HOLDING DEBTORS' FREEDOM FOR RANSOM? *RANSOM V. FIA CARD SERVICES*

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INTRODUCTION

The current financial environment has given rise to an increasingly prevalent occurrence: bankruptcy. Consumer bankruptcy filings reached over 1.45 million in 2009[1] and although statistics are not in for 2010, filings were projected between 1.5 and 1.75 million in 2010,[2] and are projected to

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1. *See* U.S. Courts Bankruptcy Statistics, *available at* http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2009/1209_f2.pdf.

2. *See* Katherine L. Swise, *Reconciling the Irreconcilable: Calculating a Debtor's Projected Monthly Income Under §1325(b) in Light of the BAPCPA Amendments*, 2010 U. ILL. L. REV. 719, 720 (2010).

be around 1.45 million in 2011.[3] The Bankruptcy Code ("Code") has always balanced two policy goals: first, allow debtors to receive a fresh start; and second, protect creditor interests in repayment of their claims.[4] As the first major overhaul to the Code in nearly 30 years, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA")[5] was implemented to "improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system."[6] The main reason was to deter abuse of the system by debtors who were paying their creditors less than the "maximum they can afford."[7] Although Congress had noble goals, the end result "was a Code leaving bankruptcy courts 'awash in ambiguity' and 'illustrat[ive] of [some of] the most creative examples of legislative legerdemain.'"[8]

One of the many ambiguities created by BAPCPA is whether an above-median-income debtor who does not make a vehicle loan or lease payment may take an ownership cost deduction when calculating his projected disposable income through the means-test.[9] The Supreme Court granted a writ of certiorari in *Ransom v. FIA Card Services*[10] ("*Ransom*") in order to resolve a circuit split regarding this question. Before *Ransom*, twenty-one bankruptcy courts had determined that the debtor was allowed to take this deduction while thirteen bankruptcy courts and one district court found the opposite.[11] By the time *Ransom* reached the Supreme Court, three Circuits (Fifth, Seventh, and Eighth) had ruled that the debtor could deduct

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3. Bob Lawless, *Projected Filings for 2011*, CREDIT SLIPS (Jan. 26, 2011), http://www.creditslips.org/creditslips/2010/12/projected-filings-for-2011.html.

4. Kibbe v. Sumski (*In re* Kibbe), 361 B.R. 302, 315 (B.A.P. 1st Cir. 2007); Cent. Va. Cmty. Coll. v. Katz, 546 U.S. 356, 364 (2006); Ford Motor Credit Corp. v. Bankr. Estate of Parmenter, 527 F.3d 606, 609 (6th Cir. 2008); Edleman v. Gleason (*In re* Silver Mill Frozen Foods, Inc.), 23 B.R. 179, 184 (Bankr. W.D. Mich. 1982) ("While one of the purposes of the Bankruptcy Code is to insure a 'fresh start' for debtors, an equally important purpose is to provide for an equitable distribution of the bankrupt's assets among his creditors." (citing Browy v. Brannon, 527 F.2d 799, 802 (7th Cir. 1976))).

5. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended at 11 U.S.C. §§101-1532 (2006)) [hereinafter BAPCPA]. The Code has been amended before, e.g. 1984 and 1994, but BAPCPA was a major overhaul to the Code.

6. BAPCPA, *supra* note 5, *reprinted in* 2005 U.S.C.C.A.N. 88, 89.

7. H.R. REP. NO. 109-31, pt. 1, at 2 (2005).

8. *See* Swise, *supra* note 2, at 719; *see also* Fokkena v. Hartwick, 373 B.R. 645, 652 (Bankr. D. Minn. 2007) (stating that BAPCPA was "a poorly written statute").

9. While above-median-income debtors only account for about 25 percent of Chapter 13 filings, this ultimately accounts for approximately 200,000 filings per year. *See* American Bankruptcy Institute teleconference on the ruling of *Ransom v. FIA Card Servs., N.A.*, (Jan. 19, 2011), http://www.law.arizona.edu/news/collegenewsdetail.cfm?ThreadID=824.

10. Ransom v. FIA Card Servs., N.A., 562 U.S. ___ , 131 S. Ct. 716 (2011).

11. *In re* Vesper, 371 B.R. 426, 428-29 (Bankr. D. Alaska 2007).

this expense without paying a loan or lease payment, while the Ninth Circuit disallowed the deduction.[12]

This article analyzes the Supreme Court's recent decision in *Ransom* and the uncertainties that practitioners will face as a result of the decision. The *Ransom* case ultimately resolved a circuit split regarding the meaning of "applicable expenses" under the means-test for Chapter 13 debtors by favoring the creditors' position. Aside from whether the Court in *Ransom* was correct, there are tremendous implications for potential debtors filing as above-median-income debtors and finding the necessary expense deductions to qualify them for bankruptcy protection.

This article is broken down into four sections. Part I, introduces the elements required to qualify for Chapter 13 relief under the Code. Part II summarizes the Court's decision in *Ransom*. Part III, analyzes the unanswered questions left by the Court's decision in *Ransom* using three hypothetical debtor scenarios. First, much like Mr. Ransom's situation, what are the options for a debtor who enters bankruptcy with an unencumbered car? The second hypothetical debtor is one who enters bankruptcy with a loan or lease payment higher than the applicable Local Standards. Finally, the third hypothetical focuses on a question the *Ransom* case did not address, namely the issues facing a debtor who enters bankruptcy with loan or lease payments that are less than the applicable Local Standards. Finally, this article attempts to tie these hypotheticals together to provide some insight into how courts will address the issues arising from *Ransom v. FIA Card Services* in the future.

I. Disposable Income Under Chapter 13

Chapter 13 is an individual reorganization plan for debtors. It allows debtors to maintain non-exempt assets and pay creditors over a three- or five-year period. In order to qualify for relief under Chapter 13 of the Code, the debtor must satisfy four requirements:

1. Be an individual,
2. Have regular income,
3. Have noncontingent, liquidated, unsecured debts of less than $360,475, and
4. Have noncontingent, liquidated, secured debts of less than $1,081,400.[13]

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12. *See In re* Washburn, 579 F.3d 934 (8th Cir. 2009) (permitting an allowance); *In re* Tate, 571 F.3d 423 (5th Cir. 2009) (permitting an allowance); *In re* Ross-Tousey, 549 F.3d 1148 (7th Cir. 2008) (permitting an allowance); *In re* Ransom, 577 F.3d 1026 (9th Cir. 2009) (case below, refusing to allow the allowance); for a summary of other case law regarding the issue, *see* Ransom v. FIA Card Servs., N.A., 380 B.R. 799, 803-06 (B.A.P. 9th Cir. 2007).

13. *See* 11 U.S.C. § 109(e) (2006).

In addition to these four requirements are other factors the court must look at before confirming a debtor's plan. One of the most important things the court must determine is a debtor's disposable income in order to establish how much unsecured creditors will recover. Because secured creditors have access to collateral, the Code is mainly focused on providing unsecured creditors with a remedy.

Since creditors in Chapter 13, unlike in Chapter 11, do not vote on the debtor's proposed plan, the Code provides unsecured creditors with the opportunity, pursuant to 1325(b)(1),[14] to object if they feel they are being treated unfairly under the terms of the Chapter 13 debtor's plan. If a creditor or trustee does object to the plan, the debtor must pay the unsecured creditor's claim in full or commit "all of [his] projected disposable income to be received during the applicable commitment period"[15] to paying off his unsecured creditors ("disposable income test"). The statute defines disposable income as the debtor's current monthly income[16] minus the debtor's "reasonably necessary" expenses.[17] A debtor's "reasonably necessary" expenses are determined in one of two ways. If the debtor's annual income is below the median family income for his state and household size ("below-median income debtor"),[18] the judge has discretion to determine what expenses are "reasonably necessary."[19] If the debtor's annual income is above the median family income for his state and household size ("above-median-income debtor"), the "reasonably necessary" expenses are determined by the "means-test" under 11 U.S.C. § 707(b).

The means-test is used to determine eligibility for filing relief under Chapter 7. It does so by calculating which debtors have sufficient income to repay a portion of the unsecured creditors claims. If a debtor's current monthly income, when annualized, is less than the median income for the applicable state, Chapter 7 is a viable choice. If the debtor's annualized current monthly income is greater than the median income for that particular state, the debtor will most likely[20] only have Chapter 13 as option.

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14. 11 U.S.C. § 1325(b)(1) (2006).

15. 11 U.S.C. § 1325(b)(1)(A), (B) (2006) (commonly referred to as the "disposable income test").

16. 11 U.S.C. § 101(10A) (2006) (defining "current monthly income" as the average income from all sources during the previous six months preceding the filing of the petition).

17. 11 U.S.C. § 1325(b)(2) (2006).

18. These numbers are published using census data, accessible on the U.S. Trustee Program website. U.S. TRUSTEE PROGRAM/DEPT. OF JUSTICE, *Means Testing- Census Bureau, IRS Data and Administrative Expenses Multiplier*, (Feb. 14, 2011, 12:30pm), *available at* http://www.justice.gov/ust/eo/bapcpa/20101101/meanstesting.htm.

19. 11 U.S.C. § 1325(b)(2) (2006).

20. There are ways an above-median-income debtor can still qualify for Chapter 7, but this situation solely deals with above-median-income debtors in Chapter 13, so I will not focus on situations involving Chapter 7.

Although the means-test is not explicitly used in Chapter 13 cases, the means-test expenses, provided for by §707(b)(2), are used in the calculation of an above-median-income debtor's disposable income.

The income side of the disposable income test begins by looking at the debtor's current monthly income, which can then be adjusted for known or virtually certain future changes. For expenses, the means-test provides that "[t]he debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides."[21] As noted in the previous paragraph, the means-test determines the expenses for above-median-income debtors. The "National and Local Standards," and the "Collection Financial Standards"[22] ("CFS") are published by the Internal Revenue Service ("IRS") in order to calculate the repayment of delinquent taxes, but the amounts listed have been applied to determine what standard expenses an above-median-income debtor can claim. These National Standards include categories such as food and clothing and health care expenses, while the Local Standards include categories such as housing and utility non-mortgage expense, mortgage or rent expense, transportation ownership and operating costs, and other necessary expenses. As standard expense amounts, the debtor's actual expenses are generally not taken into consideration.

For this article, the relevant Local Standard expenses are the transportation costs,[23] which are broken into 2 subcategories: vehicle ownership costs and vehicle operating costs. Since neither the Code nor Form B22C, which is a step-by-step guide used to calculate the debtor's disposable income, describe what expenses fall into each category, many courts have referred to the CFS for guidance.[24] The CFS states that "ownership costs" apply to monthly loan or lease payments on an automobile, while "operating expenses" refer to maintenance, repairs, insurance, fuel, registrations, licenses, inspections, parking and tolls that are

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21. 11 U.S.C. § 707(b)(2)(A)(ii)(I) (2006) (alteration in original).

22. The Collection Financial Standards are supplemental guidelines that detail how to use the IRM tables and what the expense amounts mean. *See* IRS, Collection Financial Standards, http://www.irs.gov/individuals/article/0,,id=96543,00.html (last visited April 13, 2011).

23. The transportation standards consist of nationwide figures for loan or lease payments for ownership costs and additional amounts for operating costs that are broken by Census Region and Metropolitan Statistical Area. *See id.*

24. The Ransom court made it clear that the IRS Manuals and the Collection Financial Standards are not incorporated into the statute, but courts can still look to them for guidance. *See* Ransom v. FIA Card Servs., N.A., 562 U.S. ___ , 131 S. Ct. 716 (2011).

incurred.[25] The CFS further states that if a taxpayer has a car, but no car payment, the taxpayer can only take the operating expenses portion of the transportation costs.[26]

II. *Ransom v. FIA Card Services*

Jason Ransom filed for relief under Chapter 13 in July 2006. Based on his annualized current monthly income, he was an above-median-income debtor. Since he was an above-median-income debtor, his expenses for purposes of the disposable income test were determined by the means-test. Under the Local Standards for transportation, Ransom took the standard $471 deduction for vehicle ownership expenses for his 2004 Toyota Camry even though he owned it free and clear of any encumbrance. As a result, he had a disposable income of $210 a month, which Ransom could have proposed to pay over the 60-month commitment period.[27] Instead, Ransom proposed to pay more – $500 per month for 60-months to his unsecured creditors.[28] Under Ransom's proposed plan, his unsecured creditors would have received approximately 25 cents on the dollar[29]. But, the Chapter 13 Trustee and FIA Card Services ("FIA")[30] objected, arguing that Ransom had not committed all of his disposable income to the unsecured creditors. FIA further contended that Ransom should not be able to take the $471 vehicle ownership costs deduction because he did not have a current monthly loan or lease payment. Without the $471 vehicle ownership deduction, Ransom's disposable income was $681[31] a month. If the vehicle ownership deduction were disallowed, Ransom's unsecured creditors would then receive approximately $28,000 more over the 60-month payment plan.

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25. *Local Standards: Transportation*, IRS.GOV, http://www.irs.gov/businesses/small/article/0,,id=104623,00.html.

26. *Id.*

27. A debtors applicable commitment period is determined by 11 U.S.C. § 1325(b)(4). In layman's terms, if a debtor is an above-median-income debtor, the applicable commitment period must be five years, if the debtor is a below-median income debtor, the applicable commitment period is at least three years.

28. Brief for Appellant at 3, *In re* Ransom, No. 08-15066*,* 2008 U.S. 9th Cir. Briefs LEXIS 814 (9th Cir. April 8, 2008).

29. The 25% repayment is from case material. I could not find information based on what percentage repayment would be without the ownership cost deduction. Given the $82,500 in unsecured claims Ransom had, a payment of $681 a month would result in a 49% dividend.

30. FIA Card Services was formerly known as MBNA America Bank. On January 1, 2006 MBNA merged into Bank of America, and then on June 10, 2006 MBNA changed its name to FIA Card Services, National Association. *See Form 8-K for FIA Card Services, National Association,* YAHOO FINANCE (Oct. 20, 2006), http://web.archive.org/20070716133759/http://biz.yahoo.com/e/061020/8384408-k.html.

31. The $681 was composed of the original $210 the means-test provided plus the $471 disallowance for the ownership cost deduction.

The case essentially revolved around the meaning of the word "applicable" in §707(b)(2) of the statute.[32] Writing for the Court in an 8-1 opinion, Justice Kagan stated that the "debtor may claim not all, but only "applicable" expense amounts listed in the standard," and the question turns on whether the expense amount "is 'applicable' to him."[33] Since the Code does not define the word "applicable," the Court looked at the ordinary meaning of "applicable" in Webster's Third New International Dictionary, which defined the word as "capable of being applied: having relevance" or "fit, suitable, or right to be applied: appropriate."[34] Thus, the Court in *Ransom* found that, under the statute, an expense is applicable to a debtor when it is "appropriate, relevant, suitable, or fit."[35] The Court further reasoned that a debtor may only claim a deduction under the National or Local Standards if the deduction is appropriate for him – meaning that a deduction is appropriate "only if the debtor will incur that kind of expense during the life of the plan."[36] In other words, the word "applicable" is an eligibility requirement that determines if a debtor can use the IRS Manual tables.

The Court also relied on statutory context, stating that Congress intended the means-test to reflect a debtor's ability to afford repayment,[37] and that such an interpretation furthered BAPCPA's purpose of ensuring debtors "repay creditors the maximum they can afford."[38] The debtor claimed the word "applicable" meant the National and Local Standards are applicable to each debtor rather than serving as a filter for which deductions apply. He claimed the statutory language stating debtor's monthly expenses "*shall* be the debtor's applicable monthly expense amount under the National and Local Standards" supported this view.[39] Furthermore, Ransom argued that his interpretation highlights the difference between Congress' use of the words "actual" to describe other reasonable expenses while using the word "applicable" for the National and Local Standards.[40] Ransom argued that if Congress intended the debtor to use only his actual expenses,

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32. "The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides." 11 U.S.C. § 707(b)(2)(A)(ii)(I) (2006).

33. Ransom v. FIA Card Servs., N.A., 562 U.S. ___ , 131 S. Ct. 716, 724 (2011).

34. *Id.*

35. *Id.*

36. *Id.*

37. *Id.* at 720.

38. *Id.* at 725.

39. *Id.* at 726-27; 11 U.S.C. § 707(b)(2)(A)(ii)(I) (2010) (emphasis added).

40. Brief for Appellant at 8, Ransom v. FIA Card Servs., N.A., 131 S. Ct. 716, 178 L. Ed. 2d 603 (2011), No. 08-15066 (2008 U.S. 9th Cir. Briefs 15066).

it would not have used both words in the statute.[41] The Court determined that the debtor's interpretation "fail[ed] to comport with the statute's text, context, or purpose"[42] and does not further BAPCPA's purpose of ensuring debtors repay the maximum they can afford. The Court held that "there are no fictional expenses allowed."[43]

To decide if the vehicle ownership cost is applicable, the Court then defined the ownership expense category as covering only loan or lease payments for a vehicle. Since the debtor owned his car outright and had no loan or lease payment, the expense amount was not "applicable" to the debtor. As a result, the Supreme Court affirmed the Ninth Circuit's decision that the Local Standard expense amount is not "applicable" to a debtor who does not have a loan or lease payment on the car, and as such, the debtor may not claim an "ownership cost" deduction. In reaching its decision, the Court relied on both policy and a mechanical interpretation of §707(b)(2).

Given this result, what are the potential implications of the *Ransom* decision on debtors? In the next section, I explore the potential problems of the *Ransom* decision through several variations that may arise in the future Chapter 13 cases.

III. HYPOTHETICAL DEBTORS

A. Debtor with a Fully Paid Off Car

The first hypothetical is similar to the facts of the *Ransom* case – a debtor who submits a Chapter 13 payment plan with an unencumbered vehicle on which the debtor is making no loan or lease payments. In *Ransom*, the Supreme Court was adamant about the fact that debtors cannot take fictitious expenses, and ownership costs are only available for debtors who are currently making loan or lease payments on their vehicles.[44] While the decision may make sense in determining the payment plan details and in ensuring that debtors do not take deductions for expenses they do not have, it raises a number of other questions regarding the feasibility of plans and

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41. *See In re* Briscoe, 374 B.R. 1, 8 (Bankr. D.C. 2007).

42. I will leave the interesting question of whether Justice Kagan's announcement of a seemingly new standard of statutory construction (text, context, and purpose) is a move away from the "plain language" interpretation of bankruptcy provisions and the possible effects it will have on other sections under the Bankruptcy Code, for someone else to delve into.

43. Diane Davis, *Bankruptcy Attorneys Say Supreme Court's Ransom Case Leaves Unanswered Questions*, 23 BANKR. L. REP. 69 (Jan. 20, 2011) (BNA); *see also* Ransom v. MBNA Am. Bank, N.A., 380 B.R. 799, 807 (B.A.P. 9th Cir. 2007) (stating that "an expense amount becomes relevant to the debtor when he or she in fact has such an expense").

44. Ransom, 131 S. Ct. at 723.

the potential adjustments that judges may have to make to a debtor's current monthly income.

Imagine that an above-median-income debtor seeks relief under Chapter 13 and submits a payment plan where, because of the *Ransom* decision, he cannot take an ownership deduction expense. This results in the debtor paying roughly $470 more dollars a month under the plan, or around $28,000 more over the five-year applicable commitment period. Suppose the debtor is able to make the increased payments for the first three years of the plan, but then after year three, because of the age of his vehicle, his car's engine starts to break down and needs repairs. Vehicles that are paid off are generally older and more likely to require major repairs or need replacement than newer cars.[45] Because the debtor could not deduct an ownership expense, and the operating costs deduction covers "insurance…maintenance, fuel, state and local registration, required inspection, parking fees, tolls, [and] driver's license,"[46] where is the debtor going to find money to pay for these repairs? He is already committing "all disposable income" to his creditors so he cannot afford to purchase a new car and normal maintenance does not cover an engine repair, so he cannot afford that option either. Since he is operating under a Chapter 13 plan, the likelihood of obtaining a loan at a rate he can afford is very slim, so our debtor is left with the choice of taking money dedicated to another expense (paying the creditors' or basic necessities such as food or utilities) to pay for repairs. Without an automobile, he will not be able to get to work and earn money to continue paying on the plan.

Suppose that the debtor repairs his car, but by doing so misses two months of payments under his Chapter 13 plan, what options are available? What if, in addition to the problems with his car, the debtor's roof collapses? Without having a cushion in his payment plan, the debtor has to choose between fulfilling the payment plan and repairing his home and/or car. This fact pattern seems to suggest that *Ransom* will result in a higher failure rate for Chapter 13 payment plans, thereby denying the Code's "fresh start."[47] What can a practitioner do in order to resolve this potential problem for debtors whom he represents?

The government, in its amicus curiae brief in *Ransom*, stated that the "bankruptcy system has two safety valves to ensure that higher-income

45. Brief for Appellant at 12, Ransom, 131 S. Ct. at 178, No. 08-15066 (2008 U.S. 9th Cir. Briefs 15066); *In re* Thomas, 2007 WL 2903201 (Bankr. D. KS. Oct. 2, 2007) (holding that the reality is that a "debt-free car may need replacement during the course of the five year plan") (*quoting In re* Zaporski, 366 B.R. 758, 767 (Bankr. E.D. Mich. 2007)).

46. Ransom, 131 S. Ct. at 725, *but see In re* Pederson, 2006 Bankr. LEXIS 2725, 6 (Bankr. W.D. Iowa 2006) (holding that a debtor can take an operating expense deduction higher than the standard if the expenses are reasonably necessary and proven).

47. While there are no available statistics that have been compiled, the prevailing assumption is that there is a relatively high payment plan failure rate.

debtors without loan or lease payments will not suffer from being denied phantom vehicle expenses."[48] The first option, also mentioned by the Court in *Ransom*, is to file for a modification of the debtors repayment plan under 11 U.S.C. §1329(a). Second, the government and the Ninth Circuit Court of Appeals[49] noted that debtors who have older vehicles may be entitled to an additional $200 monthly expense allowance to help with the operation of older vehicles.[50] While each of these solutions may be viable in a narrow range of cases, the problems significantly outweigh the ability of a debtor to actually use these solutions.

The *Ransom* Court ultimately held that the statute does not authorize a cushion for debtors who may incur expenses during the life of the plan, and that the appropriate way to account for these unanticipated expenses is to bring a modification claim in light of changed circumstances under 11 U.S.C. §1329(a).[51] But what the government and the Court failed to consider[52] is that a claim for modification takes both time and money. Even though the attorney's fees would most likely be built into the remainder of the payment plan, this would not solve the debtor's problem of needing relief now. Next, in order to have a modification a plan has to be confirmed in the first place.[53] Given a debtor who needs to bring this modification does not have enough money to pay for repairs of an older car or purchase a newer car, the likelihood he is going to find the necessary funds, outside of the payment plan, to bring a modification suit is minimal. The debtor will likely be stuck with the original plan that cannot be paid once a contingency presents itself. Judge Weissbrodt, in *In re Swan*, articulated the concern best:

Considering the strong likelihood that Debtor will have to replace her vehicle during the term of the Plan, requiring that the Plan be modified if and when that occurs is, in this Court's opinion, an inefficient manner of

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48. Brief for United States as Amici Curiae Supporting Appellee at 10, Ransom, 131 S. Ct. at 178, No. 08-15066 (2008 U.S. 9th Cir. Briefs 15066).

49. Ransom v. FIA Card Servs., N.A., 577 F.3d 1026, 1031 (9th Cir. 2009); *see also* Fokkena, 373 B.R. at 652.

50. Internal Revenue Manual (IRM) §5.8.5.20.3 (Oct. 22, 2010).

51. Ransom, 131 S. Ct. at 729 (explaining that "At any time after confirmation of the plan but before the completion of payments under such plan, the plan may be modified, upon request of the debtor, the trustee, or the holder of an allowed unsecured claim, to… (1) increase or reduce the amount of payments on claims of a particular class provided for by the plan."); 11 U.S.C. § 1329(a).

52. I am not addressing the potential impacts of *res judicata* on the ability to bring a modification claim in this article.

53. There may also be an argument that modification could be better for the debtor because there is an argument that §1325 was not incorporated into §1329. This would mean the debtor could modify the plan outside of the §1325 requirements. *See* Evan J. Zucker, *The Applicable Commitment Period: A Debtor's Commitment to a Fixed Plan Length*, 15 AM. BANKR. INST. L. REV. 687, 721-22 (2007).

dealing with this issue. Every modification would require the Debtor to contact her attorney, have her attorney draft and file the necessary papers and serve notice on creditors. If a creditor should object, a hearing would have to be held, Debtor's counsel would have to file additional papers and appear at the hearing, and the Court would have to decide the motion. That process takes a significant amount of time, and costs a significant amount of money, in terms of attorney's fees, noticing costs, and judicial resources. All of that simply to allow Debtor to pay for a vehicle -- which is, in most cases, an absolute necessity in terms of allowing a debtor to maintain employment. Going through such a procedure under these circumstances in thousands of bankruptcy cases is not what Congress intended.[54]

With a modification presenting so many problems, debtors will be more likely to fail to maintain their payments, which puts the debtor back in the same position he was before bankruptcy – without the money to pay his debts and without a discharge.

The second problem with relying on §1329 as a remedy is that, "by its own terms, §1329 sets forth no standard as to when post-confirmation modification is permitted."[55] While it is generally understood that §1329 was not intended to address issues that were known at the time of confirmation,[56] courts have disagreed about whether a party seeking a §1329 modification must establish a post-confirmation change as a threshold requirement.[57] Some courts have held that no change in circumstances, either substantial or unanticipated, is required to modify,[58] while other courts do not require unanticipated changes, but require a legitimate reason for modifying.[59] Still other courts require that a "material change in circumstances, not reasonably anticipated at the time of confirmation, has occurred that would warrant relief from the prior confirmed plan."[60] For courts requiring a material change, it is difficult to determine how extensive the changes must be in order to grant modification.[61] The legislative history

54. *In re* Swan, 368 B.R. 12, 20 (Bankr. N.D. Cal. 2007).

55. Storey v. Pees, 392 B.R. 266, 270 (B.A.P. 6th Cir. 2008).

56. *Id.* at 272.

57. *Id.*

58. Meza v. Truman (*In re* Meza), 467 F.3d 874, 877-78 (5th Cir. 2006); *In re* Torres, 336 B.R. 839 (Bankr. M.D. Fl. 2005); *In re* Witkowski, 16 F.3d 739, 746 (7th Cir. 1994).

59. Barbosa v. Soloman, 235 F.3d 31, 41 (1st Cir. 2000).

60. Coastal Credit L.L.C. v. Mellors (*In re* Mellors), 372 B.R. 763, 769 (Bankr. W.D. Pa. 2007); *In re* Palmer, 419 B.R. 162, 165 (Bankr. N.D. N.Y. 2009); *In re* Belcher, 369 B.R. 465, 467 (Bankr. E.D. Ark. 2007); Murphy v. O'Donnell (*In re* Murphy), 474 F.3d 143, 149 (4th Cir. 2007); Green Tree Acceptance v. Hoggle (*In re* Hoggle), 12 F.3d 1008, 1011 (11th Cir. 1994); *In re* Jacobs, 263 B.R. 39, 46 (Bankr. N.D. N.Y. 2001).

61. Murphy v. O'Donnell (*In re* Murphy), 474 F.3d 143, 149 (4th Cir. 2007) (resolving two cases, holding that where the value of secured collateral had merely appreciated there was not a substantial change to merit a modification, but in the second

that accompanies §1329 seems to support this last standard. The House Report suggested that situations such as "a natural disaster, a long-term layoff, or family illness or accidents with attendant medical bills" that prevent compliance with the original plan would allow a modification.[62] This suggests that modification is allowed because of changed circumstances due to unanticipated events at confirmation.[63] Courts have defined a change as unanticipated if "the debtor's present financial condition could not have reasonably anticipated [the change] at the time the plan was confirmed."[64]

This definition of unanticipated change presents problems though. It seems reasonable to anticipate that vehicles that are paid off are generally older and more likely to require major repairs or need replacement during the five-year period.[65] If this is reasonable to anticipate, it may preclude some debtors from qualifying for a modification under an "unanticipated change" requirement. Furthermore, due to the wide variety of standards used by courts, a debtor may be able to obtain a modification in some jurisdictions but not in others. This has the effect of allowing some debtors to modify while others will not be so fortunate, thereby eroding uniform application of the Code.

There are also problems with the possibility of an extra $200 monthly expense for the operation of older or high mileage vehicles. The Internal Revenue Manual ("IRM"), in §5.8.5.20.3, provides that when a debtor has a vehicle that is either over six years old or has more than 75,000 miles on it, the debtor may be able to take an additional $200 monthly deduction under the operating expenses category.[66] In the examples after the section, the IRM states that if a taxpayer has a loan or lease payment on the vehicle, he

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case, a debtor who received a substantial amount of cash from the sale of secured collateral was a substantial change that merited a modification).

62. H.R. REP. No. 95-595, at 125 (1977).

63. Green Tree Acceptance v. Hoggle (*In re* Hoggle), 12 F.3d 1008, 1011 (11th Cir. 1994); (It should be noted that the applicable sections of §1329 of the bankruptcy code were not changed by BAPCPA and that Hamilton v. Lanning, 130 S. Ct. 2464, 2473 (2010) stated "absent a clear indication that Congress intended such a departure" the Code will not "erode past bankruptcy practice." (internal quotations omitted)).

64. *In re* Murphy, 474 F.3d at 149. *See, e.g.* Gerard R. Vetter, *Modifications of Chapter 13 Plans Under BAPCPA*, 28 AM. BANKR. INST. 827, *available at* http://www.abiworld.org/committees/newsletters/consumer/vol8num4/mod.pdf.

65. Brief for Appellant at 12, Ransom v. FIA Card Servs., N.A., 131 S. Ct. 716 (2011), No. 08-15066 (2008 U.S. 9th Cir. Briefs 15066).

66. IRM §5.8.5.20.3, *supra* note 50; *see also In re* Martinez, 391 B.R. 424, 429-30 (Bankr. E.D. Wisc. 2008) (holding that Chapter 7 debtors could not prorate the remaining twenty-five months of the sixty-month period in which the debtors' vehicles would have been paid off under a hypothetical sixty-month Chapter 13 repayment period to get the benefit of the $200 deduction).

cannot claim this expense.[67] This deduction is very narrow in that it only applies to debtors who own vehicles that are over six years old or who have more than 75,000 miles on their vehicles. For example, Ransom would not have qualified for this deduction because his car was only two years old when he filed for Chapter 13 relief. Moreover, while some courts have allowed this deduction and stated the debtors are entitled to it,[68] others have not been so lenient. Some courts hold that, Congress, in adopting the means-test and the applicable amounts listed in the National and Local Standards, did not incorporate the IRM, meaning that the additional $200 deduction cannot be taken.[69] Attorneys may argue that since the Supreme Court affirmed the lower court decision in *Ransom*, that part of the holding affirmed was the Ninth Circuit Bankruptcy Appellate Panel's decision to allow debtors to take this additional $200.[70] The practical effect of this deduction is that more debtors without loan or lease payments may try to take the deduction and hope that they are in a jurisdiction that allows it. This could lead to a higher objection rate from Chapter 13 trustees, more time litigating what acceptable expense deductions are, and possibly a higher failure rate of Chapter 13 payment plans. The end result is some cushion for a debtor, but not as much as the ownership deduction would allow.

Even if some courts do not allow the $200 deduction, the recent Supreme Court decision in *Hamilton v. Lanning*[71] ("*Hamilton*") may allow a debtor to argue that he is entitled to some adjustment for future expenses. The debtor in *Hamilton* was an above-median-income debtor whose income during the six months prior to bankruptcy was unrealistically high due to a one-time buyout she received during that time period. As a result, her statutory disposable income for payments to unsecured creditors was an amount she could not realistically afford and her plan could not be

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67. IRM §5.8.5.20.3, *supra* note 50; *see In re* McGuire, 342 B.R. 608, 613-14 (Bankr. W.D. Mo. 2006) (holding that because the debtors who own a car free of loan or lease payments cannot take an ownership expense, they are entitled to take an extra $200 deduction for cars that are older than six years or have 75,000 or more miles on them). For debtors willing to risk an objection, there may be an argument that the $200 deduction can be taken even if no loan or lease payment is being made. The 2005 version of the IRM stated that "in situations where the taxpayer owns a vehicle that is currently over six years old and/or has reported mileage of 75,000 miles or more, an additional operating expense of $200 will generally be allowed for the collection period that remains after the loan/lease has been retired." *See* IRM §5.8.5.5.2 (Sept. 1, 2005); *see also In re* Herbord, 2008 WL 149972, 1 (Bankr.. S.D. Ill. 2008). By removing the words "that remains after the loan/lease has been retired," from the 2010 version, the debtor may have an argument that the IRM meant to allow both the ownership and $200 deductions at the same time.

68. *In re* McGuire, 342 B.R. 608, 610-11 n.11 (Bankr. W.D. Mo. 2006).

69. *In re* Martinez, 391 B.R. 424, 429 (Bankr. E.D. Wisc. 2008).

70. *In re* Ransom, 380 B.R. 799, 808 (B.A.P. 9th Cir. 2007).

71. Hamilton v. Lanning, 560 U.S. ___, 130 S. Ct. 2464 (2010).

confirmed because it was not feasible.[72] Realizing that solely applying the disposable income test would produce an absurd result, the *Hamilton* court adopted a forward looking approach to calculating "projected disposable income" and held that "when ... calculat[ing] a debtor's projected disposable income, the court may account for changes in the debtor's income *or expenses* that are known or virtually certain at the time of confirmation."[73] The Court in *Hamilton* felt its decision was consistent with both the plain meaning interpretation of the Code and Pre-BAPCPA application of judicial discretion to account for known or virtually certain changes in the debtor's income.[74] Therefore, if a court applied the logic of *Hamilton* to the expense side of the disposable income test, it would still begin with the means-test expenses under §707(b) but, if necessary, would adjust those expenses to reflect the debtor's actual economic situation.

1. *Ransom's Interplay with Hamilton*

Ultimately, the *Ransom* and *Hamilton* decisions are at odds with each other because *Hamilton* is based on a forward-looking realistic approach whereas *Ransom* is based on a mechanistic approach. *Ransom's* mechanistic approach is tied to a strict interpretation of the language of the statute, whereas *Hamilton's* forward-looking "realistic" approach preserves judicial discretion to deviate from the specific language of the Code if it is deemed necessary. Hamilton stated that "the mechanical approach [may] deny creditors payments that the debtor could easily make," which would be inconsistent with BAPCPA goals.[75] The one congruent factor between the cases may be the underlying policy to prevent senseless results when interpreting the Code. Some courts have held that *Hamilton* is only applicable in narrow circumstances, only where there is a change in income or expenses,[76] but there is not enough case law interpreting *Hamilton* to know what its effect will be. It is possible that deviation from the "means-test" expenses for above-median-income debtors will only be considered in "exceptional" cases where significant changes exist, but once again, there is no guidance on what situations fall within this category.

The first question a debtor may ask in applying *Hamilton* is what is a known or virtually certain expense? According to the Webster's Third New International Dictionary, the applicable words are defined as follows:

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72. 11 U.S.C. § 1325(a)(6) (2006).

73. Hamilton, 130 S. Ct. at 2478 (emphasis added).

74. *Id.* at 2472.

75. *Id.* at 2476.

76. *In re* Darrohn, 615 F.3d 470, 477 (6th Cir. 2010) (holding that the debtor surrendering property constitutes a change).

1. Known is defined as "something familiar or recognized; familiar through knowledge or experience."
2. Certain is defined as "fixed, settled, stated[, or] sure, dependable,"
3. Virtually is defined as "almost entirely, for all practical purposes."

Putting these three definitions together seems to provide bankruptcy courts with the ability to alter income or expenses when, for all practical purposes, the change is well-settled, dependable, or familiar through knowledge or experience. Dictionary definitions provide a basis for a fairly liberal interpretation of when a deviation from income or expenses is allowed. For example, the fact that older cars break down more often than newer cars would generally be thought of as a well-settled fact that is familiar through knowledge or experience.

Although the cases that the *Hamilton* opinion refers to all deal with the income side of the disposable income equation,[77] the same reasoning should apply to the expense side,[78] even when the expenses "deviate from those calculated as of the date of filing under §707."[79] For example, in *In re Smith*, the court held that it could alter the expense side of the equation as well as the income side because the change was "virtually certain."[80] In *Smith*, all three debtors had homes with two mortgages. The first mortgage fully encumbered the properties of all debtors, so there was no collateral for the second mortgage to attach to. The debtors deducted from their current monthly income their second mortgages payments as secured debt payments "scheduled as contractually due"[81] even though they planned on stripping the lien under §506(a).[82] Section 506 of the Code holds that a creditor can only be secured to the extent that there is value in the asset for the lien to attach too, and to the extent the claim exceeds the value of the collateral, the claim is unsecured. Since the homes were fully encumbered by the first mortgage, the second mortgages would have nothing to attach to and would therefore be unsecured claims. Generally debtors cannot modify the claims of creditors secured by real property, but since the second mortgages were wholly unsecured, the debtors could strip the lien and treat the creditors' claims as general unsecured claims.[83] Applying *Hamilton's* rationale to the debtors proposed lien stripping, the court found a "virtually certain" change

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77. *See generally,* Hamilton, 130 S. Ct. at 2464.

78. DeHart v. Smith (*In re* Smith), 438 B.R. 69, 75 (Bankr. M.D. Pa 2010). *See also In re* Darrohn, 615 F.3d at 477 (stating that the *Hamilton* holding "clearly applie[s] to 'changes in the debtor's income *or expenses*'").

79. *In re* Barbutes, 436 B.R. 519, 524 (Bankr. M.D. Tenn. 2010).

80. *In re* Smith, 438 B.R. at 76.

81. 11 U.S.C. § 707(b)(2)(A)(iii)(I) (2006).

82. 11 U.S.C. §506(a) (2006).

83. *See* 11 U.S.C. § 1322 (2006).

and amended their expense calculation downward, disallowing the deduction for the second mortgage payments.[84]

The *In re Collier* court held that §707(b) expenses are the starting point for above-median-income debtors and the disposable income test, but variances are available upon a showing of unique circumstances.[85] The court said that the ability to take an expense under the means-test is still subject to a reasonably necessary test.[86] Furthermore, the court stated that "debtor[s] should have the ability to pay for some small diversion or source of recreation" and that "bankruptcy should not condemn the debtor to a life of abject poverty."[87] The *Collier* court refused to reduce a $68 monthly payment for a recreational 4-wheeler because of the de minimis amount.[88]

In a similar case that took future changes in expenses into account, *In re Barbutes*,[89] the court allowed the debtors an additional home maintenance expense given the debtors circumstances. The debtors were working full time and had no alternative housing choices; the expenses also were well documented.[90] In addition, the debtors were caring for their daughter and son-in-law, a disabled veteran, while the children got back on their feet.[91] The debtors sought an extra $683.70 a month for home and pool maintenance and higher utilities for their home, and while the statute did not specifically allow it, the court found special circumstances[92] and allowed it.[93] The court relied on the sacrifices the debtors had already made, the type of debt, and the extensive documentation as proof of the special circumstances.[94]

Collier seems to suggest that *Hamilton* allows debtors to provide a cushion in their Chapter 13 plans to cover emergencies. By arguing that bankruptcy should not condemn a debtor to a life of poverty, a debtor may be able to provide for a cushion in his Chapter 13 plan. Whether the debtor does so by claiming a higher recreation expense or arguing for a higher operating costs expense, the debtor can only benefit from seeking this cushion. In addition, if a debtor does have well-documented expenses and a legitimate reason to claim higher expenses, *Barbutes* provides incentives for

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84. *In re* Smith, 438 B.R. at 76. *See also In re* Darrohn, 615 F.3d at 477 (holding that surrendering property is a "change" in expenses that allows those payments of secured debt to be modified to reflect the reality of what the debtor will pay); *In re* May, 2010 Bankr. LEXIS 4046 (Bankr. E.D. Wis. 2010).

85. *In re* Collier, 2010 Bankr. LEXIS 2089, 7-8 (Bankr. M.D. Ala. 2010).

86 *Id.* at 8.

87. *Id.* at 8-9.

88. *Id.* at 9.

89. *In re* Barbutes, 436 B.R. 519 (Bankr. M.D. Tenn. 2010).

90. *Id.* at 525.

91. *Id.*

92. *See* 11 U.S.C. § 707(b)(2)(B)(i) (2006).

93. *In re* Barbutes, 436 B.R. at 525, 528.

94. *Id.* at 526.

debtors to claim those expenses, even if they are above the limits allowed by the means-test. Thus, it is possible that *Hamilton* provides bankruptcy judges with some discretion to alter the expenses for an above-median-income debtor to ensure that the debtor can survive and continue to make payments under his Chapter 13 plan.

2. *Pre-Hamilton Interpretation*

Since there is relatively little case law interpreting *Hamilton*, and since the Court in *Hamilton* said its decision was consistent with pre-BAPCPA law, debtors may be best served by referring to pre-BAPCPA and pre-*Hamilton* cases that favor the "forward-looking approach" that *Hamilton* adopted. One of the reasons *Hamilton* adopted the "forward-looking" approach was to avoid "senseless results" that would deny the protection of Chapter 13 to people who qualify for its protection.[95] Because of this same rationale, the majority of courts had adopted the forward-looking approach before *Hamilton* was decided.

In a pre-*Hamilton* case involving the expense side of the disposable income test, the court was faced with a situation where the debtor's 401(k) loan repayments would end after 24 months of a 60-month payment plan.[96] The court ultimately held that since the change in expenses was a known event, the debtor's plan could not be confirmed unless the plan devoted the extra disposable income to her creditors after her loan expenses were retired.[97]

Other courts have also adopted the same rationale. The *In re Turner* court held that the debtor's expenses could be modified when the debtor deducts expenses for a home mortgage while planning to surrender the home.[98] The court reasoned that a "fixed *debt* that will disappear: the deduction of [a] mortgage expense from the Chapter 13 debtor's disposable income is not intended to enrich the debtor at the expense of his unsecured creditors" and that a debtor cannot use a phantom deduction to reduce the recovery by his unsecured creditors without benefiting any other creditor.[99]

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95. Hamilton, 130 S. Ct. at 2475-76.

96. *In re* Nowlin, 366 B.R. 670, 672 (Bankr. S.D. Tex. 2007), *aff'd sub nom*. Nowlin v. Peake (*In re* Nowlin), 576 F.3d 258 (5th Cir. 2009).

97. *Id.* at 676.

98. *In re* Turner, 574 F.3d 349, 355-56 (7th Cir. 2009); *see also In re* Vernon, 385 B.R. 342, 347 (Bankr. M.D. Fla. 2008), *aff'g* Vernon v. Waage, No. 2:08cv-280, 2008 U.S. Dist. LEXIS 33987, at *3-4 (M.D. Fla. April 24, 2008) (holding that secured debts for property that will be surrendered must be subtracted from the expense side of disposable income).

99. *In re* Turner, 574 F.3d at 356 (alteration in original).

In a pre-*Hamilton* case, *In re Jass*,[100] the debtors had disposable income of $3625.63 a month, but they only proposed to pay $790 a month due to anticipated increased expenses for ongoing medical conditions.[101] The debtors argued that the medical bills would significantly reduce their income in the future and that the means-test expenses presented an inaccurate reflection of their disposable income.[102] Although the debtors did not provide enough evidence to prove the deduction was necessary, the court agreed that the "means-test" expenses are just a starting point and that future income and expenses can be taken into account when determining projected disposable income.[103] The debtor bears the heavy burden of proving the means-test numbers do not accurately reflect his financial situation.[104] Although courts have the ability to deviate from the means-test expenses, courts will not permit "hopeless speculation"[105] and will only account for changes that were "subject to some showing of projectability."[106]

While none of these cases dealt with an automobile, the same reasoning applies. All these cases dealt with expenses and deviations from the original numbers to more accurately reflect reality, which is exactly what a debtor in this situation will need to do. It is never known when a car may break down, but the reasoning in these cases suggests that a debtor can create a tiered plan to reduce disposable income for expenses that are "virtually certain" to take place part way through the applicable commitment period. This would most likely require data on when cars begin to break down in order to have a more definitive timeline.[107]

In addition, debtors may be best served by arguing policy to swing the courts view into allowing increased deductions on the expense side. If there is no deviation on the expense side to provide for a possible contingency, the application essentially punishes debtors for being diligent with their money and coming into bankruptcy with an older car that will likely need to be replaced instead of spending money to purchase a new car prior to entering bankruptcy. Given the dual aims of the Code, the practice of debt

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100. *In re* Jass, 340 B.R. 411 (Bankr. D. Utah 2006).

101. *Id.* at 414.

102. *Id.*

103. *Id.* at 416-17.

104. *Id.* at 419.

105. *In re* Crompton, 73 B.R. 800, 808 (Bankr. E.D. Pa. 1987) (citing 5 COLLIER ON BANKRUPTCY, ¶ 1325.08[4][a], [b], at 1325-47 to 1325-48 (15th ed. rev. 1996)).

106. *In re* Heath, 182 B.R. 557, 559 (B.A.P. 9th Cir. 1995) (holding that to include future tax refunds in income they must be subject to some showing of a projection, which the trustee failed to show). *See also* *In re* Brady, 361 B.R. 765, 769 (Bankr. D.N.J. 2007) and *In re* Boyd, 414 B.R. 223, 229 (Bankr. N.D. Ohio 2009), for more recent cases.

107. For example, the ADAC, Europe's biggest automobile club, compiles breakdown statistics on an annual basis.

avoidance and frugality should be emphasized prior to entering bankruptcy. Absent any deviation from the means-test expenses, however, debtors have an incentive to take on more debt to ensure that they not only are entitled to the "ownership deduction" but also have reliable transportation throughout while paying on their Chapter 13 plan.

There has never been a requirement that the debtor pay a single sum throughout the applicable commitment period. In an effort to compromise and take a less controversial position, the debtor may suggest that the court confirm a plan that provides a cushion for expenses part way through the applicable commitment period.[108] This would show sacrifice on the debtor's part, but also reflect the reality that older vehicles need more repair work. Another option would be to allow the Chapter 13 trustee to hold a certain amount of payments in escrow for the debtor in case an emergency is realized during the commitment period. If an emergency does happen, the Chapter 13 trustee can remit the money back to the debtor; if there is no emergency, the trustee will pay the excess funds to the creditors. If this option is taken, it is unlikely that a trustee will want to hold the escrow for the entire applicable commitment period and the trustee would most likely want a release of liability for holding the money.

Absent the available compromises listed above, the likely result of the *Ransom* decision is more Chapter 13 plans failing and possibly a higher rate of cases not being confirmed because the U.S. Trustee does not feel the plans are feasible for a five-year period. A debtor's attorney does have room to argue for the additional $200 deduction under IRM 5.5.8.20.3, or argue for a possible deviation from the means-test expenses under the reasoning of *Hamilton*. There are many different ways a debtor can go, but if he is asking for a tiered approach or a modification of expenses, he will need to provide proof that the replacement or repair expenses fall within the category of "virtually certain" to better his chances of obtaining the deduction. While post-confirmation modification may be a possibility, the *Hamilton* argument allows a debtor's changed circumstances to be addressed at the time of confirmation, which would preserve precious judicial resources[109] as well as provide a feasible plan that can be confirmed and carried out through the applicable commitment period to provide the debtor with the "fresh start" the code aims for. If none of these methods works, debtors will most likely engage in pre-bankruptcy planning and ensure they have a reliable transportation source throughout bankruptcy.

108. *See In re* Nowlin, 366 B.R. at 672, *aff'd sub nom*. *In re* Nowlin, 576 F.3d 258 (5th Cir. 2009).

109. Legislative history of BAPCPA seems to suggest that improving judicial efficiency was an aim of Congress in amending the Code. *See* H.R. REP. NO. 109-31, pt. 1, at 47 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 118 (stating that one of the primary goals of the amendments was to improve the system by "streamlining case administration").

This comes in one of two options, either purchase a newer car or obtain new loans on unencumbered vehicles prior to filing.[110] There is also no mention of the loan or lease expense being a purchase money security interest, which may allow the debtor to borrow against the vehicle for things that are already owed and must be repaid, such as to secure alimony or counsel fee payments. If a debtor does borrow against an existing vehicle, special care should be taken so it does not appear as if the lien is being incurred for the sole purpose of obtaining the Local Standard deduction. Put simply, "[i]n a world where a new car loan can decrease Chapter 13 payment obligations but keeping the old clunker does not, debtors will have even more reason to buy a new car before filing bankruptcy."[111] The only caveat is that the pre-bankruptcy planning must be in good faith and not appear as an attempt to abuse the system. As long as a legitimate reason can be developed why the debtor actually needs a newer car, it will be hard for a trustee to prevail on a good faith objection.[112] Ultimately, purchasing a newer car may be the smartest move because the debtor will have a reliable source of transportation, but may also receive a cushion through receiving the full ownership deduction by having a loan or lease payment, but we will see that situation played out with a later hypothetical debtor.

B. Debtor with Payments Higher than The Local Standards

The second hypothetical debtor, one who files for Chapter 13 relief while making a loan or lease payment on a vehicle that is above the amount listed in the Local Standards, raises questions regarding secured debt, as well as good faith.[113] Is a debtor in this situation allowed to take the full amount of his car payment or must the deduction be reduced to match the Local Standard amount?

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110. An "auto title" lending market is widely recognized. While this market generally targets less credit-worthy borrowers, higher income borrowers also take advantage of it. *See* Todd J. Zywicki, *Consumer Use and Government Regulation of Title Pledge Lending*, 22 LOY. CONSUMER L. REV. 425 (2010) (discussing the growth in nontraditional lending products and the need for them).

111. Bob Lawless, *Can You Deduct an Expense for a Car You Own?*, CREDIT SLIPS, http://www.creditslips.org/creditslips/2010/04/can-you-deduct-an-expense-for-a-car-you-own.html (last visited Feb. 4, 2011).

112. Attorneys may also have to beware of 11 U.S.C. § 526(a)(4), which allows creditors to seek sanctions against attorneys who advise debtors to incur new debt in anticipation of bankruptcy, but if the debt is incurred for reliable transportation that will improve the debtors ability to pay it does not seem to apply. 11 U.S.C. § 526(a)(4) (2006). It seems that reliable transportation will always increase the debtors' ability to pay by providing them a means of transportation for work. *See* Milavetz, Gallop & Milavetz, P.A. v. United States, 559 U.S. ___, 130 S. Ct. 1324, 1338 n.6 (2010).

113. For example, if the applicable Local Standard amount is $471, the debtors' monthly lease payment on his car would be $500.

Although debtors may not be able to deduct more than the Local Standards for their ownership expense, the means-test through §707(b)(2)(A)(iii), provides that debtors are allowed an expense deduction for monthly payments on secured debt, including debt on motor vehicles.[114] Even though the means-test forms are not binding,[115] Line 47 of Form B22C[116] allows debtors to deduct actual expenses for secured debt. The form also allows debtors to take a deduction for the Local Standard amount as well as the excess secured debt over the Local Standard. If the total payment is higher than the Local Standard, the deduction is capped at the actual loan or lease payment. This has the practical effect of encouraging large secured debt prior to entering bankruptcy – the higher the payment the debtor has, the lower the disposable income will be and the less the debtor will have to pay unsecured creditors in his plan.

The *Ransom* decision casts doubt on this method of treating secured debt. The *Ransom* Court stated, "[i]f a debtor's actual expenses exceed the amounts listed in the tables . . . the debtor may claim an allowance only for the specified sum, rather than [for] his real expenditures."[117] "For the other necessary expense categories, by contrast, the debtor may deduct his actual expenses, no matter how high they are."[118] The question is how to reconcile this language from *Ransom* with the Code's language allowing debtors to deduct "[t]he debtor's average monthly payments on account of secured debts."[119]

While the Code technically allows a deduction for secured debt, confirming a plan with expenses higher than the Local Standard amounts may be another story. Debra Miller, a Chapter 13 trustee in Indiana, stated that car payments greater than the Local Standards raise a red flag in her office.[120] BAPCPA has an overarching theme of preventing abuse and a specific goal of having the debtor pay all he is able to pay.[121] Given these goals, a debtor seeking relief under Chapter 13 with a vehicle payment higher than Local Standards allow may garner an objection for lack of a good faith filing under §1325.[122] Good faith is an important prerequisite for

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114. 11 U.S.C. § 707(b)(2)(A)(iii) (2006).

115. Ransom v. MBNA Am. Bank, 380 B.R. 799, 805 (B.A.P. 9th Cir. 2007).

116. Official Form 22C (Chapter 13), US COURTS (Dec. 2008), http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/BK_Forms_08_Official/Form_22C_1208_Combined.pdf.

117. Ransom v. FIA Card Servs., N.A., 562 U.S. ___, 131 S. Ct. 716, 727 (alteration in original).

118. *Id*.

119. 11 U.S.C. § 707(b)(2)(A)(iii) (2006).

120. Davis, *supra* note 43.

121. H.R. REP. NO. 109-31, *supra* note 7.

122. This objection, although generally from the Trustee, can also be on the court's own initiative, *see* Reymer v. Carrol, (*In re* Reymer), 403 B.R. 475 (Bankr. E.D. Mich. 2009); *In re* McNeely, 366 B.R. 542, 548 (Bankr. N.D. W. Va. 2007).

plan confirmation.[123] The question, however, is whether the requirement that the debtor propose the plan in good faith[124] has an economic component, especially after BAPCPA's amendments to the disposable income test in §1325(b).

1. *Good Faith Analysis By The Bankruptcy Courts*

Prior to BAPCPA, "bankruptcy courts, in determining 'good faith,' looked at whether the plan proposed substantial or meaningful repayment to unsecured creditors,"[125] but by introducing §1325(b) and its disposable income test, the substantial repayment inquiry was eliminated.[126] The *Farrar-Johnson* court stated that "[g]ood faith no longer ha[s] an economic component" and that "[d]isposable income is 'determined under *section 1325(b)* rather than as an element of good faith under *section 1325(a)(3)*.'"[127] Other courts have also concurred with this view, stating that "with the enactment of BAPCPA, the court's discretion to review the totality of circumstances and determine the reasonableness of a debtor's expenses in calculating disposable income has been curtailed."[128] The prevailing interpretation that the "BAPCPA amendments were intended to . . . reduce judicial discretion" strengthens this argument.[129] Other courts have disagreed with this view and hold that good faith still has an economic component. For example, the *In re Sandberg* court held that "it is bound to follow and apply the test of good faith as adopted by *Flygare*,"[130] which is a totality of circumstances view, and that Congress made no attempt to limit the existing case law concerning good faith when enacting BAPCPA.[131]

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123. 11 U.S.C. § 1325(a)(3) (2006).

124. *Id*.

125. *In re* Farrar-Johnson, 353 B.R. 224, 232 (Bankr. N.D. Ill. 2006) (quoting *In re* Smith, 848 F.2d 813, 820 (7th Cir. 1988)).

126. *In re* Farrar-Johnson, 353 B.R. at 232 (citing *In re* Smith, 848 F.2d 813, 820 (7th Cir. 1988)).

127. *In re* Farrar-Johnson, 353 B.R. at 232 (quoting *In re* Barr, 341 B.R. 181, 186 (Bankr. M.D.N.C. 2006)) (alteration in original) (emphasis added).

128. *In re* Rotunda, 349 B.R. 324, 332 (Bankr. N.D.N.Y. 2006); *In re* Barr, 341 B.R. 181, 184 (Bankr. M.D.N.C. 2006) (stating that §1325(b)'s test has subsumed a good faith based examination of the debtor's ability to pay).

129. *In re* Rabener, 424 B.R. 36, 44 (Bankr. E.D.N.Y. 2010) (alteration in original); *see also* Marianne B. Culhane & Michaela M. White, *Catching Can-Pay Debtors: Is the Means Test the Only Way?*, 13 AM. BANKR. INST. L. REV. 665, 681 (2005).

130. Flygare v. Boulden, 709 F.2d 1344, 1347 (10th Cir. 1983); *see also In re* Alt, 305 F.3d 413, 419 (6th Cir. 2002).

131. *In re* Sandberg, 433 B.R. 837, 848 (Bankr. D. Kan. 2010); *In re* Lewis, 347 B.R. 769, 774 (Bankr. D. Kan. 2006) (holding that BAPCPA did not amend *section 1325(a)(3)* so Flygare still directs the court in consideration of the debtors' good faith). *But see* Baxter v. Johnson (*In re* Johnson), 346 B.R. 256, 261-63 (Bankr. S.D. Ga. 2006) (holding that BAPCPA did limit judicial discretion but still applies some of the eleven factors).

Under this totality of circumstances view,[132] the *Sandberg* court reiterated *Flygare's* eleven factors to help determine whether a plan has been proposed in good faith. The *Flygare* factors are:

1. The amount of the proposed payments and the amount of the debtor's surplus;
2. The debtor's employment history, ability to earn and likelihood of future increases in income;
3. The probable or expected duration of the plan;
4. The accuracy of the plan's statements of the debts, expenses and percentage repayment of unsecured debt and whether any inaccuracies are an attempt to mislead the court;
5. The extent of preferential treatment between classes of creditors;
6. The extent to which secured claims are modified;
7. The type of debt sought to be discharged and whether any such debt is non-dischargeable in Chapter 7;
8. The existence of special circumstances such as inordinate medical expenses;
9. The frequency with which the debtor has sought relief . . .;
10. The motivation and sincerity of the debtor in seeking Chapter 13 relief; and
11. The burden which the plan's administration would place upon the trustee.[133]

The *Sandberg* court held that these eleven factors still maintain an economic component and are still viable in light of the disposable income test of §1325(b)(1)(B).[134] This good faith test not only adds up each applicable factor; but the weight assigned to each factor depends on the facts and circumstances of each individual case.[135]

In *Sandberg*, the debtor's plan proposed to keep a recreational boat worth $20,000, which accounted for nearly forty percent of the debtor's surplus, while only providing a 2.3% dividend to unsecured creditors.[136] Keeping the boat, a luxury good, at the expense of creditors, while also delaying other non-dischargeable payments, led to the conclusion that the plan was not proposed in good faith.[137] The *Sandberg* court found that "the bankruptcy court may still examine the ability to pay and determine whether

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132. This also includes prepetition actions of the debtor. *See In re* Hieter, 414 B.R. 665, 670 (Bankr. D. Idaho 2009).

133. Flygare, 709 F.2d at 1347-48 (alteration in original). The sixth circuit has also announced a similar twelve-part test to determine good faith. *See* Hardin v. Caldwell (*In re* Caldwell), 895 F.2d 1123, 1126-27 (6th Cir. 1990).

134. *In re* Sandberg, 433 B.R. at 842.

135. *In re* Jones, No. 07-10902-13C, 2008 Bankr. LEXIS 3127, at *11 (Bankr. D. Kan. Sept. 26, 2008) (citing Flygare v. Boulden, 709 F.2d 1344, 1348 (10th Cir. 1983)).

136. *In re* Sandberg, 433 B.R. at 838-39.

137. *Id*. at 845.

the proposed plan constitutes an abuse of the provisions, purpose, or spirit of Chapter 13."[138]

Similarly, other courts have held that "[s]imply because an item is an allowable expense on Form B22C does not shelter it from scrutiny under the Court's good faith analysis. *Section 1325(a)(3)* . . . is distinct and independent from the requirements of *1325(b)*."[139] In *In re Martin*, the court found that a debtor attempting to retain a ski boat and trailer while only paying his unsecured creditors $500 had not proposed his plan in good faith, noting that "it seems fundamentally inappropriate that a debtor might file for bankruptcy . . . and obtain a discharge of debt while still enjoying a luxury item."[140] Judge Kaplan in *In re Lasota* stated the point more bluntly:

> [That sometimes a plan] simply asks for too many advantages from the Chapter 13 process at your creditors' expense [and that] sometimes [it is necessary to] [g]ive up the Harley Davidson and increase your payment to your credit card debts and [other creditors] and then you can have a Plan confirmed that will discharge the rest.[141]

Following this line of cases, a Chapter 13 trustee or creditor facing a debtor with vehicle payments above the Local Standards may argue that the car is a luxury item and is not reasonably necessary for the "fresh start" of the debtor. As such, good faith should preclude the excess amount above the Local Standard amount.[142] This raises a concern that the debtor is

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138. *Id*. at 847.

139. *In re* Martin, 373 B.R. 731, 736 (Bankr. D. Utah 2007) (alteration in original) (emphasis added); *see also In re* Owsley, 384 B.R. 739, 750 (Bankr. N.D. Tex. 2008) (holding that "compliance with *section[s] 1325(b)(3)* and . . . *707(b)(2)(A)* is not dispositive of good faith because good faith embraces more than just lawful compliance with those sections"; good faith is assessed in the context of the totality of circumstances).

140. *In re* Martin, 373 B.R. at 736 (alteration in original); *see also In re* Cordes, 147 B.R. 498, 505 (Bankr. D. Minn. 1992) (holding that "creditors have full cause to complain if a debtor proposes to service a secured debt against expensive nonexempt assets, particularly where the claim is to receive high priority in payment under the plan. In such a case, the debtor proposes to build up equity in assets which the legislature has not found essential to a fresh start; more crucially, the debtor proposes to correspondingly defer, reduce, or even deny a return to other creditors on their prior claims, by diverting estate resources to nonessential purposes. This impermissibly tips the balance of bankruptcy relief far over to the debtor's side. Such a plan grants a windfall to the debtor, enriching him at creditors' expense to the extent of the equity accumulated post petition. It does not meet the requirement of § 1325(a)(3)").

141. *In re* Lasota, 351 B.R. 56, 59 (Bankr. W.D.N.Y. 2006) (alteration in original).

142. *See In re* Daniel-Sanders, 420 B.R. 102, 107 (Bankr. W.D.N.Y. 2009) (stating that "a Chapter 13 plan may not allow luxury expenses that impact adversely upon the rights of unsecured creditors"). *But see* Worksheet 4. IRM 5151 – Financial Analysis – Allowable Expenses And Questions And, Answers to Assist in Financial Analysis (Excerpts), 638-3rd T.M. WKS-4, *available at* http://www.lexisnexis.com (last visited April 11, 2011) (stating that "[t]here are some occupations [that] require luxury cars" and that the totality of

looking to take advantage of bankruptcy relief while not sacrificing anything.[143] The Code, however, does not give any guidance as to what loan value marks the limit of reasonableness and crosses over the line into a luxury expense. One court created a bright line test, stating that any vehicle loan over $16,000 would be considered a luxury expense.[144]

As *Ransom* noted, BAPCPA was enacted to ensure that debtors paid the maximum they could afford, and Chapter 13 trustees are not afraid to fight for that maximum dollar amount.[145] For example, courts have used the good faith analysis as a weapon to fight against debtors living too lavish a lifestyle to justify a discharge of their debts.[146] In addition to the factors previously listed, bankruptcy courts may also look at a subjective and/or objective analysis of good faith. The subjective analysis looks at the debtors' "actual state of mind" while the objective analysis focuses on "a reasonable person's hypothetical state of mind in [the] given circumstances."[147] Focusing on the objective aspect of good faith, an Ohio court refused to confirm a plan in which the debtors provided for a minimal dividend to unsecured creditors while making an $834 monthly car payment, and mortgage payments on a $365,000 home.[148] The court stated that "[a] Chapter 13 debtor who is not able to pay [his or her] creditors in full is generally expected to demonstrate a degree of belt tightening and this

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circumstances must be looked at the determine if it is reasonable, but also stating that "[i]f the taxpayer could be expected to drive a more reasonably priced car, steps should be taken to [reduce] the expense").

143. *See In re* Zalesli, 216 B.R. 425, 432 (Bankr. D.N.D. 1997) (holding that an automobile costing $416 a month was a luxury item and that "Blazers, Corvettes, campers, and fancy boats have all been regarded by courts as not reasonably necessary expenses"); *see also In re* Gibson, 142 B.R. 879, 882 (Bankr. E.D. Miss. 1992) (citing *In re* Jones, 55 B.R. 462, 446-67 (Bankr. D. Minn. 1985)) (holding that debtors who are paying for a Corvette and a Cadillac Deville could not confirm plans because debtors are not allowed to maintain their former lifestyle at the expense of creditors).

144. *In re* Daniel-Sanders, 420 B.R. at 107.

145 Ransom, v. FIA Card Servs., N.A., 562 U.S. ___,131 S. Ct. 716, 725 178 L. Ed. 2d 603 (2011)

146. *See In re* DePellegrini, 365 B.R. 830, 833 (Bankr. S.D. Ohio 2007) (debtor wished to give his two adult sons the same lifestyle they had before debtor's divorce); *In re* Dupuy, 433 B.R. 226, 229 (Bankr. S.D. Ohio 2010) (debtor and his non-debtor wife should not be able to retain a $400,000 home at a monthly cost of $2,500 at the expense of unsecured creditors); *In re* Namie, 395 B.R. 594, 594 (Bankr. D.S.C. 2008) (holding the plan was not proposed in good faith by only paying a one percent dividend to unsecured creditors while devoting nearly 75% of his household income to maintaining and curing his mortgage payment on a home worth $500,000). *But see In re* Sweet, 428 B.R. 917, 923 (Bankr. M.D. Ga. 2010) (stating that a large mortgage expense and a small dividend to unsecured creditors is not per se bad faith, but has to be looked at in the totality of circumstances).

147. *In re* McDonald, 437 B.R. 278, 286 (Bankr. S.D. Ohio 2010) (alteration in original).

148. *Id.* at 289.

may require some sacrifices."[149] In a similar fashion, an Idaho court stated that a debtor with high transportation costs and monthly residence payments exceeding $2,300, which was in excess of the Local Standards, could not have his plan confirmed unless he reduced his monthly expenses and proposed a plan that treated his creditors fairly.[150] In a 2009 New York case involving a vehicle loan in excess of $16,000, the court held that the debtor could either surrender the automobile and replace it with a lower-cost vehicle or, if she wanted to keep the vehicle, assure that repayment of the luxury component (portion of vehicle loan above $16,000) of the vehicle would not diminish the distribution that unsecured creditors would otherwise receive.[151] Still other courts have fallen somewhere in the middle, holding that good faith is still under consideration when looking at the debtor's financial situation, but the court would not expect to hear minor challenges to good faith, such as when a debtor could pay an additional $50 a month for the final ten or fifteen months of the plan.[152]

On the other hand, some courts have held that compliance with §1325(b)'s disposable income test precludes a good-faith challenge to any economic component under §1325(a)(3) based on the debtor's available income, except in cases of "manipulation, subterfuge, or unfair exploitation of the Code."[153] The *Spruch* court stated that BAPCPA did not wholly eliminate consideration of good faith, but that the analysis was only a subjective one and "should only be used to ferret out debtors 'engaging in

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149. *Id*. at 290 (alteration in original) (quoting *In re* Jones, 119 B.R. 996, 1000 (Bankr. N.D. Ind. 1990)); *see also In re* McNeely, 366 B.R. 542, 548-49 (Bankr. N.D.W. Va. 2007) (stating that "as part of that bargain, the debtor is expected to engage in a certain amount of 'belt-tightening' and forego unwarranted luxuries and a lavish lifestyle").

150. *In re* Stitt, 403 B.R. 694, 707 (Bankr. D. Idaho 2008).

151. *In re* Daniel-Sanders, 420 B.R. 102, 108 (Bankr. W.D.N.Y. 2009); *see also In re* Sandercock, No. 03-36260F, 2005 Bankr. LEXIS 3352, at *28 (Bankr. E.D. Pa. 2005) (ruling that a debtor's monthly payment of $567 for a Honda Pilot was not reasonably necessary when a similar car could have been obtained for $240 less a month); James Rodenberg, *Reasonably Necessary Expenses or Life of Riley?: The Disposable Income Test and a Chapter 13 Debtor's Lifestyle*, 56 MO. L. REV. 617, 644-48 (Summer 1991) (stating that "[t]ransportation, however, is one expense category where the courts can increase the dividend [to unsecured creditors by disallowing inappropriate vehicle expenses] with very little sacrifice by the debtor. This is possible because good, reliable, transportation is available at less than extravagant prices"). For more examples of debtors plans being rejected under a good faith analysis, see Diane M. Allen, *Effect, on "good faith" requirement of § 1325(a)(3) of Bankruptcy Code of 1978 (11 U.S.C.A. § 1325(a)(3)) for confirmation of Chapter 13 plan, of debtor's offer of less than full repayment to unsecured creditors*, 73 A.L.R. FED. 10 (1985).

152. *In re* Williams, 394 B.R. 550, 573 (Bankr. D. Colo. 2008).

153. *In re* Spruch, 410 B.R. 839, 843 (Bankr. S.D. Ind. 2008); *see also In re* Stitt, 403 B.R. at 703 (Bankr. D. Idaho 2008) (stating that under the "intermediate approach," after the debtor satisfies the mechanical projected income requirements, the court enters "a more subjective analysis of the debtor's good faith based on the totality of the circumstances").

subterfuge so blatant as to indicate that they have unfairly manipulated the . . . Code, or otherwise proposed [their] [c]hapter 13 plan in [such] an inequitable manner.'"[154] In the *Spruch* case, the court held that even though the debtors were keeping a Hummer with a $1,000 monthly payment and a vacation time share for $58 a month, the debtors did not propose their plan in bad faith since they were in compliance with §1325(b).[155] This was true even though the debtors were paying "virtually no unsecured debt" through their plan.[156] If a debtor in this situation falls under a jurisdiction with a *Spruch* approach, he may be able to receive relief under the code as well as keep his high priced vehicle.

2. *Application of Good Faith To The Hypothetical Debtor*

Needless to say, any test that a court adopts will be a highly fact intensive inquiry based on the totality of the circumstances. In the cases cited above, the majority of the debtors were trying to keep "luxury" items while only repaying a minimal amount (less than ten percent) of their unsecured debt. Repaying a minimal amount, by itself, is not indicative of bad faith, but is more likely to be ruled a bad faith proposal by paying nominal amounts.[157] If a debtor proposes a higher dividend rate, a court may be more willing to allow the debtor to keep a vehicle with payments exceeding the Local Standard amount. Furthermore, if a debtor can show that he is making sacrifices to keep the "luxury" item by cutting expenses in other categories[158] and trying to "tighten his or her belt," it may be easier for the debtor to prove the plan does not violate the good faith requirement of §1325(a)(3). A debtor is free to spend money on what he wants, but "[s]ection 1325(a)(3) requires . . . that the debtor justify that what he has proposed to keep for himself vis-a-vis what he proposes to pay his creditors under his plan is a fair allocation under the circumstances."[159] To show the vehicle is being kept in good faith, a debtor could prove that it would be more cost effective to keep it because there is some equity built up and it would cost more to replace it than to continue paying it off. Yet, given that there are more affordable cars available, it may be hard to show that a vehicle with a large payment is required when the debtor could most likely

154. *In re* Spruch, 410 B.R. at 844 (alteration in original) (quoting *In re* Williams, 394 B.R. 550, 572-73 (Bankr. D. Colo. 2008)).

155. *In re* Spruch, 410 B.R. at 844.

156. *Id.*

157. *See* Allen, *supra* note 151.

158. *See In re* Daniel-Sanders, 420 B.R. 102, 107 (Bankr. W.D.N.Y. 2009); I*n re* McGillis, 370 B.R. 720, 751 (Bankr. W.D. Mich. 2007) (stating that "[t]he Mercedes or Lexus may be [retained] in exchange for a less expensive apartment").

159. *In re* McGillis, 370 B.R. at 751 (alteration in original).

surrender the vehicle and obtain a more affordable one.[160] Another consideration when asking a debtor to surrender the vehicle is that, while a different car payment may be less, the financing rates for debtors in bankruptcy may bring the debtor back up to the same payment he previously had. The Chapter 13 trustee must balance what the payment terms would look like for a newer car as opposed to letting the debtor keep his current car. If it would cost more to obtain a new vehicle, the debtor will most likely be able to retain his current vehicle and not have a bad faith proposal, even though the payments are higher than the Local Standards.

Ultimately, it is counsel's job to present the debtor in a manner that makes it appear as if he deserves relief under Chapter 13, and is an "honest but unfortunate debtor."[161] This means taking into account the *Flygare* factors, including their economic components, the general spirit of Chapter 13 of preventing abuse, and most importantly, any other factors unique to the debtor. The debtor has the ultimate burden of establishing that all requirements of 11 U.S.C. §1325 have been met.[162] In order to walk this line, it must be remembered that Chapter 13 is a bargain between debtors and creditors and that "[h]ow a debtor proposes or intends to carry on his post-confirmation lifestyle in the face of the Chapter 13 'super discharge' has a great bearing on the issue of his motivation, sincerity and whether the plan is proposed in the spirit of Chapter 13."[163] With a high monthly payment on a vehicle, the probability of an objection by the Chapter 13 trustee or the court raising the good faith question *sua sponte*, is fairly high and it is unlikely that a plan will be confirmed unless there is a very good reason or unique circumstances the higher cost vehicle must be retained. This is especially true given the language in *Ransom* that a debtor cannot exceed the Local Standard amounts, even if his actual cost is more.

Some courts have described the good-faith "totality of circumstances" analysis as a '"smell test' intended to screen debtors who do not pass muster," and that "[i]t seems fundamentally inappropriate that a debtor might file for bankruptcy relief and obtain a discharge of debt while still enjoying a luxury item."[164] Even with this guidance, good faith analysis will

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160. *See In re* Sandercock, No. 03-36260F, 2005 Bankr. LEXIS, at *28 (ruling that a debtor's monthly payment of $567 for a Honda Pilot was not reasonably necessary when a similar car could have been obtained for $240 less a month). For examples of pre-BAPCPA cases dealing with this issue, see Rodenberg, *supra* note 151.

161. *In re* Martin, 373 B.R. 731, 736 (Bankr. D. Utah 2007).

162. *In re* McDonald, 437 B.R. 278, 284 (Bankr. S.D. Ohio 2010) (quoting *In re* Henry, 328 B.R. 529, 538 (Bankr. S.D. Ohio 2004)); *In re* Owsley, 384 B.R. 739, 742 (Bankr. N.D. Tex. 2008).

163. *In re* Sandercock, 2005 Bankr. LEXIS, at *34 (alteration in original) (quoting *In re* Zalesli, 216 B.R. 425 (Bankr. D.N.D. 1997)).

164. *In re* Martin, 373 B.R. 731, 736 (Bankr. D. Utah 2007) (alteration in original).

always be case by case. The bankruptcy court in *In re Williams*[165] may have provided the best guidance to practitioners by saying that good faith analysis is like the old adage, "pigs get fat, but hogs get slaughtered."[166] In other words a debtor can take advantage of the system to some extent, but cannot gorge on it. While the Code allows debtors to deduct secured debts, the higher the vehicle payment deduction a debtor takes, the more he begins to smell like a hog.

C. Debtor with Car Payments Less than the Applicable Local Standard

This brings us to the final hypothetical debtor: one who files for relief under Chapter 13 while making loan or lease payments on a vehicle that are less than the amounts stated in the Local Standards.[167] This situation encompasses debtors whose payments last the entire applicable commitment period as well as those whose loan or lease payment ends during the applicable commitment period.

The *Ransom* Court held that a debtor may claim a deduction if the deduction is appropriate for him, and the deduction is only appropriate if the debtor will incur that kind of expense during the life of the plan.[168] The only requirement the Court gave to fall within the "applicable" category is to have a loan or a lease payment on a vehicle. The Court specifically declined to resolve the issue of a debtor with a payment less than the Local Standards,[169] but it did state that a debtor's out-of-pocket cost may well not control the amount of the deduction.[170] This will likely be an issue that plays itself out in numerous courts over the coming months.

1. *Debtors With A Loan or Lease Payment Terminating During The Applicable Commitment Period*

For debtors who enter bankruptcy with a loan or lease payment that will terminate during the applicable commitment period, such as the debtor who only has one or two payments left on his loan when the plan is confirmed, the situation seems to be a relatively straightforward problem under a *Hamilton*[171] approach. A payment of an expense that will end at a specified date, much like surrendering property,[172] seems to be a "known or

165. 394 B.R. 550 (Bankr. D. Colo. 2008).
166. *Id.* at 573.
167. For example, if the applicable Local Standards were $471, the debtors monthly lease payment would be $250.
168. Ransom v. FIA Card Servs., N.A., 562 U.S. ___, 131 S. Ct. 716, 725 (2011).
169. *Id.* at 728 n.8.
170. *Id*. at 728.
171. Hamilton v. Lanning, 560 U.S. ___, 130 S. Ct. 2464 (2010).
172. *In re* Liehr, 439 B.R. 179, 186-87 (B.A.P. 10th Cir. 2010).

virtually certain"[173] change at the time of confirmation. As such, a court could easily adjust the amount of disposable income for this future change through a tiered approach where the debtor's payments increase part way through the applicable commitment period. If a court does not apply this reasoning, the Chapter 13 trustee or a creditor could move for a modification of the payment plan under §1329[174] after the final loan or lease payment is made. Given the Supreme Court's liberal view of post-confirmation modification, it would seem that modification would be applicable no matter what standard a court applied, but the *Hamilton* procedure for incorporating the known change at the time of confirmation is the most efficient and effective approach. Once again, this situation encourages debtors to refinance or purchase cars that will have loans for the entire applicable commitment period, thus ensuring they maintain their ownership deduction throughout their applicable commitment period.

2. *Debtors With A Loan or Lease Payment Lasting The Entire Applicable Commitment Period*

It is a more difficult analysis when debtors enter bankruptcy with a loan or lease payment that is less than the Local Standards amount and will not terminate during the payment period. A fair reading of the *Ransom* opinion suggests that debtors who have any loan or lease payment on a vehicle qualify for the full amount of the deduction.[175] The *Ransom* Court held that an expense is only applicable to the debtor if he or she "will incur that kind of expense during the life of the plan."[176] Professor Daniel Austin[177] and Debra Miller,[178] Chapter 13 trustee, agree that a debtor may deduct the full ownership cost if the vehicle loan or lease payment is less than the standard deduction.[179]

This interpretation seems to conflict with the Court's underlying rational in *Ransom*. The Court gave great weight to the BAPCPA policy of ensuring that a debtor pays the maximum amount that he can afford. Allowing a debtor to take the full deduction when he does not actually incur

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173. Hamilton, 130 S. Ct. at 2478.

174. 11 U.S.C. § 1329 (2006).

175. Ransom, 131 S. Ct. at 724; *see also* Brief for United States as Amici Curiae Supporting Appellee at 19, *In re* Ransom, No. 08-15066, 2008 U.S. 9th Cir. Briefs LEXIS 814 (9th Cir. April 8, 2008) (stating that the United States government agrees with this view as well).

176. Ransom, 131 S. Ct. at 724.

177. Professor of Bankruptcy and Commercial Law at Northeastern University School of Law.

178. Chapter 13 Trustee for the Northern District of Indiana and incoming president of the National Association of Chapter 13 Trustees.

179. *See* Davis, *supra* note 43.

it means the debtor not only builds a cushion for emergencies but also pays less to his unsecured creditors than he actually can afford. This is more troubling when compared with debtors who avoid debt and enter bankruptcy with a fully paid-off car.[180] The *Ransom* Court did note that "Congress chose to tolerate the occasional peculiarity that a brighter-line test produces"[181] and this appears to be one of those peculiarities in which people in different circumstances are not provided the same opportunity to succeed in bankruptcy.[182] As the Petitioners Brief in *Ransom* notes, this bright-line test essentially punishes debtors who are financially responsible going into bankruptcy while rewarding debtors who choose to spend more money prior to filing for bankruptcy.[183] In his dissenting opinion in *Ransom*, Justice Scalia mentioned this potential situation, stating that "a debtor [who] enter[ed] bankruptcy[and] purchase[d] a junkyard car for a song plus a $10 promissory note payable over several years . . . would get the full ownership expense deduction."[184] The Court responded by saying that "money is fungible" and that Congress does not direct debtors to spend their money in a particular way.[185] Looked at from the debtor's perspective, the choice between spending money on a newer, reliable car that provides a larger expense deduction in bankruptcy and paying back a higher dividend to unsecured creditors whose claims will eventually be dismissed is a simple one. Because the debts will be discharged, the debtor might as well spend the money benefiting himself instead of his creditors. In essence, the debtor is better off purchasing a newer car prior to entering bankruptcy because the full Local Standards deduction applies, thereby lowering his disposable income and allowing him to retain some money to build a cushion.

While the majority of courts have ruled that a debtor can take the full deduction when his actual payment is less than the Local Standards, a few courts have ruled otherwise. The courts adopting the minority position have claimed that the Local Standards are a "cap" on the expense side of disposable income. Relying on language in the IRM, merely having an "applicable" expense is not enough; debtors can only claim the IRS Local Standards amount or their actual expense, whichever is less.[186] Furthermore, these courts hold to the belief that "Congress' decision to use the IRS standards within the Bankruptcy Code strongly suggests that courts

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180. *See discussion supra* Part III, Debtor With A Fully Paid Off Car.

181. Ransom, 131 S. Ct. at 729.

182. Fokkena v. Hartwick, 373 B.R. 645, 652 (D. Minn. 2007) (stating that any will be arbitrary and result in some unfairness, but a line has to be drawn nonetheless).

183. Brief for Petitioner at 55, Ransom v. FIA Card Servs., N.A., 131 S. Ct. 716, 178 L. Ed. 2d 603 (2011), (No. 09-907), 2010 WL 3007907.

184. Ransom, 131 S. Ct. at 732 (Scalia, J., dissenting) (alteration in original).

185. *Id*. at 729 (majority opinion).

186. *Collection Financial Standards*, IRS.GOV, http://www.irs.gov/individuals/article/0,,id=96543,00.html (last updated Feb. 17, 2011).

should look to how the IRS determined those standards; that is, as to how the IRS would have applied them in similar circumstances."[187] In a case that addressed this specific issue, the court in *In re Reyes* held that while the debtors can deduct some ownership expense because they have a lease payment on their vehicle, the expense was limited to the lesser of the Local Standards amount or their actual ownership expense.[188] The court noted that this decision was consistent with BAPCPA's goal of ensuring debtors repay as much of their debt as possible.[189]

In conclusion, the majority of courts have held that a debtor can take the full Local Standards amount as long as the expense is "applicable" to them. Plain meaning interpretation shows that "[b]y statutorily adopting strict allowances based on National and Local Standards, Congress sought . . . an effort to limit excessive mortgage and [vehicle payments] enjoyed by above-median-income debtors."[190] If Congress wanted to restrict the applicable expenses to actual expenses, it could easily have done so in the Code. Furthermore, "the expense amounts specified under the National Standards and Local Standards . . . are determined without reference to a particular debtor's actual monthly payments."[191] These courts have two rationales for reaching this conclusion. First, the plain meaning interpretation[192] of the Code "contains no directive to use the Local Standards as a cap as suggested by the Financial Analysis Handbook." Second, there is no ambiguity in the language of §707(b)(2)(A)(ii). Because courts feel there is no ambiguity, debtors are entitled to take both the applicable monthly expenses and the actual monthly expenses that fall under the Other Necessary Expenses category.[193] This interpretation allows

187. *In re* Rezentes, 368 B.R. 55, 61 (Bankr. D. Haw. 2007) (quoting *In re* Slusher, 359 B.R. 290, 309 (Bankr. D. Nev. 2007)) (holding that the debtors can only deduct their actual monthly housing expense of $300, even though the Local Standard for housing expense was $2000).

188. *In re* Reyes, 401 B.R. 910, 916-17 (Bankr. C.D. Cal. 2009) (holding that the debtors could only deduct their actual monthly payment, which was less than the Local Standard amount); *see also In re* French, 383 B.R. 402, 406 (Bankr. W.D. Kent. 2008) (holding that the debtors could only deduct their actual monthly payment of $320.10 as their ownership expense because it was less than the Local Standards).

189. *In re* Reyes, 401 B.R at 917.

190. *In re* Egbert, 384 B.R. 818, 829-30 (Bankr. E.D. Ark. 2008) (alteration in original).

191. Brief for United States as Amici Curiae Supporting Appellee at 19, *In re* Ransom, No. 08-15066, 2008 U.S. 9th Cir. Briefs LEXIS 814, at *19 (9th Cir. April 8, 2008) (alteration in original). *See, e.g.,* Fokkena v. Hartwick, 373 B.R 645, 652 (D. Minn. 2007).

192. For a good discussion on plain meaning interpretation, *see In re* Egbert, 384 B.R. 818, 826 (Bankr. E.D. Ark. 2008).

193. *In re* Naslund, 359 B.R. 781, 791-93 (Bankr. D. Mont. 2006); *see also In re* Hardacre, 338 B.R. 718, 727-28 (Bankr. N.D. Tex. 2006) (holding that the debtor is allowed to take the full Local Standard deduction when her actual payment is less, but the deduction must be reduced by her actual expense amount so as to not double count her deduction when

courts to establish the baseline that *Ransom* requires, that the debtor has a loan or lease payment, but simplifies the administration of cases by limiting judicial discretion. Limiting judicial discretion also furthers the goal of streamlining cases.[194] Following this rationale, the *In re Naslund* court allowed the debtor to take the Local Standard amounts for both his mortgage expense and vehicle ownership expense even though both payments were less than the applicable standards.[195] Other courts have also relied on the plain meaning of the Code, which provides "[t]he debtor's monthly expenses *shall* be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards."[196] The Code language, in conjunction with the belief that the IRM language is not controlling, led the *In re Barrett* court to hold that a debtor was allowed to take the full Local Standards deduction of $471 for her vehicle when her monthly payment was only $75.13.[197]

3. *BAPCPA Policy and Good Faith*

While the majority of courts addressing this issue have allowed a debtor to take the entire Local Standards amount when his loan or lease payment is less, the "good faith" requirement of Chapter 13 remains a concern.[198] Given the recent Supreme Court decisions in *Ransom* and *Hamilton*, courts may look more towards policy and construe BAPCPA in a manner that avoids extreme or absurd results and limits the ability of debtors to pay less than they can truly afford.

As previously stated, some courts hold that good faith does not require a substantial payment to unsecured creditors, and that as long as the statutory requirements are fulfilled, the debtor should be able to deduct the full Local Standard.[199] For example, in *In re James*, where the debtors

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she takes a secured debt deduction as well); *In re* Plumb, 373 B.R 429, 438-40 (Bankr. W.D.N.C. 2007) (holding debtors are allowed to take full $471 deduction even though their actual payment was $235.83); *In re* Musselman, 379 B.R. 583, 589 (Bankr. E.D.N.C. 2007).

194. *See In re* Nowlin, 366 B.R. 670, (Bankr. S.D. Tex 2007), *aff'd sub nom.* Nowlin v. Peake (*In re* Nowlin), 576 F.3d 258 (5th Cir. 2009).

195. *In re* Naslund, 359 B.R. at 793 (holding the debtors could deduct the full $471 when their actual monthly payment was only $133, and the average monthly payment over 60 months was $85.15); *see also In re* Swan, 368 B.R. 12, 21-22 (Bankr. N.D. Cal. 2007) (holding that the debtor could take the full Local Standard amount of $1,644 for a mortgage allowance even though her actual monthly payment was $800).

196. 11 U.S.C. § 707(b)(2)(A)(ii)(I) (2006) (alteration in original) (emphasis added).

197. *In re* Barrett, 371 B.R. 855, 859 (Bankr. S.D. Ill. 2007).

198. *See In re* McGillis, 370 B.R. 720, 747 (Bankr. W.D. Mich. 2007) (stating that "[a]bility to pay must be part of Section 1325(a)(3) good faith if that section is to properly complement Section 1325(b)").

199. *In re* McDonald, 437 B.R. 278, 285 (Bankr. S.D. Ohio 2010); *In re* Lofty, 437 B.R. 578, 586 (Bankr. S.D. Ohio 2010).

actual income and expenses[200] showed a disposable income of $1,986, but the means-test calculated disposable income was $985, the court ruled that the plan was not proposed in bad faith simply because their actual expenses were less than the "means-test" expenses.[201] Furthermore, since the ability to pay factors have been subsumed into §1325(b), the good faith standard is not violated by not committing more money to the plan than the disposable income test requires.[202] This rationale limits judicial discretion, one of the reasons BAPCPA was enacted, and helps to maintain uniformity in Code interpretation.[203] While this conclusion may be applicable in some jurisdictions, the *Hamilton* case and recent reliance on BAPCPA policy seems to have weakened the importance of the mechanical means-test and calls into question the vitality of this line of cases.

The newfound focus on policy and the spirit of Chapter 13 unveils new objections for creditors and the Chapter 13 trustee. Even after meeting §1325(b) requirements, good faith still "requires the debtor to establish to the court's satisfaction that he is in fact making an honest effort under the circumstances to repay his creditors through his proposed plan."[204] Congress stated that "[t]he heart of the bill's consumer bankruptcy reforms consists of the implementation of an income/expense screening mechanism ('needs-based bankruptcy relief' or 'means-testing'), which is intended to ensure that debtors repay creditors the maximum they can afford."[205] Furthermore, one of the main reasons Congress enacted bankruptcy reform was to ensure that debtors who had the money to repay creditors actually do repay those sums.[206] Echoing this sentiment, courts have held that, even after statutory requirements are met, it may "still examine the ability to pay

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200. These actual income and expense numbers are provided on a debtors Schedule I (income) and J (expenses).

201. *In re* James, 379 B.R. 903, 908 (Bankr. D. Neb. 2007).

202. *Id*.

203. *See* Culhane, *supra* note 129.

204. *In re* McGillis, 370 B.R. 720, 753 (Bankr. W.D. Mich. 2007).

205. H.R. REP. NO. 109-31, pt. 1, at 2 (2005) (alteration in original).

206. *See, e.g., Bankruptcy Reform Act of 1999 (Pt. II): Hearing on H.R. 833 Before the Subcomm. on Commercial and Admin Law of the House Comm. on the Judiciary*, 106th Cong. 298 (1999) (statement of Thomas S. Neubig, Ernst & Young LLP – Policy Economics and Quantitative Analysis Group, concluding that "large numbers of 1997 U.S. chapter 7 filers have the ability to repay large portions of their debts); *id.* at 228-29 (statement of Michael E. Staten, Credit Research Center, concluding that "about 25 percent of chapter 7 debtors could have repaid at least 30 percent of their non-housing debts over a 5-year repayment plan, after accounting for monthly expenses and housing payments" and that "[a]bout 5 percent of chapter 7 filers appeared capable of repaying all of their non-housing debt over a 5-year plan," although these "calculations assumed income would remain unchanged relative to expenses over the 5 years"); Marianne B. Culhane & Michaela M. White, *Taking the New Consumer Bankruptcy Model for a Test Drive: Means-Testing Real Chapter 7 Debtors*, 7 AM. BANKR. INST. L. REV. 27, 31 (1999) (concluding that 3.6% of sampled debtors "emerged as apparent can-pays").

and determine whether the proposed plan constitutes an abuse of the provisions, purpose, or spirit of Chapter 13."[207] Courts have looked to "whether the debtor's proposed plan . . . demonstrates a sincere intent to repay his creditors to the best of [debtor's] ability as opposed to . . . an attempt to defer or avoid the claims of legitimate creditors,"[208] and that "the difference between what the debtor can afford to pay his creditors, when compared to what he is actually proposing to pay his creditors, may be so great that the difference, in and of itself, may be sufficient to warrant rejection of the plan."[209]

This argument may gain more steam as *Hamilton* is further interpreted, resulting in Chapter 13 trustees focusing more on the debtors actual income and expense numbers than the disposable income test numbers. If there is a large discrepancy between the two, the Chapter 13 trustees may request more money being devoted to repayment before recommending plan confirmation. As noted in the previous section, good faith is a totality of the circumstances approach, with only one factor unlikely to garner a bad faith objection.[210] This means that the debtor taking the full Local Standards deduction will also be looked at in context of the dividend rate provided to unsecured creditors, the reasonableness of other expenses, the approach debtors have in entering bankruptcy, the reasons behind filing the petition, and whether an honest attempt to repay the creditors is being made.[211] A debtor satisfying the majority of the *Flygare* factors, taking the full vehicle ownership deduction when his actual payment is less than the Local Standards, by itself would not seem to rise to a level where the totality of circumstances would exhibit bad faith and merit a rejection of the payment plan.[212]

This interpretation emphasizes the importance of pre-bankruptcy planning for debtors; thereby, allowing the debtor to make the necessary changes prior to filing. The best planning may be for debtors to purchase a newer car prior to bankruptcy; thereby, ensuring reliable transportation and

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207. *In re* Sandberg, 433 B.R. 837, 847 (Bankr. D. Kan. 2010); *In re* Namie, 395 B.R. 594, 597 (Bankr. D.S.C. 2008) (holding that debtors plan of paying more than $5,735 per month on residential mortgage while only providing a dividend of one percent on unsecured claims was an abuse of Chapter 13).

208. *In re* Brown, 402 B.R. 384, 401 (Bankr. M.D. Fla. 2008) (quoting Fla., Dep't of Revenue v. Talley, No. 3:07-cv-510-J16, 2008 WL 1711410, at *4 (M.D. Fla. April 10, 2008)) (alteration in original).

209. *In re* McGillis, 370 B.R. at 749; *In re* Briscoe, 374 B.R. 1, 21 (Bankr. D.D.C. 2007).

210. *See* discussion *supra* Part III.B.1.

211. *In re* McGillis, 370 B.R. at 749-50.

212. *See In re* Nockerts, 357 B.R. 497, 507 (Bankr. E.D. Wis. 2006) (stating that "while ability to pay is a factor in the totality of circumstances test, and may even be the primary factor to be considered, if it is the only indicia of abuse, the case should not be dismissed under that test").

a full "ownership costs" deduction. In addition, vehicle payments will allow debtors to rebuild their credit history during the plan. As long as the debtors have a legitimate reason to purchase the car and satisfy the majority of other good faith factors, it will be difficult for the trustee to show a lack of good faith.

Until the majority of courts explicitly say that debtors are only allowed actual expenses as deductions, maintaining a car with payments that are less than the Local Standards seems to be the most practical way for debtors to ensure they have a cushion for any contingency that may arise during the payment plan. It has been said that "too many judges . . . fret . over whether a debtor's budget should include an allowance for cigarettes or whether the debtor is driving too expensive of a car. Far more important is consideration of what is to be the fair division of a debtor's future income between his creditors and himself."[213] Bankruptcy is a balancing act in equity, and as long as the debtor appears to be fairly balancing his interests and the creditors' interests, good faith should not be an issue in plan confirmation.

CONCLUSION

Ultimately, many of these questions are going to be interpreted differently in each jurisdiction. Given that bankruptcy courts are courts of equity, local cultures generally determine how each situation is approached. However, It is still unclear as to how far reaching *Ransom's* decision will be. For example, will this analysis of requiring the debtor to deduct only actual expenses apply to all Local and National Standards categories under the means-test? Also in question is the interplay between the *Ransom* and *Hamilton* cases. Does the fact that *Hamilton* seems to have moved away from a mechanical interpretation of income and expenses weaken the means-test and give less force to the *Ransom* mechanistic reliance?

According to *Ransom*, the core purpose of BAPCPA was to ensure that debtors are devoting the full amount of their disposable income to unsecured creditors. Taken literally, this means no cushions for expenses that do not exist at the time of plan proposal and confirmation. This could be looked at as another hit to debtors trying to obtain a discharge or just another swing in the pendulum between debtor and creditor rights. Some commentators have stated that bankruptcy courts have developed into a cottage industry that tries to make sense of a senseless statute and that "[b]ankruptcy lawyers have fashioned a new canon of statutory interpretation: if the statute seems to favor the creditor, apply the statute; if it seems to favor the debtor, assume it's a mistake and favor the creditor

213. *In re* McGillis, 370 B.R. at 750 (alteration in original).

anyway."[214] On the other hand, there is no constitutional right to a discharge, which is reserved for honest but unfortunate debtors.[215] Bankruptcy is a privilege, not a right, and that means the debtor has to operate within the parameters that Congress and the courts lay out.

Ransom further defined these boundaries for debtors; as a result, it has opened up many more questions than it has answered. Instead of encouraging frugality, the decision makes it beneficial for debtors to purchase newer cars or borrow against existing cars prior to entering bankruptcy. Deliberately devoting more income to secured debts goes against the core purpose of forcing the debtor to pay all their disposable income to unsecured creditors. Debtors will have to walk a fine line between the mechanical application of the means-test expenses and the forward-looking approach of *Hamilton*, but given the existing case law, debtors would be wise to make sure they enter bankruptcy with a vehicle whose loan payments last throughout the applicable commitment period and are less than the Local Standards. The one thing debtors can rely on is that until Congress undertakes the monumental task of rewriting the Code, courts will continue to interpret BAPCPA and will most likely rely heavier on the policy underlying BAPCPA.

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214. Justice Kagan's Torture Memo: "It Can't Possibly Mean That," UNDERBELLY (Jan. 12, 2011), http://underbelly-buce.blogspot.com/2011/01/justice-kagans-torture-memo-it-cant.html (alteration in original).

215. *In re* Stumpf, No. 1:08-bk-02127 MDF, 2011 Bankr. LEXIS 517, at *7 (Bankr. M.D. Pa. Feb. 9, 2011).