Two Worlds Collide: Domestic Relations and Bankruptcy

CONCURRENT SESSION

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Regarding Dischargeability of Debtors in Bankruptcy, in the Context of Family Law

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I. Introduction

Bankruptcy is a complex area of the law with many nuances that intercede with Family Law. Many bankruptcy clients want to obtain a discharge of debt from their family law cases. However, the Bankruptcy Code provides that many of these debts are non-dischargeable in Chapter 7 and Chapter 13 cases.

II. Discharge of Debt Obligations

Pursuant to 11 U.S.C. §727(a), the Bankruptcy Court shall grant an individual debtor a discharge of his or her debt obligations, subject to twelve (12) enumerated grounds for the denial of a discharge, as articulated at §727(a)(1)-(12). The discharge is granted, if no complaint or motion requesting denial has been filed with the Court, and/or if no such proceeding is still open/pending, on the day after 60 days from the date first set for the §341 first meeting of creditors Federal Rule of Bankruptcy Procedure ("FRBP") 4004(a). The discharge is granted in the form of an *Order of Discharge* entered by the Court automatically and without motion for entry of the same. Such orders, generally speaking, read simply as follows: "IT IS ORDERED: A discharge under 11 U.S.C. § 727 is granted to: [Name of Debtor]." The granting of a discharge is, in simple terms, the "goal" of a bankruptcy filing. [Note: There are, of course, many situations in which a discharge is not the end-goal of the filing of a bankruptcy; however, the vast majority of these situations are inapplicable to the typical consumer bankruptcy client, and especially to the typical family law client.]

☞ ***Practice Tip**: When consulting for or working with family law practitioners or clients unfamiliar with bankruptcy, it is often useful to provide the above information at the outset, something which bankruptcy attorneys often overlook because the same is rudimentary in our practice; this will help all persons involved to understand the timeline of the case. Most importantly, one must remember that the family law client, and often the practitioners as well, are unaware of the difference between the automatic stay of proceedings, discussed elsewhere in this material, and the actual discharge of the debtor's obligations, and certainly of the timeline regarding the two.*

III. Denial of Discharge

The grounds for denial of discharge listed at §727(a)(1) – (12) include, by way of example, summarizing, and without limitation: §727(a)(1), that the debtor is not an actual individual; (2) that the debtor has hidden, removed, transferred, property of the debtor or the estate, in an attempt to impede his or her creditors; (3) that the debtor has hidden, destroyed or falsified records regarding the debtor's finances; (4) that the debtor made false claims or accounts in the bankruptcy case, or withheld information; and the list continues.

To request that a debtor be denied a discharge, a creditor (or the trustee of the bankruptcy case) must commence an adversary proceeding against the debtor (with the debtor as the named defendant), by the filing of a complaint in the debtor's bankruptcy case. FRBP 4004(a). Note also the exception which allows for a motion to be filed requesting denial of discharge under §727(a)(8) & (9). Although filed in the bankruptcy case, the adversary complaint will give rise to a separate *adversary proceeding*, with a distinct case number. Such proceedings must be commenced in accordance with, and are procedurally governed by, Part 7 of the Federal Rules of Bankruptcy Procedure, entitled, aptly: *Adversary Proceedings*. As noted above, such proceeding(s) must be commenced within 60 days of the date *first set* for the §341 first meeting of creditors. FRBP 4004(a).

☞ ***Practice Tip***: *All too often, a family law attorney or client will call for a consultation or to retain your services, on behalf of a non-filing spouse, either right before the §341 meeting, or during the 60 day period. It is best practice not to rely on any date provided by the client or the consulting attorney, as they are most likely unaware of the "date first set" timeline, and may be citing to you an adjourned date, or even a re-scheduled date for a first meeting that was never conducted, but which was scheduled. Thus, the bankruptcy practitioner should always do an independent search of the CM-ECF-PACER system, using either the debtor's name, or, if possible, a case number.*

IV. Exceptions to Discharge

The exceptions to the granting of a discharge, as articulated at §727(a), should be distinguished by the practitioner from the specifically enumerated *exceptions to discharge* articulated at 11 U.S.C. §523, which, as opposed to controlling whether or not the debtor receives a discharge at all, (§727) instead controls whether or not an individual debt is, or will be, discharged by the debtor's discharge order. (§523).

§523(a) is an itemized list of nineteen (19) types of debt which are not discharged by the granting of a discharge to a debtor. These types of debt(s) include, by way of example, summarizing, and without limitation: §523(a)(1) taxes; (2) debts obtained by fraud; (3) certain types of debt not timely disclosed by the debtor; (4) debts for fiduciary defalcation, embezzlement, or larceny; (5) domestic support obligations; (6) debt(s) for willful and malicious injury; and so on.

Of the 19 non-dischargeable debts, three (3) require that the creditor commence an adversary proceeding requesting that the Court render decision that such debts are non-dischargeable; they include: §523(a)(2) debts obtained by fraud; §523(a)(4) debts for fiduciary defalcation, embezzlement, or larceny; and §523(a)(6) debt(s) for willful and malicious injury. §523(c)(1). In other words, except for the §523(a)(2), (4), and (6), those debts of the kinds listed in §523(a), are automatically rendered non-dischargeable, and are not discharged by the debtor's discharge, if granted.

While analysis of potential exceptions under §523(a)(2), (4), and (6), relating to fraud and willful injury may be necessary and helpful in representing the non-filing spouse or ex-spouse, or in bankruptcy planning for a potentially filing ex-spouse, that will be addressed later. Instead, the most facially relevant subsections of §523(a) are (5) and (15). These two (2) types of debt are each discussed in separate sections, below.

V. §523(a)(5) – Domestic Support Obligations

§523(a)(5) provides that a debt, "for a domestic support obligation[,]" ("DSO") is nondischargeable. In turn, the term "domestic support obligation" is defined at 11 USC §101(14A) as:

> [A] debt that accrues before, on, or after the date of the order for relief in a case under this title, including interest that accrues on that debt as provided under applicable nonbankruptcy law notwithstanding any other provision of this title, that is—
> (A) owed to or recoverable by—
> (i) a spouse, former spouse, or child of the debtor or such child's parent, legal guardian, or responsible relative; or
> (ii) a governmental unit;
> (B) in the nature of alimony, maintenance, or support (including assistance provided by a governmental unit) of such spouse, former spouse, or child of the debtor or such child's parent, without regard to whether such debt is expressly so designated;

> (C) established or subject to establishment before, on, or after the date of the order for relief in a case under this title, by reason of applicable provisions of—
>
> > (i) a separation agreement, divorce decree, or property settlement agreement;
> > (ii) an order of a court of record; or
> > (iii) a determination made in accordance with applicable nonbankruptcy law by a governmental unit; and
>
> (D) not assigned to a nongovernmental entity, unless that obligation is assigned voluntarily by the spouse, former spouse, child of the debtor, or such child's parent, legal guardian, or responsible relative for the purpose of collecting the debt.

The requirements listed in §101(14A) are cumulative, as demonstrated by the "and" at the end of subsection (C). Given the concise language of the statute, no simplified version of the statute can be given without jeopardizing thoroughness; however, in speaking to the client or consulting family law attorney, it may be acceptable to simply explain that a DSO means any type of debt for, "alimony, maintenance, or support" that is established by an order or judgment of the Court (in this case, most likely, the Family Law Division of the Circuit Court), regardless of whether the order or judgment was entered before or after the bankruptcy case was filed, and regardless of whether the order or judgment established the debt retroactively to before or after the bankruptcy case was filed, or whether the debt continues to accrue after the filing of the case. That being said, in representing/consulting-for either the non-filing spouse/ex-spouse, or the filing spouse/ex-spouse, very careful analysis of the language of this Code section and the related judgment or order must be done by the practitioner to verify what debts will or will not be excepted from discharge.

☞ ***Practice Tip****: In fact, in speaking with a family law attorney or family law client, it will be generally sufficient to use the terms "child support and spousal support," to describe what is, at its most basic, a DSO. The family law practitioner, and even the client if the case has progressed long enough, is well aware of the distinction, in the family law context, between child* *and spousal support on the one hand, which are calculated relatively formulaically based on income, years of marriage, number of children, parenting time, etc., and property settlement, or the "division of assets and debts", on the other hand, which, while governed by a general "equitable" principle (often construed by family law courts as 50/50), require greater negotiation, and the identification, valuation, and assignment/assumption of each individual asset or liability, or, at a minimum, of each particular category of the same. Additionally, property settlements are, with very limited exception, non-modifiable by the family law courts, after entry, whereas child support and or spousal support are generally always modifiable, with some exception(s). Despite the foregoing simplicity of explanation, the careful practitioner will, however, make sure to explain to the family law attorney or client that it is possible that part or even all of what is identified as property settlement, or asset division, or which is simply not specifically identified as child support or spousal support, may very well also fall under the control of §523(a)(5).*

As stated before, §523(a)(5) renders a DSO nondischargeable. In fact, both DSOs and non-DSOs are nondischargeable in a Chapter 7 bankruptcy. The importance of defining what debts or obligations are considered DSOs becomes particularly important in the context of a Chapter 13 bankruptcy case. This is because DSOs survive the more liberal discharge in Chapter 13, while non–DSOs, §523(a)(15), do not. §1328(a).

VI. §523(a)(15) – Non-Domestic Support Obligation(s)

§523(a)(15) excepts from discharge a debt:

> to a spouse, former spouse, or child of the debtor and not of the kind described in paragraph (5) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record, or a determination made in accordance with State or territorial law by a governmental unit[.]

The Non-DSO debt(s) described and rendered non-dischargeable by §523(a)(15) may be thought of as, for simplicity purposes, any debt or obligation that arises out of a divorce case, whether by interim order, or in the final judgment. The greatest limiting factor, however, is that such debts must be owed to a, "spouse, former spouse, or child of the debtor[.]" §523(a)(15).

In practice, this will most often prove to be indemnification and hold-harmless provisions related to the assumption of debt by the filing party, and an assertion of claim by the non-filing party in the bankruptcy case.

VII. Dischargeability in Chapter 7 vs. Chapter 13

As briefly discussed above, both DSOs and Non-DSOs are non-dischargeable in a Chapter 7 Bankruptcy. 11 U.S.C. §727. However, in Chapter 13, only a DSO is non-dischargeable under §523(a)(5), and non-DSOs, which fall under §523(a)(15) are dischargeable. 11 U.S.C. §1328. This is due to the limitation on the scope of non-dischargeability imposed by (or, perhaps, better phrased as "granted by") 11 U.S.C. § 1328(a)(2), which states, "(a) ... [A]s soon as practicable after completion by the debtor of all payments under the plan ... the court shall grant the debtor a discharge of all debts ... except any debt ... (2) of the kind specified in section 507(a)(8)(C) or in paragraph (1)(B), (1)(C), (2), (3), (4), (5), (8), or (9) of section 523(a)[.]" [Note: (a)(15) is not included in the list.]

A Chapter 13 case, however, should not be filed solely for the purpose of discharging a non-DSO debt. Where a Chapter 13 case appears to have been filed solely for the purpose of avoiding payment on a divorce property settlement, the same may be subject to a bad faith challenge. *In re: Richard S. Larson-Asplund*, Case No. 14-44240 (Bankr. E.D. Mich. 2015). In that case, the Hon. Philip Shefferly of the United States Bankruptcy Court for the Eastern District of Michigan, Southern Division, Detroit, applied the factors set forth in *In re Okoreeh-*

Baah, 836 F.2d 1030 (6th Cir. 1988) to conclude that a Debtor who was ineligible for a Chapter 7, was not entitled to a discharge in the Chapter 13 because, among other reasons: (a) most of the debt was the divorce property settlement debt (for payment of college tuition); (b) he had made deminimus pre-filing efforts to pay the debt; (c) the Debtor didn't appear to need relief from any other creditors other than his ex-spouse; and (d) the plan proposed deminimus payments to unsecured creditors.

☞ ***Practice Tip****: The distinction between DSO and Non-DSO, as it relates to dischargeability, is essentially meaningless in the context of an individual Chapter 7 bankruptcy case, because both are automatically non-dischargeable; however, the DSO/Non-DSO review should always be performed with respect to each potential claim that the client may have via the Judgment of Divorce, or as a result of the divorce in general. There are circumstances, for example, if you are representing a non-party to the divorce, such as prior counsel to the presently-filing spouse, where the debt, even though articulated in the Judgment, is neither a DSO nor a Non-DSO, and is therefore dischargeable if not secured in some manner, or incurred by fraud.*

VIII. Procedural Matters Regarding Divorce Related Debts

All debts arising out of a judgment of divorce are automatically non-dischargeable pursuant to 11 U.S.C. §§ 523(a)(5) and (15). Thus, in a Chapter 7 case, an ex-spouse creditor via Judgment of Divorce cannot obtain any relief that he or she did not already have before filing an adversary complaint in the bankruptcy case, seeking non-dischargeability under 11 U.S.C. §§ 523(a)(5) and (15). The court has held that under these circumstances an ex-spouse lacks standing. *Valdivia v. Hauk*, Case No. 15-13677, 4 (E.D. Mich. Jul. 19, 2016), citing *In re Mapley*, 437 B.R. 225, 228 (Bankr. E.D. Mich. 2010).

☞ ***Practice Tip**: At the present time, case law suggest that in the context of a Chapter 7 case, a complaint is entirely not necessary if the only grounds for seeking to except debt(s) owed to your client from discharge are §523(a)(5) and/or (15). That being said, for the sake of being thorough, it is often good practice to send a proposed consent judgment to the Debtor's counsel clearly articulating the debts, and declaring the each non-dischargeable pursuant to (a)(5) or (a)(15). If the Debtor's counsel refuses to provide the same, without expressing a thorough and well-grounded position for why the same is not necessary, the safest action may be to file the Adversary Complaint anyways, to make sure a clear ruling is obtained. In the context of a Chapter 13 case, the same stipulated order procedure should be used, to the extent that the creditor/client/ex-spouse believes the debts to fall under (a)(5), and if any dispute is raised, a complaint should be filed. In order to avoid needless confusion, any such complaint should be filed within 60 days of the first meeting of creditors, despite the fact that FRBP 4007 does <u>not</u> limit the timeframe for the filing of such a complaint.*

Where a determination between DSO and non-DSO debts is necessary, for example in a Chapter 13 case, the state and federal courts have concurrent jurisdiction to determine whether particular debts, other than those under 11 U.S.C. § 523(a)(2), (4), and (6), are subject to or excepted from discharge. FRBP 4007, Notes of Advisory Committee on Rules—1983, stating: "Subdivision (b) does not contain a time limit for filing a complaint to determine the dischargeability of a type of debt listed as nondischargeable under §523(a)(1), (3), (5), (7), (8), or (9). Jurisdiction over this issue on these debts is held concurrently by the bankruptcy court and any appropriate nonbankruptcy forum."

A clear statement of concurrent jurisdiction was articulated by the 11th Circuit in 2008, where that Court stated:

> The bankruptcy court initially found that the entire award was dischargeable as a property settlement, but we vacated that order discharging the award on appeal. In particular, we noted that the state divorce court had concurrent jurisdiction with the bankruptcy court to determine whether the divorce obligation was " in the nature of support" for purposes of § 523(a)(5), and we ruled that the bankruptcy court should await the divorce court's clarification of its intent regarding the amount of support provided in its award." *In re Cummings*, 277 Fed.Appx. 946 at 947 (11th Cir. 2008) (internal citations omitted).

The 6th Circuit has clearly held that in matters under 11 U.S.C. § 523(a)(5), the Bankruptcy Court has concurrent jurisdiction with state courts. *In re Moralez*, 128 B.R. 526 (Bankr.E.D.Mich.1991); *In re White*, 851 F.2d 170 (6th Cir.1988); *In re Rugiero*, 502 Fed.Appx. 436 (6th Cir. 2012).

Bankruptcy Courts in the Eastern District of Michigan have found that sufficient cause exists to allow a creditor to return to state court and address the limited issue of whether Debtor's obligation is in the nature of support. *In re: Robert O. Swonger*, Case No. 14-50807, Hon. Mark A. Randon, Chapter 13, Doc 39 Entered 10/10/14, (Bankr. E.D. Mich. 2014). Examples also include:

- *Fitzgerald*, 9 F.3d at 521 (explaining that a bankruptcy court's review of divorce judgments should not "intrude into the states' traditional authority over domestic relations and the risk of injustice to the non-debtor spouse or children");
- *In re Combs*, 435 B.R. 467, 469 (Bankr. E.D. Mich. 2010) (holding that former wife was entitled to stay relief to pursue her rights in Chapter 13 debtor's pension benefits under divorce judgment).

☞ ***Practice Tip****: Despite this concurrent jurisdiction, one will find most state court judges reluctant to exercise jurisdiction over a non-dischargeability ruling, and most bankruptcy judges reluctant, understandably, to make the Bankruptcy Court a forum for further domestic acrimony, which is often time consuming and litigious. Thus, the practitioner must carefully weigh and balance whether a more favorable decision will be obtained in the state court,* *(perhaps due to the Judge's already intimate knowledge of the relationship between the parties), or whether the Bankruptcy Court is a welcomed change of venue.*

IX. Factors in Determining the Nature of an Obligation

Determining if an obligation is in the nature of support in bankruptcy is a federal question. *Long v. Calhoun* (In re Calhoun), 715 F.2d 1103, 1107 (6th Cir. 1983) (citations omitted). The complaining spouse has the burden to demonstrate that the obligation at issue is in the nature of support. *Grogan v. Garner*, 498 U.S. 279, 287 (1991); *Fitzgerald v. Fitzgerald (In re Fitzgerald),* 9 F.3d 517, 520 (6th Cir. 1993) (internal citation omitted).]

In making such a determination, courts look to "traditional state law indicia" of support obligations, including: "(1) a label such as alimony, support, or maintenance in the decree or agreement, (2) a direct payment to the former spouse, as opposed to the assumption of a third-party debt, and (3) payments that are contingent upon such events as death, remarriage, or eligibility for Social Security benefits." *Rugiero v. DiNardo (In re Rugiero),* 502 F. App'x 436, 439 (6th Cir. 2012) (citing *Sorah v. Sorah (In re Sorah),* 163 F.3d 397, 401 (6th Cir.1998)). These factors are not exclusive. *Sorah*, 163 F.3d at 401.

"An award that is designated as support by the state court and has the above indicia of support (along with any others that the state support statute considers) should be conclusively presumed to be a support obligation by the bankruptcy court." Id.] However, "lower courts need not limit their analyses to consideration of the three indicia discussed above, but may also consider other factors." *McNamara v. Ficarra (In re McNamara),* 275 B.R. 832, 837 (E.D. Mich. 2002) (citing *Sorah*, 163 F.3d at 401) (other citation omitted). Even where a creditor fails to establish the conclusive presumption through the three *Sorah* factors, the Court may nevertheless resort to other factors to find that an obligation is in the nature of support. Id.; see also *Andrus v. Ajemian (In re Andrus),* 338 B.R. 746, 754-55 (Bankr. E.D. Mich. 2006) (finding that not all of the three Sorah factors were present, and looking to other indicia to determine whether the debt was for support). Examples include:

- *Rugiero*, 502 F. App'x at 439 (noting that courts have held fee awards orders do not amount to DSOs where "the state court's orders failed to tie the awards to the creditor spouse's financial needs");
- *In re Thomas*, 511 B.R. 89, 97-98 (B.A.P. 6th Cir. 2014) (The Panel upheld the bankruptcy court's conclusion that the parties and state court intended to create a support obligation, because Debtor's requirement to make half of the second mortgage payments helped provide a residence for the children.);
- *In re Westerfield*, 403 B.R. 545, 554 (Bankr. E.D. Tenn. 2009) (considering whether the debtor's assumption of the obligation will provide "support needed by the former spouse or children to meet daily needs" (citing Calhoun, 715 F.2d at 1109–10)).

X. The Use of 11 U.S.C. §523(a)(2), (4), and (6)

11 U.S.C. §523(a)(2)(A), in relevant paraphrased part, states: "A discharge under [...] this title does not discharge an individual debtor from any debt [...] for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition."

11 U.S.C. §523(a)(2)(B), in relevant paraphrased part, states: "A discharge under [...] this title does not discharge an individual debtor from any debt [...] for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by use of a statement in writing that is materially false, respecting the debtor's or an insider's financial condition, on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and that the debtor caused to be made or published with intent to deceive."

11 U.S.C. §523(a)(6), in relevant paraphrased part, states: "A discharge under [...] this title does not discharge an individual debtor from any debt for willful and malicious injury by the debtor to another entity or to the property of another entity."

☞ ***Practice Tip****: The prudent practitioner should also, when seeking relief on behalf of a non-filing spouse, or a third-party entitled to payment arising out of a Judgment of Divorce, review the facts of the case for the potential applicability of 11 U.S.C. §523(a)(2) and (6).*

The Automatic Stay and Divorce Proceedings

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I. Introduction

It is not uncommon for a divorce to be filed or for an interested party to attempt to enforce a Divorce Judgment while a bankruptcy is pending and the automatic stay is in effect. Both bankruptcy and divorce practitioners must be prepared to advise their clients appropriately and take appropriate action so that their client, and the practitioners themselves, do not violate the automatic stay.

II. Effect of the Automatic Stay on Divorce Proceedings

The filing of a bankruptcy imposes a stay against all actions against the debtor's property or recovery of a pre-petition claim against debtor. Even actions against property of the estate for a non-dischargeable debt are stayed, except for domestic support income withholding orders as identified in 11 U.S.C. §362(b)(2)(C). Therefore, even if creditor's claim falls within the one of the relevant exceptions to discharge in 11 U.S.C. §523(5) and (15), the automatic stay is in effect.

Upon filing of bankruptcy, a bankruptcy estate is created which includes all property of debtor, over which the bankruptcy court has exclusive jurisdiction. 11 U.S.C. §157 confers exclusive jurisdiction of all bankruptcy proceedings and core proceedings upon the bankruptcy court, including §157(G), motions to terminate, annul, or modify the automatic stay. Therefore, the bankruptcy court where the petition has been filed has exclusive jurisdiction to determine if the stay may be lifted. *Chao v. Hosp. Staffing Servs., Inc.*, 270 F.3d 374, (6th Cir. 2001); *In re Crabtree*, 767 F.2d 919 (6th Cir. 1985). The stay provides not only protection to the Debtor, but protects other creditors "by fostering an orderly distribution of the property of the estate according to a statutory formula". *In re Okke*, 513 B.R. 896 (W.D. Mich. 2014).

A. Exceptions to the Automatic Stay

1. Domestic Relations Matters

However, 11 U.S.C. §362(b) sets forth exclusions to the automatic stay, including certain domestic relations matters in §362(b)(2)(A) which excludes paternity actions, establishing or modifying a domestic support obligation, child custody or visitation matters, and proceedings for the dissolution of marriage "except to the extent that such proceeding seeks to determine the division of property that is property of the estate". 11 U.S.C. §362(b)(2)(A)(iv). Collection of a domestic support obligation from property that is not property of the estate is excepted from the stay in 11 U.S.C. §362(b)(2)(B). Withholding income that is property of the estate for a domestic support obligation pursuant to a judicial or administrative order, or pursuant to statute, is excepted from the automatic stay in 11 U.S.C. §362(b)(2)(C).

The court in which the collection action is proceeding has jurisdiction to determine whether the action is subject to the automatic stay. *In re Kallabat*, 482 B.R. 563 (E.D. Mich. 2012) (citing *Dominic's Restaurant of Dayton, Inc. v. Mantia*, 683 F.3d 757 (6th Cir. 2012)). But if the non-bankruptcy court is "erroneous in its decision…" the parties run the risk that the entire action will be declared void *ab initio*. *Chao v. Hospital Staffing Services, Inc.*, 270 F.3d 374, 384-85 (6th Circ. 1986) (other citations omitted).

Therefore, proceeding with a Divorce in state court after a bankruptcy is filed does not violate the automatic stay if the request for relief and/or Judgment is limited to the exceptions specified in 11 U.S.C. §362(b)(2)(A). Where a party to a divorce seeks a division of property or debt, the party and/or their divorce attorneys may face sanctions for willful violation of the automatic stay *In re Kallabat*, 482 B.R. 563 (Bankr. E.D. Mich. 2012).

2. Incarceration, Contempt and the Automatic Stay in Domestic Matters

11 U.S.C. §362(b)(1) excepts criminal actions or proceedings from the automatic stay which sometimes arise in domestic relations cases. Some courts have concluded that the stay is violated when incarceration used to compel debtor to pay support from property of the estate in a Chapter 13 Plan that provided for payment of support arrearages in the Plan. *In re Johnston*, 308 Br. 469 (Bankr. D. Ariz. 2003) (See Judge Margaret Dee McGarity's "Family Law and Bankruptcy" from ABI's 2016 Central States Bankruptcy Workshop for complete cites and more cases). Another court distinguished between a) incarceration with the intent to compel payment which violated the stay and b) incarceration to "vindicate the dignity of the court" which does not. *In re Rook*, 102 B.R. 490 (Bankr. E.D. Va. 1989), *aff'd,* 929 F.2d 694 (4^{th} Cir. 1991).

However, in the Eastern District of Michigan, Judge Tucker held that the complainant's motives in commencing a contempt proceeding were irrelevant in determining whether the automatic stay was violated. *In re Storozhenko*, 459 B.R. 697 (E.D. Mich. 2011). Instead, he distinguished civil contempt from criminal contempt in a divorce judgment enforcement matter to determine if the automatic stay applied. Guided by *United States v. Bayshore Associates, Inc.*, 934 F.2d 1391 (6^{th} Cir. 1991), the court held that the request for criminal contempt and a criminal fine payable to the court rather than the complainant was excepted from the automatic stay by analyzing the state law statute under which the requests were made. Further, the request for incarceration was also a criminal contempt sanction. The court stated "It is punitive in nature (criminal) rather than remedial (civil), because the sentence is limited to imprisonment for a definite period, and the requested imprisonment is not conditioned such that the Debtor may avoid incarceration by performing some affirmative act required by the state court's previous orders". *Storozhenko* at 704 citing *United States v. Bayshore Associates, Inc.*, 934 F.2d 1391, 1400 (6th Cir. 1991).

Where the complainant requested a "criminal restitution" payment together with receiver's fees and costs", the stay was violated because the Michigan criminal contempt statute, Mich. Comp. Laws §600.1715, does not list restitution as a possible remedy or punishment. The request was for a compensatory damage, designed to be remedial, and therefore a civil contempt sanction.

B. Consequences of Proceeding While the Stay is in Effect

1. Stay Violation Sanctions

As a practical matter, it may be impossible to proceed in a divorce without first seeking relief from the stay without risking sanctions for a stay violation or entry of a voidable order. In *Kallabat*, the divorce attorney did not seek a determination from either the state court or the bankruptcy court as to whether the stay applied, nor did he request a lift of stay in the bankruptcy court.

Instead, the divorce attorney, acknowledging that a bankruptcy was filed, proceeded with trial and requested Debtor be ordered to pay the spouse's credit card debt, alleging that Debtor had fraudulently signed his spouse's name in the credit application, and also requested that the marital home be awarded to his client. Further, following trial, he presented a proposed Judgment that contained additional language not ruled on by the state court judge. The additional language is probably considered "boiler plate" language regarding solely owned property such as life insurance and retirement accounts that merely remain in each party's name, but the provision divided property, which was a violation of the automatic stay. The court found that the divorce attorney willfully violated the stay and noted that the attorney could have asked the state court judge to determine whether the automatic stay applied, but did not. In fact, he made conclusory statements asserting at trial that the stay did not apply.

In *In re Okke* cited above, Judge Dales in the Western District of Michigan awarded significant damages ($9,500.00 including attorney fees) for stay violations against an ex-spouse where she retained property and sold some of that property awarded to the Chapter 13 Debtor in a pre-petition Judgment of Divorce. The award was granted despite the fact that the Debtor had also failed to comply with provisions of the Judgment that benefited his ex-spouse.

2. Voidability of Order

Any property settlements entered into in violation of the automatic stay are voidable. Indeed, Judge Dales in the Western District of Michigan held that a Family Court Order approving a post-petition agreement in a Chapter 13 case without obtaining relief from the stay was voidable. *In re Coats*, 509 B.R. 836 (Bankr. W.D. Mich. 2014), citing *Easley v. Pettibone Michigan Corp.*, 990 F.2d 905 (6th Cir. 1993) and *In re DeGroot*, 460 B.R. 159, 167 (Bankr. W.D. Mich. 2011) See also *In re Edwards*, 214 B.R. 613 (B.A.P. 9th Cir. 1997). The Court in *Coats* noted that while the automatic stay does not preclude post-petition litigation regarding child support or spousal support, nothing in that exception authorizes another court to determine the division of property of the estate or provide for collection of a claim, referring to the state court's order allowing the ex-spouse to withhold a portion of his required spousal support payment to debtor to satisfy an indemnification claim for payment of the second mortgage on debtor's home. *Coats at* 841.

In *DeGroot*, a Chapter 7 debtor failed to disclose his right to payment of his share of equity in the marital home of $38,000.00 pursuant to a Judgment of Divorce. The Court held that a post-petition agreement waiving most of Debtor's right to payment in exchange for a waiver of his past due and future child support obligations was void since there was no lift of stay.

C. (Non)Protection of the Non-filing Spouse by Automatic Stay

It is worth noting that a non-debtor spouse cannot use the stay to avoid the effects of a state court property division. *Lopez v. Lopez*, 478 N.W. 2d 706 (Mich. App. 1991). In this case, the state court ruled that the Plaintiff spouse was not protected by the automatic stay in Defendant/Debtor's Chapter 13 bankruptcy when the Debtor proceeded with entry of a Default Judgment of Divorce after the Plaintiff failed to appear for trial.

A non-filing spouse is also not protected by the co-debtor stay where the pre-petition Divorce Judgment provided that Debtor hold her harmless from certain debts solely in the non-filing spouse's name. *In re Jett*, 198 B.R. 489 (Bankr. E.D. Ky. 1996).

D. Chapter 13, Dischargeable & Nondischargeable Debts, and the Automatic Stay

It is not uncommon for domestic disputes to arise during the 3 to 5 year term of a Chapter 13 Plan, where property settlements under 11 U.S.C. §523(a)(15) are dischargeable. In *In re Robert O. Swonger*, Case No. 14-50807, Judge Randon held that in a Chapter 13 case, although a provision of a divorce settlement requiring the Debtor to refinance a HELOC loan secured by his home was not a Domestic Support Obligation under 11 U.S.C. §523(a)(5), the stay may be lifted for the ex-spouse to have the state court determine whether to impose spousal support as a consequence of Debtor's failure to refinance. The Judgment contained a provision that "[i]n the event that either party fails to pay any amount due as provided in this Judgment", the court may order non-deductible alimony to the other party. Judge Randon acknowledged that it was unclear whether failure to refinance constituted failure to "pay" but left it to the state court to make that determination.

III. Conclusion

If there is any question that the debt is a domestic support obligation, a criminal proceeding, that property of the estate may be at issue, or any possibility that the non-bankruptcy court may adjust a property settlement in resolution of a domestic support dispute, the creditor should first obtain a determination that the debt is in fact excepted from the automatic stay provisions under 11 U.S.C. §362(b) and/or file a motion for relief from stay in the bankruptcy court.

Judgments of Divorce and Fraudulent Transfers

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I. Introduction

In the past, courts were loath to set aside property settlements made in connection with divorce proceedings. This aversion to attacks on property settlements has slowly taken a change of course. In 1999, the Sixth Circuit, in *In re Fordu*, held that property divisions incident to divorce may be avoided by a trustee in bankruptcy if the elements of a fraudulent transfer are present[1]. In 2008, the Supreme Court of Michigan, in *Estes v. Titus*, held that a property settlement entered in connection with a divorce proceeding is subject to attack by a creditor under Michigan's fraudulent transfer statutes.[2] As a result of these cases, family law practitioners in Michigan should become more informed of fraudulent transfer laws in order to properly advise their clients during the process of property settlement negotiations.

II. Fraudulent Transfer Law

In bankruptcy, fraudulent transfers are governed by 11 U.S.C. §§ 544(b) and 548. At the state level, Michigan's fraudulent transfer law is codified at Mich. Comp. Laws § 566.31 *et seq.*—Michigan's version of the Uniform Fraudulent Transfer Act ("MFTA"). Although there are differences, the laws are generally applied in the same manner. Fraudulent conveyance laws allow a creditor (or a trustee in bankruptcy) to set aside transfers of a debtor's property that reduced the property available for satisfaction of the debtor's debts.

[1]*Corzin v. Fordu (In re Fordu)*, 201 F.3d 693 (6th Cir. 1999).
[2]*Estes v. Titus*, 481 Mich. 573 (2008).

Bankruptcy trustees are empowered by the U.S. Bankruptcy Code[3] (the "Code") to avoid fraudulent transfers through application of both state and federal fraudulent conveyance law. Under both the MFTA and the Code, there are two avenues that a creditor or trustee may pursue when seeking to avoid a fraudulent transfer: actual fraud and constructive fraud.

Actual Fraud. Actual fraud refers to transfers of property or obligations incurred by a debtor "with actual intent to hinder, delay, or defraud."[4] Where a debtor has transferred assets to another party with the specific intent of keeping those assets from the reach of creditors, the law allows creditors to "avoid" the transfer and recover the assets. Given the subjective nature of actual intent, it is difficult to prove by direct evidence; thus, courts generally rely on the traditional "badges of fraud" to establish fraudulent intent.[5] Michigan's statute on fraudulent transfers made with actual intent to defraud contains several examples of badges of fraud, including: the transfer was made to an insider, the debtor retained control of the transferred property, the transfer was concealed, the consideration for the transfer was inadequate, and the debtor was insolvent at the time of the transfer.[6]

Constructive Fraud. Constructive fraud refers to certain transfers made for less than reasonably equivalent value.[7] For constructive fraud, the creditor or trustee merely has to prove that the transfer was made (1) for less than reasonably equivalent value and (2) the debtor was insolvent or became insolvent as a result of the transfer. In other words, intent is not an issue. If the debtor's debts exceed his assets, *it does not matter if the transfer was made without any*

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[3] 11 U.S.C. § 544(b) permits a trustee to avoid transfers in accordance with state law. Therefore, if a creditor could avoid such a transfer under the state fraudulent transfer act, the trustee can avoid such transfer in a bankruptcy setting. *Id*.
[4] 11 U.S.C. § 548(a)(1)(A); M.C.L. § 566.34(1)(a).
[5] *See United States v. Leggett,* 292 F.2d 423, 426 (6th Cir. Mich. 1961).
[6] *See* M.C.L. § 566.34(2).
[7] *See* 11 U.S.C § 548(a)(1)(B); M.C.L. § 566.35(1).

deceptive intent at all, what matters is whether reasonably equivalent value was received in exchange.

The idea is that if a transfer was made for reasonably equivalent value, the debtor occupies roughly the same position as he did prior to the transfer.[8] But if the debtor made the transfer for inadequate consideration, the debtor is worse off financially, rendering him less collectible after the transfer is completed.[9] A "transfer" is defined as each "mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with" property or an interest in property.[10] An important difference between the fraudulent transfer provisions of the Code and those of the MFTA is that under the Code, the trustee can only avoid a transfer made within two years of the bankruptcy filing; but under Michigan's statutes, the look-back is six years after the transfer occurs.[11]

Insolvency. An individual is insolvent when the amount of their debt exceeds the value of their property, at a fair valuation.[12]

Reasonably Equivalent Value. Neither the Code nor the MFTA define the phrase "reasonably equivalent value." The Code does define "value," for fraudulent transfer purposes, as "property, or satisfaction or securing of a present or antecedent debt of the debtor, but [it] does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor."[13] The MFTA defines value in virtually identical terms.[14] Thus, the term "reasonably

[8]Amanda Barkey, Note: *The Application of Constructive Fraud to Divorce Property Settlements: What's Fraud Got to Do With It?*, 52 Wayne L. Rev. 221, 226 (2006) (citing ACLI Gov't Sec., Inc. v. Rhoades, 653 F. Supp. 1388, 1390 (S.D.N.Y. 1987).
[9]*Id.*
[10]11 U.S.C. § 101(54); M.C.L. § 566.31(l).
[11]M.C.L. §§ 566.31; 600.5813.
[12]11 U.S.C. § 101(32)(A); M.C.L. § 566.32(1).
[13]11 U.S.C. § 548(d)(2)(A).

equivalent value" has been deemed to have the same meaning under the MFTA as it does under the Code.[15]

The purpose of the reasonably equivalent value requirement "is to conserve the debtor's estate for the benefit of creditors."[16] The question of whether the debtor received reasonably equivalent value is a fact issue that requires a comparison between the value of what the debtor received to the value of what the debtor transferred.[17] Often, cases look for an "economic benefit" in deciding whether the exchange of value was reasonably equivalent.[18]

III. Fraudulent transfers and property settlements in divorce

In Michigan, property is divided among divorcing parties based on "fair and equitable" standards.[19] That is a significantly different standard than what is applied in determining whether a fraudulent transfer occurs under either the Code or the MFTA.

Over the years, different courts have treated fraudulent transfer claims incident to divorce in a number of ways. Historically, courts have been reluctant to avoid property settlements through constructive fraud partially due to the tension between state and federal law, along with bankruptcy courts' preference to stay out of family matters.[20]

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[14]M.C.L. § 566.33(1), stating in part:

> Value is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied. Value does not include an unperformed promise made otherwise than in the ordinary course of the promisor's business to furnish support to the debtor or another person.

[15]*See Gold v. Marquette University,* 2011 Bankr. LEXIS 1172, *28 (Bankr. E.D. Mich. 2011) (citations omitted).

[16]*Alix v. Beim (In re Fred Sanders, Inc.)*, 1997 U.S. Dist. LEXIS 19382 (E.D. Mich. Oct. 27, 1997) (citation omitted).

[17]*See In re Fordu* at 707.

[18]*See Allard v. Flamingo Hilton (In re Chomakos)*, 170 B.R. 585, 590 (Bankr. E.D. Mich. 1993), *aff'd* 69 F.3d 769 (6th Cir. 1995).

[19]*See* M.C.L. § 552.401.

[20]Amanda Barkey, *The Application of Constructive Fraud to Divorce Property Settlements: What's Fraud Got to Do With It?*, 52 Wayne L. Rev. at 227 (citing *In re Falk*, 98 B.R. 472 (D. Minn 1989); *In re Sorlucco*, 68 B.R. 748, 653 (Bankr. D.N.H. 1986).

In her Note "The Application of Constructive Fraud to Divorce Property Settlement: What's Fraud Got to do with it?", Amanda Barkey summarizes:

> Some courts have placed property settlements incident to divorce beyond the reach of fraudulent transfer laws, whether or not the settlement was actually or constructively fraudulent. Other courts have allowed the defense of issue preclusion in constructive fraud claims to preclude avoidance. Still other courts use a "surface determination" test in constructive fraud claims in order to determine whether the transfer was made for reasonably equivalent value, thus avoiding looking too carefully at the decree entered by the state court.[21] (citations omitted)

The Sixth Circuit rejected both the issue-preclusion defense[22] and the "surface determination" test in *Fordu* and concluded that "the standards for measuring the fairness of a property division in the domestic relations arena and reasonably equivalent value in a fraudulent transfer case are separate and distinct."[23] The case was remanded to the bankruptcy court for further proceedings on the Trustee's fraudulent transfer claims.[24] Although *Fordu* dealt with Ohio fraudulent transfer statutes, two of the four statutes at issue are identical to Michigan's fraudulent transfer statutes.[25] So, *Fordu* made it clear that property transfers in divorce must be examined for reasonably equivalent value under a challenge by a bankruptcy trustee.

Any remaining question of whether the MFTA applies to transfers made pursuant to a settlement agreement in a divorce proceeding was put to rest by the Supreme Court of Michigan, in *Estes v. Titus*. In *Estes v. Titus,* a creditor of Jeff Titus sought to set aside transfers made by

[21] *Id.*(citing cases)

[22] The Sixth Circuit rejected the issue preclusion defense for three main reasons. First, the divorce judgment was entered by consent and, thus, not actually litigated. Second, the trustee was not in privity with the debtor. Third, the standards for measuring fairness in a divorce case are different than the standards for measuring reasonably equivalent value in a fraudulent transfer case. *See In re Fordu* at 705-07 (6th Cir. 1999).

[23] *Id.* at 707.

[24] *Id.* at 711.

[25] Compare O.R.C. §§ 1336.04(A) and 1336.05 to M.C.L. §§ 566.34 and 566.35.

Titus to his ex-wife under a property settlement incorporated into their judgment of divorce.[26] In a unanimous opinion, the Court held that the MFTA applies to such transfers unless the property was owned by the husband and wife as tenants by the entirety ("TBE").[27] The MFTA makes an exception for property held as TBE when the creditor seeking to avoid the transfer is a creditor of only one of the spouses.[28] In that situation, there is not an avoidable transfer of property under the MFTA. So, if a creditor or bankruptcy trustee is seeking to avoid a transfer under the MFTA, it is important to determine if the property was owned as TBE and if the debt is joint or the sole debt of only one of the spouses. But, if a bankruptcy trustee is seeking to avoid the transfer under the two year look-back provided under the Code, the TBE exception does not apply.[29]

Estes v. Titus dealt with allegations of actual fraud; however, based on the Court's "plain-language" analysis, it is axiomatic that the constructive fraud provisions of the MFTA would also apply to a divorce-related settlement agreement. The *Estes v. Titus* case was remanded for a determination on whether Titus made the transfers with actual intent to defraud such that the transfers were avoidable under the MFTA.[31]

In 2013, in an unpublished decision, the Sixth Circuit also included the allocation of debt in its determination of whether a debtor-spouse received reasonably equivalent value under a divorce agreement.[32] Finally, in a divorce proceeding, one spouse may have a claim against the other for the value of any separate property contributed to the marriage.[33] It is important to consider any such claims when conducting a fraudulent transfer analysis.[34]

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[26] *Estes v. Titus* at 578.
[27] *Id.* at 592.
[28] *Id.* at 580-82; M.C.L § 566.31(b)(iii).
[29] *See Lasich v. Wickstrom* (*In re Wickstrom*), 113 B.R. 339, 350 (Bankr. W.D. Mich. 1990).
[31] *Estes v. Titus* at 593.
[32] *See Suhar v. Bruno (In re Neal)*, 541 Fed. Appx. 609 (6th Cir. 2013).
[33] *See* M.C.L. § 566.33(1).
[34] *See Meoli v. Cooper (In re Allen)*, 521 B.R. 613 (Bankr. W.D. Mich. 2014).

IV. Conclusion

Every family law practitioner should keep in mind the fraudulent transfer laws when negotiating property settlements in divorce proceedings, particularly if insolvency is in question. Prepare a spreadsheet that reflects the estimated value of the assets each person is receiving and the allocation of any marital debt. Appraisals, informal or formal, will always be helpful if a transfer is challenged. Try to tie transfers together, so that your client is giving something of reasonably equivalent value for what is being received. Finally, inform your client of what could happen if a creditor or trustee in bankruptcy challenges any of the transfers.

ONGOING PROBLEMS IN IDENTIFYING WHAT CONSTITUTES A DEBTOR'S PROJECTED DISPOSABLE INCOME

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PROJECTED DISPOSABLE INCOME – VOLUNTARY RETIREMENT CONTRIBUTIONS

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I. SUMMARY OF ISSUES PRESENT IN DIVERGENT CASE LAW

A Chapter 13 debtor's ability to make voluntary retirement contributions and the impact of such contributions on the calculation of a debtor's projected disposable income available to fund a Chapter 13 Plan have increasingly divided courts nationwide. Several factors have led to academic debate, substantial litigation, and divergent case law related to the seemingly concise issue of whether a Chapter 13 debtor is allowed to make voluntary contributions to a qualified retirement account during a Chapter 13 reorganization. The most significant factor is the inartful, oddly-worded statute that the analysis often turns on, 11 USC 541(b)(7) (specifically, "the other hanging paragraph" following 11 USC 541(b)(7)(A)(i)(III). Next, countless factual nuances exist from case to case and debtor to debtor. These nuances have a stronger likelihood of producing varying, results-driven, equity based rulings with the only other direction for courts an ambiguous and confusing statute. Lastly, the issue strikes at the heart of omnipresent balancing act imposed on bankruptcy courts, that being the consideration of providing honest but unfortunate debtors a true opportunity for a fresh start vs. ensuring fairness to creditors.

The case summaries provided are separated by certain common elements in the facts of the individual cases and the outcome/holding. The facts will determine the relevant statutory provision and the proper application of that provision in each case. Facts that courts have found material in rendering decisions on this issue include whether the debtor is above or below-median income, whether the debtor was regularly contributing to the voluntary retirement account pre-petition or the debtor intends only to commence contributions post-petition or on the eve of filing, and the debtor's history and motivation for contributing.

The analysis should always start with whether the debtor is above or below the applicable median income based on the debtor's household size and the location of the debtor. If a debtor is below median, consistent with 11 USC 1325(b)(2) the court must simply evaluate the fact specific question of whether the voluntary retirement contribution is a "reasonably necessary" expense. As one would expect, courts have arrived at different conclusions depending on an individual debtor's circumstances. Despite this analysis that a court must undertake, it is counterintuitive to scrutinize the reasonableness of a below-median debtor's expenses when the same debtor would presumably be eligible to discharge all general unsecured debt in a Chapter 7 case. If the same debtor filed and obtained a Chapter 7 discharge prior to filing the Chapter 13, the debtor would eliminate the basis for disposable income related objection. It should be noted that pursuant to 11 USC 1325(b)(1), in the event of an objection by an unsecured creditor or trustee, a debtor can either pay all unsecured claims in full (i.e., a 100% dividend plan) consistent with 1325(b)(1)(A) OR commit all of the debtor's projected disposable income for the applicable commitment period consistent with 1325(b)(1)(B). A debtor need not do both. If a plan provides for full payment of all claims, he or she need not provide for all of the debtor's projected disposable income.

Further statutory interpretation and analysis is necessary if a debtor is above-median due to the effect of 11 USC 1325(b)(3) which states that, for an above-median debtor, disposable income "shall be determined in accordance with subparagraphs (A) and (B) of section 707(b)(2)" which provides for certain allowable expenses consistent with IRS guidelines set out in the Internal Revenue Manual 5.15.1.7-.10 (rev. ed. 2012). The IRS guidelines do not include voluntary retirement contributions as a allowable expense. However, another statutory provision references "disposable income" in the context of Chapter 13. 11 USC 1306 incorporates as property of the estate all property designated by 11 USC 541. Section 541(b)(7)(A) provides, in part, that "any amount" that is "withheld by an employer from the wages of employees for payment as contributions" to a qualified retirement account, is not property of the estate. The section continues with what has been designated as the "hanging paragraph". . . "except that such amount under this subparagraph shall not constitute disposable income as defined by section 1325(b)(2)." Stated concisely, the hanging paragraph makes no sense. A court's interpretation of the "except that" language often governs the ruling.

Three interpretations of the hanging paragraph have emerged, each leading to a different outcome. Summaries and citations to cases representing several variations and applications of each interpretation are provided below. What is most likely the prevailing majority interpretation is that the hanging paragraph serves to specifically exclude voluntary retirement contributions from the disposable income calculation . This interpretation eliminates considerations of timing and amount of contributions and is limited only by the good faith requirement. These courts essentially disregard the "except that" language and focus on the "shall not constitute disposable income" language. The second line of cases (and the interpretation represented by the BAP opinion in Seafort) finds significance in Section 541's definition of "property of the estate" as that which exists as of the commencement of the case. As such, the hanging paragraph of 541(b)(7) only applies to voluntary retirement contributions which exist as of the petition date. The third line of cases essentially finds hanging paragraph inapplicable to post-petition earnings, in effect eliminating the potential exclusionary effect of the "shall not constitute disposable income" language as it relates to projected disposable income. It would seem to be an odd result to render language inapplicable in the only context in which the language may apply in the first place, i.e., as it relates to post-petition earnings in a Chapter 13.

II. STATUTORY FRAMEWORK:

11 USC 541(b)(7)(A)

(b) Property of the estate does not include—

(7) any amount—

(A) withheld by an employer from the wages of employees for payment as contributions—

(i) to—

(I) an employee benefit plan that is subject to title I of the Employee Retirement Income Security Act of 1974 or under an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986;

(II) a deferred compensation plan under section 457 of the Internal Revenue Code of 1986; or

(III) a tax-deferred annuity under section 403(b) of the Internal Revenue Code of 1986;

except that such amount under this subparagraph shall not constitute disposable income as defined in section 1325(b)(2);

(emphasis added)

11 USC 1325(b)(1)

(b)
(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan—
(A)
the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or

(B)
the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.

11 USC 1325(b)(2)

(2) For purposes of this subsection, the term "disposable income" means current monthly income received by the debtor (other than child support payments, foster care payments, or disability payments for a dependent child made in accordance with applicable nonbankruptcy law to the extent reasonably necessary to be expended for such child) less amounts reasonably necessary to be expended—
(A)
(i)
for the maintenance or support of the debtor or a dependent of the debtor, or for a domestic support obligation, that first becomes payable after the date the petition is filed; and

(ii)
for charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to a qualified religious or charitable entity or organization (as defined in section 548(d)(4)) in an amount not to exceed 15 percent of gross income of the debtor for the year in which the contributions are made; and

(B)
if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

11 USC 1325(b)(3)

(3) Amounts reasonably necessary to be expended under paragraph (2), other than subparagraph (A)(ii) of paragraph (2), shall be determined in accordance with subparagraphs (A) and (B) of section 707(b)(2), if the debtor has current monthly income, when multiplied by 12, greater than—

(A)
in the case of a debtor in a household of 1 person, the median family income of the applicable State for 1 earner;

(B)
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

(C)
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 $525 per month for each individual in excess of 4.

III. CASE LAW SUMMARIES – ABOVE MEDIAN DEBTORS:

A. Voluntary Contributions NOT in effect as of petition date and proposed post-petition commencement, deemed NOT ALLOWED:

Burden v. Seafort (In re Seafort), 437 B.R. 204 (B.A.P. 6th Cir. 2010)

The issue before the panel was whether chapter 13 debtors who were repaying 401(k) loans, but not making any 401(k) contributions at the time their bankruptcy petitions were filed, could use the income which became available when the loans were repaid to start making contributions to their 401(k) plans rather than committing the extra income to repay creditors. On appeal of rulings in favor the debtors, the court held that the income which became available after the 401(k) loan was repaid was not excluded from the property of the estate under 11 U.S.C.S. § 541(a) and (b). Only 401(k) contributions that were being made at the commencement of the case were excluded from property of the estate under § 541(b)(7). Income that became available after the filing of a case was "projected disposable income," and that income was not excluded from property of the estate. Projected disposable income had to be used to pay creditors pursuant to 11 U.S.C.S. § 1325(b)(1)(B) and could not be used to commence making payments to a 401(k) plan. Once the debtors repaid their 401(k) loans, the funds that became available had to be committed to the plan for the repayment of unsecured creditors.
Seafort v. Burden (In re Seafort), 669 F.3d 662 (6th Cir. 2012)

Appellant Chapter 13 debtors challenged a decision of the U.S. Bankruptcy Appellate Panel for the Sixth Circuit, which held that the post-petition income that became available after a debtor completed repayment of a 401(k) loan was not excluded from property of the estate or disposable income under 11 U.S.C.S. § 541(b)(7) and had to be committed to a Chapter 13 plan under 11 U.S.C.S. § 1325(b). The 6th Circuit affirmed the Panel's decision.

However, the Court went much further than simply affirming the decision of the Panel (which related only to the specific issue of voluntary contributions NOT being made as of the petition date but commencing only post-petition after the 401(k) loan was completed). The Court, relying heavily on the rationale of In Re Prigge (see below) took the opportunity to address (albeit in a footnote while expressly stating that their view is "irrelevant because "the issue is not presently before us"), the Court expressed disagreement with the Trustee's concession that had the debtors been contributing as of the petition date, the continuing contributions may be excluded from disposable income. Id. at 674 n.7. Oddly, in the sentence preceding the footnote, the Court specifically stated that "[a]lthough 'awkward' perhaps, we conclude, based on the language and structure of Chapter 13, incorporating § 541, that Congress intended to exclude from disposable income and projected disposable income available for unsecured creditors only voluntary retirement contributions already in existence at the time the petition is filed." Seafort v. Burden (In re Seafort), 669 F.3d 662, 674 (6th Cir. 2012). The apparent direction offered in the footnote has resulted in objections to confirmation of Chapter 13 Plans by Chapter 13 Trustees in the Eastern District of Michigan when voluntary retirement contributions exist, even existing/continuing contributions, and such objections have generally been upheld by the Eastern District of Michigan Judges (see, e.g., Judge Opperman's opinion in In Re Rogers, No. 12-32558 (E.D.Mich.Bankr. October 17, 2012, available at http://www.mieb.uscourts.gov/apps/courtOpinions/opinions/12-32558%20Rogers%20Opinion%2010-17-12.pdf).

Despite the Seafort Court's reliance on Collier, Collier disagrees with the outcome of Seafort. As summarized by the Court in In re Anh-Thu Thi Vu:

"A more recent edition of Collier identifies *Prigge* as one of 'a few courts [that] have concluded that section 541(b)(7) only protects retirement funds already in the hands of the employer,' a conclusion that Collier explains 'makes no sense' because disposable income only encompasses post-petition income, and because funds that have already been paid to the debtor's retirement account are addressed under other sections of the Bankruptcy Code. 5 COLLIER ON BANKRUPTCY, ¶ 541.23[1] (16th ed. rev.). Collier concludes that the reference to § 1325(b) in § 541(b)(7)(A)(i)'s hanging paragraph 'removes any doubt' that qualifying voluntary retirement contributions 'are to be excluded from the disposable income calculation.' Id.

Collier takes issue with the Sixth Circuit Court of Appeals' reliance on Collier in *Seafort*, noting that the court did not consider Collier's 'more in-depth discussion of disposable income at ¶ 1325.11[4].' *Id.* That section of Collier explains that qualifying retirement contributions are not considered disposable income, and cites *Seafort* as 'erroneously holding' that § 541(b)(7) applies only to contributions in the hands of the employer on the petition date, 'which is illogical' because disposable income only includes income received post-petition. 5 COLLIER ON BANKRUPTCY, ¶ 1325.11[4][c] n. 5 (16th ed. rev.) (citing *McDonald v. Burgie* (*In re Burgie)*, 239 B.R. 406 (B.A.P. 9th Cir. 1999) (Pre-petition assets have never been considered disposable income))." See, In re Anh-Thu Thi Vu, No. 15-41405-BDL, 2015 Bankr. LEXIS 1967, at *6 (U.S. Bankr. W.D. Wash. June 16, 2015).

B. Voluntary Contributions NOT in effect as of petition date and proposed post-petition commencement, deemed ALLOWED:

In re Cantu, 553 B.R. 565 (Bankr. E.D. Va. 2016)

Debtor was entitled to make voluntary contributions to his retirement plan, having completed payments on one of his retirement plan loans, where the voluntary contributions would be in the same monthly amount as his former loan payments because 11 U.S.C.S. § 541(b)(7) allows debtors to deduct voluntary retirement plan contributions from disposable income, and the debtor here was proceeding in good faith.

In re Nowlin, 366 B.R. 670 (Bankr. S.D. Tex. 2007)

The above median income debtor was both contributing to a 401(k) and paying a 401(k) loan as of the petition date. The debtor sought to exclude both expenses from disposable income for the entire plan, despite the fact that the loan was ending midway through the plan. The court ruled that both were excludable from disposable income, but when the loan repayment was complete she could only divert a portion of that income to her 401(k) contribution before her maximum contribution was reached. The court permitted her to maximize her contribution upon the loan being repaid but required the remainder of the income to be committed to the plan.

In re Kimanzi Musili Mati, 390 B.R. 11 (Bankr. D. Mass. 2008)

The above median debtor increased his 401(k) contributions from 5% to 10% post-petition, apparently in response to other objections related to his expenses. In other words, he shifted expenses away from other arguably objectionable line items to his 401k contribution. The court upheld the full contribution as a deduction from disposable income and denied the Trustee's lack of good faith objection.

"The Court finds that the Debtor's 401(k) contributions do not evidence bad faith under the totality of the circumstances in this case. The Debtor is merely taking advantage of what the law allows. Indeed, by excluding 401(k) contributions from property of the estate and expressly removing them from the definition of disposable income under section 1325(b), *see* 11 U.S.C. § 541(b)(7), Congress has implemented a policy of protecting and encouraging retirement savings. As noted by the court in In re Johnson, 346 B.R. 256, 262-63 (Bankr. S.D. Ga. 2006), BAPCPA's amendments to section 1325(b) alter the good faith inquiry under section 1325(a)(3) by narrowing the scope of judicial discretion and excluding certain sources of income that do not need to be committed to Chapter 13 plans. In particular, debtors, pursuant to section 541(b)(7), may shelter contributions to certain qualified employee benefit plans. Id. at 263. The court in Johnson concluded that the debtors could fund their 401(k) plans in good faith as long as their contributions did not exceed the limits legally permitted by their 401(k) plans." In re Kimanzi Musili Mati, 390 B.R. 11, 17 (Bankr. D. Mass. 2008).

In re Drapeau, 485 B.R. 29 (Bankr. D. Mass. 2013)

The Court explicitly rejected the reasoning of Seafort, the Court was left to determine whether funds proposed to be used by debtors to make voluntary contributions to their retirement accounts constituted disposable income that had to be included in the calculation of payments required under their plan, or whether those contributions were excluded from disposable income by operation of 11 U.S.C.S. § 541(b)(7). The court held that § 541(b)(7) excluded postpetition voluntary contributions to the retirement plans and annuities specified therein from the scope of disposable income under 11 U.S.C.S. § 1325(b)(2), so long as made in good faith. That good faith determination was case-specific and would often turn on whether a debtor had made contributions in similar amounts over an extended period of time. But where, as here, there was a history of similar prepetition contributions, temporarily interrupted on account of a circumstance beyond a debtor's control (e.g., a limited period in which a debtor could not contribute on account of a hardship withdrawal), it appeared that any good faith obstacle had been overcome and the Court approved the deduction from projected disposable income the intended future voluntary contributions.

In rejecting the rationale of Seafort, the Court found: "In sum, the Court holds that § 541(b)(7) excludes postpetition voluntary contributions to the retirement plans and annuities specified therein from the scope of disposable income under § 1325(b)(2), so long as made in good faith. That good faith determination is case-specific and will often turn on whether a debtor has made contributions in similar amounts over an extended period of time. But where, as here, there is a history of similar prepetition contributions, temporarily interrupted on account of a circumstance beyond a debtor's control (e.g., a limited period in which a debtor could not contribute on account of a hardship withdrawal), it appears to this Court that any good faith obstacle has been overcome." Id. at 38.

In re Vanlandingham, 516 B.R. 628 (Bankr. D. Kan. 2014)

The issue in Vanlandingham was whether a Chapter 13 debtor's voluntary contributions to a 401(k) plan that first began after debtor filed her bankruptcy petition may be excluded from calculation of disposable income. The court determined that 1. Contributions for retirement plans are not among the enumerated deductions in 11 U.S.C.S. § 707(b)(2)(A), but 11 U.S.C.S. § 541(b)(7) excludes wages withheld for that purpose from property of the estate and provides that these withholdings shall not constitute disposable income as defined in 11 U.S.C.S. § 1325(b)(2), and; 2. Nothing in the Code requires that a debtor have established 401(k) contributions prior to filing a Chapter 13 case and, consistent with the forward looking approach of projected disposable income, and in the absence of a lack of good faith objection under 11 U.S.C.S. § 1325(a)(3), debtor's plan excluding those contributions from disposable income should be confirmed.

C. Voluntary Contributions IN EFFECT as of petition date, deemed NOT ALLOWED:

In Re Rogers, No. 12-32558 (E.D.Mich.Bankr. October 17, 2012)

Above median debtors included a deduction totaling $2,062.50 per month on line 55 of the means test for existing and continuing voluntary IRA and 401(k) contributions. Trustee and an unsecured creditor objected. Relying on the direction set forth in the Seafort footnote, Judge Opperman ruled that the debtors were not allowed to deduct from disposable income the voluntary retirement contributions.

In re Prigge, 441 B.R. 667 (Bankr. D. Mont. 2010)

The debtor declared bankruptcy in August 2009, after he was sued by two individuals who claimed they bought a house from the debtor that had flooding, drainage, and grading problems, and one year after he was divorced. The debtor claimed he had an annualized income of $ 89,739, and he proposed a plan for paying his creditors $ 100 per month for 60 months. The individuals who sued the debtor and a Chapter 13 trustee filed objections to the debtor's plan, and the debtor amended his plan, proposing to pay creditors $ 100 per month for 4 months and $ 300 per month for 56 months. The court found that the amended plan could not be confirmed because the debtor deducted contributions he made to a 401(k) plan when he calculated his disposable income. The debtor was required to use the means test adopted by 11 U.S.C.S. § 707(b)(2)(A) to calculate his disposable income because he was an above-median income debtor, and contributions to voluntary retirement plans were not a necessary expense under § 707(b)(2)(A)(ii). In re Prigge, 441 B.R. 667, 669 (Bankr. D. Mont. 2010).

The Debtor in Prigge relied exclusively on 11 USC 1322(f), a provision that applies only to excluding 401(k) loan repayments from disposable income, in justifying the deductibility of the 401(k) contributions rather than relying on the exclusionary language of 11 USC 541(b) which specifically applies to voluntary retirement contributions. Specifically citing the Debtor's improper reliance on 11 USC 1322(f), the Court found that the Debtor "failed to satisfy his burden of proof under the disposable income test of 11 USC 1325(b)(2)." Id. at 677. The Court failed to address the effect of the language of 11 USC 541(b). In fact, the only place in the opinion in which 11 USC 541(b) is mentioned is in a footnote that essentially acknowledges the provision's existence but fails to analyze it further.

In re McCullers, 451 B.R. 498 (Bankr. N.D. Cal. 2011)

The debtor owed $27,000 to his ex-wife, $71,461 to general unsecured creditors, and $23,780 on a loan he received from his 401(k) retirement plan at the time he declared bankruptcy. He proposed a plan for repaying his creditors that allowed him to pay support to his ex-wife and to repay the loan he received from his 401(k) plan outside of his Chapter 13 plan, and required him to pay $200 per month for 60 months to the Chapter 13 trustee to pay debts he owed to other creditors. Although the trustee acknowledged that the debtor was entitled to deduct payments he was required to make to repay the loan he received from his 401(k) plan when he determined his disposable income, he filed an objection to the debtor's plan because the debtor claimed a deduction of $1,921 per month for payments to his 401(k) plan, which included repayment of the loan and ongoing contributions to the 401(k) plan. The court found that the debtor could deduct the amount he was required to pay each month to his 401(k) plan when he determined his projected disposable income, but could not deduct additional, voluntary contributions he made to the plan, and it required the debtor to amend his Chapter 13 plan

Parks v. Drummond (In re Parks), 475 B.R. 703 (B.A.P. 9th Cir. 2012)

At the time the debtors declared Chapter 13 bankruptcy, they were both employed and had been contributing approximately $318 per month to their respective 401(k) plans. In calculating their disposable income on Official Bankr. Form 22C, the debtors claimed a deduction of $318 per month for their 401(k) contributions and showed monthly disposable income of $40.04, and they used the disposable income amount of $40.04 when preparing their Chapter 13 plan. A trustee who was appointed to administer the debtors' plan filed an objection to confirmation of the debtors' plan on the ground that deductions for voluntary postpetition 401(k) contributions were not authorized for purposes of calculating disposable income under 11 U.S.C.S. § 1325(b)(2) based on the bankruptcy court's holding in In re Prigge, and the bankruptcy court sustained the objection. The appellate panel affirmed. Although courts were divided on the issue, the panel agreed with the bankruptcy court's decision in Prigge and held that 11 U.S.C.S. § 541(b)(7)(A) did not authorize Chapter 13 debtors to exclude voluntary postpetition retirement contributions in any amount for purposes of calculating their disposable income.

D. Voluntary Contributions IN EFFECT as of petition date, deemed ALLOWED:

Baxter v. Johnson (In re Johnson), 346 B.R. 256 (Bankr. S.D. Ga. 2006)

In one of the first cases to opine on the issue post-BAPCPA, the above median debtor proposed a continued contribution to a 401k and reduced disposable income by this amount. The court approved the contribution and deduction from disposable income. “Sections 541(b) (7) and 1322(f) both plainly state that these contributions ‘shall not constitute disposable income.’ Congress has placed retirement contributions outside the purview of a Chapter 13 plan. Debtors may fund 401(k) plans in good faith, so long as their contributions do not exceed the limits legally permitted by their 401(k) plans.” Id. at 263.

In re Njuguna, 357 B.R. 689 (Bankr. D. N.H. 2006)

The Court found no ambiguity in 11 USC 541(b)(7) in this case involving above-median debtor seeking to deduct from disposable income continued voluntary retirement contributions. “BAPCPA changed the way 401k contributions and loan payments are treated in Chapter 13. Congress sought to protect 401k contributions by excluding them from the bankruptcy estate and providing that neither 401k contributions nor 401k loan payments shall constitute disposable income. The Trustee's objection is denied.” Id. at 691.

In re Anh-Thu Thi Vu, No. 15-41405-BDL, 2015 Bankr. LEXIS 1967 (U.S. Bankr. W.D. Wash. June 16, 2015)

Debtor was contributing an average of $877.00 per month to a voluntary retirement account. The above median debtor deducted this amount on the means test. The Court approved the deduction and found that the debtor's voluntary retirement contributions were not "disposable income" as that term was defined in 11 U.S.C.S. § 1325(b)(2) because 11 U.S.C.S. § 541(b)(7)(A)(i)'s hanging paragraph excluded pre-petition voluntary retirement contributions from the calculation of current monthly income. The court declined to rule on whether and to what extent the debtor's deducting of qualified retirement contributions from her income in calculating CMI and disposable income might constitute a lack of good faith in filing a Chapter 13 plan. Instead, the Court gave the parties the opportunity to resolve the matter after ruling that the deduction in general was allowable.

In re Jensen, 496 B.R. 615 (Bankr. D. Utah 2013)

The Debtor in Jensen commenced voluntary contributions 3 months prior to filing the petition. The Court upheld the deduction of the contribution from disposable income, relying on the rationale of In Re Seafort (i.e., contributions must be in effect as of the petition date).

E. Contributions commenced on eve of filing, deemed NOT ALLOWED

In re Smith, No. 09-64409, 2010 Bankr. LEXIS 1942 (U.S. Bankr. N.D. Ohio June 15, 2010)

Shortly before the debtors filed their bankruptcy petition, the one debtor increased his retirement plan contribution from three percent of his income to 15 percent of his income. The bankruptcy court held that, while the retirement plan contributions were not property of the bankruptcy estate and did not constitute disposable income, the pre-petition increase in the contributions indicated the debtors' lack of good faith in proposing the plan. The one debtor increased his contribution by five times his typical contribution, which reduced the distribution to unsecured creditors by more than half. Further, the debtors presented no financial-planning justification for the increase and the debtors' contributions went far beyond reasonably measured retirement planning and were unfair to unsecured creditors.

IV. CASE LAW SUMMARIES – BELOW MEDIAN DEBTORS:

A. Voluntary Contributions IN EFFECT as of petition date, deemed ALLOWED:

In re Bruce, 484 B.R. 387 (Bankr. W.D. Wash. 2012)

The Debtor included $160 monthly 401k deduction when calculating disposable income. The Court found In Re Parks inapplicable based on below median debtor and 11 USC 1325(b)(2)'s reasonably necessary for the maintenance and support of debtor and dependents standard governing. Court found following facts important in finding contribution was "reasonably necessary":

“ In this case, the Court notes the following: the monthly amount contributed ($160.33) is reasonable relative to the debtor's gross monthly income ($5501.37); the contribution has actually been reduced since the debtor initially filed a chapter 7; Bruce is allowed a match by his employer for the contribution enhancing the value of the contribution; Bruce's Schedule J budget is reasonable; and the employer offers and Bruce has no other form of pension or retirement.” Id. at 390.

The Court in Bruce made an interesting point with respect to statutory construction arguments commonly made in support of the contrary position:

“Lastly, a word about the statutory construction of the ‘except that’ clause in 11 U.S.C. § 541(b)(7)(A)(i). The *Parks* opinion and its predecessors assign significance to the fact that the exclusion of 401(k) loan repayments from disposable income resides specifically within chapter 13, while the exclusion for 401(k) contributions resides in chapter 5. This argument would be more persuasive if the exclusion of 401(k) loan repayments from disposable income had been placed in § 1325(b)(2), with other disposable income exclusions and deductions. Instead it is appended to a provision prohibiting chapter 13 plans from modifying 401(k) loans in § 1322(f). The exclusion of 401(k) contributions from disposable income is in § 541(b), appended to the exclusion of such contributions from property of the estate. Neither provision is located where one might expect to see deductions from disposable income, § 1325(b)(2). Instead, their location appears to be driven by the placement of the other provisions dealing with 401(k) loan repayments and 401(k) contributions to which they are appended, and their location denotes no significance on the question of their effect on disposable income.” Id. at 394.

In re Devilliers, 358 B.R. 849 (Bankr. E.D. La. 2007)

In a consolidated case, one of the debtors, a below-median debtor, including in his schedule I a deduction for a voluntary retirement contribution. The Ch. 13 Trustee objected to the expense as unnecessary and unreasonable. The Court upheld the deduction, finding that 11 USC 541(b)(7) excludes such contributions from disposable income. The Court went a step further and found that a Court need not inquire into the reasonableness of the contribution. “The Code simply contains no requirement that contributions to a retirement account be ‘reasonable or necessary.’ Perhaps more accurately, Congress has determined that contributions to a qualified retirement account are, by their very nature, reasonable and necessary. By providing for a debtor's eventual retirement, retirement contributions become part of debtor's fresh start.”

B. Voluntary Contributions NOT in effect as of petition date, deemed NOT ALLOWED:

In re Williams, No. 11-30332, 2012 Bankr. LEXIS 733 (U.S. Bankr. S.D. Ga. Jan. 23, 2012)

Debtor's schedules disclosed a monthly payment of $674 on a pre-petition loan from his § 401(k) plan. At the current rate, the loan would have been repaid in approximately 23 months. Debtor had ceased making contributions approximately 5 years before he took out the § 401(k) loan. The trustee argued that, as a condition of confirmation of the chapter 13 plan, debtor should agree to increase his plan payments once the § 401(k) loan was repaid. Debtor contended the loan contribution repayments were excluded from disposable income, given the public policy of encouraging citizens to make arrangements for their retirement. However, because he had not been making contributions to his retirement for a substantial period before the petition date, debtor was not able to start such contributions during the pendency of his chapter 13 case to the detriment of his unsecured creditors. Debtor's projected disposable income after repayment of the § 401(k) loan was relevant.

In re Noll, No. 10-35209-svk, 2010 Bankr. LEXIS 4868 (U.S. Bankr. E.D. Wis. Dec. 21, 2010)

In re Read, 515 B.R. 586 (Bankr. E.D. Wis. 2014)

Debtor urged the court to allow her to deduct her 401(k) contributions to calculate her disposable income, but the relevant statutory provisions had not changed since Noll (a prior case where the same court disallowed the deduction), and neither had the court's evaluation of this issue, and, as a result, debtor's timing in this case was fatal to her arguments. She did not start making contributions until after the petition date. The hanging paragraph in 11 U.S.C.S. § 541(b)(7)(A) was applicable only to voluntary contributions existing as of the commencement of the bankruptcy case by virtue of § 541(a)(1). Since debtor was not making a voluntary contribution to her retirement plan at the time she filed her case, her post-petition contributions were not excluded from the disposable income calculation. She was thus not dedicating sufficient disposable income to her unsecured creditors as required by 11 U.S.C.S. § 1325(b).

PROJECTED DISPOSABLE INCOME – NON-FILING SPOUSE/PARTNER INCOME

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STATUTORY FRAMEWORK

11 USC 101(10A) The term "current monthly income" means the average monthly income from all sources that the debtor receives (or in a joint case the debtor and the debtor's spouse receive) without regard to whether such income is taxable income, … and **(B)** includes any amount paid by any entity other than the debtor (or in a joint case the debtor and the debtor's spouse), on a regular basis for the household expenses of the debtor or the debtor's dependents (and in a joint case the debtor's spouse if not otherwise a dependent).

11 USC 1325(b)(4)(A) The "applicable commitment period" for a Chapter 13 plan 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 ...

CASE LAW SUMMARIES

Disclosure

In re Rodgers, No. 14-41824-13, 2014 WL 4988388 (Bankr. W.D. Mo. Oct. 7, 2014)
"If the Debtor is unable to provide information about his non-filing spouse's income, expenses, and contributions to the household, he must propose a plan which pays unsecured creditors in full. Since his Plan does not do that, it cannot be confirmed."

In re Haroldson, No. 14-26941 MER, 2016 WL 3034794 (Bankr. D. Colo. May 19, 2016)
Even though the Debtor and non-filing spouse maintained separate financial lives, the Court concluded the Debtor must account for all of the non-filing spouse's income and expenses. "Disclosure of [a non-filing spouse's] income is necessary, not only to show the Debtor is committing all of [his] disposable income to Plan payments, but also to show feasibility and good faith, two additional requirements for confirmation under 11 U.S.C. § 1325." The Court required the Debtor to file amended schedules.

In re Ortiz-Feliciano, 532 B.R. 185 (Bankr. D.P.R. 2015)
The Court determined an evidentiary hearing was necessary to determine if the debtor and non-filing spouse operated as a "single economic unit." The Debtor maintained the spouse covered most of the Debtor's expenses, but there was not enough evidence offered to support that assertion. The Court could not 'accept as fact that a married couple will pool all income and expenses like a quasi-partnership or that a married couple will even share all household

expenses, whatever that means, equally', *In re Welch,* 347 B.R. at 254, and/or conclude *ipso facto* that the Debtor and his non-filing spouse operate as a "single economic unit" without further ado."

In re Blackshear, 531 B.R. 711 (E.D. Mich. 2015), appeal dismissed (Dec. 9, 2015)
The Chapter 13 Trustee objected to Debtor's plan as it did not have a complete picture of Debtor's disposable income where the non-filing spouse's income was not disclosed on Schedule I. Although the Bankruptcy Court did not have a complete picture of the finances of Blackshear's husband, it determined that the Means Test contained enough information about his financial situation to calculate Blackshear's disposable income and conclude that Blackshear was devoting all of that income to plan payments, that the plan was proposed in good faith, and that the plan is feasible.

In re Ramsay, 440 B.R. 85 (Bankr. M.D. Pa. 2010)
The Court found abuse where the Chapter 7 Debtor was financially supporting his fiancée's children in lieu of offering a dividend to his unsecured creditors. The Court remarked that while there was no legal obligation to care for his fiancée's children, he did have a legal obligation to his creditors. The Court found that, "there may be a set of circumstances in which a debtor who lives with a domestic partner and the partner's children may owe a duty to support the partner's children. However, in this case, there is insufficient evidence on the record for me to find that Debtor assumed *in loco parentis* status with regard to his fiancée's children."

Marital Adjustment/ Applicable Commitment Period

In re Quarterman, 342 B.R. 647 (Bankr. M.D. Fla. 2006)
The Chapter 13 Trustee objected to Debtor's plan arguing the Debtor was not contributing disposable income to fund his plan. The Court overruled the Trustee's objection. The Court in Quarterman determined that, "[t]he parenthetical stating that, in a joint case, a debtor's current monthly income shall include the debtor's spouse's income suggests that, in a single case, the spouse's income is not included in the debtor's current monthly income; otherwise, the parenthetical would be superfluous. However, part (B) of section 101(10A), states that current monthly income also "includes any amount paid by any entity *other than the debtor (or in a joint case the debtor and the debtor's spouse),* on a regular basis for the household expenses of the debtor or the debtor's dependents (and in a joint case the debtor's spouse if not otherwise a dependent)...." 11 U.S.C. § 101(10A)(B)." The Court reasoned, "it appears that, in a single case, a debtor's spouse's income shall be included in the debtor's current monthly income to the extent that it is paid 'on a regular basis for the household expenses of the debtor or the debtor's dependents.]" It concluded, "based upon the explicit language of section 101(10A), current monthly income does not include *all* the income of the non-debtor spouse, but rather only amounts expended on a regular basis for household expenses."

In re Borders, No. 07-12450, 2008 WL 1925190 (Bankr. S.D. Ala. Apr. 30, 2008)
The Trustee objected to confirmation of the Debtor's plan where the Debtor took a line 13 "Marital Adjustment" deduction for expenses paid directly by the nondebtor husband. The Court determined the best interpretation of "current monthly income" is one where the parenthetical in the definition is not superfluous. "Congress was surely aware that '[t]he additional income of a spouse is completely irrelevant if that spouse's income is not available to cover household

expenses.'" The Court further stated, "To conclude otherwise would mean that a married debtor who files individually would be worse off than one who files jointly because the debtor would appear from his or her B22C to have money to pay into a plan that he or she really does not have because it belongs to a non-filing spouse." The Court concluded the Debtor met her burden and proved she satisfied the requirements of 11 USC 1325(b)(4)(A). She had listed all her income and non-filing spouse's income, but after subtracting his individual expenses, she was below median income and thus a three year commitment period was all that was required.

In re Abisso, 490 B.R. 464 (Bankr. D. Mass. 2013)
The Trustee objected to Debtor's 48 month plan asserting the Debtor is above median income (and thus should propose a 60 month plan) when calculating current monthly income under 11 USC 1325(b)(4)(A). The Trustee asserted the form wrongly allows for a Debtor to take a marital adjustment on line 13 for domestic support obligations, taxes and other payroll deductions. The Court rejected the Trustee's reliance on the minority view on this issue. "Debtor is entitled to the marital adjustment on Line 13 of the B22C Form to deduct the portion of her non-filing spouse's income that is not contributed on a regular basis to the Debtor's household expenses for the purpose of determining her applicable commitment period."

In re Epperson, 409 B.R. 503 (Bankr. D. Ariz. 2009)
The Chapter 7 Trustee brought a motion to dismiss for abuse which was denied. The Debtor who maintained a residence with his domestic partner was entitled a household size of two on the means test. Further, only the domestic partner's $900 contribution needed to be included in the income calculation. "The Court finds that the Debtor is not required to include all of the Roommate's income in current monthly income and similarly the Debtor need not include all of the Roommate's income in his Schedule I."

In re Rable, 445 B.R. 826 (Bankr. N.D. Ohio 2011)
The Debtor and his non-filing spouse reside in the same home. Even though the first and second mortgages are in the non-filing spouse's name, the Debtor cannot take a marital adjustment to his disposable income calculation on line 17 of Form B22A. The Debtor was denied relief under Chapter 7 based on presumed abuse under 11 USC 707.

Good Faith

In re Waechter, 439 B.R. 253 (Bankr. D. Mass. 2010)
The Trustee objected that the Debtor's amended plan failed to include all of her disposable income and therefore was not proposed in good faith. The Debtor and her nondebtor spouse had a premarital agreement to keep finances separate. The Debtor was paying all of the household expenses. The Court ruled that "based on the totality of the circumstances, the Debtor's plan, in which she proposes to pay a disproportionate amount of the couple's shared household expenses, is not proposed in good faith" and sustained the Trustee's objection to confirmation of the plan.

In re Garrett, No. 14-04063-5-DMW, 2015 WL 1546149 (Bankr. E.D.N.C. Mar. 31, 2015)
A Chapter 7 Debtor's case was dismissed for abuse where the Debtor was making significant monthly contributions to his domestic partner, including rent for a separate apartment. "Although the court is sympathetic to the Debtor's desires to help those who are unwilling or unable to support themselves, the Debtor's bankruptcy filing exhibits bad faith. Debtors cannot

choose to give unreasonable amounts of money to friends and loved ones instead of paying debts on which they are legally obligated."

In re Toxvard, 485 B.R. 423 (Bankr. D. Colo. 2013)
The Trustee objected to Debtor's Chapter 13 plan on the basis the Debtor was not committing all of her projected disposable income. The Court concluded the Debtor may include the full amount of $1720 paid by her non-filing spouse in the Line 19 marital adjustment on Form B22C. However, 50% of the household expenses for the residence shared by the Debtor and non-filing spouse would constitute income to the Debtor.

In re Vinger, 540 B.R. 782 (Bankr. D. Colo. 2015)
The Court concluded a 60 month plan was required where the debtor's income is above median. The Court determined the Debtor's marital deduction of 50% of the rent expense was inappropriate.

In re Stampley, 437 B.R. 825 (Bankr. E.D. Mich. 2010)
The United States Trustee filed a motion to dismiss Debtor's Chapter 7 case where the Debtor could not provide a meaningful dividend to unsecured creditors. The Court found a debtor's calculation of disposable income includes non-filing spouse's income and expenses. The Court concluded, "in a bankruptcy case filed by one spouse, when calculating the filing spouse's net disposable income, the joint expenses of the debtor and the non-filing spouse should be allocated in proportion to their income." Where the Debtor was subsidizing the non-filing spouse at the expense of her creditors, the Court granted the United States Trustee's motion to dismiss.

In re Martellini, 482 B.R. 537 (Bankr. D.S.C. 2012)
The Court sustained Trustee's good faith objection to confirmation of Debtor's plan. The Debtor sought to surrender luxury items, but Debtor wife would continue to make payments on these items. Although the non-filing spouse was not overspending her pro-rata share, the Court took issue with luxury items under a good faith analysis. "Court finds the plan is not proposed in good faith because Debtor's family, through the guise of Debtor ceding his interest to his wife, proposes to continue ownership of and payments on a $39,000 boat and $12,000 jet ski while atthe same time Debtor pays less than 30% of his unsecured debt."

PROJECTED DISPOSABLE INCOME – SOCIAL SECURITY BENEFITS

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STATUTORY FRAMEWORK

11 U.S.C. 101(10A) defines *current monthly income* to specifically exclude "benefits received under the Social Security Act".

42 U.S.C. §407(a) provides that the right to future payments under Tittle II of the Social Security Act (Federal Old-Age, Survivors and Disability Insurance Benefits) shall not be "subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law."

Both 11 U.S.C. 707(b)(2) and 11 U.S.C. 1325(b)(2) define a debtor's income with reference to *current monthly income* as defined by Section 101(10A), but Section 707(b)(3) does not. Courts have considered whether Social Security income should be included when deciding the good faith of a proposed plan under 11 U.S.C. §1325(a)(3), and when deciding whether to dismiss a chapter 7 case under the totality of circumstances analysis of 11 U.S.C. §707(b)(3).

CASE LAW SUMMARIES

The basics

Hamilton v. Lanning, 130 S.Ct. 2464 (2010)

Affirming the 10th Circuit's holding that when calculating projected disposable income a court can consider evidence of a substantial change in the debtor's circumstances. The Supreme Court rejected a mechanical approach to calculating projected disposable income and instead adopted a forward-looking view that could account for "known or virtually certain changes" in the debtor's income.

Baud v. Carroll 634 F.3d 327 (6th Cir. 2011)

Appeal to the Sixth Circuit from the District Court for the Eastern District of Michigan that reversed the Bankruptcy Court's order sustaining the Chapter 13 trustee's plan objection concerning the applicable commitment period. The Sixth Circuit affirmed the district court's holding that the applicable commitment period for above median income debtors was a minimum plan length of 60 months. In so holding, however, the Court stated that the calculation of a debtor's projected disposable income must exclude income that is specifically excluded from the definition of current monthly income under 11 U.S.C. 101(10A), such as benefits received under the Social Security Act.

The good faith requirement of chapter 13 – 11 U.S.C. §1325(a)

Opinions from courts within the Sixth Circuit

<u>In re Upton 363 B.R. 528 (Bankr. S.D. Ohio 2007)</u>

The Chapter 13 trustee objected to the debtor's plan because it was not proposed in good faith since the Debtors did not include benefits received under the Social Security Act in the calculation of current monthly income. The Court ruled that the means test form is not always an accurate reflection of a debtor's current circumstances and "can lead to anomalous, or even absurd results if it is the only information used in determining a debtor's projected disposable income." While agreeing with the trustee that reference to Schedules I and J is appropriate for determining projected disposable income, the analysis is limited by the exclusion of certain income pursuant to the definition under Section 101(10A). The Court concluded that the Social Security income could not be included in the analysis for determining projected disposable income for purposes of Section 1325(b). The court went on to state "Satisfying the disposable income test required by 11 U.S.C. §1325(b), however, does not end the Court's inquiry in considering confirmation of a plan. Debtors are still required to propose a plan in good faith pursuant to 11 U.S.C. §1325(a)(3)."

<u>Mains v. Foley, 2012 U.S. Dist. LEXIS 23802 (W.D. Mich.)</u>

The District Court for the Western District of Michigan affirmed the Bankruptcy Court's decision to deny confirmation of a chapter 13 plan for lack of good faith because the debtors' calculation of projected disposable income excluded benefits they received under the Social Security Act. The Bankruptcy Court held that although Social Security benefits are to be excluded from the objective section 1325(b) analysis, the benefits are relevant to the subjective section 1325(a)(3) good faith analysis. Agreeing with the Bankruptcy Court, the District Court stated: "Congress actually reinforced the point in the 2005 BAPCPA amendments by expressly excluding Social Security benefits from the objective "disposable income" analysis of section 1325(b), but leaving undisturbed the open-ended and unqualified subjective determination of good faith under section 1325(a). As this case demonstrates, it is entirely possible for a debtor to satisfy the objective test of section 1325(b) while at the same time leaving ample factual basis upon which to find a subjective lack of good faith."

<u>In re Mihal, 2015 Bankr. LEXIS 1683 (E.D. Mich.)</u>

The Bankruptcy Court overruled the chapter 13 trustee's objection to plan confirmation. The trustee's objection was based solely on the debtors' inability to satisfy the good faith requirement of 11 U.S.C. §1325(a)(3) because they excluded their Social Security income from the projected disposable income calculation. The Court followed a line of decisions that conclude, relying primarily on statutory construction and a plain reading of the code, debtors are under no obligation to commit any of their Social Security income to their plan. The court stated "Section 1325(a), which contains the good faith requirement, begins with the phrase 'except as provided in subsection (b)', thereby explicitly referring and giving precedence to subsection (b), which, as noted, clearly states that Social Security income is not part of the debtor's disposable income." The court also disagreed with the decision in *Mains v. Foley*, rejecting the conclusion that Congress could have altered the definition of good faith in Section 1325 to specifically address the inclusion of Social Security income as a good faith requirement. The *Mihal* court reasoned "very little can be surmised from the fact that Congress failed to eliminate an item from the nearly infinite bounds of the 'good faith' definition, particularly where that item is specifically dealt with elsewhere."

What other Circuits have said

<u>Drummond v. Welsh (In re Welsh), 2013 U.S. App. LEXIS 5880 (9th Cir. 2013)</u>

Affirming the Bankruptcy Appellate Panel, the 9th Circuit held that consideration of disposable income is defined in great detail and does not bear on the good faith analysis. The good faith inquiry lies in the debtor's "motivation and forthrightness with the court", while the disposable income requirement "focuses on the amount of funds that Congress expects a debtor to devote to paying off unsecured creditors."

<u>Ranta v. Gorman, 721 F.3d 241 (4th Cir. 2013)</u>

The 4th Circuit opined on the issue of whether a court could take into account Social Security income a debtor proposes to contribute to a plan when considering feasibility. Relying on *Baud v. Carroll*, the court held that a debtor with zero or negative projected disposable income could offer income that falls outside the definition of disposable income, such as Social Security, to make a plan feasible.

<u>Beaulieu v. Ragos (In re Ragos), 700 F.3d 220 (5th Cir. 2012)</u>

Affirming the bankruptcy court for the Eastern District of Louisiana, the 5th Circuit concluded the debtors did not act in bad faith by doing what the Bankruptcy Code allows. It held "retention of exempt social security benefits alone is legally insufficient to support a finding of bad faith under the Bankruptcy Code."

<u>Anderson v. Cranmer (In re Cranmer), 697 F.3d 1314 (10th Cir. 2012)</u>

The bankruptcy court denied confirmation because the debtor's plan excluded Social Security Income from the projected disposable income calculation. The District Court reversed. Affirming the District Court, the 10th Circuit Court of Appeals followed the reasoning of the 9th Circuit in *Welsh*: "When a Chapter 13 debtor calculates his repayment plan payments exactly as the Bankruptcy Code and the Social Security Act allow him to, and thereby excludes SSI, that exclusion cannot constitute a lack of good faith."

Fink v. Thompson (In re Thompson), 439 B.R. 140 (8th Circuit 2010)

The Bankruptcy Appellate Panel for the 8th Circuit affirmed the bankruptcy court's decision to confirm the debtors' plan over the chapter 13 trustee's objection. The trustee alleged lack of good faith because the debtors' plan did not include all of their SSI. The BAP reasoned that the Bankruptcy Code requirements include an ability to pay test and a good faith test for confirmation, and considering inclusion of Social Security income under both tests would be duplicative.

Totality of the circumstances in chapter 7 - 11 U.S.C. 707(b)(3)

In re Riggs, 495 B.R. 704 (Banr. W.D. Va. 2013)

The bankruptcy court held that in deciding whether to dismiss a case under the totality of circumstances test of 707(b)(3), the court could consider benefits received from Social Security. The Court relied first on the plain meaning of the statute and the phrase "totality of the circumstances… of the debtor's financial situation", stating that "the receipt of Social Security benefits, clearly a reliable and continuing source of income, is part of that 'totality', a term which strikes this Court as being as inclusive as it is possible to employ." The court further noted that there was nothing in the statute to suggest Social Security income should be excluded from consideration under (b)(3), while specifically excluding it from the "operation of general automatic rules", such as dismissal under 707(b)(2) or determination of projected disposable income in a chapter 13.

In re Johnson, 2014 Bankr. Lexis 798 (W.D. Mo. 2013)

The bankruptcy court in the Western District of Missouri disagreed with the *Riggs* court based primarily on the reasoning of an 8th Circuit Court of Appeals decision {*Carpenter v. Ries, 614 F.3d 930 (8th Cir. 2010)*} that looked to the anti-assignment provision of the Social Security Act in deciding whether a lump sum Social Security benefit payment was excluded from estate property. The Court concluded that since §407 of the Social Security Act must be read as an exclusion provision, "which automatically and completely excludes Social Security proceeds from the bankruptcy estate."

In re Moriarty, 530 B.R. 637 (W.D. Virginia 2015)

The bankruptcy court granted the Debtor's Motion for Partial Summary Judgment that asserted her Social Security income should not be considered for the purposes of Section 707(b)(3)(B). The court reasoned that it could not "read the statute in isolation from the context of the entire statutory scheme." The court concluded that if it considered such income under

707(b)(3), it would essentially be exercising control over the Social Security income, contrary to the anti-assignment provision of the Social Security Act. The court expressed concern that excluding Social Security income from consideration under 707(b)(2) but not under the totality analysis of (b)(3) in finding abuse would essentially force a debtor to pledge the income in a chapter 13 plan.