all necessary disclosures.

In re Quintero, 2006 Bankr. LEXIS 906 (N.D.Cal., 2006)

The court refused to approve the reaffirmation agreement as the creditor failed to include the required disclosures and as a result of the creditor’s error, the Court ruled that the creditor was not permitted to repossess car.

In re Donald, 343 B.R. 524 (Bankr. E.D. N.C., 2006)

The court denied the request to approve the reaffirmation agreement as the agreement did not contain all of the required disclosures and some of the disclosures contained in the agreement were incorrect or misleading.

In re Simonin, 360 B.R. 627, 2006 Bankr. LEXIS 3986

The Creditor drafted a reaffirmation agreement that erroneously listed the amount that the debtors were to reaffirm as \$12,000.00 less than the actual amount owed. The agreement was signed by all parties and was filed with the court. After discovering the discrepancy, the creditor sought to rescind the agreement. The court allowed the rescission of the agreement as the discrepancy in the amount owed was so great that it would not normally exist in the absence of a mistake.

VI. Certification of Debtor’s Attorney

- a. §524(k)(5)(A) requires the debtor’s attorney to certify the following in reaffirmation agreements:
 - i. He/she is the attorney for the Debtor and represented this Debtor during the course of negotiating this Reaffirmation Agreement;
 - ii. That the agreement represents a fully informed and voluntary agreement by the Debtor and does not impose an undue hardship on the Debtor or any dependent of the Debtor;
 - iii. He/She has fully advised the Debtor of the legal effect and consequences of this Reaffirmation Agreement including but not limited to a default under such agreement.
- b. §524(k)(5)(B)
 - i. If a presumption of undue hardship has been established the certification shall state that in the opinion of the attorney the debtor is able to make the payment

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1. The presumption can be avoided if schedules I and J and the debtors Statement in Support of the Reaffirmation Agreement clearly displays the debtors ability to make the payments required in the reaffirmation agreement;
- ii. Must also include signature of Debtor's attorney and the date signed

In re Mendoza, 2006 Bankr. Lexis 1698 W.D. TX 2006

Debtor's counsel executed the declaration portion of the reaffirmation agreement; however, the attorney failed to check the box certifying that he had made the requisite disclosures to the client; specifically, that the agreement does not represent an undue hardship, the agreement was voluntary on the part of the debtors or the box stating that even though the agreement is an undue hardship, the attorney is of the opinion that the debtor can make the monthly payments required under the agreement. The court found that even though the attorney signed the reaffirmation agreement, the failure to properly certify that the required disclosures were made caused the reaffirmation agreement to be declared invalid.

In re Isom, 2007 WL 2110318 (Bankr. E.D. of VA)

The Debtor was represented by counsel during her chapter 7 bankruptcy case; however, debtor's counsel refused to execute an affidavit or declaration to accompany the reaffirmation agreement. The court held that without the attorney's certification the reaffirmation agreement was unenforceable. The court noted that reaffirmation agreements are an integral part of a Chapter 7 case and debtor's counsel cannot abandon the client for that portion of the case.

In re Minardi, __ B.R. __, 2009 WL 210718 (Bankr. N.D. Okla. Jan. 23, 2009)

The court ruled that, if the debtor was represented by counsel during the course of the Chapter 7 case, the attorney must execute the reaffirmation agreement for the agreement to be valid. The court noted that it would not recognize efforts by the debtor's bar to exclude reaffirmation agreements from the services provided.

In re Smith, Case No 07-109 (Bankr. S.D. Ohio)

The court found that Debtor's counsel acted properly by not executing the reaffirmation agreement, where counsel believed the agreement would cause the debtor to suffer an undue hardship. The court found that it is debtor's counsel's duty to fully inform the debtor of the consequences of reaffirming a debt; however, if debtor's counsel chooses not to sign Part C when an undue hardship exists, the court will review the agreement and determine if debtor's counsel's presence is necessary.

In In re Jackson, 360 B.R. 32, (Bankr. Conn. 2007)

The court approved the reaffirmation agreement of a pro se debtor who stated to the court that she fully understood the consequences of entering into the reaffirmation agreement and that she wanted to retain the vehicle. The court determined that the agreement did not impose an undue hardship on the debtor or her dependents.

In re Stevens, 343 B.R. 524, (Bankr. E.D. N.C. 2006)

The debtor was not represented by counsel during negotiations of the reaffirmation agreement. The court, after reviewing the reaffirmation agreement and conducting a hearing, approved the reaffirmation agreement in which debtor's counsel failed to file an attorney certification and the debtor did not file a motion to approve the agreement. The court found that the reaffirmation agreement did not impose an undue hardship on the debtor.

V. Debtor’s Statement in Support of the Reaffirmation Agreement

a. §524(k)(6)(A) requires the following statement by the debtor:

I believe this reaffirmation agreement is in my best interest and will not impose an undue hardship on my dependents or me. I can afford to make the payments on the reaffirmed debt because my monthly income (take home pay plus any other income received is \$_____, and my actual current monthly expenses including monthly payments on post-bankruptcy debt and other reaffirmation agreements total \$_____, leaving \$_____ to make the required payments on this reaffirmed debt. I understand that if my income less my monthly expenses does not leave enough to make the payments, this reaffirmation agreement is presumed to be an undue hardship and must be reviewed by the court. However, this presumption may be overcome if I explain to the satisfaction of the court how I can afford to make payments here:

I received a copy of the Reaffirmation Disclosure Statement in Part A and a completed and signed reaffirmation agreement.

b. If the debtor is not represented by an attorney, in the negotiation of the reaffirmation agreement 524(k)(7) requires that the debtor file a Motion for Court Approval.

c. The Motion must state:

I am not represented by an attorney in connection with this reaffirmation agreement.

I believe this reaffirmation agreement is in my best interest based on the income and expenses I have disclosed in my Statement of Support of this affirmation agreement.

Therefore, I ask the court for an order approving this reaffirmation agreement.

d. If the Court grants the debtor’s motion and approves the reaffirmation agreement, the court order must state the following:

The Court grants the debtor’s motion and approves the reaffirmation agreement described above.

- e. §524(l) states that “notwithstanding any other provision of this title, the following shall apply:”
- i. A creditor may accept payments from the debtor before and after the filing of an agreement of the kind specified in subsection (c) with the court;
 - ii. A creditor may accept payments from a debtor under such agreement that the creditor believes in good faith to be effective;
 - iii. The requirements in subsections (c)(2) and (k) shall be satisfied if the disclosures required under those subsections are given in good faith.

VI. Presumption of Undue Hardship

a. Pursuant to §524(m)(1), a reaffirmation agreement is presumed to be an undue hardship on the debtor, until 60 days after it is filed with the court, if the debtor’s monthly income less the

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debtor's monthly expenses as shown on the debtor's Statement in Support of the agreement is less than the scheduled payments on the reaffirmed debt.

- b. This presumption may be rebutted in writing by the debtor if the debtor's statement contains an explanation that identifies additional sources of funds to make the scheduled reaffirmation payments.
- c. If the presumption is not rebutted to the court's satisfaction, then the court *may* disapprove the reaffirmation agreement.
- d. However, no reaffirmation agreement will be disapproved without notice and a hearing and this section mandates the conclusion of this hearing before the entry of the debtor's discharge.

In re Payton, 338 B.R. 899 (Bankr. D. N.M., 2006)

The court held that there is a presumption of undue hardship if the monthly income and expenses listed in the reaffirmation agreement indicate a deficit and the inability to make the reaffirmation payments. The debtor may rebut the presumption through other sources or additional income.

The court held that it is not required to rely solely on the expenses and income listed in the Debtor's Statement in Support of the reaffirmation agreement in deciding whether to approve or disapprove the agreement.

In re Laynas, 345 B.R. 505 (Bankr. E.D. Penn., 2006)

In this case, the debtor's Schedules I and J indicated different numbers from those in the debtor's Statement in Support of the Reaffirmation Agreement. According to the schedules, the debtor could not afford the payment; however, the amounts as shown in the Statement in Support of the Reaffirmation Agreement indicated the Debtor could afford the payment.

Even though the numbers in the debtor's Statement did not create the presumption of undue hardship, the court evaluated the accuracy of the information in the debtor's Statement by reviewing other indicators of financial condition. The debtor did not provide an explanation for the differences between the debtor's Statement in Support of the Reaffirmation Agreement and the schedules. The court found that courts should also consider other factors regarding "the debtor's best interest", such as whether the debtor needs the vehicle or whether the debtor would actually lose the vehicle without the agreement (ride through). The court disapproved the agreement.

In re Mendoza, 2006 Bankr. LEXIS 1698 (Bankr. W.D. Texas, 2006)

The court determined that the presumption of undue hardship existed as the debtors did not file the required Statement in Support of Reaffirmation Agreement

In re Stillwell, 2006 Bankr. LEXIS 1847 (Bankr. N.D. Okla., 2006)

The court found that a presumption of an undue hardship arose when the debtors' schedules indicated they could not afford the reaffirmation agreement payments, even though the debtors speculated that overtime would allow them to make the payments.

In re Riggs, 2006 Bankr. LEXIS 2732 (W.D. Missouri, 2006)

The court declined to approve a reaffirmation agreement when the debtor would take two years to repay a loan on an older model vehicle that may not continue to run.

In re Wilson, 2007 Bankr. LEXIS 817 (D. N.M., 2007)

Pursuant to § 524(k), the court only needs to review the Statement in Support of the Reaffirmation Agreement to determine if there is an undue hardship; that the Schedules I and J contain numbers different from Part D is irrelevant.

In re Reihart, Case No. 06-00497, (M.D. of Penn, 2006)

The amounts listed in the Statement in Support of the Reaffirmation Agreement differed from Schedules I and J significantly and the difference was unexplained. The Court disregarded the Statement in Support of the Reaffirmation Agreement and examined Schedules I and J. The Court scheduled a hearing to allow the debtor the opportunity to explain the difference between Part D and Schedules I and J.

Fed.R.Bankr.P. 4008

- a. In December 2008, the amended Rule 4008 became effective. As amended, Rule 4008 requires that a reaffirmation agreement be filed with the court within 60 days from the date first set for the 341 meeting;
- b. The court can, at any time, extend this deadline.
- c. Rule 4008, also mandates that the debtor's Statement in Support of the Reaffirmation Agreement, be accompanied by a 4008 Statement of Comparison, which compares the income and expenses as shown on schedules I and J with the amounts listed in the Statement in Support of the Reaffirmation Agreement.
- d. The 4008 Statement of Comparison also needs to explain why the amounts listed in the Statement in Support of the Reaffirmation Agreement are different than those as stated in the schedules.

REDEMPTION

I. Amendments Affecting Redemption

- a. The provision governing redemption is §722. Prior to the 2005 amendments, it provided that:
 - i. An individual debtor may, whether or not the debtor has waived the right to redeem under this section, redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under Section 522 of this title or has been abandoned under section 554 of this title, by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien.
- b. There was a dispute as to whether the redemption amount could be paid in installments. The minority of courts allowed the debtor to redeem in installments.
 - i. The Court in *In re Bell* noted that the bankruptcy court's inability to monitor the installment payments and to expeditiously and meaningfully enforce the installment redemption raises serious issues of adequate creditor protection and prohibited installment redemption.¹
 - ii. In *In re Schweitzer*, the Court stated that Congress was well aware that the typical debtor may not be financially able to afford a lump sum redemption. However, the Court also noted that the reaffirmation process was available to such debtors who sought to make installment payments. The Court further acknowledged that reaffirmation alternative may be imperfect, but that the "deficiencies are more properly direct to Congressional review, and consequently, provide a poor excuse for judicial legislation."²
- c. §722 as amended explicitly requires that the redemption amount be paid in full at the time the property is redeemed. As amended, §722 states:

"an individual debtor may, whether or not the debtor has waived the right to redeem under this section, redeem tangible personal property intended primarily for personal, family, or household use, from a lien securing a dischargeable consumer debt, if such property is exempted under §522 of this title or has been abandoned under §554 of this title, by paying the holder of such lien the amount of the allowed secured claim of such holder that is secured by such lien *in full at the time of redemption.*"
- d. Federal Rule of Bankruptcy Procedure 6008 still applies and the issues raised in *Sears, Roebuck & Co. v. Spivey*,³ and *In re White*⁴ have been left unresolved by the amendments to §722.

1 700 F.2d 1053 (6th Cir. 1983).

2 19 B.R. 860 (Bankr. E.D. N.Y. 1982); *In re Clark*, 10 B.R. 605 (Bankr. C.D. Ill. 1981); *In re Miller*, 4 B.R. 305 (Bankr. E.D. Mich. 1980); *In re Cruseturner*, 8 B.R. 581 (Bankr. D. Utah 1981).

3 265 B.R. 357 (E.D. N.Y. 2001).

4 231 B.R. 551 (D. Vt. 1999).

II. Amendments Affecting the Valuation of Collateral

- a. A dispute existed relating to the valuation of secured property and resulted in division among jurisdictions as to how value was to be determined in a §722 redemption context.
- b. To emphasize the division, statutory interpretation by the U.S. Bankruptcy Court for the Northern District of Illinois resulted in 3 different methods of determining value (average trade in value, replacement value and the mid-point between wholesale and retail value).⁵
 - i. The Northern District of Illinois in *In re Triplett* relied on legislative history and case law in concluding that the debtor had to pay the creditor the value of the collateral, not the balance due on the contract, in order to redeem.⁶
 - ii. Several years later, the Northern District of Illinois ruled in *In re Smith* that replacement value applies in the context of a Chapter 7 redemption.⁷
 - iii. In 2004, the same year as the Court's decision in *In re Smith*, the same Court held that the mid-point value was appropriate and noted that "the valuation issue cannot be resolved by resorting to either the statutory text of 722 or its legislative history."⁸
- c. The most extreme valuation standard was established in *In re Donley*. The Bankruptcy Court in the Southern District of Ohio found that the replacement value standard is not appropriate in chapter 7 cases because such a standard does not reflect the purpose of the valuation and the proposed disposition or use of such property.⁹ The *Donley Court* noted that the legislative history of §722 does not support the replacement value standard. The Court held that the appropriate valuation standard should be that which the creditor would receive if the redemption did not occur and it were forced to repossess and sell the property, which in this case, consisted of two mobile homes. The Court further held that the agreed upon appraised value of \$10,000 for the mobile homes was irrelevant because such value assumed that the trailers would remain in place. The Court noted that, under a repossession and resale of the property, this assumption would be false. In concluding that the debtor could redeem the mobile homes for \$1,250, the Court noted that extensive repairs would be needed after the mobile homes were removed from the property and that a purchaser would not be expected to offer much money for the mobile homes.¹⁰
- d. §506 as amended provides that the value for redemption shall be the replacement value without deducting for the costs of sale or marketing.¹¹ This amendment adopted the Supreme Court's holding in *Rash*.¹²
- e. §506(a)(2) further clarifies the valuation standard by defining the replacement value as the "price a retail merchant would charge for property of that kind considering the age and condition of the property at the time the value is determined."

5 *In re Triplett*, 256 B.R. 594 (Bankr. N.D. Ill. 2000); *In re Smith*, 307 B.R. 912 (Bankr. N. D. Ill. 2004); *In re Stark* (Bankr. N.D. Ill. 2004)

6 *In re Triplett*, 256 B.R. 594 (Bankr. N.D. Ill. 2000).

7 *In re Smith*, 307 B.R. 912 (Bankr. N.D. Ill. 2004).

8 *In re Stark* (Bankr. N.D. Ill. 2004).

9 *In re Donley*, 217 B.R. 1004 (Bankr. S.D. Ohio 1998).

10 *Id.*

11 11 U.S.C. 506(a)(2).

12 *Associates Commercial Corporation v. Rash*, 117 S.Ct. 1879, 138 L.Ed. 148 (1997).

In re Mayland, 2006 Bankr. LEXIS 967 (Bankr. M.D. N.C., 2006)

The Debtors obtained financing for a vehicle in the amount of \$24,129.90. On March 17, 2006, the Debtors filed a Chapter 7 case. At the time of filing, the balance due on the loan was \$20,398. On March 22, 2006, the Debtors filed a Motion to Redeem, which valued the vehicle at \$12,125 on the premise that 90% of the NADA retail value was the appropriate valuation for redemption. The secured creditor argued that the entire NADA retail value, \$13,900, was the proper value.

Pre-BAPCPA, the standard for valuing property in a Chapter 13 cramdown was set forth in *Rash*. Thereafter, most courts used replacement value. Pre-BAPCPA, this court used 90% of the NADA retail value as the replacement value to account for the car being in less than peak condition. The majority of courts, however, held that *Rash* did not apply in Chapter 7 cases. BAPCPA amended §506(a) to provide that personal property securing an allowed claim is replacement value at the time of filing without deductions for costs of sale or marketing. For property acquired for personal, family, or household purposes, “replacement value” is the price a retailer would charge considering the age and condition of the property. The court held that 90% of the retail value listed in NADA was a proper starting point and was consistent with §506(a)(2). The court held that the new standard was applicable to both Chapter 7 and Chapter 13 cases for redemption purposes. In this case, 90% of the retail value listed in NADA was the proper valuation because the vehicle was purchased for personal purposes.

In re Brown, 2006 Bankr. LEXIS 713 (Bankr. D. S.C., 2006)

On January 19, 2006, the Debtor filed a Chapter 7 case. The Debtor filed a Motion to Redeem, which valued the Debtor’s vehicle at \$6,000. The Debtor’s value was based on the NADA retail and trade-in values for a 2002 Dodge Intrepid SE; the Kelley Blue Book trade-in value for a 2002 Dodge Intrepid ES; and a Vehicle Valuation Report trade-in value for a 2002 Dodge Intrepid ES. The Intrepid SE and the Intrepid ES were two different trim levels. The secured creditor obtained an appraisal for a 2002 Dodge Intrepid ES; the appraisal valued the vehicle at \$8,575, noting that the vehicle required \$656 in repairs. The court held that the NADA values provided by the Debtor would be given no evidentiary weight, as the correct trim level according to the Schedules was the ES and not the SE.

Pre-BAPCPA, the proper valuation method for Chapter 7 redemption was “replacement value more closely related to a retail value”. BAPCPA amended §506(a)(2) to provide that the value for personal property used primarily for personal, family, or household purposes should be determined based upon the price a retailer would charge for similar property in that condition at that time, but without deducting costs for sale or marketing. Therefore, although costs for sale and marketing could not be deducted, the redemption value could change based upon the age and condition of the vehicle.

In this case, the only credible evidence of the vehicle’s condition was that of the secured creditor with the \$656 repair estimate. The court held that the Debtor had failed to establish that the condition of the vehicle warranted a deviation from the value asserted by the secured creditor. The court held that the \$656 worth of damage to the vehicle was an indication of its condition and that after deducting the cost of repairs from the secured creditor’s \$8,575 appraisal, the redemption value was \$7,919.

In re Kowalski, 2007 Bankr. LEXIS 772 (N.D. Ohio, 2007)

The Debtors filed a Chapter 13 case that was converted to a Chapter 7 case. During the Chapter 13 case, the Debtors objected to the vehicle creditor’s secured claim as excessive; the objection was sustained and the value presented by the Debtors was accepted. In the Chapter 7 case, the secured creditor argued that the Debtors were bound by the Chapter 13 valuation in determining the amount required to redeem the vehicle. The Debtors argued that the value listed in a market publication was the proper amount.

The court held that the Chapter 13 valuation applied. The court held that because the Debtors had placed the value of the property at issue and the court had ruled upon it, the valuation supported the application of § 348(f)(1).

In re Ortiz, 2007 Bankr. LEXIS 1286 (S.D. Florida, 2007)

The Debtor filed Chapter 7 and filed a motion to redeem a motor vehicle. The vehicle required extensive repairs and maintenance.

The court held that replacement value was the standard for valuing a vehicle for redemption purposes, and that retail value was the proper measure of replacement value. The court also deducted from retail the costs of repair and maintenance to bring the vehicle up to retail standards, rather than wholesale costs.

See also *In re Clark*, 2007 Bankr. LEXIS 765 (N.D. Ohio, 2007).

In re Kidwell, 2007 Bankr. LEXIS 3438 (Bankr. E.D. Tenn. 2007)

The Debtor filed a Chapter 13 case and valued a motor vehicle at \$8,894.00 in the plan. The case was converted to a Chapter 7 case, and the Debtor filed the statement of intention indicating an intent to reaffirm the debt on the vehicle. Shortly thereafter, the Debtor filed a Motion to Redeem the vehicle for the sum of \$3,520.00, and the secured creditor objected to the Motion based upon the value. The secured creditor argued that the Debtor could not redeem for failure to timely amend the statement of intention to reflect the redemption.

The Court held that although the Debtor did not perform the stated intention within 30 days after the 341 Meeting, the Debtor filed a Motion to Redeem within that time, which was effectively an amendment to the statement of intention.

The Bankruptcy Code provides that the value of personal property securing an allowed claim is based upon the replacement value; the Code also provides that the replacement value is equal to the retail value, taking into account age and condition of the property. The Debtor's expert utilized the Kelly Blue Book "private party" value, as it more closely approximated actual retail cash sales rather than credit sales. The Court held that the Debtor's expert's opinion was most in line with the standard set forth in the Code, as redemption is a cash transaction, and that the redemption amount was \$3,520.00.

In re Parker, 363 B.R. 621 (Bankr. M.D. Fla. 2007)

The Debtors filed a statement of intention indicating an intent to redeem a van. 47 days after the 341 Meeting, the secured creditor repossessed the van; that same day, the Debtors filed a Motion to Redeem. The secured creditor returned the van to the Debtors, and the Debtors filed a Motion for Sanctions for violation of the automatic stay.

The Court held that the Code provides little guidance as to what steps a debtor must take to "perform his intention" to redeem property. If the debtor fails to "perform his intention" timely, the automatic stay is terminated. The Debtors argued that their efforts to obtain financing of the redemption amount were sufficient performance of the stated intention to keep the stay in place. The Court held that the Debtors did not demonstrate minimal effort to redeem simply by seeking financing; the Debtors did not contact the creditor for an extension of time, nor did the Debtors file a Motion to Redeem within the 45-day period after the 341 Meeting. The Court held that the automatic stay terminated prior to the repossession and that sanctions were not appropriate.

See also *In re Kidwell*, supra, in which the court held that although the debtor elected to reaffirm the debt on a motor vehicle and did not do so within 30 days after the 341 Meeting of Creditors, the statement of intention was effectively amended within the 30-day period when the debtor filed a Motion to Redeem.

In re Morales, 387 B.R. 36 (Bankr. C.D. Cal. 2008)

On March 2, 2008 the Debtor filed a Motion for Authority to redeem personal property and approval of associated financing under 11 U.S.C.S. § 722. In the Motion the Debtor sought to redeem a 2006 Chrysler Sebring Touring 4D from Creditor HSBC Auto Finance pursuant to §722. The Debtor provided in their motion that the vehicle was in “fair” condition and had approximately 47,000 miles. The matter was before the court to determine the appropriate method for calculating the replacement value of a vehicle under the retail value standard of the second sentence of 11 U.S.C.S. §506(a)(2).

The Bankruptcy Code authorized individual debtors to redeem personal property intended for personal, family, or household use in certain circumstances by paying the lienholder the full amount of the allowed secured claim at the time of redemption, 11 U.S.C.S. § 722. The proper date for valuation of property under 11 U.S.C.S. § 722 was the date of the hearing on the redemption motion. As a general matter, the debtor and the creditor agreed that the debtor was eligible to redeem the vehicle under 11 U.S.C.S. § 722. The court concluded that the correct method for calculating the retail value of a vehicle under 11 U.S.C.S. § 506(a)(2) ultimately depended on the facts presented in each case. As a general principle, however, the court stated that, absent unusual circumstances, the retail value should be calculated by adjusting the Kelley Blue Book or National Automobile Dealers Association Guide (NADA) retail value, for a like vehicle by a reasonable amount in light of any additional evidence presented regarding the condition of the vehicle, and any other relevant factors. Furthermore, the court stated that value should be calculated as of the petition date, not the valuation hearing.

The court found based on the evidence that was presented, that the replacement value of the vehicle under the retail value standard of 11. U.S.C.S §506(a)(2) was \$10,126. The Debtor could redeem the vehicle provided that he paid this amount to the creditor at the time of redemption.

LEASES

- I. When the 1978 Code was enacted few, if any, personal property leases existed. In the early 1990s, leases became one of the preferred methods for individuals to obtain vehicles or other property. Section 365 has been amended to reflect the economic realities of the evolution that has occurred in consumer credit and provides that an individual may assume a lease in a Chapter 7 case by notifying a creditor in writing of the debtor's intent to assume the lease. Specifically, the Debtor notifies the Creditor of the intent to assume, and not later than thirty days after notification, the debtor must assume the lease and the liability becomes the liability of the debtor and not the estate. Creditors may condition their consent to the assumption on the cure of all pre-petition defaults. Any liability flowing from the lease assumption is the responsibility of the debtor and not the bankruptcy estate.
- II. The failure of a debtor to assume a lease will give rise to a termination of the automatic stay and removal of the property from the estate under § 362(h)(1).¹³ If a lease is not assumed by an individual debtor in a Chapter 11 or 13 case at confirmation, the lease is deemed rejected under 11 U.S.C. § 365(p)(3).
- III. The court in *In re Creighton*, 2007 Bankr. LEXIS 579 (D. Mass 2007) held that the execution of a lease assumption agreement is not sufficient to legally obligate the Debtor on the assumed lease; § 365(p)(2)(B) provides that when the debtor notifies a lessor in writing that the lease will be assumed, such lease “will be assumed by the debtor and not by the estate”. However, the court held that a reaffirmation agreement is also necessary premised on the following:
- a. The court held that the language of § 365(p)(2)(B) contemplates some future act that will effectuate the lease assumption, and because of this, the lease assumption agreement is not enough.
 - b. The court further found that the debt is dischargeable under § 524, because a portion of the consideration for a lease assumption agreement is “based upon otherwise dischargeable prepetition debt”. *Id.* at 12.
 - c. The court also held that § 524(c) is applicable to lease assumption agreements even though a lease is not secured by an asset of the estate; § 521(a)(2) requires a debtor to state its intention to surrender, reaffirm, or redeem with respect to debts secured by property of the estate, but it does not negate the applicability of § 524(c) to lease assumption agreements.
 - d. Finally, the court reasoned that lease assumptions must comply with both § 365(p)(2) and § 524(c), because § 362(h)(1)(A) does not specify how the Debtor assumes the lease or whether or not it is subject to § 524(c). Congress has not removed lease assumptions from the protections of § 524(c). The court held that a lease assumption agreement is an agreement between the debtor and the claimholder for which part of the consideration is a dischargeable debt, within the meaning of § 524(c).
- IV. Other courts have followed *Creighton* and have held that a lease assumption must be accompanied by a reaffirmation to render the assumed lease debt non-dischargeable. *In re Robinson*, 2007 Bankr. LEXIS 3020 (Bankr. S.D. Ohio 2007); *In re Finch*, 2006 WL 3900111 (Bankr. D. Colo. 2006).
- V. At least one court, however, has ruled that the reaffirmation requirements of § 524(c) do not apply to leases assumed in Chapter 7 cases pursuant to §365(p). The bankruptcy court in *In re Starline Jackson*, Case No. 06-44335 (Bankr. E.D. Mich. 2006, J. Shefferly), found that a lease assumed under §365(p) does not require a reaffirmation agreement. The *Starline Jackson* court noted that §365(p) does not specifically mention any of the rights and disclosures required under §524 relating to reaffirmation

¹³ 11 U.S.C. § 362(h)(1) (2005).

agreements. Accordingly, the court reviewed other provisions of the Bankruptcy Code to determine whether §365(p) incorporated §524. Specifically, the court noted that §362(h)(1)(A), addressing the effect of the failure of a Chapter 7 debtor to timely meet the requirements under §521(a)(2), clearly differentiates the act of reaffirming a debt under § 524(c) and assuming an unexpired lease under § 365(p). Therefore, the court reasoned, reaffirming a pre-petition debt is a wholly separate act from assumption of a lease. See also *In re Gundy*, Case No. 07-57777, (Bankr. E.D. Mich. 2008, J. Tucker).

- VI. Also note: *in re Gaylor* in which the Court held that the lease assumption process outlined in §365(p) does not require court approval and an order of the court. *In re Gaylor*, 2007 Bankr. LEXIS 4479 (Bankr. D. Conn. 2007). The *Gaylor* Court, however, declined to rule on the issue of whether a lease assumed under §365(p) constitutes a waiver of discharge akin to a reaffirmation agreement. See also *In re Walker*, 2007 Bankr. LEXIS 1547 (Bankr. M.D. N.C. 2007); *In re Rogers*, 359 B.R. 591 (Bankr. D. S.C. 2007)(Suggesting, but not holding that a §524 reaffirmation is necessary to waive discharge).

365(d)(4)

- I. Congress also amended §365(d)(4) to alter the circumstances under which a non-residential real property lease is deemed rejected through the inaction of the parties. Under BAPCPA a non-residential real property lease is deemed rejected if the trustee does not assume the lease within 120 days after the order for relief or the entry of an order confirming plan, whichever comes earlier. The bankruptcy court may only extend this period for cause for 90 days upon motion of the trustee or lessor. Further extensions may only be granted by written consent of the lessor.
- II. In *In re Cunningham*, 2007 Bankr. LEXIS 1705 (Bankr. D. Ariz. 2007), the bankruptcy court applied a strict standard for compliance with § 365(d)(4). Post-petition, the debtors and the lessor entered into an agreement amending the pre-petition lease. The debtors, however, failed to file a motion to assume the lease within the deadline imposed by §365(d)(4). The court found that the debtors did not timely file a motion to assume the lease under §365(d)(4) and the fact that the debtors and the lessor entered into a modification of the lease post-petition neither tolled nor waived the §365(d)(4) period. Accordingly, the court deemed the lease rejected.

The Fourth Option – Pay and Drive

- a. Prior to BAPCPA, §521 provided that if an individual debtor’s schedule of assets and liabilities included consumer debts which are secured by property of the estate:
 - i. The debtor must, within 30 days after the filing of the petition or on or before the date of the meeting of creditors, whichever is earlier, file with the clerk a statement of his intention with regard to such property.
- b. The debtor had the option of surrendering, redeeming, or reaffirming and was obligated to perform the stated intention within 45 days after filing of the statement of intention.
- c. The construction of §521 led to a dispute as to whether a Chapter 7 debtor could continue making regular payments on a secured claim without entering into a written reaffirmation agreement.
- d. Through the 2005 amendments to §521, Congress attempted to abolish the fourth option also known as “pay and drive” or “ride through”.
- e. Section 521(a)(2) requires that the Debtor within 30 days after the filing of the petition or before the date scheduled for the 341 Examination, file a statement of retention or surrender of property, and
 - i. Specifying that the property is exempt and indicating that the debtor will redeem the property or reaffirm the debt.

Section 521(a)(2)(C) incorporates §362(h) which vacates the automatic stay and removes property from the estate if the debtor does not meet the mandates of §521.

Section 521(a)(6) requires that the debtor reaffirm the debt or redeem the property within 45 day after the 341 examination. If the debtor fails to do so, the automatic stay terminated, the property is no longer property of the estate and creditors can take action as allowed under applicable non-bankruptcy law as to the property.

Section 521(d) validates provisions by placing debtor in default based upon the filing of a bankruptcy case.

I. Cases Prohibiting the Fourth Option

- a. In *In re Donald*, 343 B.R. 524 (Bankr. E.D. N.C., 2006) the debtors signed a reaffirmation agreement for the debt on a Lexus. The loan documents contained an ipso facto clause which provided that the filing of bankruptcy constitutes a default. The payments were current as of the date of filing. The debtors’ attorney did not sign a declaration or affidavit under §524(c)(3). The agreement was filed April 5, 2006. The debtors’ Statement of Intention indicated that the debtors would retain the vehicle and continue to make payments, but it did not mention reaffirming the debt. The debtors argued that they could keep the car without reaffirming and that they signed the agreement only to make sure they could keep the car if they were wrong.

Pre-BAPCPA, there was a “ride-through option” (also called the “pay and drive”), in which a debtor could keep a vehicle and continue to pay without reaffirming the debt. While a minority of courts pre-BAPCPA held that this was not the case and that the debtor had to choose redemption, reaffirmation, or surrender, the majority held that the debtor was not required to choose only one of these three options; he could choose to “ride through”. The notice of

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intention requirement was a notice requirement only and did not alter the debtor's rights with respect to the property. The BAPCPA amended §521, but none of these amendments eliminated the "ride through option".

§362(h) creates an exception to §521(a)(2)(C) so that any debtor who does not comply with the time limits for filing his statement of intention will lose the protection of the automatic stay, and the property is no longer the estate's. The purpose of this exception is to encourage debtors to comply with §521. In order to do so, the debtor must state his intention to reaffirm or redeem; otherwise, the stay is lifted. This section terminates the stay, but it does not eliminate the ride-through option.

§521(a)(6) eliminates the ride-through, but only in cases in which the creditor has an allowed claim for the purchase price. The court stated that this provision would rarely be applicable in Chapter 7 cases, because for a claim to be allowed, a proof of claim must be filed. Creditors do not file proofs of claim in no-asset Chapter 7s. Even if one is filed and the claim is an "allowed claim", it must be for the "purchase price", which is not the same as a claim for a "purchase money obligation" or one secured by a PMSI. It is the price agreed upon for which property is sold and purchased. The court held that if Congress had meant something other than the full purchase price, it would have said so. Creditors rarely have an allowed claim for the full purchase price. In this case, the debtors had paid down their debt, so the claim was for less than the purchase price, and the court held that §521(a)(6) did not apply.

The court held that ipso facto bankruptcy default clauses are validated by the amendments therefore in order for the debtors to retain the vehicle; they would have to redeem the vehicle or reaffirm their obligation to the creditor. In this case the debtors chose to reaffirm the debt. The Court agreed that the reaffirmation agreement was a wise decision, it was in the best interest of the debtors and did not impose an undue hardship on the debtors. Accordingly, the reaffirmation agreement was approved. The court held that the addition of §§521(a)(2)(C), 362(h), 521(a)(6) and 521(d) indicates that Congress intended to eliminate the ride-through.

The court noted that in other cases, the debtor may sign a reaffirmation agreement that the Court disapproves and the Debtor may keep the vehicle through payments. The court also held that a creditor may allow a debtor to keep a vehicle and pay on it without reaffirming the debt.

- b. In *In re Norton*, 2006 Bankr. LEXIS 1788 (Bankr. E.D. Tenn., 2006) the debtor filed Chapter 7 on May 2, 2006; the schedules included a Statement of Intention, which indicated that the debtor would retain and make payments on a parcel of real property and a PT Cruiser. The Trustee moved to extend the period of time in which the debtor had to perform the intent as to the car and to extend the automatic stay. The court held that because the Trustee's motion was filed 16 days prior to the deadline for filing the Statement, the motion was timely. The court granted the motion, holding that the car was of consequential value to the estate and that the secured creditor had a substantial equity cushion; the court ordered the debtor to turn the vehicle over to the Trustee. Subsequent to the court's order, the debtor's case was dismissed for failure to timely submit tax returns.
- c. In *In re Anderson*, Case No. 06-10297 (Bankr. D. Delaware, 2006) the debtor's Statement of Intentions indicated that they sought to reaffirm various debts, including a debt owed on their vehicle however the debtors did not sign reaffirmation agreements. After discharge, the debtors defaulted, and the creditor repossessed the vehicle. The debtors reopened their bankruptcy case in order to file a Show Cause Petition. The debtors argued that the fourth option was still viable after BAPCPA.

BAPCPA added §521(a)(6), which requires that the debtor either reaffirm the debt or redeem the property within 45 days after the first meeting of creditors in order to keep a vehicle if the secured creditor has both a purchase money security interest in the property and an allowed claim. §521(a)(6) also provides that the failure to reaffirm or redeem will result in a termination of the stay as to that property. The creditor did not file a proof of claim in this case, but the court held that whether the claim was an “allowed claim” need not be decided, because the creditor was entitled to repossess pursuant to § 521(a)(2)(C) incorporating §362(h)(1). §362(h), states in subsection (1) that the stay will be terminated if the debtor fails to file a Statement of Intention agreeing to surrender, redeem, reaffirm, or assume, and perform that intention. The term “allowed claim” is not used in this section, and there is no language describing the “fourth option”. In this case, the debtors filed the Statement but did not reaffirm the debt, and the court held that the stay was terminated.

The original contract between the debtors and the creditor contained a default on filing clause; BAPCPA makes such clauses enforceable under §521(d) when the debtor fails to comply with §521(a)(6) or §362(h)(1) or (2). State law permits repossession via a default on filing clause. However, the court held that the creditor violated the discharge injunction when it sent the debtors a letter seeking the deficiency balance on the vehicle contract after the debt had been discharged. The court ordered sanctions to deter future conduct, and the debtors did not regain possession of the vehicle.

See Also:

- a. *In re Rice*, 2007 Bankr. LEXIS 945 (E.D. Penn., 2007) §362(h) disabled the “ride through” option by forcing the debtor to either surrender, reaffirm, or redeem the vehicle to avoid the lift of the automatic stay).
- b. *In re Steinhaus*, 2006 Bankr. LEXIS 2116 (Bankr. D. Idaho, 2006) (the automatic stay was terminated when the Statement of Intention indicated the debtor would retain and make payments on the vehicle but failed to indicate whether the debtor would reaffirm or redeem.); *In re Boring*, 346 B.R. 178 (Bankr. N.D. W.V., 2006) (the automatic stay was terminated as the debtor only indicated in the Statement of Intentions that she would retain and pay on the vehicle, and not whether she would reaffirm or redeem); *In re Stevens*, 343 B.R. 524, (Bankr. E.D. N.C. 2006), the court held that the 2005 BAPCPA amendments terminated the “ride-through” option and in order for the vehicle to be retained, the debtor must reaffirm or redeem the vehicle, *In re Rice*, 2007 Bankr. LEXIS 945 (Bankr. E.D. PA 2007)(§362(h) eliminates the Fourth Option by taking away the Debtor’s ability to keep personal property while making payments on the original pre-petition loan by terminating the automatic stay after a debtor fails to comply with §521(a)(2)(A); and *In re Anderson*, 2006 Bankr. LEXIS 2015 (Bankr. D. Delaware, 2006)(Fourth Option was not available and the stay was terminated when the debtors filed a statement of intentions stating that they would reaffirm but failed to enter into a reaffirmation agreement.)

II. Cases allowing Fourth Option

- a. *In re Blakeley*, 2007 Bankr. LEXIS 538 (D. Utah, 2007), holding that although BAPCPA has eliminated the “ride through”, under limited circumstances in which the debtor complies with all of §§ 521 and 362(h), the debtor can “ride through” the bankruptcy if the court declines to approve the reaffirmation agreement. See also *In re Husain*, 2007 Bankr. LEXIS 768 (E.D. Virginia, 2007)(vehicle was not reaffirmed however the court held that the discharge injunction would continue as long as the debtor was current in payments and insured the property.

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- b. *In re Moustafi*, 371 B.R. 434 (Bankr. D. Ariz. 2007), a pro se debtor's Statement of Intentions reflected her intent to reaffirm the vehicle. The debtor signed a reaffirmation agreement indicating that she had \$2,000.00 in income and no expenses. The debtor's schedules I and J indicated that her monthly net income, after deducting the \$519.00 vehicle payment and other monthly expenses, was a negative \$179.00. It was also determined that the vehicle was worth \$21,000.00 while the loan balance and reaffirmation amount was \$26,304.00. The court held a hearing pursuant to §524(c)(6) to review the reaffirmation agreement. The court had to decide if the reaffirmation agreement was in the best interest of the debtor, whether the reaffirmation agreement imposed an undue hardship on the debtor, and if not, could the creditor repossess the vehicle.

The court concluded that the reaffirmation agreement was not in the best interest of the debtor as the debt was greater than the value of the vehicle and the debtor's expenses exceeded her income. The court then had to determine if the disapproval of the reaffirmation agreement meant that the debtor failed to perform her intentions as required by §521(a)(2) which would permit the creditor to repossess the vehicle.

The court, held that the automatic stay was not vacated as the debtor had done all that was required under §521. The court stated that the BAPCPA only eliminates the option if a debtor does not act to reaffirm a debt.

- c. See also *Coastal Fed. Credit Union v. Hardiman*, 398 B.R. 161 (E.D.N.C. 2008); *In re Bower*, 2007 Bankr. LEXIS 2580 (Bankr. D. Or. 2007); *In re Husain*, 364 B.R. 211 (Bankr. E.D. Va. 2007); *In re Stevens*, 365 B.R. 610 (Bankr. E.D. Va. 2007); *In re Chim*, 381 B.R. 191 (Bankr. D. Md. 2008); *In re Riggs*, 2006 Bankr. LEXIS 2732 (Bankr. W.D. Mo. 2006); *In re Isom*, 2007 Bankr. LEXIS 2437 (Bankr. E.D. Va. 2007); *DaimlerChrysler Fin. Servs. Ams., LLC v. Sibert (In re Sibert)*, 2007 Bankr. LEXIS 4241 (Bankr. D. Md. 2007); *In re Openshaw*, 2007 Bankr. LEXIS 3489 (Bankr. D. Utah 2007); *In re Quintero*, 2006 Bankr. LEXIS 906 (Bankr. N.D. Cal. 2006).
- d. In *DaimlerChrysler Fin. Servs. Americas LLC v. Jones (In re Jones)*, 397 B.R. 775, 778 (S.D. W. Va. 2008), the United States District Court for the Southern District of West Virginia overruled the decision of the bankruptcy court, which allowed the 4th option. The Court found that the debtor did not file a proper Statement of Intention pursuant to §521(a)(2) and §362(h) as the statement did not indicate whether the debtor reaffirm, surrender, or redeem. The Court, however, did not address if the ruling would have been different had a proper statement of intent been filed and had the debtor entered into a reaffirmation agreement, but the agreement was disapproved by the court.
- e. *In re Baker*, 2009 U.S. Dist. LEXIS 6333 (D. Delaware, January 29, 2009), the United States District Court for the District of Delaware affirmed the decision of the bankruptcy court which prevented a creditor from repossessing the vehicle even though the court declined to approve the reaffirmation agreement. The Court held that a debtor who attempted to reaffirm the obligation, but the bankruptcy court denied approval of the reaffirmation agreement, was entitled to continue to "pay and drive" since debtor had complied with §521 and §362(h) by timely filing a proper statement of intent and timely signing a reaffirmation agreement.

III. Ipso Facto Clauses

§521(d), as amended, provides that insolvency and bankruptcy provisions in contracts and lease agreements are valid and that such provisions create a default if the automatic stay is vacated as a result of the debtor's failure to assume a lease pursuant to §365(p), reaffirm a contract pursuant to §524(c), or redeem pursuant to §722.¹⁴

Cases:

- a. *In re Rowe*, 342 B.R. 341 (Bankr. D. Kansas, 2006) (relief from stay automatically granted when the debtor chooses the fourth option, but the creditor's right to repossess is determined by state law.)
- b. *In re Anderson*, 2006 Bankr. LEXIS 2015 (Bankr. D. Delaware, 2006)(ipso facto clauses are enforceable and the court must determine if , under state law, the clause creates a default that would allow repossession)
- c. *In re McFall*, 356 B.R. 674 (Bankr. N.D. Ohio, 2006) (The debtor's Statement of Intention did not comply with §521 by failing to state an intention to either reaffirm, redeem, or surrender, the automatic stay was terminated and repossession of the vehicle did not violate the automatic stay.)
- d. However, see *In re Hinson*, Case No. 06-01574, (Bankr. E.D.of N.C. 2006), (ipso facto clause is not effective as the debtor attempted to comply with their statement of intentions and offered to reaffirm the debt pursuant to original terms and the creditor refused to allow reaffirmation on the original contracts terms. The creditor added the requirement that the Debtor to pay the creditor's attorney fees.) See §362(h)(1)(B)

IV. Additional requirements under §521

- a. If the debtor chooses to retain personal property and either reaffirm or redeem, §521(a)(6) provides that it must be accomplished within 45 days after the date first set for the 341 examination.
- b. If the debtor fails to either reaffirm or redeem pursuant to the Statement of Intention within the 45-day time period, the property ceases to be property of the estate.¹⁵ If the debtor fails to assume a lease, the leased property ceases to be property of the estate and the stay is automatically terminated.¹⁶

See:

- a. *In re Woods*, 16 CBN 449 (Bankr. E.D. Mich., 2006)(the court is not required to enter an order confirming whether the automatic stay was terminated pursuant to §521(a)(6).)
- b. *In re Craker*, 337 B.R. 549 (Bankr. M.D. N.C., 2006) (the automatic stay was terminated after the debtor filed her statement of intention within the prescribed time period but failed to indicate on the statement whether she intended to reaffirm, redeem, or surrender.)
- c. *In re Hinson*, 352 B.R. 48 (Bankr. E.D. N.C., 2006) (the automatic stay was not terminated when the debtor timely filed the statement of intention and timely took action to enter the reaffirmation agreement on its original terms.)

¹⁴ 11 U.S.C. 521(a)(6).

¹⁵ 11 U.S.C. 362(h)(1)(B).

¹⁶ 11 U.S.C. 365(p).

CHAPTER 13

I. 910-DAY VEHICLE CLAIMS

A. Generally

- a. In 2005, 11 U.S.C. §1325(a) was amended to provide specific treatment for a creditor with a purchase money security interest securing a debt incurred by the debtor for the purchase of a motor vehicle within 910 days prior to the petition filing date. Generally this provision is referred to as the “Hanging Paragraph”.

The provision at the end of §1325(a)(9) provides:

For purposes of paragraph (5), section 506 shall not apply to a claim described in that paragraph if the creditor has a purchase money security interest securing the debt that is the subject of the claim, the debt was incurred within the 910-day preceding the date of the filing of the petition, and the collateral for that debt consists of a motor vehicle (as defined in section 30102 of title 49) acquired for the personal use of the debtor, or if collateral for that consists of any other thing of value, if the debt was incurred during the 1-year period preceding that filing.

- b. The majority of cases hold that the Hanging Paragraph, as it modifies claims under §1325(a)(5) in relation to §506, prevents a debtor from bifurcating and cramming down a claim by a creditor holding a purchase money security interest in a motor vehicle purchased for personal use within 910 days prior to the petition date. Thus, for the Chapter 13 Plan to be confirmed, a creditor must be treated as fully secured for the full amount of the claim, with interest payable at the *Till* rate.
1. *In re Johnson*, 337 B.R. 269 (Bankr. M.D. N.C., 2006)(denying confirmation of the Plan, which proposed cramdown, because the Hanging Paragraph disallowed bifurcation and cramdown of 910 claims).
 2. *In re Robinson*, 338 B.R. 70 (Bankr. W.D. Missouri, 2006) (denying confirmation of the Plan, which proposed cramdown, because the Hanging Paragraph disallowed bifurcation and cramdown of 910 claims).
 3. *In re Parish*, 2006 Bankr. LEXIS 1205 (Bankr. M.D. Florida, 2006)(granting the creditor’s Motion to Strike the Debtor’s Motion to Value, because a 910 claim could not be stripped down).
 5. *In re Brown*, 339 B.R. 818 (Bankr. S.D. Georgia, 2006)(holding that 910 claims were allowed secured claims and denying Plan confirmation for failure to provide for present value to the 910 claim holders).
 6. *In re Montoya*, 341 B.R. 41 (Bankr. D. Utah, 2006)(denying confirmation of the Plan, which proposed cramdown, because the Hanging Paragraph disallowed bifurcation and cramdown of 910 claims).
 7. *In re Rowley*, 348 B.R. 479 (Bankr. S.D. Ill. 2006) (holding that a lack of equity in the vehicle did not remove the claim from the constraints of the hanging paragraph).

8. *In re Trejos*, 352 B.R. 249 (Bankr. D. Nevada, 2006) (holding that the statute must be read in context and bifurcation is not permitted).
 9. *In re Lorenz*, 2007 Bankr. LEXIS 1445 (E.D. Virginia, 2007) (holding that although the debtor used the vehicle for some business purposes, it was used primarily for personal purposes, and therefore under the hanging paragraph, the claim could not be bifurcated).
 10. See also *In re Turner*, 2006 Bankr. LEXIS 628 (Bankr. D. S.C., 2006); *In re Montgomery*, 341 B.R. 843 (Bankr. E.D. Kentucky, 2006); *In re Quevado*, 2006 Bankr. LEXIS 1194 (Bankr. S.D. Cali., 2006); *In re Vega*, 344 B.R. 616 (Bankr. D. Kansas, 2006); *In re Arguin*, 345 B.R. 876 (N.D. Ill., 2006); and *In re Phillips*, 2007 Bankr. LEXIS 791 (E.D. Virginia, 2007).
- c. The minority rule is set forth in *In re Carver*, 338 B.R. 521 (Bankr. S.D. Georgia, 2006), which held that the Hanging Paragraph completely eliminates §506 and premised thereon such creditor is unsecured for purposes of the Chapter 13 Plan. *Carver* held that a 910-day vehicle claim must receive payments that are the greater of 1) the full amount of the claim without interest, or 2) the cramdown amount with interest paid on the secured portion. *Id.* at 528.
- d. Another variation is set forth in *In re Wampler*, 2006 Bankr. LEXIS 1192 (Bankr. D. Kansas, 2006). The *Wampler* reasoned that finding 910 claims to be fully secured would result in an “absurd conclusion”. *Id.* at 17-18. The opinion stated that “[l]anguage within the context of §1325(a) requires a different interpretation of the phrase ‘allowed secured claim’ than was considered by the Supreme Court in [*Dewsnup v. Timm*, 502 U.S. 410 (1992)].” *Wampler* at 22. The court found that if a 910 creditor were treated as the majority of courts held, with its claim fully secured regardless of the collateral’s value, debtors would be unable to discharge the unsecured portion, no matter how small the secured portion. *Id.* at 25. The court relied upon a recent revision of *Collier on Bankruptcy*:

Language added at the end of section 1325(a) by the 2005 amendments to the Bankruptcy Code removes certain claims from the protections of section 1325(a)(5). This new language states that for purposes of section 1325(a)(5), section 506 shall not apply to certain claims. Such claims, therefore, cannot be determined to be allowed secured claims under section 506(a) and are not within the ambit of section 1325(a)(5). Such claims may still be modified under section 1322(b)(2), which allows modification of the rights of holders of secured claims, with certain exceptions, but the restrictions on modification that apply to allowed secured claims under section 1325(a)(5) do not apply. A debtor is presumably bound only by the dictates of good faith and the other provisions of the Code in determining how such claims may be modified. Some courts, understandably, may look to prior law for guidance regarding what modifications are equitable.

8-1325 Collier on Bankruptcy-15th Ed. Rev. P 1325.06(1)(a).

- e. The anti-cramdown provision applies to motor vehicles and any property other than a motor vehicle which may be determined to be some “other thing of value” purchased within 1 year prior to the petition filing. *In re Curtis*, 345 B.R. 756 (Bankr. D. Utah, 2006) (holding that tractor-trailers are not motor vehicles, but are other things of value and subject to the anti-cramdown provision).

B. Interest on 910 Vehicle Claims

- a. Since deferred payments aggregating to the *amount* of the claim on the effective date cannot fully compensate a creditor for the *value* of the claim, a creditor is entitled to compensation for the lost time-value inherent if paid in installments. “In order for the secured creditor to get payments over time under the plan having a present value equal to the allowed amount, as the above quoted statutory language directs, the debtor normally pays interest on the allowed amount.” *GMAC v. Jones*, 999 F.2d 63, 66 (3d Cir. 1993); see also *Rake v. Wade*, 508 U.S. 464, 472, note 8 (1993), *superseded on other grounds by statute*, *Financial Sec. Assur. v. T-H New Orleans Ltd. Pshp. (In re T-H New Orleans Ltd. Pshp.)*, 116 F.3d 790, 796 (5th Cir. 1997); *In re Ehrhardt*, 240 B.R. 1, 4 (B.C. W.D. Mo. 1999); *In re Felipe*, 229 B.R. 489, 491 (Bankr. S.D. Fla. 1998); *In re Jones*, 188 B.R. 281 (Bankr. D. Or. 1995); *In re Johnson*, 63 B.R. 550, 551 (Bankr. D. Colo. 1986); *In re Mothershed*, 62 B.R. 113 (Bankr. E.D. Arkansas 1986); *In re Gincastro*, 48 B.R. 662, 665 (Bankr. D. R.I. 1985); *In re Williams*, 44 B.R. 422, 425 (Bankr. N.D. Miss. 1984); *GMAC v. Lefevre*, 38 B.R. 980, 984 (Bankr. D. Vt. 1983); *In re Trent*, 42 B.R. 279, 281 (Bankr. W.D. Virginia 1984); *Norton Bankruptcy Law and Practice 2d* § 122:8 (1998); *Lundin Chapter 13 Bankruptcy 3d* § 111-1 (2002).
 1. Likewise, the Congressional Record indicates that section 1325(a)(5)(B)(ii) “contemplates a present value analysis that will discount value to be received in the future.” H.R. Rep. No. 598, 95th Cong. 2d Sess. 414, *reprinted in* 1978 U.S. Code Cong. & Ad. News 6370.
- b. The Supreme Court in *Till v. SCS Credit Corp.*, 541 U.S. 465 124 S. Ct. 1951; 158 L. Ed. 2d 787 (2004), set forth the interest rate applicable to secured debts crammed down pursuant to section 1325(a)(5) of the bankruptcy code. The *Till* Court interpreted section 1325(a)(5)(B)(ii) to require an interest rate that compensates creditors for the additional risk of default when it encounters a bankrupt debtor. The Court in *Till* required an interest rate of prime, plus a risk factor depending on the qualities of the debtor.
- c. In the context of the BAPCPA, the majority of courts that have held that the Hanging Paragraph prevents bifurcation also hold that the *Till* rate of prime plus risk of nonpayment is the correct rate of interest to apply to Chapter 13 cases to 910-day claims.
- d. In *In re Robinson*, *supra*, the court held that because Congress did not specifically overturn *Till* when it enacted BAPCPA, *Till* is still good law and is still applicable to claims affected by the Hanging Paragraph. *Id.* at 74-75. The court noted that debtors are still permitted to modify the rights of secured creditors under §1322(b)(2), and the Supreme Court in *Till* included interest rates within the rights that may be modified. *Id.* at 75.
 1. See also *In re Wright*, 338 B.R. 917 (Bankr. M.D. Ala., 2006)(holding that *Till* is not confined to cases involving undersecured creditors, but to all Chapter 13 cases in which the Plan is confirmed over creditor objection).
 2. *In re Fleming*, 339 B.R. 716 (Bankr. E.D. Missouri, 2006)(holding that 910 claims are still subject to modification under §1322(b)(2), including the interest rate, and that the *Till* rate is appropriate for meeting the present value requirement).
 3. *In re Shaw*, 341 B.R. 543 (Bankr. M.D. N.C., 2006)(holding that if Congress had intended to overturn *Till* in the BAPCPA amendments, it would have done so).

4. *In re Pryor*, 341 B.R. 648 (Bankr. C.D. Ill., 2006) (holding that interest is to be calculated at the *Till* rate in order to meet the present value requirement of §1325(a)(5)(B)).
5. See also *In re DeSardi*, 340 B.R. 790 (Bankr. S.D. Texas, 2006); *In re Scruggs*, 342 B.R. 571 (Bankr. E.D. Arkansas, 2006); *In re Murray*, 346 B.R. 237 (Bankr. M.D. Georgia, 2006); *In re Brooks*, 2006 Bankr. LEXIS 1129 (Bankr. E.D. N.C., 2006); *In re Bufford*, 2006 Bankr. LEXIS 1052 (Bankr. N.D. Texas, 2006); *In re Soards*, 2006 Bankr. LEXIS 1084 (Bankr. W.D. Kentucky, 2006); and *In re Lowder*, 2006 Bankr. LEXIS 1191 (Bankr. D. Kansas, 2006).
6. See also *In re Taranto*, 6th Circuit BAP Case No. 06-8034, reversing a ruling from the Bankruptcy Court of the Western District of Michigan and holding that the *Till* rate applies. The panel held that BAPCPA did not change § 1325(a)(5)(B)(ii) and that *Till* is still binding, regardless of whether the *Till* rate is higher than the contract rate.
7. *In re Wilson*, 2007 Bankr. LEXIS 2784 (BAP 10th Cir. 2007), reversing the decision of the Kansas Bankruptcy Court, which followed the decision from *In re Wampler*, 2006 Bankr. LEXIS 1192 (Bankr. D. Kansas, 2006). The court in *Wampler* found that the Hanging Paragraph stripped a 910 claim of its secured status, held that such claim “may not include unmatured or... postpetition interest.” *Id.* at 32. The decision in *Wampler* was appealed to the 10th Circuit Court of Appeals but it was ultimately dismissed. The BAP of the 10th Circuit, refused to adopt the minority view and held that 910 claims must be treated as a “secured claim for the full amount of its loan balance on the petition date and §1325(a)(5)(B)(ii) required the Debtor to pay interest at the *Till* rate...”
8. *Drive Financial Services, L.P. v. Bobby and Freda Jordan (In re Jordan)*, Case No. 07-40265, (5th Cir. March 2008), the 5th Circuit Court of Appeals ruled that the *Till* rate applies to 910 claims and post-BAPCPA cases.

e. The minority view is set forth in the following cases:

1. *In re Carver*, *supra*, finding that the Hanging Paragraph did not prevent bifurcation of a 910 claim, and the holder of the claim must receive payments that are the greater of 1) the full amount of the claim without interest, or 2) the cramdown amount with interest paid on the secured portion. *Carver* at 528.
2. *In re Wampler*, *supra*, finding that the Hanging Paragraph stripped a 910 claim of its secured status, held that such claim “may not include unmatured or... postpetition interest.” *Id.* at 32.
3. *In re Green*, 348 B.R. 601 (Bankr. M.D. Georgia 2006), holding that because § 506 does not apply to 910 claims, the debt was not entitled to interest through the Chapter 13 plan.

C. Equal Payments

a. §1325(a)(5)(B)(iii) requires equal monthly payments to creditors in confirmed Chapter 13 cases.

§1325(a)(5)(B)(iii) in pertinent part provides as follows:

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(5) with respect to each allowed secured claim provided for by the plan—

(B)(iii) if—

(I) property to be distributed pursuant to this subsection is in the form of periodic payments, such payments shall be in equal monthly amounts; and

(II) the holder of the claim is secured by personal property, the amount of such payments shall not be less than an amount sufficient to provide the holder of such claim adequate protection during the period of the plan;

- b. Two lines of cases have developed with respect to BAPCPA's requirement of post confirmation adequate protection as required under 11 U.S.C. §1325.
- c. The majority of courts interpreting the "equal monthly amount" language in Section 1325(a)(5) have found that the provision mandates that equal monthly payments to the holder of an allowed secured claim begin with the first disbursement from the trustee following confirmation.
- i. *In re Denton*, 2007 WL 1701921 (Bkrcty.S.D.Ga.), the Court held that creditors must receive equal monthly payments with the trustee's first post-confirmation disbursement. The court also stated, "[p]ost confirmation, § 1325(a)(5)(B)(iii)(I) reduces the amount of money for attorney's fees by locking in a fixed monthly payment on every allowed secured claim." The Court defined "periodic" as "payments that recur at regular intervals" and "periodic payments" refers to "all regularly-recurring post confirmation payments on an allowed secured claim". Applying that definition of "periodic payments" to the requirement for equal monthly amounts the Court determined that equal payments must start with the first post confirmation disbursement.
 - ii. *In re Lemieux*, 347 B.R. 460 (Bankr. D. Mass. 2006), the debtors proposed a plan that would require a "balloon payment" several months after confirmation of the plan. The Court found that the debtors' proposed plan violated the "equal monthly amount" requirement of Section 1325(a)(5)(B)(I).
 - iii. See also *In re Wagner*, 342 B.R. 766 (Bankr. E.D. Tenn., 2006), the Court held that "equal monthly amounts" requires that the periodic payments owed to a secured creditor must begin in month one of the confirmed plan. In denying confirmation of the plan, the *Wagner* court found that the proposed treatment of the secured creditor violated Section 1325(a)(5)(B)(I) because "the Debtor's plan must provide for equal monthly payments to New Falls Corporation over the life of the plan until the lien claim is satisfied."
 - iv. The Sixth Circuit Court of Appeals has recently adopted this position in *In re Nichols*, 440 F.3d 850, 857 n. 6 (6th Cir. 2006). The *Nichols* court, although deciding a pre-BAPCPA case, noted that:
 - a. [t]he language in amended *section 1325(a)* of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, however, which addresses the components necessary to confirm a plan, reinforces the importance of maintaining the creditor's lien rights. Unlike the previous *section 1325*, the new language seems to

require that payments made after confirmation be in equal amounts and keep pace with depreciation during the term of the plan.

- d. The second line of cases allow attorney’s fees are to be paid before the equal monthly payments begin but require that creditors receive post-confirmation adequate protection payments until the attorney’s fees are paid. The post-confirmation adequate protection payments are treated as super priority claims and have priority over the attorney’s fees in the event of a default in payment.
 - i. In *In re DeSardi*, 340 B.R. 790 (Bankr. S.D. Texas, 2006), the court held that the provision only requires that payments be equal monthly from the time payments begin until the time they are set to end. The court noted that §1325(a)(5)(B)(ii) used the language “as of the effective date of the plan”; yet the equal monthly payments provision, §1325(a)(5)(B)(iii), did not use such language. That section merely provides that “If... property to be distributed pursuant to this subsection is in the form of periodic payments, such payments shall be in equal monthly amounts.” The court held that the payments must be level once begun and terminate once the creditor was fully paid. Although the Court held that equal monthly payments do not have to begin with the first post-confirmation disbursement, the Court found that creditors must continue to receive post-confirmation adequate protection payments until such time as the equal monthly payments begin. Additionally, the Court noted that the post-confirmation adequate protection payments have priority over debtor’s counsel’s fees.
 - ii. *In re Dispirito*, 371 B.R. 695 (Bankr.D. NJ 2007), the Court held that if debtor’s counsel’s fees were paid prior to adequate protection payments, the creditor would not be adequately protected. The court further held that adequate protection payments do not cease at confirmation and that the creditor’s claim for adequate protection payments is classified as an administrative expense, pursuant to §503 and §507(b), that has priority over debtor’s counsel’s fees.
 - a. To qualify for the “super-priority” status: 1) the adequate protection payments must be provided under §362, §363, or §364; 2) the creditor must have a claim pursuant to §507(a)(2) (which gives priority to a claim under §503(b), which is claim that is “the actual, necessary cost and expenses of preserving the estate”; 3) the adequate protection offered must be inadequate.
 - b. The courts in *Dispirito* and *DeSardi* held a creditor with a lien on the vehicle is entitled to adequate protection under §363, and those creditors have claims under §507(a)(2) and §503(b). If the debtor’s attorney’s fees are paid first, then the amount of adequate protection would be \$0.00 and that is inadequate.
- d. §1325(a)(5)(B)(iii)(II) requires that the amount of periodic payments made to the holder of a claim secured by personal property over the life of the Plan “shall not be less than an amount sufficient to provide to the holder of such claim adequate protection during the period of the plan.” 11 USC §1325(a)(5)(B)(iii)(II).
 1. In *In re Bufford*, the Bankruptcy Court for the Northern District of Texas, Dallas Division, referred to §361, as applied to §§362, 363, or 364, for guidance on what constitutes “adequate protection”. *In re Bufford*, 2006 Bankr. LEXIS 1052 at 30 (Bankr. N.D. Texas, 2006).

2. The court in *Bufford* agreed with the Fifth Circuit that within the context of §362, adequate protection is “ ‘the amount of an asset’s decrease in value from the petition date’ ”. *Bufford* at 32, quoting *In re Stembridge*, 394 F.3d 383, 387 (5th Cir. 2004). The court held that payment of the creditor’s claim in full over the life of the plan with the appropriate interest rate was sufficient to meet this standard for adequate protection.
- c. *In re Davis*, 343 B.R. 326 (Bankr. M.D. Florida, 2006), the Court declined to determine the “parameters of what qualifies as ‘equal monthly payments.’ ” Id. at 7.

D. Surrender in Full Satisfaction of a 910 Vehicle Claim

- a. §1325(a)(5)(C) allows a debtor to surrender collateral to a creditor to meet plan confirmation requirements.

*(a) Except as provided in subsection (b), the court shall confirm a plan if:
...(5)(C) the debtor surrenders the property securing such claim to such holder.*

- b. In *In re Ezell*, 338 B.R. 330 (Bankr. E.D. Tenn., 2006), the court held that §1325(a)(5)(C) is also subject to the Hanging Paragraph, and that surrender of a 910-day vehicle is in full satisfaction of the claim, because such a claim is fully secured for the amount of debt owed. See also *In re Payne*, 2006 Bankr. LEXIS 1696 (Bankr. S.D. Bankr. Ohio, 2006)(The plain meaning of the Hanging Paragraph is that it is to apply to all of §1325(a)(5)).
 1. *In re Brown*, 2006 Bankr. LEXIS 1583 at 14 (Bankr. N.D. Florida, 2006)(holding that “[i]f the 910 claim of a creditor is fully secured upon a debtor’s retention of the vehicle under §1325(a)(5)(B), then it is completely logical that it is also fully secured upon surrender under §1325(a)(5)(C).”).
 2. *In re Sparks*, 2006 Bankr. LEXIS 1589 (Bankr. S.D. Ohio, 2006)(finding the decision of *In re Payne* to be “well-reasoned”).
 3. See also *In re Long*, 2006 Bankr. LEXIS 1605 (Bankr. E.D. Tenn., 2006); *In re Osborn*, 348 B.R. 500 (Bankr. W.D. Mo. 2006) (affirmed by *In re Osborn*, 2007 Bankr. LEXIS 497 (8th Cir. BAP, 2007)); *In re Turkowitch*, 355 B.R. 120 (Bankr. E.D. Wis. 2006); *In re Feddersen*, 355 B.R. 738 (Bankr. S.D. Ill. 2006); *In re Nicely*, 2006 Bankr. LEXIS 2068 (Bankr. W.D. Missouri, 2006); *In re Evans*, 2006 Bankr. LEXIS 2215 (E.D. Mich., 2006); *In re Pinti*, 2007 Bankr. LEXIS 744 (S.D. N.Y., 2007); *In re Holland*, 2007 Bankr. LEXIS 1354 (E.D. Tenn, 2007); *In re Tucker*, 2007 Bankr. LEXIS 1324 (E.D. Tenn, 2007); *In re Blanco*, 2007 Bankr. LEXIS 682 (N.D. Ill, 2007); *In re Gable*, 2007 Bankr. LEXIS 774 (E.D. Tenn, 2007); *In re Harrell*, 2007 Bankr. LEXIS 763 (E.D. Tenn, 2007);
 4. *GMAC v. Michael Jerome Carter (In re Carter)*, (U.S. Dist. Ct. M.D. GA 2008), the District Court affirmed the Bankruptcy Court’s confirmation of debtor’s plan that proposed to surrender a motor vehicle in full satisfaction of the debt. The District Court held that the hanging paragraph eliminates §506 as to all claims whether the debtor intends to surrender or retain the collateral.
- c. But see, *In re Duke*, 2006 Bankr. LEXIS 1318 (Bankr. W.D. Kent., 2006), in which the Bankruptcy Court held that although the Hanging Paragraph applies to all of §1325(a)(5), including subsection C, property rights in estate assets are determined by state law, and

surrender of a 910-day vehicle does not fully satisfy the claim, allowing a creditor to pursue the deficiency claim.

1. The leading case is *In re Particka*, 2006 Bankr. LEXIS 3160 (Bankr. E.D. Mich. 2006) (holding that because § 506 only applies to property in which the estate has an interest, and property that is surrendered is not property of the estate, surrendered property should not be treated differently post-BAPCPA than it was pre-BAPCPA, as the amendments and thus the hanging paragraph do not effect surrendered vehicles; therefore, a debtor cannot surrender in full satisfaction of the debt. Once property is surrendered, the estate has no interest and a creditor can proceed as it would under applicable state law).
 2. *Particka*, supra, was followed by the Northern District of Mississippi in *In re Clark*, 2007 Bankr. LEXIS 590 (N.D. Missouri, 2007), which vacated an order previously entered by the same court, and held that once a vehicle was surrendered, it was no longer part of the bankruptcy estate and § 506 no longer applies to it, and neither does the hanging paragraph.
 3. The interpretation of the statute prohibiting surrender to fully satisfy the claims of a 910 claim creditor is gaining momentum. See also *In re Hoffman*, 359 B.R. 163 (E.D. Mich., 2006); *In re Leaks*, 2006 Bankr. LEXIS 3673 (N.D. Georgia, 2006); *In re Morales*, 359 B.R. 211 (N.D. Ill., 2007); *In re Slocum*, 2006 Bankr. LEXIS 3895 (N.D. Georgia, 2006); and *In re Marino*, 2006 Bankr. LEXIS 2242 (S.D. Florida, 2006).
- d. The 4th (District of Columbia, Maryland, North Carolina, South Carolina, Virginia, West Virginia), 6th (Kentucky, Michigan, Ohio, Tennessee), 7th (Illinois, Indiana, Wisconsin), 8th (Arkansas, Iowa, Minnesota, Missouri, Nebraska, North Dakota, South Dakota), and 10th (Colorado, Kansas, New Mexico, Oklahoma, Utah, Wyoming), 11th (Alabama, Florida, Georgia) Circuit Courts have weighed in on surrender in full satisfaction::
- *Wright v. Santander Consumer USA Inc. (In re Wright)*, 07-1483, 2007 WL 1892502 (7th Cir. July 2007), the 7th Circuit Court of Appeals affirmed the bankruptcy court's ruling that the collateral could not be surrendered in full satisfaction of the debt. The court held that, "Article 9 of the Uniform Commercial Code plus the law of contracts entitle the creditor to an unsecured deficiency judgment after surrender of the collateral...That unsecured balance must be treated the same as other unsecured debts under the Chapter 13 plan." The court found that the elimination of §506 through the hanging paragraph returns the parties to their contractual rights. See also, *In re Rodriguez*, BAP WW-07-1046-MoDJ, Bankr. Case No. 06-41999 (BAP 9th Cir. 2007); *In re Newberry*, Case No. 06-60241, 2007 WL 1308318 (Bankr. W.D.Tex. 2007).
 - *In re Osborn*, 07-1726, (8th Cir. February 2008), the 8th Circuit Court of Appeals reversed the ruling of the bankruptcy court, which was affirmed by the Bankruptcy Appellate Panel, that the debtor can surrender a motor vehicle purchased within 910 days of the filing date in full satisfaction of the debt and that the creditor is not entitled to an unsecured claim for the deficiency balance. The court noted that the "trend" is to allow the creditor an unsecured deficiency claim. The court stated "nothing in § 1325(a)(5) says that [the] 'allowed secured claim' is satisfied by the debtor choosing the surrender option in subparagraph (C). The court determined that upon surrender, the parties are left to their state-law rights. Both state law and the contract gave the creditor the right to a deficiency balance and nothing in the

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bankruptcy codes disallows such a claim. See also, *In re Moore*, No. 07-1315, (8th Cir. February 2008).

- *AmeriCredit Financial Services, Inc. v. Robert Harris Long and Ginger Denise Long (In re Long)*, Case No. 06-6252, (6th Cir. March 2008), the Sixth Circuit Court of Appeals reversed the bankruptcy court's ruling that collateral can be surrendered to a creditor in full satisfaction of the claim. The Sixth Circuit Court of Appeals found that a "gap" exists in the hanging paragraph contained within 11 U.S.C. §1325 and applying a "literal interpretation of the statute would create an unintended and illogical result." The "gap" is caused by the code's failure to address what happens to a 910 claim when a debtor elects to surrender the collateral according to 11 U.S.C. §1325 (a) (5) (C) rather than retaining the collateral pursuant to 11 U.S.C. 1325 (a) (5) (B). The Sixth Circuit Court of Appeals elected to fill the "gap" with pre-BAPCPA case law, which allowed a creditor to file an unsecured claim for any deficiency balance remaining after the liquidation of the collateral, by utilizing "the common law principle of interpretation known as 'the equity of the statute'". The appellate court held, "the hanging paragraph was intended to protect secured creditors by eliminating debtors' ability to cram-down debt under § 1325 (a) (5) (B)."

The Sixth Circuit Court of Appeals did diverge from the decisions of the Seventh and Eighth Circuit Courts of Appeals on the issue of whether federal or state law should apply after the collateral is surrendered. Both the Seventh and Eighth Circuits found that the elimination of §506 through the hanging paragraph returns the parties to their state court rights. The Sixth Circuit Court of Appeals believes that a "national rule should be adopted and substituted for the widely varying procedural and substantive foreclosure, repossession and deficiency judgment rules provided for by the 50 states as "Congress has demonstrated an intent to federalize and make uniform the treatment of purchase-money security mortgages in bankruptcy".

- *DaimlerChrysler Financial Services, LLC, v. John Jason Ballard and Michelle Ballard, and Michael Justin Quick*, Case No. 07-5109 and 07-5112, (10th Cir. May 2008), The 10th Circuit Court of Appeals overturned the decision of the Bankruptcy Appellate Panel which held that the vehicle may be surrendered in full satisfaction of the claim. The 10th Circuit Court reasoned that "the hanging paragraph does not abrogate a creditor's right to assert a deficiency claim authorized by state law." The court determined that §1325(a)(5)(C) simply provides for the surrender of the collateral and there is no valuation component to the surrender option as there is for in §1325(a)(5)(B).
- *Tidewater Finance Company v. Jennifer Lee Kenney and Frank J. Santoro*, Case No. 07-1664, (4th Cir. June 2008); the 4th Circuit Court reversed an opinion from the Bankruptcy Court that allowed the vehicle to be surrendered in full satisfaction of the debt. The 4th Circuit has joined the "growing number of circuit courts" that recognize the creditor's right to assert an unsecured claim pursuant to state law. Once the debtor surrenders the collateral the court held the parties are left to their contractual rights according to state law. "Because §502 directs bankruptcy courts to allow claims stemming from contractual debts and neither diminishes nor disapproves of secured claims, it is evident to us that such deficiency claims must be permitted to the extent that state law allows for them."

- *DaimlerChrysler Financial Services, LLC, v. Rolliffee Franlin Barrett, Jr., Mary Ann Barrett, and Richard Johnson, Cheryll Johnson*, Case No. 07-14796 and 07-14797, (11th Cir. September 2008); the 11th Circuit Court joined the other circuits and decided that a creditor may pursue an unsecured deficiency balance resulting from the surrender of vehicle that enjoys the protections of the hanging paragraph contained within 11 U.S.C. §1325. The court determined that “[l]eaving the parties to their contract, and looking to applicable state law, is required by well-established Supreme Court precedent.

E. PMSI/NEGATIVE EQUITY CASES:

Three lines of cases have developed with respect to whether a 910 claim is subject to bifurcation when the transaction includes the financing of negative equity.

a. The first line of cases hold that the entire claim is afforded the protections of section 1325(a) and cannot be bifurcated into secured and unsecured claims.

- *General Motors Acceptance Corporation v. Peaslee (In re Peaslee)*, 373 B.R. 252, 2007 WL 2318071 (U.S. Dist. Ct. W.D.N.Y. 2007), the United States District Court for the Western District of New York reversed the Bankruptcy Court which held that the financing of negative equity destroys the creditor’s purchase money security interest therefore allowing the claim to be bifurcated into secured and unsecured components. The U.S. District Court held that the entire claim, including the portion of the claim attributable to the payoff of negative equity on the debtor’s trade-in, qualified as a purchase money security interest and thus was not subject to cramdown. The U.S. District Court found that the price of the vehicle includes “obligations for expenses incurred in connection with acquiring rights in the collateral.” The U.S. District Court further explained that a purchase money security interest requires a “close nexus” between the acquisition of the vehicle and the secured obligation. Consequently, charges incurred to pay off the negative equity in another vehicle “enable the debtor to acquire rights in the new vehicle”. The court also noted that one of the reasons for the creation of the hanging paragraph was to protect creditors from the abuse of cramdown. The United States Court of Appeals for the Second Circuit has certified the question of whether negative equity is included within the purchase price to the New York Court of Appeals.
- See also *In re Graupner*, 2007 WL 1858291 (M.D.Ga. 2007); *In re Petrocci*, 370 B.R. 489, 2007 WL 1813217 (Bankr. N.D.N.Y. 2007); *In re Cohrs*, 2007 WL 2050980 (Bankr. E.D.Cal. 2007); *In re Wall*, Case No. 07-50204 (Bankr. W.D.N.C. 2007); *In re Burt*, Case No. 07-23193 (Bankr. D.Utah 2007); *In Re Pharis*, Case No. 07-30527 (Bankr. W.D.LA 2007); *In re Honeycutt*, Case No. 06-48771 (Bankr. E.D.Mich. 2006); *In re Wisser*, Case No. 07-40714 (Bankr. W.D.Mo. 2007); *In re Shockley*, Case No. 07-15884 (Bankr. S.D. Ohio 2008); *In re Ford*, 387 B.R. 827 (Bankr. D. Kansas 2008); *In re Myers*, 393 B.R. 616 (Bankr. S.D. Ind. 2008); *In re Muldrew*, Case No. 08-11866, (U.S. Dist. E.D.Mich. 2008);
- *Steven Michael Graupner v. Nuvell Credit Union*, Bankr. Case No. 06-40237, D.C. Case No. 07-00037-CV-CDL-4 (11th Cir. August 2008); the bankruptcy court, after reviewing the Georgia Motor Vehicle Sales Finance Act, determined that the negative equity component of the transaction was part of the cash sales price and the creditor had a purchase money security interest in the full amount of the claim. The bankruptcy court’s ruling was affirmed by the United States District Court and the debtor appealed this matter to the 11th Circuit Court of Appeals. The 11th Circuit affirmed the lower court’s decision. The court determined that negative equity constitutes purchase money and relied on the comments to

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section 9-103 of the UCC. Comment 3 in particular provides that ‘obligations for expenses incurred in connection with acquiring rights in the collateral’ can be included in the term price. The court further explained that there is a “close nexus” between the negative equity and the debtor’s purchase of the new vehicle. The court also noted that one BAPCPA’s goals was to provide additional protection to secured creditors and that it would be absurd to interpret the hanging paragraph in such a manner that conflicts with that goal.

b. The second line of cases have applied the “transformation rule”. These cases hold that the inclusion of the negative equity destroys the purchase money security interest status and the claim can be bifurcated into secured and unsecured claims.

- *In re Price*, 363 B.R. 734 (Bankr. E.D.N.C. 2007), the Court held that the negative equity component of the transaction destroys the purchase money status and the entire claim is not subject to the protections of the hanging paragraph contained in §1325(a) and may be bifurcated into secured and unsecured claims.
- See also *In re Sanders*, Case No. 07-50783 (Bankr. W.D. TX. 2007); *In re Mitchell*, 379 B.R. 131 (M.D.Tenn. 2007)

c. The third line of cases applies the dual status rule, which provides the portion of the claim attributable to the negative equity will be treated as unsecured, while the remaining claim is secured.

- *CitiFinancial Auto v. Hernandez-Simpson*, 369 B.R. 36 (Bankr. D.Kan 2007), the Court held that the negative equity component does not destroy the purchase money status of the entire claim and therefore the negative equity portion was treated as an unsecured claim and the remaining balance paid according to the unnumbered paragraph contained in §1325(a).
- See also *In Re Conyers*, Case No. 07-50855 (Bankr. M.D.N.C. 2007); *In re Blaylock*, Case No. 07-11327 (Bankr. N.D. Miss. 2007); *In Re Westfall*, 2007 WL 2777709 (Bankr. N.D. Ohio 2007)(the Court previously applied the transformation rule, but subsequently applied the dual status rule); *In re Hayes*, 376 B.R. 655 (Bankr. M.D.Tenn. 2007); *In re Riach*, Case No. 07-64645 (Bankr. D.OR 2008)

d. GAP Insurance and Warranties:

- , *In re White*, 352 B.R. 633 (Bankr. E.D.La. 2006) and *In re Hayes*, 376 B.R. 655 (Bankr. M.D.Tenn 2007) where the Courts held that GAP insurance is not a component of purchase money, but extended warranties and service contracts are included in the purchase money component.
- *GMAC v. Horne*, 390 B.R. (E.D.Va. 2008), which reversed in part and remanded *In re Pajot*, 371 B.R. 139, (Bankr. E.D.Va. 2007). The Court in *Horne* held that the negative equity could not be crammed down; however, the insurance and extended warranties could be crammed down. The *Horne* case is currently on appeal to the Fourth Circuit.
- *In re Murray*, 352 B.R. 340 (Bankr. M.D.Ga. 2006), the Court ruled that extended service contracts and warranties are “inextricably related to the collateral” and are therefore included in the purchase price. See also *In re Pajot*, 371 B.R. 139, (Bankr. E.D.Va. 2007); *In re Sprating*, 2007 WL 3102154 (Bankr. M.D.Ga. 2007); *In re Macon*, 376 B.R. 778 (Bankr. D.S.C. 2007); *In re Wisner*, Case No. 07-40714 (Bankr. W.D.Mo. 2007); *In re Spratling*, 2007 WL 3102154 (Bankr. M.D.Ga. 2007); *In re Riach*, Case No. 07-64645 (Bankr. D.OR 2008)

- e. *In re Trejos*, 06-1400 (BAP 10th Cir. 2007), the BAP affirmed the Bankruptcy Court which held that the creditor's entire claim qualified for protection under section 1325(a) despite the assignment of the claim from the dealer to a finance company. The debtors conceded that the dealer had a purchase money security interest but they claimed that assignment of the claim destroyed the purchase money security interest as to the finance company. The BAP found that "the debt to the dealer was a 'purchase money obligation' since it was an 'obligation of an obligor incurred as all or part of the price of the collateral or for value given to enable the debtor to acquire rights in or the use of the collateral..." The BAP held the vehicle "constituted 'purchase money collateral'. The BAP held that the assignee, the finance company, "steps into the shoes" of the assignor, the dealer.
- f. See also, *In re Horn*, 338 B.R. 110 (Bankr. M.D. Ala., 2006)(allowing bifurcation because after multiple refinancing, the creditor did not have a PMSI).
- g. *In re Gray*, 382 B.R. 438, 2008 Bankr. LEXIS 416 (Bankr. S.D.Tenn. 2008), the court held that GMAC's claim was not subject to bifurcation pursuant to the hanging paragraph as any negative equity was paid for with a down payment and other rebates. The debtors' former vehicle was encumbered by a secured lien in the amount of \$14,362.48. The GMAC gave the debtors \$10,100.50 for the trade in, which left \$4,261.98 in "negative equity". According to the contract, the \$4,261.98 was accounted for with a combination of a cash down payment and rebates. Since the loan proceeds were not used to finance the "negative equity" the claim did not lose its purchase money security interest status. The court reasoned that the debtor could have remitted the cash down payment and the rebates to the secured creditor to pay off the remaining \$4,261.98, but as a matter of convenience this amount was paid by GMAC.

See also, *In re Myers*, 2008 Bankr. LEXIS 877 (Bankr. E.D.Tenn. 2008), the court found that creditor's fell within the protection of the hanging paragraph as the transaction did not include "negative equity". As part of the transaction the debtor turned in a 2005 Kia Optima, the creditor provided a trade-in value of \$11,670.00, which is the same amount owed on the vehicle. The creditor then remitted the \$11,670.00 to the secured creditor. The debtor argued that the deal included "negative equity" and therefore the claim could be bifurcated into secured and unsecured claims. The court defined equity as "the difference between the property value and the total amount of liens against it". Since the amount of the liens on the trade-in and the value allocated to the trade-in were the same, there was no "positive" or "negative equity"

F. Personal Use

In re Lewis, 2006 Bankr. LEXIS 1628 (D. Kansas 2006)

The Debtors filed Chapter 13 in January 2006. The Debtors were the title holders of a motor vehicle they purchased on behalf of their adult daughter; the vehicle was subject to a lien in favor of Wells Fargo Bank, which financed the purchase price. The Debtors' daughter was in possession of the vehicle, drove the vehicle, and made the payments until the Debtors filed the bankruptcy petition. The Debtors' Chapter 13 plan proposed to pay Wells Fargo the value of the vehicle under § 506(a) and treat the remaining balance as a general unsecured claim. Wells Fargo objected to the plan, arguing that the vehicle was subject to the protections of the hanging paragraph and that BAPCPA prevented the Debtors from bifurcating the claim. The court held that the vehicle was not protected by the hanging paragraph because it was not purchased for the Debtors' personal use; rather, it was purchased for the Debtors' daughter. The court held that the Debtors' construction of the hanging paragraph is correct, which applies the paragraph to vehicles purchased for the debtor's personal use, whereas Wells Fargo's construction, that the vehicle merely be acquired for the personal use of anyone in order to fall under the paragraph, was incorrect. The court held that *In re Jackson*, which held that a vehicle purchased for use by the debtor's wife was still purchased for the personal use of the debtor, was not on point and could not be applied to a situation with an independent adult child not living with the Debtors. However, the court denied confirmation of the plan, holding that the plan was not proposed in good faith. The Debtors, rather than

surrendering the vehicle, proposed to pay Wells Fargo themselves without taking the vehicle back from the daughter and using money that would otherwise go to unsecured creditors.

In re Lorenz, 2007 Bankr. LEXIS 1445 (E.D. Virginia, 2007)

The Debtor purchased a 2004 Chevrolet truck with the intention of using the vehicle for the Debtor's business and also for personal purposes. The court held that although the Debtor did use the vehicle to travel to and from work sites and to haul equipment and supplies, the Debtor primarily used the vehicle for personal purposes, including family vacations, running errands, taking the children to school and day care, taking the children to various activities, and general family outings. The court held that these uses constituted personal uses to the extent that the vehicle fell under the Hanging Paragraph, and the Debtor could not bifurcate the creditor's claim into secured and unsecured portions.

See also *In re Joseph*, 2007 Bankr. LEXIS 1049 (W.D. Louisiana, 2007) (the debtor's use of a vehicle to travel to and from work is insufficient to remove the vehicle from "personal use" for purposes of the hanging paragraph).

F. Adequate Protection

- a. Section 1326(a)(1) provides that "unless the court orders otherwise, the debtor shall commence making payments no later than 30 days after the date of the filing of the plan or the order for relief, whichever is earlier, in the amount – A) proposed by the plan to the trustee... and C) that provides adequate protection directly to a creditor holding an allowed claim secured by personal property to the extent the claim is attributable to the purchase of such property by the debtor for that portion of the obligation that becomes due after the order for relief, reducing the [plan payments to the Trustee] by the amount so paid and providing the trustee with evidence of such payment, including the amount and date of payment."
- b. The court in *In re Beaver*, 337 B.R. 281, 284 (Bankr. E.D. N.C., 2006) refused to hold that this provision requires payments directly to the creditor in all situations; the court held that "if the debtor has chosen another method of providing adequate protection, no pre-confirmation direct payments are needed." The court noted that direct cash payments are only one way to provide adequate protection, but not "the exclusive method," and if Congress had intended to change that well-established practice, it would have done so expressly. *Id.* at 284-285.
 1. In its first footnote, the court added that courts have discretion to alter any requirement of direct payments according to §1326(a)(1), which begins "unless the court orders otherwise..." *Id.* at 284.
 2. See also *In re Simmons*, 2006 Bankr. LEXIS 1163 (Bankr. D. S.C., 2006)(holding that even if the debtor is required by the statute to make payments directly to the creditor, such requirement is irrelevant if the court orders otherwise).
- c. In *In re Clay*, 339 B.R. 784 (Bankr. D. Utah, 2006), the court held that §1326(a)(1) manifested Congressional intent to allow debtors to continue to make contractual payments directly to creditors and that because the debtor is required make adequate protection payments directly to the creditor under §1326(a)(1)(C), the debtor should be able to make the direct payments after confirmation. *Id.* at 788.
- d. In *In re Brown*, 348 B.R. 583 (Bankr. N.D. Georgia, 2006), the court held that pre-petition adequate protection payments were meant to protect against depreciation and should be applied to principal only, not to interest.

- e. See also *In re Singer*, 2007 Bankr. LEXIS 1439 (E.D. Penn., 2007); In *Singer*, a creditor repossessed a vehicle pre-petition, the court held that the creditor's continued retention of the vehicle post-petition was a willful violation of the automatic stay; the court also held that no adequate protection was required because of the Creditor's substantial equity cushion in the property.

Projected Disposable Income – “Here’s Another Fine Mess”

**A. Benjamin Goldgar
United States Bankruptcy Court
Northern District of Illinois**

1. The Issue

Section 1325(b)(1) provides that if the trustee or an unsecured creditor objects to confirmation, the debtor's plan can't be confirmed unless the plan *either* (A) proposes to pay all claims in full, *or* (B) provides that all of the debtor's "projected disposable income" will be used to make payments to unsecured creditors.

What does "projected disposable income" mean?

2. The Statutory Language

a. Pre-BAPCPA

Section 1325(b)(1)(B) required the debtor to devote to the plan all of the debtor's "projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan." Section 1325(b)(2) defined "disposable income" as "income received by the debtor and which is not reasonably necessary to be expended (A) for the maintenance or support of the debtor or a dependent of the debtor" and (B) for business expenses.

Pre-BAPCPA, courts generally calculated "disposable income" using the monthly figures from Schedules I and J and then calculated "projected disposable income" by simply multiplying the resulting number by the proposed duration of the plan. *See In re Petro*, 395 B.R. 369, 373-74 (B.A.P. 6th Cir. 2008).

b. Post-BAPCPA

Section 1325(b)(1) is substantially the same post-BAPCPA. In particular, BAPCPA left in place the phrases "disposable income" and "projected disposable income."

Section 1325(b)(2), however, has been completely revised to introduce a new definition of “disposable income.” “Disposable income” now means “current monthly income received by the debtor” minus expenses that are calculated differently depending on whether the debtor’s family income is above or below the median family income for the state.

“Current monthly income” (or “CMI”), in turn, is a new term defined in section 101(10A) as “the average monthly income from all sources that the debtor receives (or in a joint case the debtor and the debtor’s spouse receive) without regard to whether such income is taxable income, derived during the 6-month period” before the case was filed.

3. The Problem with New Section 1325(b)(2)

Most people agree that new section 1325(b)(2) is badly drafted and operates clumsily. Because it bases monthly “disposable income” on the debtor’s CMI (a debtor’s average income during the six months pre-petition), it fails to take into account that a debtor’s income during that period might be unusually high or low. A debtor could therefore end up with plan payments that are either too high or too low – depending on what it means for disposable income to be “projected.”

Unfortunately, Congress declined to help with that question. In BAPCPA, Congress provided us with a new definition of “disposable income,” but Congress left “projected disposable income” undefined, just as it had been pre-BAPCPA.

4. Current Judicial Interpretations of “Projected Disposable Income.”

Courts are deeply divided about the meaning of “projected disposable income.” The interpretations fall roughly into three groups, *see generally In re Johnson*, ___ B.R. ___, 2009 WL 331920, at *5-9 (Bankr. N.D. Ill. Jan. 23, 2009) (describing the three approaches):

a. The “Conclusive” or “Plain Meaning” Approach

Courts taking the “conclusive” approach read “projected disposable income” literally. To reach “projected disposable income,” they simply multiply the debtor’s CMI by the number of months in the plan. These courts hold that the definition of “disposable income” is clear and say that to “project” disposable income one simply “does the math,” a process consistent with Congress’s intent in BAPCPA to limit the discretion of bankruptcy judges. No adjustments based on post-petition changes in income (a/k/a reality) are possible. *See, e.g., Maney v. Kagenveama (In re Kagenveama)*, 541 F.3d 868 (9th Cir. 2008); *In re Alexander*, 344 B.R. 742 (Bankr. E.D.N.C. 2006).

b. The “Presumptive” Approach

Courts adopting the “presumptive approach” consider “projected disposable income” to be ambiguous. They also emphasize that “projected disposable income” must be different from “disposable income.” These courts begin their calculation the same way as the “conclusive approach” courts, multiplying CMI by the months in the plan, but consider that figure only a presumption. The presumption can be rebutted with evidence that CMI does not represent the debtor’s income. This approach is thought to be consistent with Congress’s intent in BAPCPA to ensure that creditors are paid as much as possible. *See, e.g., In re Lanning*, 545 F.3d 1269 (10th Cir. 2008); *In re Frederickson*, 545 F.3d 652 (8th Cir. 2008).

c. The “Composite” Approach

Courts employing this approach agree that “projected disposable income” is ambiguous but decline to adopt a presumption that Congress has not expressly created. Instead, they find an irreconcilable conflict between CMI, as defined in section 101(10A)

and the new definition of “disposable income” and give effect to the definition of CMI only to the extent it can be harmonized with section 1325(b)(1). The income inclusions and exclusions in section 101(10A) are considered, but only to the extent the debtor expects to receive that income during the period of the plan. *See, e.g., In re Kibbe*, 361 B.R. 302 (B.A.P. 1st Cir. 2007); *In re Hardacre*, 338 B.R. 718 (Bankr. N.D. Tex. 2006).

5. “Projected Disposable Income” in the Sixth and Seventh Circuits

Decisions in the Sixth and Seventh Circuits reflect the national division over the meaning of “projected disposable income.” Here is a non-exhaustive list:

a. Sixth Circuit

i. Conclusive Approach. *In re Anderson*, 383 B.R. 699 (Bankr. S.D. Ohio 2008) (Humphrey, J.); *In re McGillis*, 370 B.R. 720 (Bankr. W.D. Mich. 2007) (Hughes, J.); *In re Kolb*, 366 B.R. 802 (Bankr. S.D. Ohio 2007)(Walter, J.).

ii. Presumptive Approach. *In re Thomas*, 395 B.R. 914 (B.A.P. 6th Cir. 2008) (Gregg, McIvor, and Shea-Stonum, JJ.); *In re Petro*, 395 B.R. 369 (B.A.P. 6th Cir. 2008) (Fulton, McIvor, and Shea-Stonum, JJ.); *In re French*, 383 B.R. 402 (Bankr. W.D. Ky. 2008) (Lloyd, J.); *In re McCarty*, 376 B.R. 819 (Bankr. N.D. Ohio 2007) (Shea-Stonum, J.); *In re Grant*, 364 B.R. 656 (Bankr. E.D. Tenn. 2007) (Stair, J.); *In re Riggs*, 359 B.R. 649 (Bankr. E.D. Ky. 2007) (Howard, J.).

b. Seventh Circuit

i. Conclusive Approach. *In re Mancl*, 381 B.R. 537 (W.D. Wis. 2008) (Crabb, J.); *In re Hedge*, 394 B.R. 463 (Bankr. S.D. Ind. 2008) (Lorch, C.J.); *In re Greer*, 388 B.R. 889 (Bankr. C.D. Ill. 2008) (Perkins, J.); *In re Spraggins*, 386

B.R. 221 (Bankr. E.D. Wis. 2008) (Kelley, J.); *In re Ross*, 375 B.R. 437 (Bankr. N.D. Ill. 2007) (Squires, J.); *In re Nance*, 371 B.R. 358 (Bankr. S.D. Ill. 2007) (Meyers, J.); *In re Guzman*, 345 B.R. 640 (Bankr. E.D. Wis. 2006) (Kelley, J.).

ii. Presumptive Approach. *In re Royal*, 397 B.R. 88 (Bankr. N.D. Ill. 2008) (Hollis, J.); *In re Hilton*, 395 B.R. 433 (Bankr. E.D. Wis. 2008) (McGarrity, C.J.); *In re Foster*, No. 05-50448 HCD, 2006 WL 2621080 (Bankr. N.D. Ind. Sept. 11, 2006) (Dees, C.J.); *In re Demonica*, 345 B.R. 895 (Bankr. N.D. Ill. 2006) (Barbosa, J.); *In re Fuller*, 346 B.R. 472 (Bankr. S.D. Ill. 2006) (Pepper, J.).

iii. Composite Approach. *In re Johnson*, ___ B.R. ___, 2009 WL 331920 (Bankr. N.D. Ill. Jan. 23, 2009) (Wedoff, J.); *In re Carlton*, 362 B.R. 402 (Bankr. C.D. Ill. 2007) (Gorman, J.).

6. Prospects for Further Judicial Guidance.

On March 23, 2009, the U.S. Supreme Court denied cert. in *Frederickson*. Although a cert. petition is pending in *Lanning*, see *In re Lanning*, 545 F.3d 1269 (10th Cir. 2008), *petition for cert. filed*, 77 U.S.L.W. 3449 (U.S. Feb. 3, 2009) (No. 08-998), there is no reason to believe the petition will be granted given the Court's refusal to hear *Frederickson*. On a brighter note, the Seventh Circuit has accepted a direct appeal from the bankruptcy court's decision in *Johnson*. See *In re Johnson*, ___ B.R. ___, 2009 WL 331920 (Bankr. N.D. Ill. Jan. 23, 2009), *appeal accepted*, No. 09-1212 (7th Cir. Feb. 23, 2009). Lawyers in the Seventh Circuit, at least, stand to get some definitive guidance.

7. Selected Articles on the Projected Disposable Income Mess.

Lisa Barbacci Afarin, *Section 1325(b)(1)(B) and the Predicament of Determining Projected Disposable Income*, 17 J. Bankr. L. & Prac. 2 (2008); Jeffrey R. Drobish, *The Forbidden Crystal Ball: Interpreting “Projected Disposable Income” for Chapter 13 Bankruptcy Plans after BAPCPA*, 85 Wash U. L. Rev. 185 (2007); Alane A. Becket & William A. McNeal, *Projected Disposable Income in Chapter 13: a Menu of Fact, Fiction and Forms*, Am. Bankr. Inst. J., May 26, 2007, at 20; David W. Allard & Katherine R. Catanese, *The Means Test: Seeing Clearly the CMI*, Am. Bankr. Inst. J., Feb. 26, 2007, at 12.

**Rebutting the Presumption
of
Substantial Abuse**

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I. Introduction

Upon passing the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”), the requisite oversight of bankruptcy cases drastically changed—individual debtors were suddenly required to begin undergoing a complex mathematical formula, called the “means test,” to determine whether or not they were presumptively abusing the bankruptcy system.¹ Under 11 U.S.C. § 707(b)(2), the court “shall presume abuse exists” if the debtor ‘fails’ this test, whereupon, the debtor will then only be permitted to rebut the presumption of abuse “by demonstrating special circumstances” pursuant to the guidelines of § 707(b)(2)(B)(i). Once there is a finding that the debtor does not have special circumstances to rebut the presumption, the judge can exercise discretionary powers to determine whether or not the bankruptcy case should be dismissed.² Once the bankruptcy case is dismissed, the debtor will lose the protection of the automatic stay received under 11 U.S.C. § 362 and will not be able to obtain a discharge of his debts under 11 U.S.C. § 727.

The key to surviving a motion to dismiss under 11 U.S.C. § 707(b)(2) (hereafter a “(B)(2) Motion”) will be one of three options: (1) arguing that the debtor didn’t fail the means test, (2) arguing that there are special circumstances that rebut the presumed abuse, or (3) arguing that, despite a presumption of abuse, there are significant policy reasons why the court should exercise its discretion and not dismiss the case. This article primarily explores and analyzes the current case law of the second of the three options, but, in addition, also provides information on the other two options to surviving a (B)(2) Motion.

¹ Kathleen Murphy & Justin H. Dion, “Means Test” or “Just a Mean Test”: An Examination of the Requirement that Converted Chapter 7 Debtors Comply with Amended Section 707(b), 16 Am. Bankr. Inst. L. Rev. 413 (2008).

² See § 707(b)(1) where, “after notice and a hearing, the court...may dismiss a case filed by an individual debtor” (emphasis added).

II. The “Means Test” & Proving its Elements

The means test was designed to be a “snap shot” review of the debtor’s financial state at the date of the bankruptcy petition filing. Based on the specific wording of 11 U.S.C. § 707(b)(2)(A), most courts have held that the means test is not to take into consideration any post-petition changes in the debtors’ circumstances—i.e., only the debtors’ financial circumstances on the date of the bankruptcy filing may be taken into account.³ Initially, prior to arguing that there are special circumstances that rebut the presumption of abuse, the debtor should consider arguing that the presumption of abuse never even arose by reviewing the various deductions to determine whether or not various secured payments were properly deducted⁴ as well as whether various allowances were properly deducted.⁵

As the means test formula is very specific and inflexible, many pre-petition expenses that negatively affect the debtor may be outside the means test formula and cannot properly be used. Anything that occurs to the debtor post-petition also should not be used within this realm of defense. Only expenses allowed under § 707(b)(2)(A) should be considered when determining that the presumption of abuse arises; post-petition changes or unusual expenses outside of the test are instead special circumstances that are to be used to rebut the presumption of abuse under § 707(b)(2)(B).

³ *In re Rudler*, 388 B.R. 433, 348 (1st Cir. B.A.P. 2008), *In re Hoss*, 392 B.R. 463, 467 (Bankr. D. Kan. 2008), *In re Quigley*, 391 B.R. 294, 303 (Bankr. N.D. W.Va. 2008), *In re Hayes*, 376 B.R. 55, 64 (Bankr. D. Mass. 2007).

⁴ Ongoing in many bankruptcy courts is the continuing debate of whether secured payments on property being surrendered can be deducted under the means test. Most courts have permitted the deductions, even if the debtor intended on the petition date to surrender the property and does so., e.g., *Rudler*, 388 B.R. at 439; accord, *In re Maya*, 374 B.R. 750 (Bankr. S.D. Cal. 2007); *In re Longo*, 364 B.R. 161 (Bankr. D. Conn. 2007); *In re Osborne*, 374 B.R. 68 (Bankr. W.D.N.Y. 2007). Although most courts have permitted the deductions, largely citing the “plain language” of the statute as support, some courts have not allowed the deduction, finding that it goes against the “purpose” of the statute, see *In re Harris*, 353 B.R. 304, 308 (Bankr. E.D. Okla. 2006).

⁵ 11 U.S.C. § 707(b)(2)(A)(ii) allows expenses in addition the IRS standards that are to be deducted, including: health insurance; disability insurance; health savings account expenses; expenses needed to maintain the safety of the debtor or debtor’s family from family violence; necessary expenses for caring for elderly, ill, or disabled household members or immediate family; administrative expenses for administering a chapter 13 plan; actual expenses to send a dependant child to a private or public elementary or secondary school; housing or utility expenses in excess of the allowance specified in the IRS Local Standards; and expenses for payment priority claims.

III. Special Circumstances: What does this mean?

In order to rebut the presumption of abuse, the debtor is required to demonstrate special circumstances to the court. Two examples of such circumstances were specifically provided in § 707(b)(2)(B) by Congress: a serious medical condition or a call/order to active duty in the Armed Forces. These two circumstances are, of course, not to be considered the exclusive circumstances that can be used by debtors.

Courts who have considered the meaning of “special circumstances” have had varying interpretations as to what types of special circumstances can be used to rebut the presumption of abuse. Some courts, alternatively, have not had to bother coming up with an interpretation of the substantive meaning of special circumstances. These latter courts instead found procedural reasons to dismiss the debtor’s case and ignore the debtor’s circumstances. This is because 11 U.S.C. § 707(b)(2)(B) has procedural requirements along with its substantive requirements that must be strictly followed.⁶

A. Procedural Requirements of § 707(b)(2)(B)

In order to prevent a defense of special circumstances from being ignored for procedural reasons, the debtor must (1) itemize the additional expenses or adjustments of income, (2) provide documentation for these expenses or adjustments, (3) and provide a detailed explanation of why these expenses or adjustments “are necessary and reasonable.” Furthermore, the debtor must “attest under oath to the accuracy of any information provided” and show that, with these expenses included in the means test calculations, that they would have survived the test.⁷ Some courts in reliance of those procedural requirements have refused to consider whether the

⁶ *In re Fonash*, ___ B.R. ___, 2008 WL 5248175 at *5 (Bankr. M.D. Pa. 2008); *In re Hernandez*, 2008 WL 5441279 at *4 (Bankr. N.D. Ohio 2008); *In re Pageau*, 383 B.R. 221, 225 (Bankr. D.N.H. 2008); *In re Tamez*, 2007 WL 2329805 at *6 (W.D. Tex. 2007).

⁷ 11 U.S.C. §§ 707(b)(2)(B)(ii)-(iv).

substantive merits would create a special circumstances defense.⁸ There is a substantial likelihood that a failure to provide evidentiary support of the special circumstances will cause the case to be dismissed without a decision on the actual merits—whether the debtor’s circumstances would qualify as special circumstances—and even if the debtor has circumstances that the court wouldn’t find special, without the corroborating evidence, there is less of a chance that the court will choose to exercise its discretion to not dismiss the case despite the presumption of abuse.

B. Substantive Requirements of § 707(b)(2)(B)

There are two different lines of court cases interpreting meaning of special circumstances. These lines of interpretations are a result of the courts attempting to determine the meaning behind Congress providing examples in § 707(b)(2)(B)(i), the serious medical condition and Armed Forces examples. The first line of cases have a narrow interpretation of the statute so that only limited types of circumstances could rebut the presumption, whereas the other line takes a more expansive view of the meaning of the statute.

1. *Ejusdem Generis*

Some courts have used the doctrine of *ejusdem generis* (“of the same kind”) for their statutory interpretation, determining that circumstances be must similar the statutory examples—a very high threshold to meet. Few courts applying this standard have been able to determine what types of circumstances would be special enough to be equivalent to the statutory examples, and therefore, only rarely has a court using this standard found a debtor “to have special circumstances.” Under this narrow standard, debtors have had to demonstrate circumstances that show commonality to Congress’s examples; characteristics of types of circumstances these courts sometimes look for, when using this doctrine, include: (1) unanticipated, (2) truly unavoidable, (3) beyond the reasonable control of the debtor, (4) out of the ordinary, (5)

⁸ See, as an example, *Fonash* in Footnote Six.

unforeseeable.”⁹ Courts in these cases rarely take into account whether there will be any disposable income after a conversion to Chapter 13 or whether other bankruptcy law would support such circumstances.¹⁰

2. Expanded View

Courts taking a more expanded view of special circumstances have done so for varying reasons. Some courts found the examples provided by Congress to be just that—examples—and that the plain language of § 707(b)(2)(B) did not limit the special circumstances exception to only situations similar in nature to the statutory examples.¹¹ Other courts, citing various congressional reports, found that the Armed Forces and medical condition examples were added, not to provide guidance on the types of circumstances, but rather to provide explicit protections for those who would have these special circumstances.¹²

In re Delbeq provides significant analysis of Congress’s likely intent when drafting § 707(b)(2)(B); *Delbeq* found that the special circumstances hurdle is not necessarily the high hurdle that so many bankruptcy courts find it to be, and instead found that based on the Conference Report accompanying H.R. 3150, “the term special circumstances [in fact merely] requires a fact-specific, case-by-case inquiry into whether the debtor has a ‘meaningful ability’ to pay his or her debts in light of an additional expense or adjustment to income not otherwise reflected in the means test calculation” rather than a determination of whether debtor’s

⁹ Look to *In re Cribbs*, 387 B.R. 324 (Bankr. S.D. Ga. 2008) for good analysis on this line of cases and further resources. on these characteristics. See also, *In re Morris*, 384 B.R. 235 (Bankr. W.D. Mo. 2008), *In re Delunas*, 2007 WL 737763 (Bankr. E.D. Mo. 2007), *In re Lightsey*, 374 B.R. 377 (Bankr. S.D. Ga. 2007), and *In re Johns*, 342 B.R. 626 (Bankr. E.D. Okla. 2006). Not all courts using the *ejusdem standard* have required these specific characteristics.

¹⁰ See *In re Pageau*, 282 B.R. 221, 229-231 (Bankr. D.N.H. 2008) and *In re Johns*, 342 B.R. 626, 629 (Bankr. E.D. Okla. 2006). Courts that do not follow *ejusdem generis* but also believe that the debtor’s circumstances should not be reviewed as if it were in a Chapter 13 include: *In re Haman*, 366 B.R. 307, 313-314 (Bankr. D. Del. 2007) and *In re Champagne*, 289 B.R. 191, 201 (Bankr. D. Kan. 2008).

¹¹ *In re Haman*, 366 B.R. 307, 313-314 (Bankr. D. Del. 2007).

¹² *In re Delbeq*, 386 B.R. 754, 756-760 (Bankr. S.D. Ind. 2007)(discussing comments made by Senator Jeff Sessions regarding his intent behind his proposed amendments adding these examples).

circumstances were outside the control of the debtor. The court, in addition, found that there does not appear to be any direct authority that limits the interpretation of special circumstances to only circumstances that the debtor has no control over. As the examples in § 707(b)(2)(B) could have also been due to voluntarily acts of the debtor, i.e., the debtor joining the military, an *ejusdem generis* interpretation that limits circumstances to only those circumstances outside the control of the debtor is off-track.¹³

IV. Outcomes

In the period since October 2005, there have been a wide variety of circumstances that have come before the courts. Courts have held that fluctuations of income can be special circumstances, the birth of additional children can be special circumstances, and suffering extra child care costs due to a child's disability can be special circumstances.¹⁴ A review of cases, published and unpublished, appears to show that courts tend to find against the debtor. This is often due to debtors not being able to demonstrate the financial effects of the circumstances¹⁵ or due to the courts having a narrow interpretation of special circumstances.¹⁶ Some of the most frequently debated special circumstances substantive issues have been the issue of repayment of loans made from retirement funds and the issue of student loan debt, non-dischargeable under 11 U.S.C. § 523(a)(8).

¹³ *Id.*

¹⁴ For cases involving fluctuations of income, see, *In re Robinette*, 2007 WL 2955960 (Bankr. D.N.M. 2007) and *In re Tamez*, 2007 WL 2329805 (W.D. Tex. 2007), for a case involving extra child care costs, see *In re Scarfiotti*, 375 B.R. 618 (Bankr. D. Co. 2007), and for a case involving the birth of an additional child, see *In re Martin*, 371 B.R. 347 (Bankr. C.D. Ill. 2007). Courts have also held on the side of the debtor for: extra costs due to mileage expenses for business purposes, e.g., *In re Turner*, 376 B.R. 370 (Bankr. D.N.H. 2007); costs to travel to have visitation with children, e.g., *In re Robinette*, 2007 WL 2955960; costs of joint debtors—legally separated—maintaining separate households, e.g., *In re Armstrong*, 2007 WL 1544591 (Bankr. N.D. Ohio 2007); costs of joint debtors—happily married—maintaining separate households so that debtor-wife would not lose custody of her children from her first marriage, e.g., *In re Graham*, 262 B.R. 844 (Bankr. S.D. Ohio 2007).

¹⁵ See the section above on the procedural requirements of 11 U.S.C. § 707(b)(2).

¹⁶ See the section above on the courts using an *ejusdem generis* standard.

A. Retirement Loan Repayments

Often, when trying to make ends meet, many debtors at a point prior to filing bankruptcy take out loans from their retirement funds; if not repaid, these loans will often be counted by the Internal Revenue Service as “income.” Many debtors desire to pay back these loans, despite their being unsecured, to not only avoid the taxes on this “income” but also to recoup their future retirement. Most decisions that held that repayment of retirement loans are special circumstances were later overturned or vacated and so there is not any case support for those debtors trying to argue that repayment of these loans should be special circumstances.¹⁷

Although there are few cases that have found retirement loan repayment to be special circumstances,¹⁸ two courts have exercised discretion and chose to not dismiss the cases rather than find special circumstances. Their decisions were based on the specific facts of the cases where there would not have been distributions to unsecured creditors in a Chapter 13 and where the debtors had non-extravagant lifestyles.¹⁹

One case favoring debtors that involved retirement loan repayment is *In re Cribbs*, but rather than finding the need to repay the specific loans to avoid certain outcomes to be a special circumstance—the focus of other courts—the *Cribbs* court instead focused on the debtors’ reasons for taking out the loans in the first place, finding the reasons for taking out the loans to be special circumstances. The debtors, under this set of facts, took out almost \$30,000.00 in retirement loans in an attempt to pay back their creditors based on representations from an agency they hired to negotiate their debt with their creditors. The negotiations failed and the debtors ended up filing bankruptcy. As the debtors would have to pay back the money to avoid

¹⁷*McVay v. Otero*, 371 BR 190 (W.D. Tex. 2007) (vacating the bankruptcy court’s order finding special circumstances) and *Eisen v. Thompson*, 370 B.R. 762 (N.D. Ohio 2007), (vacating *In re Thompson*, 350 B.R. 770 (Bankr. N.D. Ohio 2006)).

¹⁸*In re Lenton* is one of the few cases not overturned on appeal, 258 B.R. 651, 662 (Bankr. E.D. Pa. 2006).

¹⁹*In re Mravik*, 399 BR 202 (Bankr. E.D. Wis. 2008) and *In re Skvorecz*, 369 B.R. 638 (Bankr. D. Colo. 2007).

being taxed on the loan as income, and as the debtors had taken out the loans in an effort to avoid bankruptcy and pay their creditors, the court found substantial public policy reasons for letting the debtors go forward with their Chapter 7, considering that the debtors had given up exemptible property in their attempt to pay their creditors.²⁰

B. Student Loans

The issue of whether student loan payments are a special circumstance will likely to continue to be a hot topic in the future. Overall, while most courts who have considered the issue had student loan debt not be a special circumstance, more courts have found student loans to be special circumstances than repayment of retirement loans. But as student loan debt load is drastically increasing nationwide, there is potential more courts will be faced with this issue.²¹

For courts finding student loans to be special circumstances, there were two grounds that the courts often based their conclusion upon: that the debt itself was non-dischargeable and/or that the debtor would have had no distribution to unsecured creditors in a Chapter 13 plan.²²

²⁰ *Cribbs* is also one of the rare cases with a narrow interpretation of special circumstances, the *ejusdem generis* standard. The court adopted the:

“narrower view because [it] regard[ed] the broader interpretation to be so expansive and unfettered that it swallows the rule. In other words, the ‘meaningful ability to repay’ standard for finding that there are ‘special circumstances’ eviscerates the means test calculation by reintroducing, in every case, a more subjective judge-driven ‘smell test’ to decide whether debtors can afford to repay. Under this approach, inability to repay standing alone makes the circumstance ‘special.’” 387 B.R. at 329.

²¹ According to the 2003-2004 National Postsecondary Student Aid Study, the average debt load for those obtaining 4-year college degree was \$19,902.00, for those obtaining a Master’s degree, \$26,895.00 (excluding any undergraduate debt), and for those obtaining a Doctoral degree, \$49,007.00 (excluding any undergraduate debt). Statistics available at <http://www.finaid.org/loans>. Tuition costs to attend University of Illinois College of Law for 2008-2009 were set at \$36,000.00 (excluding administrative fees, books, and living expenses) for a non-Illinois resident, according to the school’s website at <http://www.law.uiuc.edu/prospective-students/costs-tuition.asp>, causing many law school students to graduate with well over \$100,000.00 in debt.

²² The lack of distribution in a Chapter 13 was usually due to the (non-dischargeable) student loan payments preventing the debtor from having any disposable income for the Chapter 13. Cases with these conclusions include: *In re Martin*, 371 B.R. 347, 355 (Bankr. C.D. Ill. 2007), *In re Delbecq*, 368 B.R. 754, 759 (S.D. Ind. 2007), *see generally*, *In re Templeton*, 354 B.R. 213, (Bankr. W.D. Okla. 2007), *In re Robinette*, 2007 WL 2955960 *5 (Bankr. D.N.M. 2007), *but see contrary*, *In re Hamam*, 366 B.R. 307, 315-318 (Bankr. D. Del. 2007) (finding student loan payments to be a “special circumstance” due to their nondischargeability but also finding that a debtor’s finances can not be reviewed for a potential Chapter 13 plan under a (B)(2) Motion—possibility of a Chapter 13 plan is only reviewable with a 11 U.S.C. § 707(b)(3) “totality of the circumstances” or “bad faith” motion to dismiss). Courts sometimes cited both reasons—non-dischargeability and lack of funding for a Chapter 13—but some cited only one of these reasons in their consideration of the issues.

Those courts having the opposite view—the view that the loans are not special circumstances—have based their conclusions on comparisons to other non-dischargeable debt, arguing that debtors committing intentional torts shouldn't be able to claim special circumstances because of their own non-dischargeable debt,²³ or they used the *ejusdem generis* standard and finding that student loan debt was not unforeseeable, outside the control of the debtor, or special enough.²⁴

Occasionally, for a handful of the courts that held that that student loan payments are not special circumstances, the cases involved financial circumstances where the debtor still had disposable income²⁵ after deducting the loan payments, meaning that the student loan payments weren't a critical issue that would have rescued the debtor from the (B)(2) Motion.²⁶ Under the procedural requirements of § 707(b)(2)(B)(iv), the debtor must show that the financial effects of the special circumstances causing them to fail the means test; where a debtor still fails the means test after deducting the student loans, the presumption of abuse will continue arise.

C. UST Discretion: Affecting the Substantive Case Law?

Many of the early cases tend to be pro-debtor, on numerous types of issues, but more recently, the arguments tend to focus more on retirement loan repayments and student loans, with the courts increasingly finding against the debtor. This may largely be due to role of the United States Trustee in the bankruptcy system.

The United States Trustee program (“UST”), a division of the Department of Justice, perform administrative oversight of bankruptcies and its mission “is to promote the integrity and efficiency of the bankruptcy system.”²⁷ One of its roles is to implement the means test that was

²³ *In re Lightsey*, 374 B.R. 377, 381 n. 3 (Bankr. S.D. Ga. 2007).

²⁴ *E.g.*, *In re Pageau* 383 BR 221 (Bankr. D.N.H. 2008), *In re Gillespie* 2008 WL 4671008 (Bankr. D.R.I. 2008),

²⁵ Courts have considered the “disposable income” for these cases under a Chapter 13 disposable income test and under the § 707(b)(2) test.

²⁶ *E.g.*, *In re Vaccariello*, 375 B.R. 809, 816 (Bankr. N.D. Ohio 2007).

²⁷ *United States Trustee Program: Oversight Hearing Before the H. Comm. on the Judiciary and Subcomm. on Commercial and Admin. Law* 110th Cong. (2007) (statement of Clifford J. White III).

Cases Under §707(b)(2) and (3)
A Survey of Judicial Positions on the Means Test,
Totality of Circumstances and Bad Faith

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§707(b)(2) — Income

Unemployment Compensation

In re Baden, 396 B.R. 617 (Bankr. M.D. Pa. 2008). Chapter 13 trustee objected to confirmation of debtors' proposed plan on basis that plan failed to commit all of debtors' disposable income to plan. Specifically, trustee argued that unemployment benefits received by debtors during six months prior to filing had to be included as part of debtors' CMI. Court held that unemployment compensation payments debtors received over six-month period preceding petition date were not "benefits received under the Social Security Act," and therefore had to be included in calculating CMI.

In re Sorrell, 359 B.R. 167 (Bankr. S.D. Ohio 2007). UST moved to dismiss under Section 707(b)(2). Court held that unemployment compensation payments debtors received over six-month period preceding petition date were "benefits received under the Social Security Act," that could not be included in calculating CMI.

Veteran's Benefits

In re Hedge, 394 B.R. 463 (Bankr. S.D. Ind. 2008). Unsecured creditor objected to confirmation of debtor's proposed plan on basis that plan failed to commit all of debtor's disposable income to plan. Court held that debtor's veterans benefits had to be included in calculation of debtor's CMI as such benefits did not fall within an enumerated exception to CMI.

Retirement Distributions

In re DeThamplé, 390 B.R. 716 (Bankr. D. Kan. 2008). Chapter 13 trustee objected to confirmation of debtor's proposed plan on basis that plan failed to commit all of debtor's disposable income to plan. Debtor-wife received distribution from her employee retirement plan

(401K) within the six-month period preceding petition date. Court held that debtors, in calculating their CMI, had to include income realized from 401K distribution.

***In re Wayman*, 351 B.R. 808 (Bankr. E.D. Tex. 2006).** Chapter 13 trustee objected to confirmation of debtor's proposed plan on basis that plan failed to commit all of debtor's disposable income to plan. Debtor, as part of property settlement agreement with former spouse, obtained custody, care, and control of former spouse's individual retirement account (IRA) prior to the six-month period preceding petition date. Debtor later received early distribution from IRA during the six-month period preceding petition date. Court held that debtor, in calculating her CMI, did not have to include income realized from IRA distribution because income was actually earned when the debtor first obtained custody, care, and control over the IRA.

***In re Sanchez*, Case Nos. 06-40886 and 06-40865, 2006 WL 2038616 (Bankr. W.D. Mo., July 13, 2006).** Chapter 13 trustee objected to confirmation of debtors' proposed plans on basis that plans failed to commit all of debtors' disposable income to plans. Debtors received distributions from their employee retirement plans (401K) within the six-month period preceding petition date, but argued that the distributions were actually "earned" prior to that six-month period. Court held that debtors, in calculating their CMI, had to include income realized from 401K distributions because earnings contributed to a 401K plan are not actually "received" until withdrawn and a distribution takes place.

Contributions from Non-Filing Spouse

***In re Travis*, 353 B.R. 520 (Bankr. E.D. Mich. 2006).** UST moved to dismiss under Section 707(b)(2). Court held that only amounts regularly contributed by non-debtor spouse to debtor's household expenses had to be included in debtor's CMI.

Self-Employed Income

Drummond v. Wiegand (In re Wiegand), 386 B.R. 238 (B.A.P. 9th Cir. 2008). Chapter 13 trustee objected to confirmation of debtors' proposed plan on basis that plan failed to commit all of debtor's disposable income to plan. Specifically, Chapter 13 trustee argued that debtors improperly calculated CMI when they deducted business expenses from debtor-husband's self-employed income at Part II of Form 22C. The bankruptcy court overruled the trustee's objection, and entered an order confirming the debtors' plan. On appeal the bankruptcy appellate panel reversed, holding that a chapter 13 debtor engaged in business cannot deduct ordinary and necessary business expenses from gross receipts for the purpose of calculating CMI at Part II of Form 22C.

Amounts Paid Regularly for Household Expenses

In re Swanson, No. 08-81388, 2008 WL 4540181 (Bankr D. Neb. Oct. 7, 2008). The UST moved to dismiss under 11 U.S.C. Sections 707(b)(2) and (3). In his motion, the UST asserted that certain housing and support payment expenses claimed by the debtor on his means test form were either improper, or were required to be offset by the very same amounts received by the debtor's fiancé during the six month period prior to filing. Specifically, the UST asserted that because the debtor's housing payments were being made by his fiancé at the time he filed his case, those expense deductions were either improper, or, if allowable, had to be offset as payments made by his fiancé on a regular basis for the household expenses of the debtor. Similarly, the UST asserted that to the extent the support payments in question were being made to the debtor's fiancé those payments had to be included as income on Debtor's Form 22A. The bankruptcy court agreed, holding that the debtor's claimed housing and support payment expenses had to be

offset by the same amounts received from the debtor's fiancé for those expenses, and that dismissal was proper pursuant to Section 707(b)(2).

Other Sources of Income

In re Royal, 397 B.R. 88 (Bankr. N.D. III. Nov. 7, 2008), Chapter 13 trustee objected to confirmation of debtor's proposed plan on basis that plan failed to commit all of debtor's disposable income to plan. Among other things, the trustee argued that the debtor's "earned income tax credit" should be considered income for the purposes of CMI on the debtor's Form 22A. The bankruptcy court agreed, ruling that because earned income tax credits were not specifically excluded from the plain language of Section 101(10A), Congress intended it to be included in the calculation of CMI.

§707(b)(2) — Household Size

In re Ellringer, 370 B.R. 905 (Bankr. D. Minn. 2007). UST moved to dismiss case under Section 707(b)(2). Court denied motion, ruling that Section 707(b)(7) precluded the filing of a motion based on a presumption of abuse. In doing so, the Court found that the term "household," for the purposes of Section 707(b)(7), includes the debtor and all other people living in the debtor's living quarters, whether related to the debtor or not. In making this determination, the Court utilized the Census Bureau's definition of household and rejected the Internal Revenue Service's position, which references dependents listed on a taxpayer's latest income tax return. Specifically, the Court found that because Section 101(39A)(A) utilizes the Census Bureau's definition of "household" in defining "median family income" it was appropriate to use that same definition in defining "household" for the purposes of Section 707(b)(7).

***In re Jewell*, 365 B.R. 796 (Bankr. S.D. Ohio 2007).** UST moved to dismiss case under Section 707(b)(2). Court held that debtors' daughter and her dependants — each of whom were dependent upon the debtors for their support, were unable to contribute any of their income to the debtors after paying their expenses, showed no evidence that their living arrangement was intended to be temporary, and showed no evidence that they failed to function as an economic unit with the debtors — were part of debtors' household. In making this determination, the Court rejected both the Census Bureau's definition, and the Internal Revenue Service's position regarding what constitutes a household.

§707(b)(2) - Expenses Housing and Utility

***In re Sullivan*, 370 B.R. 314 (Bankr. D. Mont. 2007).** UST moved to dismiss case under Section 707(b)(2). Court held that replacement costs for broken furnace and deck that posed safety threat to debtors and their family were allowable adjustments to local standard deduction for household expenses and utilities, but that other claimed adjustments — such as replacement of a fence, finishing a bathroom, and resurfacing a driveway — were not.

***In re Turner*, 376 B.R. 370 (Bankr. D. N.H. 2007).** UST moved to dismiss case under Section 707(b)(2). The debtors successfully rebutted the presumption of abuse. However, in its ruling, the Court noted that the local standard deduction for household expenses and utilities takes into account amounts necessary for maintenance and repair such as pest control expenses.

Vehicle Expenses — Line 22A

***In re Martinez*, 391 B.R. 424 (Bankr. E.D. Wis. 2008).** UST moved to dismiss case under Section 707(b)(2). At the time the case was filed the debtors owned 2 six- year-old-plus vehicles, each of which was encumbered. The debtor's claimed an additional operating expense for each vehicle in the amount of \$200.00, or in the alternative, a pro-rated operating expense

for each vehicle of less than \$200.00 (i.e., 200/60 months) based on when the debtors might extinguish all encumbrances on the vehicles under a hypothetical Chapter 13 plan. The Court held that the debtors were not entitled to claim the additional \$200.00 vehicle operating expense because each vehicle was encumbered on the petition date, and indicated that any attempt to pro-rate the additional \$200.00 vehicle operating expense would be speculative, and hence, inappropriate.

In re Slusher, 359 B.R. 290 (Bankr. D. Nev. 2007). Chapter 13 trustee objected to confirmation of plan because debtor, among other things, deducted the IRS Local Standard for vehicle ownership for a vehicle owned free and clear of liens. The bankruptcy court ruled that while the debtor was not entitled to claim an ownership expense for the unencumbered vehicle, he was entitled to claim an additional \$200.00 operating expense for the vehicle because it was more than six years old. **Vehicle Ownership Expenses — Lines 23/24 Representative Cases**
Allowing Ownership Expense

Neary v. Ross-Tousey (In re Ross-Tousey), 549 F. 3d 1148 (7th Cir. 2008). UST moved to dismiss case under Section 707(b)(2). The UST challenged the debtors' attempt to deduct the IRS Local Standard for vehicle ownership for a vehicle they owned outright. The bankruptcy court denied the UST's motion. The district court reversed and held that debtors must have an "actual" expense for vehicle ownership before the expense can be "applicable" to the debtor and thus allowable on the means test. On appeal the 7th Circuit reversed, agreeing with the bankruptcy court that the plain language of the statute supports the allowance of a monthly ownership expense and that "applicable expense" cannot mean the same as "actual expense."

Hildebrand v. Kimbro (In re Kimbro), 389 B.R. 518 (B.A.P. 6th Cir. 2008), *appeal pending* Case No. 08-5871 (6th Cir. Aug. 24, 2008). Chapter 13 trustee objected to confirmation of plan because debtors deducted the IRS Local Standard for vehicle ownership for vehicle owned free and clear of liens. The bankruptcy court overruled the trustee's objection and entered an order confirming the debtors' plan. On appeal the BAP affirmed, holding that above-median debtors were entitled to deduct an applicable monthly vehicle ownership expense for a vehicle that was not encumbered by a loan or lease payment.

Representative Cases Denying Ownership Expense

Babin v. Wilson (In re Wilson), 383 B.R. 729 (B.A.P. 8th Cir. 2008). Chapter 13 trustee objected to confirmation of plan because debtors deducted the IRS Local Standard for vehicle ownership for vehicle owned free and clear of liens. The bankruptcy court overruled the trustee's objection and entered an order confirming the debtors' chapter 13 plan. On appeal the bankruptcy appellate panel reversed, holding that debtors without vehicle loan or lease payments are not permitted to claim the vehicle ownership expense because such expenses are not applicable under Section 707(b)(2)(A)(ii)(1).

Ransom v. MBNA America Bank, N.A. (In re Ransom), 380 B.R. 799 (B.A.P. 9th Cir. 2007). Unsecured creditor objected to confirmation of plan because debtor deducted the IRS Local Standard for vehicle ownership for vehicle owned free and clear of liens. The bankruptcy court sustained the creditor's objection and entered an order denying confirmation of the debtor's chapter 13 plan. The bankruptcy appellate panel affirmed, ruling that the language of Section 707(b)(2)(A)(ii)(I), the common meaning of

"applicable," and the overall scheme of the Bankruptcy Code each reveal that vehicle ownership expenses only apply if a debtor actually has vehicle financing costs.

Tate v. Lentz, et al. (In re Tate), Case No. 08-32, 2008 WL 4489761 (S.D. Miss. Sept. 29, 2008), *appeal pending* Case No. 08-60953 (5th Cir. Oct. 6, 2008). UST moved to dismiss case under Section 707(b)(2). The UST challenged the debtors' attempt to deduct the IRS Local Standard for vehicle ownership for two vehicles they owned outright. The bankruptcy court granted the UST's motion. The district court affirmed ruling that the debtors could not claim vehicle ownership expense amounts on vehicles for which they have no vehicle ownership expenses.

Payroll Taxes — Line 25

In re Hale, Case No. 07-32744, 2007 WL 2990760 (Bankr. N.D. Ohio Oct. 10, 2007). UST moved to dismiss case under Section 707(b)(2). The UST challenged, among other things, the debtors' claimed expense deduction for payroll taxes. The bankruptcy court granted the motion, ruling that the debtors' claimed expense deduction for payroll taxes was overstated. In doing so, the court noted that the debtors were only entitled to deduct their actual tax liability, not necessarily the amounts withheld from their pay which was overstated due to over-withholding.

Court Ordered Payments — Line 28

In re Casey, 356 B.R. 519 (Bankr. E.D. Wash. 2006). Chapter 13 trustee objected to confirmation of plan because debtor, among other things, failed to properly amortize court ordered support payments that were due to expire on the 24th month of his plan. The bankruptcy court sustained the objection, ruling that the debtor was required to

amortize court ordered payments over a 60 month period per Section 707(b)(2)(A)(iv) of the Code.

Telecommunications — Line 32

In re Stimac, 366 B.R. 889 (Bankr. E.D. Wis. 2007). Chapter 13 trustee objected to confirmation of debtors' proposed plan on basis that plan failed to commit all of debtors' disposable income to plan. Court held that debtors were entitled to claim cellular telephone expenses necessary for their or their dependents health and welfare, or for the production of income; but that debtor's claimed land line expense could not be deducted as an expense since it was subsumed within the IRS Local Standard for housing and utilities.

Family Care — Line 35

In re Hicks, 370 B.R. 919 (Bankr. E.D. Mo. 2007). UST moved to dismiss case under Section 707(b)(2). The UST challenged, among other things, the debtor's claimed expense deduction for support of his healthy 21 year old son. The bankruptcy court granted the motion, ruling that the debtor's claimed expense deduction was improper because debtor's son was not an elderly, chronically ill, or disabled person in need of support as required under Section 707(b)(2)(A)(ii)(11) of the Code.

Payments on Secured Claims — Line 42 — Surrendered Collateral

Morse v. Rudler, et al. (In re Rudler), 388 B.R. 433 (B.A.P. 1st Cir. 2008), *appeal pending* Case No. 08-9007 (1st Cir. Jul. 16, 2008). UST moved to dismiss two cases under Section 707(b)(2). The UST's motions challenged the debtors' claimed secured debt repayment expenses for a vehicle and homes they intended to surrender. The bankruptcy court ruled that the debtors were entitled to claim the expenses. The bankruptcy appellate panel consolidated both

matters on appeal and affirmed, holding that the debtors could claim the expenses notwithstanding their intent to surrender.

***Randle v. Neary (In re Randle)*, Case No. 07-631, 2007 WL 2668727 (N.D. Ill. July 20, 2007).** UST moved to dismiss case under Section 707(b)(2). The UST's motion challenged the debtor's claimed secured debt repayment expense for a home she intended to surrender. The bankruptcy court ruled that the debtor was entitled to claim the expense. The district court affirmed, holding that the debtor could claim the expense notwithstanding her intent to surrender. The district court concluded that the debtor's mortgage payments "were still contractually due . . . even if [she] had not been paying [the] monthly mortgage payments," and that her filing of a Statement of Intent to surrender was "not an actual surrender."

***In re Ray*, 362 B.R. 680 (Bankr. D. S.C. 2007).** UST moved to dismiss case under Section 707(b)(2). The UST's motion challenged the debtors' claimed secured debt repayment expense for vehicles they intended to surrender. The bankruptcy court ruled that the debtors were not entitled to claim the expense, noting that in considering the phrase "amounts scheduled as contractually due" Congress contemplated a forward looking calculation requiring consideration of events contemplated in the debtors' Statement of Intent.

Payments on Secured Claims — Line 42 — 401K Loans

***Eisen v. Thompson (In re Thompson)*, 370 B.R. 762 (N.D. Ohio 2007).** UST moved to dismiss case under Section 707(b)(2). The UST's motion challenged the debtor's claimed secured debt repayment expense for a retirement plan loan repayment. The bankruptcy court ruled that the debtor was entitled to claim the expense. The district court

reversed, holding that the debtor could not claim the expense because the loan payments in question were not associated with a debt.

Statement of Presumed Abuse under §704(b)

In re Draisey, 395 B.R. 79 (B.A.P. 8th Cir. 2008). UST filed a motion to dismiss pursuant to Section 707(b)(3) within the 60 day deadline established under Fed. R. Bankr. P. 1017. Debtor challenged the motion arguing that the UST was required to file a statement indicating either a presumed abuse or a lack of a presumed abuse within the 10 day deadline established under Section 704(b). The bankruptcy court denied the UST's motion, ruling that the UST's filing of a statement indicating either a presumed abuse or a lack of a presumed abuse within the 10 day deadline established under Section 704(b) constituted a prerequisite to the filing of a motion to dismiss pursuant to Section 707(b)(3). The bankruptcy appellate panel reversed, holding that under the plain language of Section 704(B), the filing of a statement under Section 704(b) is not a condition precedent to filing a motion to dismiss under Section 707(b)(3).

In re Molitor, 395 B.R. 197 (Bankr. S.D. Ga. 2008). Debtors' Section 341 meeting of creditors was continued, and not concluded until 28 days after its originally scheduled date. UST filed a statement of presumed abuse within 10 days after that date, and a motion to dismiss pursuant to Sections 707(b)(2) and (3) within 30 days thereafter. Debtors challenged the (b)(2) portion of the motion, arguing that the statement of presumed abuse was filed after the 10 day deadline established under Section 704(b). The bankruptcy court denied the Debtor's objection to the motion, ruling that the 10 day deadline established under Section 704(b) runs 10 days after the date on which the debtor's 341 meeting of creditors concludes.

In re Close, 384 B.R. 856 (D. Kan. 2008). Debtors' Section 341 meeting of creditors was continued, and not concluded until 28 days after its originally scheduled

date. UST filed a statement of presumed abuse within 10 days after that date, and a motion to dismiss pursuant to Sections 707(b)(2) and (3) within 30 days thereafter. Debtors challenged the (b)(2) portion of the motion, arguing that the statement of presumed abuse was filed after the 10 day deadline established under Section 704(b). The bankruptcy court entered an order denying the (b)(2) portion of the motion. The district court affirmed, ruling that the 10 day deadline established under Section 704(b) runs 10 days after the originally scheduled date for a debtor's 341 meeting of creditors notwithstanding whether the 341 meeting has been continued.

§707(b)(3)(A) — Bad Faith

In re Oot, 368 B.R. 662 (Bankr. N.D. Ohio 2007). Bad faith found in debtor's lack of candor in filing schedules, funding of retirement plans prepetition and attempts to reaffirm luxury items after filing.

In re O'Brien, 373 B.R. 503 (Bankr. N.D. Ohio 2007). Dismissal justified under bad faith and totality of circumstances for debtors who purchased new home and vehicle within three months of filing, falsely characterized their unsecured debt as being "in collections," and listed their income on recent credit applications as being double what they listed on Form 22A.

In re Felske, 385 B.R. 649 (Bankr. N.D. Ohio 2008). Debtors attempt to reaffirm new, expensive house at expense of other creditors found to be abusive.

In re Haney, Case No. 06-40350, 2006 WL 3020961 (Bankr. W.D. Ky. Oct, 19, 2006), **affd.**, Case No. 06-150, 2007 WL 781321 (W.D. Ky. March 9, 2007). Case dismissed under bad faith and totality of circumstances where wife incurred substantial credit card debt shortly

before filing and then did not list non-filing spouse's income despite the fact that the couple shared income and expenses.

In re James, 345 B.R. 664 (Bankr. N.D. Iowa 2006). Use of bonuses received shortly before filing to purchase luxury items rather than paying down debt constitutes bad faith.

In re Mitchell, 357 B.R. 142 (Bankr. C.D. Cal. 2006). Incurring substantial credit card debt shortly before filing without a meaningful ability to repay debt constitutes bad faith.

§707(b)(3)(B) — Totality of Circumstances

Ability to Repay

In re Haar, 360 B.R. 759 (Bankr. N.D. Ohio 2007). Ability to pay may be exclusive factor in (b)(3) analysis.

In re dePellegrini, 365 B.R. 830, (Bankr. S.D. Ohio 2007). Mere fact that debtor "passed" the means test is no defense against (b)(3) motion.

In re Richie, 353 B.R. 569 (Bankr. E.D. Wis. 2006). Removal of "substantial" from statute demonstrates Congressional intent to make it easier to dismiss cases; debtor who was voluntarily unemployed had ability to repay debt.

Standards for Dismissal

In re Mestemaker, 359 B.R. 849 (Bankr. N.D. Ohio 2007). Debtors \$300 per month excess income over expenses exceeded "abuse threshold" under (b)(2) and was sufficient to indicate abuse under totality of circumstances.

In re Croskey, Case No. 06-33437, 2007 WL 1302571 (Bankr. N.D. Ohio May 1, 2007). 401(k) contributions and loan repayments are not permissible deductions when

determining a debtor's section 707(b)(3) ability to pay; case dismissed where, after the 401(k) allocations were excluded, the debtors could pay 100% of unsecured creditors in a 60-month plan.

***In re Lenton*, 358 B.R. 651 (Bankr. E.D. Pa. 2006), appeal pending Case No. 07-cv-178-ER (E.D. Pa. Dec. 26, 2006).** Court looked to debtor's ability to repay over applicable chapter 13 commitment period in determining case was abusive.

***In re Campbell*, Case No. 06-01656, 2007 WL 1376226 (Bankr. N.D. Iowa May 7, 2007).** Totality of circumstances demonstrated abuse where debtors had over \$500,000 in 401(k) accounts, gross annual income of over \$100,000, unsecured debt primarily consisted of "careless" credit card usage and debtors had ability to repay over 25% of their unsecured debt in 60 months.

***In re Pennington*, 348 B.R. 647 (Bankr. D. Del. 2006).** Where net monthly income is sufficient to repay 25% of unsecured debt within five years, filing is abusive under totality of the circumstances test.

added by BAPCPA by reviewing all cases for “abuse.” In “presumed abuse” cases,²⁸ the UST has 30 days to file either a motion to dismiss or file a statement why such a motion would not be appropriate.²⁹

According to the UST’s statistics, between October 2006 and June 2007, nine percent of debtors in Chapter 7 were above their state’s median income levels, but of these debtors, only ten percent were presumed abusive under the means test. During that period, the UST declined to file motions to dismiss in thirty percent of these presumed abuse cases, primarily for circumstances such as “job loss, reduction in income, or medical condition[s].”³⁰ Almost one in five of these decisions to not file a motion to dismiss under § 707(b)(2) were related to “high medical expenses or loss of income from illness or injury.”³¹ Over time, as case law has expanded on the topic and as the UST offices have streamlined their oversight procedures, the UST has likely been more carefully selecting the debtors for its § 707(b)(2) motions.

V. Judicial Discretion to Dismiss the Case

Despite failing to rebut the presumption of abuse, a debtor and his attorney may still plead with a bankruptcy judge to exercise his discretion to not dismiss the bankruptcy case.³² Various policy reasons would support such a plea. Despite the fact that Congress has determined that certain types of cases are to be presumptively abusive and despite the fact that the debtor may not have any special circumstances,³³ there may be times when the Chapter 13 alternative would be a poor choice for policy reasons, i.e., the only members of society to benefit would be

²⁸ Presumed abuse: where the debtor fails the means test, the debtor is presumed to be abusing the bankruptcy system.

²⁹ *Id.* See also 11 U.S.C. § 704(b). In the bankruptcy system, it’s the UST’s oversight role to file these motions.

³⁰ *Id.*

³¹ *Hearing on Working Families in Financial Crisis: Medical Debt and Bankruptcy the H. Comm. on the Judiciary and Subcomm. on Commercial and Admin. Law 110th Cong.* (2007) (statement of Clifford J. White III).

³² This discretion is available pursuant § 707(b)(1) where, “after notice and a hearing, the court...*may* dismiss a case filed by an individual debtor.” See *In re Mravik*, 399 BR 202 (Bankr. E.D. Wis. 2008) and *In re Skvorecz*, 369 B.R. 638 (Bankr. D. Colo. 2007) where both courts found a presumption of abuse but then both exercised their discretion to not dismiss the cases.

³³ This may depend on the interpretation of “special circumstances.”

the lawyers involved in the bankruptcy case. In Chapter 13, loans taken out of retirement accounts are included in the Chapter 13 plan,³⁴ and furthermore, in a Chapter 13, student loan payments are not included in the calculations of disposable income available for a Chapter 13 plan.³⁵ The reality is that if the narrow standard turns out to be the true intent of Congress, then the policies laid out by Congress in § 707(b)(2) will not match with many policies laid out by Congress in 11 U.S.C. § 1300 *et. seq.*, despite the fact that it will be the area of law the debtors will soon be forced to comply with after they convert their Chapter 7 into a Chapter 13 to avoid a complete dismissal of their bankruptcy.

³⁴ 11 U.S.C. § 1322(f).

³⁵ Payments on student loan debts are continued in a Chapter 13 plan, and if the plan calls for full payment of all allowed claims, interest on the student loans may be paid pursuant to 11 U.S.C. § 1322(b)(10). Under 11 U.S.C. § 1328(a)(4), student loan debts are non-dischargeable in a Chapter 13 just as they are under any other chapter in bankruptcy, unless the “hardship” exception in 11 U.S.C. § 523(a)(8) applies.