BAPCPA Consumer Issues: 10-Year Anniversary Special

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CONCURRENT SESSION

2015

BAPCPA –
10 YEARS AGO WHAT WERE WE WORRIED ABOUT AND HOW DID IT PLAY OUT? [1]

T'was the night before BAPCPA and all through the house
Not a consumer practitioner was sleeping
What would the courts espouse?

The 2005 Code books were lined on the bookshelves with care,
In hopes that some clarity soon would be there;

The lawyers were huddled alone at their desks,
With visions of Debt Relief Agent badges pinned to their chests.
Their calculators were at the ready – to this we can attest-
As they struggled and grappled about how to conduct a Means Test.

Projected Disposable Income – did it mean we looked back?
How in the world would we ever keep track?

The Applicable Commitment Period was it time or was it money?
One thing for sure – it was not very funny.

The 910 car creditors sat in their offices with glee
The Code now had a Hanging Paragraph for all to see.

The Automatic Stay once a beacon of hope,
But with two dismissals in one year there would be no more rope!

Chapter 11 for individuals was always way cool –
But what would become of the Absolute Priority Rule?

It is now 10 years later and we have had time to look back.
Were the predictions well founded or were we off track?

What was the issue or the concern that raised doubt?
What generated that concern and how did it play out?

The panel will look back at some of the issues that were of great concern to practitioners and the court when the Bankruptcy Abuse Preventions and Consumer Protection Act was being enacted and will discuss how those concerns actually played out over the past 10 years.

[1] With apologies to Clement Clarke Moore.

DEBT RELIEF AGENTS

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The first thing we do, let's kill all the lawyers...

Nay, that I mean to do.

Henry The Sixth, Part 2 Act 4, scene 2, 71–78

Ten years ago we were told that we were required to let the public know that we are now Debt Relief Agencies. Now here we are lumped in with petition preparers! Gee, and you thought graduated from law school and passed the bar exam.....

11 U.S.C. § 528 - Requirements for debt relief agencies

(a) A debt relief agency shall -

(1) not later than 5 business days after the first date on which such agency provides any bankruptcy assistance services to an assisted person, but prior to such assisted person's petition under this title being filed, execute a written contract with such assisted person that explains clearly and conspicuously -

(A) the services such agency will provide to such assisted person; and

(B) the fees or charges for such services, and the terms of payment;

(2) provide the assisted person with a copy of the fully executed and completed contract;

(3) clearly and conspicuously disclose in any advertisement of bankruptcy assistance services or of the benefits of bankruptcy directed to the general public (whether in general media, seminars or specific mailings, telephonic or electronic messages, or otherwise) that the services or benefits are with respect to bankruptcy relief under this title; and

(4) clearly and conspicuously use the following statement in such advertisement: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." or a substantially similar statement.

(b)

(1) An advertisement of bankruptcy assistance services or of the benefits of bankruptcy directed to the general public includes—

(A) descriptions of bankruptcy assistance in connection with a chapter 13 plan whether or not chapter 13 is specifically mentioned in such advertisement; and

(B) statements such as "federally supervised repayment plan" or "Federal debt restructuring help" or other similar statements that could lead a reasonable consumer to believe that debt counseling was being offered when in fact the services were directed to providing bankruptcy assistance with a chapter 13 plan or other form of bankruptcy relief under this title.

(2) An advertisement, directed to the general public, indicating that the debt relief agency provides assistance with respect to credit defaults, mortgage foreclosures, eviction proceedings, excessive debt, debt collection pressure, or inability to pay any consumer debt shall—

(A) disclose clearly and conspicuously in such advertisement that the assistance may involve bankruptcy relief under this title; and

(B) include the following statement: "We are a debt relief agency. We help people file for bankruptcy relief under the Bankruptcy Code." or a substantially similar statement.

This provision and related ones led us to have many questions such as:

- What is a "Person"?
- What is an "Assisted Person" (AP)?
- Are AP's "assisted" upon the first telephone contact with the attorney, or the attorney's staff, and must the AP sign a contract within 5 days of the initial phone call?
- If an AP does not promptly provided enough information for a debtor attorney to give a fee quote, or provide a meaningful contract, what is the debtor attorney, or DRA, to do?
- Who "may be" a debt relief agency?
- Who must disclose and comply with other requirements?
- Are debtor attorneys Debt Relief Agents?
- Are bankruptcy clinic attorneys Debt Relief Agents? (DRA)
- How about creditor attorneys who prepare bankruptcy documents?
- Are personal injury attorneys DRA's if the client is in bankruptcy?
- How about landlord-tenant attorneys? Estate planners? Ministers?
- Are there any educational requirements or tests to pass to become a DRA or can anyone simply "self designate"?
- If "everyone" is a DRA, then does the designation fail to have any meaning whatsoever?
- Is the attorney governing body in the jurisdiction, such as the state bar organization or the state supreme court, permitted to regulate attorneys?
- Is that regulating state body the only regulator of attorneys?
- Does the "gag order" on the discussion of incurring debt interfere with the attorney-client relationship?

- If so, is that permissible interference?
- If the attorney may not advise the client to incur debt, isn't the attorney permitted to tell the client "what the law is."
- Is telling the client to surrender a new luxury automobile and purchase an inexpensive, used "work-mobile," encouraging the assisted person to incur debt, or is it actually encouraging the assisted person to reduce debt?
- Does the DRA designation help to inform the public or confuse the public?
- If statements such as "federally supervised repayment plan" or "Federal debt restructuring help" may confuse the public, will the term Debt Relief Agent make things perfectly clear?
- Will the public be misled by the DRA requirement as both lawyers and non-lawyers must use exactly the same designation or label?

Many attorneys did not take kindly to being labeled a Debt Relief Agent. Some judges agreed and found the provision unenforceable. Indeed, one bankruptcy court decided, upon its own motion that on October 17, 2005, the effective date of the BAPCPA, "whether amendments to the Bankruptcy Code, which become effective today, regulating Debt Relief Agencies apply to attorneys licensed to practice law who are members of the Bar of this Court." In re Attorneys at Law & Debt Relief Agencies, 332 B.R. 66, 67 (Bankr. S.D. Ga. 2005). Chief Judge Lamar W. Davis of the Bankruptcy Court for the Southern District of Georgia warned that if attorneys were encompassed within the definition of debt relief agencies, "a new layer of regulation will be superimposed on the bar of this Court . . . . That is a burden which should not be borne by the Bar needlessly or merely out of an abundance of caution." Id.

Senator Russell Feingold from Wisconsin proposed an amendment specifically addressing attorneys and the debt relief agency provisions, which "bankruptcy lawyers are very concerned about." 151 Cong. Rec. S2316 (daily ed. Apr. 22, 2005) (statement of Sen. Feingold). Senator Feingold's amendment proposed to insert the clause "other than an attorney or an employee of an attorney" in 11 U.S.C. § 101(12)(A), the definition of "debt relief agency." 151 Cong. Rec. S2180 (daily ed. Apr. 22, 2005).

Senator Feingold stated that his amendment was necessary because,

> [r]equiring lawyers to call themselves ‘debt relief agencies’ will do more to confuse the public than to protect it. I think members of the public generally understand what the word ‘lawyer’ means, but the phrase ‘debt relief agency’ is vague and unhelpful. It is also misleading, because there are significant differences between lawyers and nonlawyers, but both would be identifying themselves as debt relief agencies under this bill . . . .

In 2005, some legal practice related vendors began passing out “Federally Designated Debt Relief Agents” badges to lawyers as a joke. Some found this amusing. Some did not. Many attorneys simply refused to comply with the DRA requirements.

The U. S. Supreme Court addressed the controversial Debt Relief Agency provision of BAPCPA. In an opinion written Justice Sotomayor, the Supreme Court held that lawyers who provide bankruptcy assistance to assisted persons are in fact debt relief agencies under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA). The case is Milavetz, Gallop & Milavetz, PA v US, Nos 08-1119 and 08-1225, 130 S Ct 1324 (US Sup Ct).

The court found that BAPCPA was Congress's effort to discourage debtors from filing for bankruptcy and thereby to encourage them to pay their debts. Congress did so by making the requirements for filing bankruptcy more difficult. We do not know if the law did in fact encourage more people to pay their debts, but we do know that BAPCA did make bankruptcy more difficult and complicated.

American Bankruptcy Law Journal
MEANS TESTING IN THE NEW § 707(B)
79 Am. Bankr.L.J. 231, 277 (2005).

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VI. THE OVERALL IMPACT OF § 707(b) UNDER BAPCPA

With an understanding of the working details of BAPCPA's means test, it is possible to draw some tentative conclusions about the impact that the means test—and the other changes to the grounds for relief under § 707(b)—will have on consumer bankruptcy. Four major effects are likely.

A. INCREASED COST OF ADMINISTRATION

It is a certainty that the introduction of the BAPCPA means test will increase the cost of administering consumer bankruptcy cases.[2] For the debtor and the debtor's counsel, the means test introduces the need for substantial additional information to be collected, analyzed, and reported, including the following:

• For all debtors, the reporting of CMI requires the collection and review of six months of income data, from records of the debtor (pay stubs or other employment documents, bank and other statements showing interest, closing statements on home sales); from the same records of the debtor's spouse (and if the spouse is not a joint debtor, separate records showing how much of the spouse's income is contributed to household expenses); and from records showing any other source of funding for household expenses.

• For debtors whose CMI is above the applicable medians, the reporting of deductions also requires substantial effort. Although the deductions provided by the IRS's National and Local Standards are straightforward, these allowances are subject to statutory adjustments for additional food, clothing, and energy costs, and the debtor is required to make offsetting calculations of

[2] The Congressional Budget Office has estimated that the total additional costs imposed by BAPCPA on the private sector will exceed the level ($123 million annually) at which reporting is required under the Unfunded Mandates Reform Act of 1995 (2 U.S.C. §§ 1501-1571). H.R. Rep. 109-31 at 45 (setting out CBO report of April 4, 2005).

secured debt. The deductions for IRS Other Necessary Expenses and the additional statutory expense allowances require the debtor to establish both actual expense levels and necessity, often with specific documentation. Deductions for secured debt payments must be calculated on a contractual basis over a five-year period, and arrearages must be determined from records of late charges and costs issued by the creditors. Finally, the Chapter 13 administrative expense allowance requires the calculation of projected plan payments subject to the percentage fee allowed by the Executive Office for United States Trustees.

• For debtors whose CMI and deductions lead to a presumption of abuse, rebuttal of the abuse requires additional documentation establishing special circumstances.

All of the scheduled information will be subject to random audit[3] and may subject debtor's counsel to liability for any factual errors that should have been discovered through investigation.[4] The assembly and review of the documentation required to comply with the means test will thus require substantial additional work by debtor's counsel, and will add significantly to the cost of debtor representation.[5]

Diligent U.S. trustees and bankruptcy administrators, possibly acting through case trustees, will be required to review the means test information provided by every debtor, checking the appropriateness of the CMI calculations and any claimed deductions, and filing motions for § 707(b) relief both where the presumption of abuse has been raised and where the "totality of circumstances" might indicate abuse in the absence of the presumption.[6] For debtors with CMI above the applicable median, creditors will have the option of reviewing this information as well, but only by adding new costs to their collection procedures.

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[3] BAPCPA § 603(a), codified at 28 U.S.C. § 586(f) (2005).

[4] *See, e.g.,* 11 U.S.C. § 707(b)(4)(C)-(D) (2005) (providing that the signature of an attorney on a bankruptcy petition constitutes a certification of "a reasonable investigation" and an "inquiry" regarding the information in the debtor's schedules); see Vance & Cooper, supra note 10.

[5] The Congressional Budget Office has estimated that the direct cost of "completing a reasonable investigation of debtors' financial affairs and, for chapter 7 cases, computing debtor eligibility ... would be between $240 million and $800 million in fiscal year 2007 ... and would remain in that range through fiscal year 2010." See H.R. Rep. No. 109-31 at 45 (2005).

[6] Although the CBO recognizes that "private trustees would be responsible for conducting the initial review of a debtor's income and expenses and filing the majority of motions for dismissal or conversion," it nevertheless estimates that means testing will impose additional costs on the U.S. Trustee Program in an amount of "about $150 million over the 2006-2010 period." Id. at 37.

B. RARE APPLICATION OF THE PRESUMPTION

Despite the high cost of its administration, the means test is likely to generate a presumption of abuse in very few cases once its operation becomes understood. First, because most debtors in bankruptcy have incomes below the median, a substantial majority of filers will be within the safe harbor based on median income. A study of 1995 bankruptcy filings found that more than 75 percent of the debtors had income less than the national median, and that this percentage would likely increase if, as in BAPCPA, state medians were used.[7] A later study, using 1998 and 1999 case filings, concluded that more than 84 percent of debtors had incomes below the applicable state median.[8]

For those debtors whose income is above the median, pre-bankruptcy planning will frequently allow sufficient deductions from income to avoid a presumption of abuse. In particular, the unlimited deductions for secured debt and charitable contributions have the potential to remove otherwise disposable income. The charitable contribution deduction would be particularly effective because the court is prohibited from considering such contributions even in the context of a non-presumptive determination of abuse.

C. CONTINUED CENTRALITY OF JUDICIAL DISCRETION

Although the use of IRS expense standards limits to some degree the discretion that courts have employed in making determinations of a debtor's ability to pay debt under the pre-BAPCPA versions of §§ 707(b) and 1325(b), the disputes that will arise under the BAPCPA version of these provisions will nearly all be resolved by discretionary judicial determinations. As suggested above, most debtors will be able to avoid the means-test presumption, and so the questions likely to be raised in § 707(b) motions will involve the non-presumptive bases for a finding of abuse: bad faith and the totality of circumstances bearing on the debtor's financial condition. Where a presumption does arise, it is likely that the debtor will assert special circumstances to rebut the presumption, and the courts will be required to make discretionary determinations as to whether the claimed circumstances justify additional expenses or a reduction in income. In the end, the most significant changes to § 707(b) in reducing abuse will not involve the means test, but will result (1) from the specification of the amount of disposable income that should result in a finding of abuse, and (2) from the expanded standing allowed in cases of debtors with more than median income.

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[7] 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, 37-38 (1999).

[8] See Ed Flynn & Gordon Bermant, Bankruptcy By The Numbers: Pre-Bankruptcy Planning Limits Means-Testing Impact, 19 A. Bankr. Inst. J. 22 (Feb. 2000).

D. THE IRS AS A BANKRUPTCY REGULATOR

Perhaps the least discussed impact of the BAPCPA means test is the change that it will make in the role of the IRS's Collection Financial Standards. Until BAPCPA, these standards, as set out in the Internal Revenue Manual, were entirely for the internal use of revenue officers negotiating consensual payment of delinquent taxes.[9] Therefore, promulgation of the standards was not subject to the rule-making procedures set forth in the Administrative Procedure Act ("APA"), 5 U.S.C. § 553.[10] However, under BAPCPA, the standards have the force of law in determining whether a debtor receives Chapter 7 bankruptcy relief. This difference will make the IRS an agency regulating bankruptcy, and impose on the IRS new rule-making responsibilities in compliance with the APA.

The APA generally requires executive agencies to follow defined procedures when they promulgate rules.[11] Most agency rulemaking is governed by the informal rulemaking procures set out in § 553(c).[12] Section 553(c) requires an administrative agency to publish notice of a proposed rule in the Federal Register and allow an opportunity for the public to comment.[13]

Although there is an exception to this requirement for "[i]nterpretative rules, general statements of policy, or rules of agency organization, procedure, or practice,"[14] the IRS collection standards, as used in BAPCPA, are substantive, legislative rules, not interpretations of other law. "For purposes of the APA, substantive rules are rules that create law, while in contrast interpretive rules merely clarify or explain existing law or regulations and go to what the administrative officer thinks the statute or regulation means."[15] Rules that "create rights, impose obligations, or effect a change in existing law pursuant to authority delegated by Congress," are legislative rules.[16]

Any changes that the IRS makes to the National Standards, Local Standards and Other Necessary Expenses will change existing law—the entitlement of a debtor to Chapter 7 relief—rather than merely clarifying or explaining a statute. The notice and comment provisions of the

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[9] See IRM § 1.11.1, which deals generally with "Internal Management Documents" of the IRS, and refers to the IRM itself (in § 1.11.1.2) as the "largest piece" of the system of internal management documents.

[10] See 5 U.S.C. § 553(a)(2) (2000) (excluding matters relating to agency management or personnel); § 553(b)(A) (excluding rules of agency organization, procedure or practice).

[11] See 5 U.S.C. §§ 553(b)-(c), 554, 556, 557 (2000).

[12] See Jeffrey S. Lubbers, *A Guide to Federal Agency Rulemaking* (3d ed. 1988) 43-45.

[13] 5 U.S.C. § 553(b), (c) (2000).

[14] *Id*. at § 553(b)(A).

[15] *Dismas Charities, Inc. v. U.S. Dep't of Justice*, 401 F.3d 666, 679 (6th Cir. 2005) (internal quotation marks and citations omitted).

[16] *Hemp Indus. Ass'n v. Drug Enforcement Admin.*, 333 F.3d 1082, 1087 (9th Cir. 2003); *see also Warder v. Shalala*, 149 F.3d 73, 80 (1st Cir. 1998), *cert. denied*, 526 U.S. 1064 (1999), ("[R]ules are legislative when the agency is exercising delegated power to make law through rules, and rules are interpretative when the agency is not exercising such delegated power in issuing them.") (quoting *Metropolitan School Dist. v. Davila*, 969 F.2d 485, 490 (7th Cir. 1992)).

APA thus apply, and for the first time the public (and organizations representing various interests) should have an opportunity to comment on the IRS standards.[17]

CONCLUSION

The changes made by BAPCPA to § 707(b) of the Bankruptcy Code will have significant effects on consumer bankruptcy, including a clearer definition of the higher income individuals who should be denied Chapter 7 relief and a greater opportunity for creditors and case trustees to present motions for denial of relief to these individuals. All of this is in keeping with the intent expressed by BAPCPA's sponsors. However, the means test, which the sponsors saw as the principal method for effectuating their intent, probably will not do so. Its definition of income is complicated and arbitrary, unlikely to provide a good measure of a debtor's actual ability to pay debts, but likely to generate uncertainty and litigation. Its allowed deductions from income, using the IRS's Collection Financial Standards only in part, are similarly complex and arbitrary, but they are sufficiently generous (particularly for secured debt and charitable contributions) that even quite wealthy debtors will often be able to avoid the presumption of abuse. Motions under § 707(b) will continue to be determined by exercises of judicial discretion, under the totality of circumstances and bad faith standards that apply when the means-test presumption does not arise or has been rebutted. The major impact of the means test will be a significant increase in the cost of administering all consumer bankruptcy cases.

[17] Indeed, the IRS may wish to propose collection standards for bankruptcy that differ from the standards that it uses internally.

Section 1325(b)(1)(B): Interpreting "Projected Disposable Income" After The BAPCPA

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What issues arose as a result of the BAPCPA amendments to section 1325?

The BAPCA amendments to section 1325(b) led to questions about how the phrase "projected disposable income" should be interpreted in light of significant amendments to the definition of "disposable income." The major issue was whether "projected disposable income" should be calculated mechanically using the figures determined by the debtor's Official Form 22C (the "mechanical approach") or whether the calculation should instead take into account actual or anticipated changes to the debtor's income and expenses (the "forward-looking approach").

What in the BAPCPA caused the issue?

Section 1325(b)(1) directs that the bankruptcy court may not confirm a chapter 13 plan over the objection of an unsecured creditor or the trustee unless the plan provides that all unsecured creditors will be paid in full or that all of the "projected disposable income" to be received by the debtor for the duration of the plan will be applied to make payments to unsecured creditors.[18]

While "projected disposable income" is not defined in section 1325(b) or elsewhere in the Bankruptcy Code, "disposable income" is defined in section 1325(b). Before the BAPCPA became effective in October 2005, "disposable income" was defined as income received by the debtor not "reasonably necessary to be expended" for the debtor's "maintenance or support,"

[18] 11 U.S.C. § 1325(b)(1).

"charitable contributions," or "business . . . expenditures."[19] To determine the debtor's "disposable income," courts typically looked to the debtor's Schedules I and J.[20] Courts calculated "projected disposable income" by multiplying "disposable income" by the number of months in the debtor's plan. However, courts generally also took into account changes in income or expenses that were known or virtually certain.[21]

Under the BAPCA, the income side of the "disposable income" equation is tied to the definition of "current monthly income" in section 101(10A) and usually equates to the historical average of the debtor's statutorily defined income during the six-month period before commencement of the bankruptcy case.[22] The expense side of the equation retains the "reasonably necessary to be expended" language, but defines those terms such that expenses are largely determined under section 707(b)(2) when the debtor's current monthly income is above-median.[23] The resultant disposable income figure is shown in Official Form 22C-2.[24]

The historical "current monthly income" calculation required under the BAPCPA, and the more rigid method of calculating expenses for above-median debtors established under the BAPCPA, led to a debate about whether a forward-looking approach or mechanical approach to "projected disposable income" was the most appropriate.

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[19] 11 U.S.C. § 1325(b)(2)(A)-(B)(2000).
[20] *See* Official Form 6, Scheds. I-J (2000).
[21] *See Hamilton v. Lanning*, 560 U.S. 505, 515-17 (2010).
[22] *See* 11 U.S.C. § 1325(b)(2), 11 U.S.C. § 101(10A)(i).
[23] *See* 11 U.S.C. § 1325(b)(3).
[24] Before the effective date of this form, December 1, 2014, the calculation was shown on Official Form 22C.

How was the issue resolved?

In 2010, the Supreme Court decided the "projected disposable income" issue in *Hamilton v. Lanning* by adopting the forward-looking approach.[25] After considering the text of section 1325 and pre-BAPCPA practice, the Court held that when a bankruptcy court calculates a debtor's "projected disposable income," the court may account for changes in the debtor's income that are known or virtually certain at the time of confirmation.[26]

Although *Lanning* involved the debtor's income, the Court stated that its holding also applied to expenses.[27] Two circuits subsequently used the forward-looking approach to address payments for real property or vehicles that debtors would not have in the future because they intended to surrender the property. Decisions from the Fourth and Sixth Circuits held that debtors' "projected disposable income" must reflect the debtors' intention to surrender property.[28] Similarly, the Bankruptcy Appellate Panel for the First Circuit concluded that *Lanning's* forward-looking approach to "projected disposable income" required the elimination of a mortgage expense that the debtors would not pay in the future because their chapter 13 plan provided that the creditor's second mortgage would be stripped off and the regular payments on the mortgage loan would cease.[29]

Other post-BAPCPA cases addressed the issue of whether social security income, which generally was included in "projected disposable income" in pre-BAPCPA days, still should be

[25] *Hamilton v. Lanning*, 560 U.S. 505 (2010).
[26] *Id.* at 524.
[27] *Id.*
[28] *See Morris v. Quigley (In re Quigley)* 673 F.3d 269 (4th Cir. 2012); *Darrohn v. Hildebrand (In re Darrohn)*, 615 F.3d 470 (6th Cir. 2010). *See also Brothers v. Turner (In re Turner),* 574 F.3d 349, 356 (7th Cir. 2009) (reaching similar result prior to *Lanning*) and *Zeman v. Liehr (In re Liehr)*, 439 B.R. 179 (B.A.P. 10th Cir. 2010).
[29] *Kramer v. Bankowski (In re Kramer)*, 505 B.R. 614 (B.A.P. 1st Cir. 2014).

included post-BAPCPA. As section 101(10A)(B) expressly excludes such income from the definition of "current monthly income," five circuits have indicated that it should not.[30]

[30] *See Mort Ranta v. Gorman (In re Gorman)*, 721 F.3d 241 (4th Cir. 2013); *Beaulieu v. Ragos (In re Ragos)*, 700 F.3d 220 (5th Cir. 2012); *Baud v. Carroll (In re Carroll)*, 634 F.3d 327 (6th Cir. 2011); *Drummond v. Welsh (In re Welsh)*, 711 F.3d 1120 (9th Cir. 2013)(Social Security income not included in disposable income and could not be considered as part of good faith analysis under section 1325(a)(3)); *Anderson v. Cranmer (In re Cranmer)*, 697 F.3d 1314 (10th Cir. 2012).

Section 1325(b)(1)(B): The Meaning of the "Applicable Commitment Period"

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In the years following the enactment of BAPCPA, a number of bankruptcy courts dealt with disputes concerning the application of the "applicable commitment period" ("ACP") in section 1325(b)(1)(B).[31] BAPCPA modified sections 1322(d) and 1325(b). Prior to BAPCPA, section 1322(d) stated that the debtor's plan "may not provide for payments over a period that is longer than three years, unless the court, for cause, approves a longer period, but the court may not approve a period that is longer than five years."[32] Under BAPCPA, subsection (d) was amended to provide different treatment for above- versus below-median income debtors.[33] Section 1322(d)(1) now provides that above-median income debtors "may not provide for payments over a period that is longer than 5 years."[34] Below-median income debtors "may not provide for payments over a period that is longer than 3 years" subject to some exceptions.[35]

Prior to BAPCPA, a confirmation objection triggered a requirement that the debtor pay his or her "projected disposal income" over a three-year period into the plan under section 1325(b)(1)(B).[36] BAPCPA substituted the phrase "three year period" with the term "applicable

[31] *E.g.*, *In re* Green, 378 B.R. 30 (Bankr. N.D.N.Y. 2007) (holding: (1) the ACP is three to five years depending on income; (2) **§ 1322(d)** and not **§ 1325(b)(1)(B)** controls the term of a plan; (3) negative disposable income results in a debtor not having projected disposable income to commit for the ACP pursuant to **§ 1325(b)(1)(B)**; and (4) "disposable income" and "projected disposable income" are interrelated and are based on historical numbers as mandated in **§ 1325(b)**).
[32] 11 U.S.C. § 1322(d) (2004).
[33] *Id.* § 1325(d)(1)(2008).
[34] *Id.*
[35] *Id.* § 1322(d)(2)(2008).
[36] *Id.* § 1325(b)(1)(2004).

commitment period."[37] Debtors are now required to devote all of their "projected disposable income" during the ACP to unsecured creditors.[38]

Generally, courts were divided on four issues relating to the ACP. Courts that adopted the temporal theory construed the language as a durational requirement.[39] Alternatively, other courts adopted the multiplier theory, concluding that the ACP is a sum to be paid to unsecured creditors, determined by multiplication of "disposable income" by the number of months in the plan.[40] At least one court held that the ACP has both a temporal and monetary feature,[41] and several bankruptcy courts concluded that the ACP is only a confirmation requirement when a debtor has

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[37] *Id.* § 1325(b)(1)(B) (2008); Pub. L. No. 109-8, §318(2), 119 Stat. 23, 93 (2005).
[38] *Id.* BAPCPA defined "applicable commitment period" as follows:

> (4) For purposes of this subsection, the "applicable commitment period" –
>
> (A) subject to subparagraph (B), shall be –
> (i) 3 years; or
> (ii) not less than 5 years, if the current monthly income of the debtor and the debtor's spouse combined, when multiplied by 12, is not less than –
> (I) in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;
> (II) in the case of a debtor in a household of 2, 3, or 4 individuals, the highest median family income of the applicable State for a family of the same number or fewer individuals; or
> (III) in the case of a debtor in a household exceeding 4 individuals, the highest median family income of the applicable State for a family of 4 or fewer individuals, plus $ 575 per month for each individual in excess of 4; and
>
> (B) may be less than 3 or 5 years, whichever is applicable under subparagraph (A), but only if the plan provides for payment in full of all allowed unsecured claims over a shorter period.[38]

[39] *See In re* Brady, 361 B.R. 765, 776 (Bankr. D.N.J. 2007) (citing Alane A. Beckett & Thomas A. Lee, III, *Applicable Commitment Period: Time or Money?*, 25-MAR AM. BANKR. L.J. 16 (2006)).

[40] *E.g.*, *In re* Swan, 368 B.R. 12 (Bankr. N.D. Cal. 2007).
[41] *In re* Fuger, 347 B.R. 94 (Bankr. D. Utah. 2006). The court found the term applicable commitment period ambiguous and looked to legislative history and pre-BAPCPA practice. The court concluded that the term embraces both a monetary and temporal analysis. "It is monetary in the sense that it has always required debtors to commit to pay unsecured creditors a set return. It is temporal in the sense that it has always required debtors to determine that return by projecting over a specific time period, and it provides debtors with a time limit for performing under a chapter 13 plan." *Id.* at 99.

"projected disposable income."[42] Lastly, some courts have explored the interrelationship between plan modification under section 1329, and the ACP.[43]

A. The "Applicable Commitment Period" is a Temporal Concept

The Ninth Circuit BAP held in 2007 that the ACP is a temporal requirement.[44] The BAP determined that the below-median income debtors could not make a lump sum payment to obtain a discharge."[45] Emphasizing the minimal change to section 1325(b)(1),[46] the BAP concluded that the mere substitution of the phrase "applicable commitment period" did not change the section's meaning.[47] The BAP also relied on policy for its holding,[48] eventually concluding that debtors would not be abiding by the rules if an upfront lump sum payment was permitted, absent a modification.[49]

Courts offered a number of reasons for the temporal conclusion. Some courts made extensive textual comparisons, highlighting Code sections where "period" means a length of time and emphasizing alternative phrases that have a multiplier meaning.

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[42] *E.g.*,Coop v. Frederickson (*In re* Frederickson), 375 B.R. 829 (B.A.P. 8th Cir. 2007).
[43] *E.g.*, *In re* Ewers, 366 B.R. 139 (Bankr. D. Nev. 2007).
[44] Fridley v. Forsythe (*In re* Fridley), 380 B.R. 538 (B.A.P. 9th Cir. Dec. 18, 2007) (J. Klein). Below-median income debtors confirmed a plan in June of 2006 that provided for $125 monthly payments for 36 months. The debtors' tax returns reported a 45% increase in their gross income, but they did not file a report of the changed circumstances or income. In May 2007, the fourteenth month of their plan, the debtors paid the trustee $2,900. This payment slightly exceeded the balance due under the plan. The Debtors, subsequently, filed a motion for discharge without ever making a plan modification. The trustee objected. Judge Snyder in the bankruptcy court for the Western District of Washington denied the motion. "[T]he debtors plan, as well as § 1325(b)(4)(B), required a plan modification in order to shorten the applicable commitment period, unless unsecured creditors were paid in full." *Id*. at 540.
[45] *Id.* at 545 (explaining that § 1325(a) refers to completion, and that completion includes payments over the requisite time period).
[46] *Id.* at 544 (citing *In re* Keller, 329 B.R. 697, 702-03 (Bankr. E.D. Cal. 2005); *In re* Slusher, 359 B.R. 290, 302-03 (Bankr. D. Nev. 2007)).
[47] *Id.* (citing *In re Slusher*, 359 B.R. at 300-305; *In re Casey*, 356 B.R. 519, 527 (Bankr. E.D. Wash. 2006)).
[48] *Id.* ("[P]art of the statutory bargain inherent in chapter 13 is that the debtors must, for the prescribed life of the plan, run the gauntlet of exposure to trustee or creditor requests to increase payments. BAPCPA, by creating a debtor's duty to make information available to those who could propose modifications, actually reinforced this aspect of the statutory bargain.").
[49] *Id.* (stating "the debtor cannot short circuit that exposure merely by prepayment").

Additionally, some courts considered the Code's context when interpreting the meaning of the ACP. In *In re Luton*, the court explained that "when the phrase 'applicable commitment period' is examined in the context of all the other provisions of the Code, particularly sections 1325(b)(4)(A) and 1325(b)(4)(B), the court concludes that Congress intended a literal interpretation of the phrase."[50] Similarly, in *In re Schanuth* and *In re McGuire*, the courts concluded that a monetary analysis would render section 1325(b)(4) meaningless.[51]

Still other courts use additional statutory construction tools to support their interpretations.[52] For example, the court in *Schanuth* determined that since the statute's plain meaning did not lead to an absurd result the "applicable commitment period" was meant to have a temporal meaning.[53] The court in *Slusher* stated that "[i]t is hard to imagine analyzing the plain meaning of applicable commitment period and coming to the conclusion that the word 'period' means anything other than time."[54] In the absence of a Bankruptcy Code definition, the *Slusher* court also relied on the dictionary definition of "period" as a "length of time."[55]

[50] *In re* Luton, 363 B.R. 96, 98 (Bankr. W.D. Ark. 2007); *see also In re* Beasley, 342 B.R. 280, 284 (Bankr. C.D. Ill. 2006) (concluding that formulas and forms "lead to a fully-dispositive calculation of the applicable commitment period. When the calculation is complete, a debtor is directed to a three-year or five-year commitment period, and no further analysis is suggested, required, or allowed by any portion of the relevant statutes").

[51] *In re* Schanuth, 342 B.R. 601, 607 (Bankr. W.D. Mo. 2006) (stating that a monetary analysis would render section 1325(b)(4) "awkward, if not meaningless."); *In re* McGuire, 342 B.R 608, 615 (Bankr. W.D. Mo. 2006) (stating that "a monetary interpretation of [applicable commitment period] renders § 1325(b)(4)(B) meaningless.").

[52] *In re* Schanuth, 342 B.R. 601 (Bankr. W.D. Mo. 2006). The court rejected the monetary argument for three reasons. First, the court found that the term applicable commitment period's use of the term "period" has a temporal meaning - chronological division - and that division is described in the temporal term of three or five years. *Id.* at 607. Second, the court found that a monetary analysis would render section 1325(b)(4) "awkward, if not meaningless." *Id.* Finally, the use of a monetary analysis would be a departure from pre-BAPCPA practice that is not warranted by the language or structure of the statute. *Id.* at 608.

[53] *Id.* (internal citations omitted).

[54] *In re* Slusher, 359 B.R. 290, 301 (Bankr. D. Nev. 2007); *see also In re* Grant, 364 B.R. 656 (Bankr. E.D. Tenn. 2007); *In re* Dew, 344 B.R. 655, 661-62 (Bankr. N.D. Ala. 2006)("It is impossible to read sections 1322(d)(2), 1325(b)(4)(A) and 1329(c) and conclude the Bankruptcy Code contemplates something other than a defined length of time for payments to be made under a chapter 13 plan, i.e. the applicable commitment period").

[55] *Id.* "With respect to the general use of the words used, this examination may include dictionaries, etymologies, and guides to grammar and common usage such as the various canons of statutory construction." *Id.* at 295-96 (citing

Finally, certain courts determined that legislative history demonstrated Congress' intent for a temporal requirement, as the House Report specifically says "Five-Year Duration" and a "shorter period of time" when discussing section 1325(b)'s applicable commitment period.[56]

B. The "Applicable Commitment Period" is a Multiplier

Although the temporal interpretation represented the majority, some courts permitted lump sum payments to unsecured creditors.[57] The courts that adopt this "multiplier" interpretation acknowledge policy and practical realities.[58] Several opinions deal with chapter 13 plans that propose payments in excess of the statutory requirement, and therefore, the lump sum payment is deemed to be in the best interest of the debtor and creditors.[59]

For example, in *In re Swan*, the court confirmed a 36-month plan paying more than five times the statutorily required amount to unsecured creditors,[60] explaining that it benefited creditors and "further[ed] the Code's fresh start policy."[61] With regards to the ACP, the court opined that the debtor may "pay the same amount to unsecured creditors that would be required over five years, in three years."[62] The *Swan* court noted that prior to BAPCPA, debtors could "pay off the plan balance before 36 months without paying unsecured creditors in full,"[63] and there was no evidence to suggest that Congress intended to halt that practice.[64]

Bank of Am. Nat'l Trust & Savs. Ass'n v. 203 N. LaSalle St. P'ship., 526 U.S. 434, 460 (1999) (using dictionaries to determine meaning of "on account of") (other citations omitted).

[56] H.R. REP. NO. 109-31(1), Apr. 8, 2005 (emphasis added); *e.g.*, *In re* Davis, 348 B.R. 449, 457 (Bankr. E.D. Mich. 2006) (conceding that legislative history on BAPCPA is "scant").

[57] *E.g.*, *In re* Swan, 368 B.R. 12 (Bankr. N.D. Cal. 2007).

[58] *E.g.*, *In re* Fuger, 347 B.R. 94, 101 (Bankr. D. Utah 2006) (noting "that practicality supports the Court's holding).

[59] *E.g.*, *In re* Green, 378 B.R. 30 (Bankr. N.D.N.Y. 2007) (affirming a 36-month plan for an above-median income debtor with negative "disposable income" according to Form B22C).

[60] *In re Swan*, 368 B.R. at 13.

[61] *Id.* at 24 (explaining that unsecured creditors are not entitled to interest and that an earlier repayment benefits creditors because of the time value of money).

[62] *Id.*

[63] *Id.* at 26 (relying on citations in *In re* Fuger, 347 B.R. at 101, including *In re* Sunahara, 326 B.R. 768 (B.A.P. 9th Cir. 2005) (court may approve a plan modification allowing a debtor to complete plan in fewer than 36 months

C. The Applicable Commitment Period is Both a Temporal and a Monetary Concept

The bankruptcy court in *In re Fuger* utilized both interpretations of the "applicable commitment period."[65] The court found the term ambiguous and explained that the pre-BAPCPA meaning of the statute included a temporal and monetary component, and that the amended section "is still focused on the amount a debtor will return to unsecured creditors, rather than a length of time . . ."[66]

In *Fuger*, the above-median income debtors' Means Test yielded negative "disposable income," but the plan proposed to pay a total of $500 to unsecured creditors.[67] The court held that the debtors' plan was confirmable because "it makes little sense to hold the debtor hostage for 60 months where he can satisfy the requirements of § 1325(b)(1)(B) in a shorter period."[68] However, *Fuger's* holding is limited to the facts of the case.

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without paying unsecured creditors in full); *In re* Richardson, 283 B.R. 783 (Bankr. D. Kan. 2002); *In re* Forte, 341 B.R. 859 (Bankr. N.D. Ill. 2005); *In re* Miller, 325 B.R. 539 (Bankr. W.D. Pa. 2005)).

[64] *Id.*

[65] *In re* Fuger, 347 B.R. at 99 (Bankr. D. Utah. 2006).

[66] *Id.* at 98-99 Although the amendment changed the method for determining "projected disposable income," the thought process that underlies section 1325(b)(1)(B) remains the same. *Id.* at 99 n.20 (internal citation omitted).

[67] *Id*. at 95-96.

[68] *Id.* at 101. The court stated that the trustee could object to the debtors' proposed projected disposable income, leaving the door open for an interpretation of projected disposable income that varies from Form B22C.

D. The Applicable Commitment Period is Irrelevant When Debtors Do Not Have "Projected Disposable Income"

The interplay between the interpretations of "projected disposable income" and the ACP was most apparent in this group of cases. Principally, these courts calculated "projected disposable income" pursuant to the formulaic approach and concluded that plans shorter than 60 months for above-median debtors were confirmable because section 1325(b)(4) is irrelevant if there is no "projected disposable income."[69]

In *In re Frederickson*, the Eighth Circuit BAP explained that "if there is no projected disposable income, then subsection (b)(4) and the applicable commitment period do not even come into play."[70] In affirming the bankruptcy court, the BAP held that an above-median income debtor with negative "disposable income" can confirm a plan of less than five years, if the other statutory requirements are met.[71] However, the Eighth Circuit Court of Appeals reversed the bankruptcy court and the BAP explaining that "disposable income" differs from "projected disposable income." After making this distinction and adopting the view that the ACP is a temporal requirement, the Court of Appeals found that a debtor's plan must extend for the entire ACP where a debtor has "projected disposable income."[72]

Some bankruptcy courts held that the ACP is irrelevant when the debtor has negative "disposable income," reasoning that, without "projected disposable income," the ACP as defined

[69] *E.g.*, Coop v. Frederickson (*In re* Frederickson), 375 B.R. 829 (B.A.P. 8th Cir. 2007) (affirming the bankruptcy court's confirmation of 48 month plan for above-median income debtor). In the dissent, Judge Federman determines that the applicable commitment period is a temporal requirement based on legislative history. *Id.* at 837 (Federman, J., dissenting). See *supra* note 291 and accompanying text (quoting legislative history in Section 318).
[70] *In re* Frederickson, 375 at 831.
[71] *Id.* at 835.
[72] *Coop v. Frederickson (In re Frederickson)*, 545 F.3d 652, 659-60 (8th Cir. 2008) (stating that "a debtor's 'disposable income' calculation . . . is a starting point for determining the debtor's 'projected disposable income,' but that the final calculation can take into account consideration changes that have occurred in the debtor's financial circumstances as well as the debtor's actual income and expenses as reported on Schedules I and J; also stating that "the 'applicable commitment period' is logically a temporal requirement that does not lead to anomalous or absurd results" (relying on citations in *In re Slusher*, 359 B.R. at 301; *In re Schanuth*, 342 B.R. at 606-08)).

in section 1325(b)(4) has no role.[73] In *In re Alexander*, the court stated that "[t]here is no reason to extend plans artificially if there is no requirement that debtors pay a dividend to unsecured creditors over time."[74]

The bankruptcy court in *In re Green* reasoned that the ACP is income-driven under section 1325(b)(4), but its relevance to a debtor lies within the context of section 1325(b)(1)(B), namely, "projected disposable income" and "unsecured creditors."[75] If neither exists "then the § 1325(b)(1)(B) formula loses its meaning."[76] The court also concluded that the meaning of the ACP within sections 1325(b)(1)(B) and 1322(d) "are not necessarily synonymous."[77]

Similarly, the court in *In re Brady* focused on context.[78] The court emphasized that section 1325(b)(1)(B)'s ACP was predicated on the debtor having "projected disposable income," reading that only "if the debtors have projected disposable income to be received during the five years that constitutes the applicable commitment period."[79] The temporal meaning of "period" was not questioned.[80]

The rationale that the durational component of the ACP is conditioned upon a debtor having "projected disposable income" was not unanimous. Some courts instead adopted a

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[73] *In re* Alexander, 344 B.R. 742 (Bankr. E.D.N.C. 2006). Boynton v. Boynton (*In re* Lawson), 361 B.R. 215, 220 (Bankr. D. Utah 2007) (holding that the applicable commitment period concept is "fundamentally irrelevant" where an above-median income debtor has negative monthly disposable income on line 58 of Form B22C).
[74] *In re* Alexander, 344 B.R. at 751.
[75] *In re* Green, 378 B.R. 30, 34 (Bankr. N.D.N.Y. 2007).
[76] *Id.* "In other words, we need income to be received and creditors to be paid if the [applicable commitment period], whether 3 or 5 years, is to have significance." *Id.* at 35.
[77] *Id.* (explaining that all plans have a § 1322(d) term, some plans have a § 1322(d) term that coincides with the duration required under § 1325(b)(1)(B), but cautioning the analysis that requires the two terms to always be equal).
[78] *In re Brady*, 361 B.R. 765, 776 (Bankr. D.N.J. 2007).
[79] *Id.* (emphasis added).
[80] *Id.* "While it is certainly true that the term "period" signifies a portion of time and may therefore be labeled "temporal", the phrase is only relevant to specify the length of time that a required payment of projected disposable income to unsecured creditors must be made." *Id.* at 776-77 (citing *In re* Alexander, 344 B.R. at 751 and 5 Keith M. Lundin, CHAPTER 13 BANKRUPTCY, § 500.1 at 500-2 (3d ed. 2006)).

temporal requirement and maintained that the plain language required that the plan comport with section 1325(b)(4)'s durational requirement to be confirmable.[81]

E. Interpreting the "Applicable Commitment Period" in Plan Modification

Some courts also considered the ACP as it related to plan modifications under section 1329. In *In re Ewers*, the debtors sought to modify their plan from 5 years to 3 years, and the court held that "so long as the requirements of 11 U.S.C. § 1329(b) are satisfied, which includes the requirement of good faith," the debtor's proposed amendment was permissible.[82] The trustee argued that the ACP requires debtors to pay their unsecured creditors in full or provide a 60-month plan.[83] The court rejected this argument because it would essentially restrict the terms of a plan and render modifications under section 1329 superfluous.[84] The *Ewers* court explained that the good faith requirement of section 1329 would satisfy any concerns regarding manipulation of the statutory requirements of the ACP.[85] The court concluded that when sections 1329(a)(2) and 1325(b) are read in context they "are distinct and complementary."[86]

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[81] *In re* Musselman, 2007 WL 4357161 (Bankr. E.D.N.C. Nov. 30, 2007) (holding that an above-median income debtor had to propose a plan lasting 60 months, regardless of whether the debtor has positive disposable income); *In re* Hylton, 384 B.R. 579 (Bankr. D. W. Va. 2007) (holding that the plain language of § 1325(b)(4)(A) requires the above-median income debtor to propose a 60-month plan).
[82] *In re* Ewers, 366 B.R. at 140, 143.
[83] *Id.* at 140.
[84] *Id.* at 143 (describing the BAPCPA change to § 1325(c) that replaced "three years" with "applicable commitment period") (citing Kawaauhau v. Geiger, 523 U.S. 57, 62 (1998) to support that Bankruptcy Code statutory interpretation requires that an interpretation of one Code section cannot render another superfluous). "A plan modified under this section may not provide for payments over a period that expires after the applicable commitment period under section 1325(b)(1)(B) after the time that the first payment under the original confirmed plan was due, unless the court, for cause, approves a longer period, but that court may not approve a period that expires after five years after such time." 11 U.S.C. § 1325(c) (2008).
[85] *Id.* at 144.
[86] *Id.* at 142.

F. Continuing Concerns and Current Law

Ten years after the enactment of BAPCPA, confusion still exists regarding the nature of the ACP.[87] Courts continue to struggle with whether the ACP is a temporal or multiplicative requirement, which leads to doubt concerning debtors with negative income and those that are self-employed.[88]

However, the Eleventh Circuit Court of Appeals has recently shed some light on the issue in *Whaley v. Tennyson (In re Tennyson)*, 611 F.3d 873 (11th Cir. 2010). In *Tennyson*, the debtor had above-median income, but negative disposable income.[89] He proposed a 36-month plan that did not pay unsecured creditors in full.[90] The Chapter 13 Trustee objected, asserting that section 1325(b) required a 5-year plan.[91] The case was appealed to the Court of Appeals after the bankruptcy court approved the 36-month plan.[92]

The key issue was "whether an above median income debtor, with negative disposable income" may confirm a plan for less than five years that does not provide for full payment of unsecured creditors.[93] The Eleventh Circuit decided that an above-median income debtor must remain in bankruptcy for five years unless the debtor pays all unsecured claims in full.[94] In doing so, the Court opined that the ACP is a temporal term by analyzing the plain meaning approach, considering Congressional intent, and looking to Supreme Court case law.[95]

The bankruptcy court had confirmed the debtor's plan, reasoning that the ACP is a multiplier in the section 1325(b)(1)(B) formula where "projected disposable income" equals the

[87] *See* 8-1325 COLLIER ON BANKRUPTCY, P 1325.11 at 1325.11[d] (Alan N. Resnick & Henry J. Sommer, Eds., 16th ed. 2015).
[88] *Id.*
[89] *Whaley v. Tennyson (In re Tennyson)*, 611 F.3d 873, 875 (11th Cir. 2010).
[90] *Id.*
[91] *Id.*
[92] *Id.*
[93] *Id.* at 874.
[94] *Id.*
[95] *Id.*

product of "disposable income" and the ACP.[96] In rejecting that assertion, the Eleventh Circuit noted that, if the ACP was only meant to work within the formula, and not stand alone as a concept, the formula was flawed – if a debtor had negative disposable income, the outcome would always be negative, and the ACP would be pointless.[97] Furthermore, a plain reading of the ACP language indicates a temporal purpose – "period" means duration, "commitment" means that a debtor must serve for that time, and "applicable" means that there are alternative periods.[98] Section 1325(b)(4) also states that the "applicable commitment period *shall* be . . .,"[99] which indicates a lack of discretion in plan lengths.[100] And, when contrasted with section 1322(d), which sets out the maximum lengths for chapter 13 plans, section 1325(b) is necessary, as it sets out the minimum lengths for plans and the framework for altering those minimums if unsecureds are paid in full.[101]

The Supreme Court's decision in *Hamilton v. Lanning*, 560 US, 130 S.Ct. 2464 (2010), also supports this conclusion – the opinion noted that section 1325(b) is not a mechanical formula, and therefore, the Eleventh Circuit concluded that the ACP must have an independent existence.[102] Relying on Congressional intent, the Eleventh Circuit noted that the ACP was discussed in tandem with a section that involves amendments to duration.[103] Finally, discussing policy concerns, the Court opined that confirmation of a 36-month plan would "deprive the unsecured creditors of their full opportunity to recover" after a potential post-confirmation modification.[104]

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[96] *Id.* at 876.
[97] *Id.* at 877.
[98] *Id.*
[99] *Id.*
[100] *Id.*
[101] *Id.* at 878.
[102] *Id.* at 878-79.
[103] *Id.* at 879.
[104] *Id.*

More recently, several courts have joined in the Eleventh Circuit's finding in *Tennyson*. The Sixth Circuit Court of Appeals in *Baud v.Carroll* held that the temporal requirement of the ACP applies to debtors with zero or negative projected disposable income.[105] Also agreeing with the Eleventh Circuit, the Fourth and Ninth Circuit Courts of Appeals in *Pliler v. Stearns* and *Danielson v. Flores*, respectively, found that where unsecured creditors have not been paid in full an above-median-income debtor with negative disposable income is obligated to maintain a plan that lasts for five years.[106]

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[105] *Baud v. Carroll,* 634 F.3d 327, 356 (6th Cir. 2011) (concluding that "applying the applicable commitment period to debtors with zero or negative projected disposable income would best serve BAPCPA's goal of ensuring that debtors repay creditors the maximum amount they can afford.").

[106] *Pliler v. Stearns,* 747 F.3d 260, 266 (4th Cir. 2014) (stating that "a plain reading of the Bankruptcy Code, and Section 1325 in particular, mandates that an above-median-income debtor maintain a bankruptcy plan for five years unless all unsecured creditor claims are paid in full and irrespective of projected disposable income.); *Danielson v. Flores (In re Flores)*, 735 F.3d 855, 858 (9th Cir. 2013) (finding that the ACP imposes a temporal requirement, which applies regardless of the debtor's projected disposable income).

Who Has Been Left "Hanging" by the Paragraph Inserted into Section 1325(a)

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The enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) added language to §1325(a) of the Bankruptcy Code which included an unnumbered paragraph inserted after §1325(a)(9) referring back to §1325(a)(5) pertaining to circumstances in a Chapter 13 proceeding when the provisions of §506 of the Bankruptcy Code would not apply to certain secured loans. The language added was intended primarily to benefit holders of claims secured by cars and provided that:

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

This addition to §1325 is commonly referred to as the "hanging paragraph" and defines what constitutes a "910 car claim". Like other language added under BAPCPA, the text is no model of clarity. From inception, there has been confusion and conflict as to what claims are subject to the provisions, though no one could have envisioned that the paragraph would result in hundreds decisions including nine by circuit courts. The chaos created by the decisions, though more settled now, have not been fully resolved so there may still be more to be written on this in the decade to come.

I. What issues arose as a result of the adoption of the statutory language of the "hanging paragraph" of §1325(a)?

From the beginning, efforts to parse the language of the hanging paragraph to discern what treatment a claim would be afforded has proven difficult. Practitioners struggled to first to define whether a claim was subject to the hanging paragraph; and second, what the language meant in terms of treatment of the claims in achieving confirmation of chapter 13 plans. Courts, finding no clear path for deciphering the language as written, sought a simplified mechanism for the analysis by resolving that if the following four questions were answered in the affirmative, a claim would be subject to the hanging paragraph and a debtor would be required to treat the creditor as if it were fully secured. The questions to be asked:

(1) Did the creditor have a purchase money security interest? (2) Was the debt at issue incurred within 910 days before filing the petition? (3) Was a motor vehicle the collateral for the debt? (4) Was the motor vehicle acquired for the personal use of the debtor?[107]

Sadly, answering those questions did not solve the problem, rather there were many more questions raised including:

- What was the definition of the phrase "purchase money security interest"?
- Was the definition of "purchase money security interest securing a claim" to be defined expansively or narrowly?
- Was the requirement that the vehicle be "acquired for personal use" to be read literally or expansively?
- Did treatment of the creditor's claim depend on whether the debtor intended to retain or surrender the property?
- Did the language in the hanging paragraph apply to preventing the modifiability of the contract interest rate or did the debtor retain the ability to address the interest rate as permitted by §1322(b)(2)?

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[107] *In re Conyers*, 379 B.R. 576, 579 (Bankr. M.D.N.C. 2007).

In fewer than 100 words, the drafters of BAPCPA generated many questions requiring convoluted interpretations and forced resolutions. Needless to say, because there has been great confusion, the treatment of claims arguably subject to the treatment prescribed by the language added to §1325 has resulted in extensive litigation. There are hundreds of written decisions to date about this paragraph as both debtors and creditors (each with a significant stake in the outcome), sought to resolve the meaning of the added language. The decisions to date have had important and considerable impact on the rights of both creditors and debtors in the chapter 13 plan confirmation process, yet questions still remain.

II. How did the concerns play out and what is the state of the law today?

Simply put, there is no clear and consistent reading of the paragraph by the courts who have considered the issues.

a. Defining Purchase Money Security Interest

The decisions that have emanated in connection with efforts to define "purchase money security interest" have had to consider whether the hanging paragraph should apply to a car loan that includes sums not specific to the actual acquisition purchase price. Those sums could include amounts rolled into the loan for expenses such as insurance coverage, warranty protections or other related costs. Most commonly however, the sums in question are amounts which are the "negative equity" from a prior car loan. The term "negative equity" refers to the unpaid balance on a car loan when a vehicle is being "traded in" as part of the consideration at the time the buyer purchases a new car. In those instances, the new lender will pay off the old loan but will add any deficit to the new loan. [108] The addition of other costs or fees or the "negative equity" to the acquisition loan has caused debtors to challenge the treatment of the claim as the assertion is that

[108] Donald Gray Carlson, *Cars in Chapter 13: Does Negative Equity Destroy the Jurisdiction of the Hanging Paragraph?* 20 ABI L. Rev. 535(2012).

such inclusion precludes the loan from qualifying as it is not a loan on account of a purchase money security interest.

The definition of "purchase money security interest" has proven crucial to determining whether a car loan falls into the hanging paragraph limitations and whether the treatment is within the parameters or a "910 car claim". Over the ten years since the implementation of BAPCPA, a split has emerged among the circuits on the applicability of the "hanging paragraph" in the presence of a negative equity component to a car loan. The majority of courts have found that claims that include the financing of negative equity still entitle the lender to a "910 car claim" which must be paid in full. Eight circuits, the Second, Fourth, Fifth, Sixth, Tenth and Eleventh, have reached the conclusion that the definition of purchase money security interest should be read to include negative equity.[109] The Ninth Circuit however, has taken a different position in the case of *Americredit Financial Services v. Penrod, (In re Penrod).* [110] The Court declined to adopt holdings in other jurisdictions and rejected the argument that a negative equity balance which was rolled into the new loan was an expense incurred in connection with acquiring rights in the collateral. The Court was not persuaded that because financing of negative equity had become a customary industry practice and a practical reality necessary to many motor vehicle sales transactions, that is should alter the fact that negative equity did not fall within Article 9's definition of "price" or "value given." The decision in the case was challenged but the Supreme Court denied certiorari.

Outcome: The split (however small) remains.

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[109] *See, e.g. Reiber v.GMAC, LLC (In re Peaslee*), 585 F.3d 53(2nd Cir.2009); *Wells Fargo Fin. Acceptance Co. v Price (In re Price*, 562 F.3d 618(4th Cir. 2009); *Ford Motor Credit Corp. v. Dale, (In re Dale),* 582 F.3d 568 (5th Cir.2009); *Nuvell Credit Corp. v. Westfall, (In re Westfall),* 599 F.3d 498 (6th Cir.2010); *Ford v. Ford Motor Credit Corp., (In re Ford),* 574 F.3d 1279 (10th Cir. 2009) and *Graupner v. Nuvell Credit Corp. (In re Graupner),* 537 F.3d 1295 (11th Cir. 2008).

[110] 611 F.3rd 1175, (9th Cir. 2010) *cert. denied*, 132 S. Ct. 108 (2011).

b. Deficiency or no deficiency in case of vehicle surrender?:

The majority of courts that have addressed the issue agree that the treatment of the 910 car claim depends on whether the debtor intends to retain the vehicle or surrender the property. Due to the ambiguity in the statutory language, a number of circuit courts have joined the fray. In undertaking the analysis, one intuitively would have thought that because the language in the hanging paragraph was intended to prevent the debtor from bifurcating claims into secured and unsecured components, that the same considerations would be applicable in the event that a vehicle was surrendered such that the creditor would have received the indubitable equivalent[111] of its claims upon surrender and sale and that no deficiency claim would be available. It stood to reason that the cramdown protections of the hanging paragraph would also serve to protect the debtor and that creditor's would be prohibited from asserting a deficiency claim upon surrender of the collateral. That has not proven to be the case in the majority of decisions. The 910 car claim language was designed to benefit secured car creditor claimants and the resulting opinions issued have largely held that the hanging paragraph does not preclude a creditor from asserting a deficiency claim after liquidation of the collateral, relying primarily on state law solutions in light of the fact that treatment under §506 is precluded[112].

Outcome: The majority of circuit courts have allowed undersecured creditors to assert a deficiency claim upon surrender.

c. Can the contract rate of interest be modified?

[111] 11 U.S.C. §1129(b)(2)(A)(iii).

[112] *See e.g Tidewater Finance Co. v. Kenney*, 531 F.3d 312 (4th Cir.2008); ***In re Long***, 519 F.3d 288 (6th Cir., 2008) ; *In re Adkins*, 425 F.3d 296 (Fed. 6th Cir., 2005); *In re Wright*, 492 F.3d 829 (7th Cir., 2007); *Capital One Auto Finance v. Osborn,* (In re Osborn), 363 B.R. 72 (B.A.P. 8th Cir., 2007); *In re Rodriguez*, 375 B.R. 535 (B.A.P. 9th Cir., 2007); *In re Ballard*, 526 F.3d 634 (10th Cir., 2008); *In re Barrett*, 543 F.3d 1239 (11th Cir., 2008).

There are a number of bankruptcy courts that have considered the issue of whether a debtor is able to modify the contract interest rate on a car loan that is subject to the hanging paragraph. The majority of cases have found that nothing in the text of the hanging paragraph referred to or required elimination of the ability to modify the interest rate. There is generally agreement among the decisions issued that the contract interest rate for a car loan which is subject to treatment under the provisions of the hanging paragraph can also be adjusted to a *Till*[113] rate determination as permitted by the provisions of §1322(b)(5).[114]

Outcome: The hanging paragraph did not affect the ability of the debtor to modify the contract rate notwithstanding that it is subject to the "910 car claim" treatment under the chapter 13 plan.

d. <u>How broadly is the term "personal use" defined</u>?

The term "personal use" has been explored in a number of cases where a creditor asserted protections under the hanging paragraph for a "910 car claim." Struggling with how to define the phrase has yielded an inconsistent and divergent set of results as the case law has emerged over the past ten years. Courts are in general agreement that the definition for "personal use" is a determination that must be considered based upon the totality of the circumstances as well as the intended use for the vehicle at the time it was acquired.

There are cases which define "personal use" very narrowly such that "at the time of the acquisition the acquirer intended that a significant, material portion of the use of the vehicle would be (a) for the benefit of the debtor(s) in the bankruptcy case, (b) for non-business purposes,

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[113] *Till v. SCS Credit Corp*., 541 U.S.465 (2004). Supreme Court decision determining that interest rate is modifiable and the rate is determined based upon a formula based upon prime rate which is adjusted for risk.

[114] *In re Wilson*, 374 B.R. 251 (B.A.P. 10th Cir. 2007) (10th Cir. *In re Bufford*, 343 B.R. 827 (Bankr. N.D. Tex. 2006); *In re Fleming*, 339 B.R. 716 (Bankr. E.D. Mo. 2006); *In re Desardi*, 340 B.R. 790 (Bankr. S.D. Tex. 2006) Drive Financial Services, L.P. v. Jordan, 521 F.3d 343 (5th. Cir., 2008).

and (c) for satisfaction of debtor(s)' wants, needs, or obligations.[115] Some courts have determined a vehicle is not for personal use even if its use enabled the debtor to make a significant contribution to the gross income of the family unit for determination because the travel provided monetary benefits to the debtor and debtor's family and such benefits are personal to debtor and his family and not business.[116] There is also a line of cases which hold that if the car is used for both personal and business purposes ("dual purposes") but used primarily for business purposes, then the matter will be determined based upon the totality of the circumstances. In other words, whether the vehicle's personal use is "significant and material".[117] The path is clearer in cases where the facts reflect that the car was purchased for the use of a non-filing person like a spouse, child etc., and the courts have consistently held that such a vehicle will not be considered to be purchased for the debtor's personal use and is not subject to the hanging paragraph[118].

Outcome: There is no bright line test if the vehicle is used for dual purposes and remains fact specific and based upon the totality of the circumstances.

[115] *In re Solis*, 356 B.R. 398, 411 (Bankr. S.D. Tex. 2006).
[116] *In re Hill*, 352 B.R.69 (Bankr. W.D. La. 2006); *In re Marinez*, 363 B.R. 525 (Bankr. S.D. Tex. 2007) *In re Johnson*, 350 B.R. 712, 716 (Bankr. W.D. La. 2006. *In re Andoh*, 370 B.R. 377, 384 (Bankr. D. Colo. 2007).

[117] *In re Joseph*, 2007 Bankr.LEXIS 1049 (Bankr.W.D.La.2007); *In re Lorenz*, 368 B.R. 476 (Bankr. E.D. Va. 2007); *In re Solis*, at 402-403; *Wilson,* 2006 WL 3512921, 2006 Bankr.Lexis 3325, *In re Solis,* 356 B.R. 398 (Bankr.S.D.Tex.2006), *In re Hill,* 352 B.R. 69 (Bankr.W.D.La.2006), *In re Johnson,* 350 B.R. 712 (Bankr.W.D.La.2006), *In re White,* 352 B.R. 633 (Bankr.E.D.La.2006).

[118] See e.g. *In re Lewis*, 347 B.R. 769 (Bankr. D. Kan. 2006); *In re Solis*, 356 B.R. 398, 411 (Bankr. S.D. Tex. 2006); *In re Beasley*, 2007 WL 2986124 (Bankr. M.D. Ga. October 9, 2007); *In re Smith*, 2007 Bankr.LEXIS 1872 (Bankr.S.D.Tex. May 29, 2007) (citing a long string of cases).