Vulnerable Borrowers in Bankruptcy:
Older Consumer Debtors Faced with Selected Issues

Student Loans and Vulnerable Borrowers:

1. Overview of Student Loan Repayment
    a. The Growing Problem of Student Loan Debt
        ABA Journal: 12 More Law Schools Sued Over Reporting of Law Grad Employment and Salary Stats
        ABA Journal: The Law School Bubble
    b. Total Disability Discharge
        Dept. of Education Discharge Application
    c. Death Discharge / Cancellation
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        11 U.S.C. § 523
        Brunner v. New York State Higher Educ. Serv. Corp., 831 F.2d 395 (2d Cir. 1987)
        In the Matter of Gerhardt, 348 F.3d 89 (5th Cir. 2003)
        In re Murphy, 282 F.3d 686 (5th Cri. 2002)
        In re Smith, 442 B.R. 550, 264 Ed. Law Rep 794 (Bankr. S.D. Tex., 2010)
        In re Henslee, Case No. 06-35570-H5-7 (Bankr. S.D. Tex. 2010)
2. FDCPA violations in the collection of student loans against the elderly - Are they more susceptible?
    The Fair Debt Collection Practices Act, As amended by Pub. L. 109-351, §§ 801-02, 120 Stat. 1966 (2006)
3. Applicability of new laws
    Income -Based Repayment Plan Question and Answers
    H.R. 2028 (introduced by Representative S. Cohen) and S. 1102 (introduced by Senator R. Durbin)
4. NACBA initiative
    NACBA Student Loan Debt Crisis Survey - February 7, 2012
5. Means Test and Student Loans
    In re Haman, 366 B.R. 307 (Bankr. Del. 2007)
    In re Champagne, 389 B.R. 191 (Bankr. Kan. 2008)
    In re Sanders, Case No. 10-11939-WRS (Bankr. M.D. Ala. 2011)

Non-Filing Dependents and Their Effect on the Means Test: Discussion of how non-filing dependents affect a consumer debtor's case, who qualifies as a dependent, and what expenses and income of dependents are included in the means test. Handout included.

Case Law:
In re Dunbar, 99 B.R. 320, 324-25 (Bankr. M.D. La. 1989).
In re Justice, 404 B.R. 506 (Bankr. W.D. Ark. 2009)

Secondary Sources:
"Dismissal for 'abuse' of Chapter 7 and the means test," 1 Bankruptcy Practice Handbook § 5:2 (2d ed.).

The Debtor's Capacity: The law governing powers of attorney, and the use of powers of attorney in bankruptcy cases.

Case Law:
U.S. v. Spurlin, 664 F.3d 954 (5th Cir. 2011).
Comerica Bank-Texas v. Texas Commerce Bank, N.A., 2 S.W.3d 723 (Tex. App.--Texarkana 1999, n.w.h.).

Statutes:
Tex. Prob. Code §§ 481-506; 768-782.
Tex. Estates Code §§ 751.001-752.115.
Tex Fin. Code §§ 342.504, 345.354, 345.355, 347.053, 348.410, 348.411, 353.407, 353.408.
Tex. Bus. Org. Code § 153.553(b).
Tex. Bus. & Comm. Code §§ 21.001, 21.102.

Medical Issues: Handout included.
1. Dischargeability of Medical Bills (Generally)
2. ObamaCare ("The Patient Protection and Affordable Care Act")
Articles:
"Study Links Medical Cost and Personal Bankruptcy," Business Week
"Medical Bankruptcy: Myth Versus Fact," David Dranove and Michael L. Millenson
"The Impact of Health Care Reform on Personal Bankruptcy," Sarah Miller
3. Texas Health Care Reform
Articles:
"Healthcare reform looms large in Texas," www.reuters.com
"Texas Health Care Reform Goals," Health and Human Services Commission
"Senate Bill 10 Sets Stage for Health Care Reform," Health and Human Services Commission
"Biggest recipient of 'Obamacare'? Texas," www.lasvegassun.com

4. Dischargeability of Heal Loans
Case Law:
United States v. Wood, 925 F.2d 158 (7th Cir. 1991).
In re Johons, 787 F.2d 1179, 1181 (7th Cir. 1986).
Statute:
42 U.S.C. § 294f(g)

Reverse Mortgages: Discussions with a Mortgage Broker on the decision to enter into a reverse mortgage; as well as issues with common scams and pitfalls. We will provide informative materials for advising your clients on reverse mortgages, as well as case law regarding how reverse mortgages are treated in bankruptcy.

Articles:
"Reverse Mortgage Loans: Borrowing Against Your Home", AARP
"Senior Alert: Reverse Mortgage Offers", Attorney General of Texas
"Reverse Mortgages: Get the Facts Before Cashing in on Your Home's Equity", Federal Trade Commission
"Moving Forward With a Reverse Mortgage?", Office of Consumer Credit Commissioner

Case Law:
In re Brown; 428 B.R. 672; 2010 Bankr. LEXIS 2094
In re Boudreaux; 2010 Bankr. LEXIS 777
In re Evans; 2011 Bankr. LEXIS 1425
In re Early; 2008 Bankr. LEXIS 1605
In re Jacono; 360 B.R. 84; 2006 Bankr. LEXIS 3743
In re Thorne, 2008 Bankr. LEXIS 4379

348 F.3d 89
In the Matter of: Jonathon R. GERHARDT, Debtor.
United States Department of Education, Appellee,
v.
Jonathon R. Gerhardt, Appellant.
No. 03-30040.
United States Court of Appeals, Fifth Circuit.
October 23, 2003.
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Eneid A. Francis (argued) and Stephen A. Higginson, Asst. U.S. Attys., New Orleans, LA, for Appellee.

M. Elizabeth Bowman (argued), Bowman & Howley, Gretna, LA, for Appellant.

Appeal from the United States District Court for the Eastern District of Louisiana.

Before REAVLEY, JONES and CLEMENT, Circuit Judges.

EDITH H. JONES, Circuit Judge:

Over a period of years, Jonathon Gerhardt obtained over $77,000 in government-insured student loans to finance his education at the University of Southern California, the Eastman School of Music, the University of Rochester, and the New England Conservatory of Music. Gerhardt is a professional cellist. He subsequently defaulted on each loan owed to the United States Government.

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In 1999, Gerhardt filed for Chapter 7 bankruptcy and thereafter filed an adversary proceeding seeking discharge of his student loans pursuant to 11 U.S.C. § 523(a)(8). The bankruptcy court discharged Gerhardt's student loans as causing undue hardship. On appeal, the district court reversed, holding that it would not be an undue hardship for Gerhardt to repay his student loans. Finding no error, we affirm the district court's judgment.

I. STANDARD OF REVIEW

We review the decision of a district court, sitting as an appellate court, by applying the same standards of review to the bankruptcy court's findings of fact and conclusions of law as applied by the district court. *In re Jack/Wade Drilling, Inc.*, 258 F.3d 385, 387 (5th Cir.2001). Generally, a bankruptcy court's findings of fact are reviewed for clear error and conclusions of law are reviewed de novo. *Williams v. IBEW Local 520 (In re Williams)*, 337 F.3d 504, 508 (5th Cir. 2003).

Whether courts review the "undue hardship" determination de novo is a matter of first impression in this circuit. A number of our sister circuits have confronted this precise issue, determining that the dischargeability decision is a question of law subject to de novo review. *See In re Long*, 322 F.3d 549, 553 (8th Cir.2003); *In re Rifino*, 245 F.3d 1083, 1086-87 (9th Cir.2001); *In re Brightful*, 267 F.3d 324, 327 (3d Cir.2001); *In re Hornsby*, 144 F.3d 433, 436 (6th Cir.1998); *In re Woodcock*, 45 F.3d 363, 367 (10th Cir.1995); *In re Roberson*, 999 F.2d 1132, 1137 (7th Cir. 1993); *Brunner v. New York State Higher Educ. Serv. Corp.*, 831 F.2d 395, 396 (2d Cir.1987). Similarly, this court has held that determining dischargeability of a debt arising from a willful and malicious injury under 11 U.S.C. § 523(a)(6) is a question of law subject to de novo review. *In re Williams*, 337 F.3d at 508. The decision to discharge Gerhardt's debts represents a conclusion regarding the legal effect of the bankruptcy court's factual findings as to his circumstances. Thus, the district court correctly applied de novo review to the bankruptcy court's dischargeability holding, and this court applies the same standard on appeal.

II. UNDUE HARDSHIP TEST

This circuit has not explicitly articulated the appropriate test with which to evaluate the undue hardship determination. The Second Circuit in *Brunner* crafted the most widely-adopted test. *See In re Cox,* 338 F.3d 1238, 1241 (11th Cir. 2003); *In re Ekenasi,* 325 F.3d 541, 546 (4th Cir.2003); *Rifino,* 245 F.3d at 1087-88; *Brightful,* 267 F.3d at 327-28; *Roberson,* 999 F.2d at 1135-36. To justify discharging the debtor's student loans, the *Brunner* test requires a three-part showing:

(1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for [himself] and [his] dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor has made good faith efforts to repay the loans. *Brunner,* 831 F.2d at 396.

Because the Second Circuit presented a workable approach to evaluating the "undue hardship" determination, this court expressly adopts the *Brunner* test for purposes of evaluating a Section 523(a)(8)

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decision.[1]

A. Minimal Standard of Living

Under the first prong of the *Brunner* test, the bankruptcy court determined that Gerhardt could not maintain a minimal standard of living if forced to repay his student loans. Evidence was produced at trial that Gerhardt earned $1,680.47 per month as the principal cellist for the Louisiana Philharmonic Orchestra ("LPO"), including a small amount of supplemental income earned as a cello teacher for Tulane University. His monthly expenses, which included a health club membership and internet access, averaged $1,829.39. The bankruptcy court's factual findings are not clearly erroneous. Consequently, we agree with the bankruptcy court's conclusion of law, which we review de novo, that flows from these factual findings. Given that Gerhardt's monthly expenses exceed his monthly income, he has no ability at the present time to maintain a minimal standard of living if forced to repay his loans.

B. Persisting State of Affairs

The second prong of the *Brunner* test asks if "additional circumstances exist indicating that this state of affairs is likely to persist [for a significant period of time]." *Brunner,* 831 F.2d at 396. "Additional circumstances" encompass "circumstances that impacted on the debtor's future earning potential but which [were] either not present when the debtor[] applied for the loans or [have] since been exacerbated." *In re Roach,* 288 B.R. 437, 445 (Bankr.E.D.La.2003). This second aspect of the test is meant to be "a demanding requirement." *Brightful,* 267 F.3d at 328. Thus, proving that the debtor is "currently in financial straits" is not enough. *Id.* Instead, the debtor must specifically prove "a total incapacity ... in the future to pay [his] debts for reasons not within [his] control."[2] *In re Faish,* 72 F.3d 298, 307 (3d Cir.1995) (quoting *In re Rappaport,* 16 B.R. 615, 617 (Bankr.D.N.J. 1981)).

Under the second prong of the test, the district court correctly concluded that Gerhardt has not established persistent undue hardship entitling him to discharge his student loans. Gerhardt holds a masters degree in music from the New England Conservatory of Music. He is about 43 years old, healthy, well-educated, and has no dependents, yet has repaid only $755 of his over $77,000 debt.[3] During the LPO's off-seasons, Gerhardt has collected unemployment, but he has somehow managed to attend the Colorado Music Festival. Although trial testimony tended to show that Gerhardt would likely not obtain a position at a higher-paying orchestra, he could obtain additional steady employment in a number of different arenas. For instance, he could attempt to teach full-time, obtain night-school teaching jobs, or even work as a music store clerk.[4] Thus, no reasons out

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of Gerhardt's control exist that perpetuate his inability to repay his student loans.

In addition, nothing in the Bankruptcy Code suggests that a debtor may choose to work only in the field in which he was trained, obtain a low-paying job, and then claim that it would be an undue hardship to repay his student loans. *See, e.g., In re Grigas,* 252 B.R. 866, 875 (Bankr.D.N.H.) (concluding that a debtor could not satisfy the second *Brunner* prong when financial distress was self-imposed). Under the facts presented by Gerhardt, it is difficult to imagine a professional orchestra musician who would not qualify for an undue hardship discharge. Accordingly, Gerhardt "has failed to demonstrate the type of exceptional circumstances that are necessary in order to meet [his] burden under the second prong" of *Brunner. Brightful,* 267 F.3d at 330. Finding no error, the judgment of the district court is AFFIRMED.

Notes:

1. Both the bankruptcy court and district court applied the *Brunner* test to the facts of this case.

2. Some examples of "additional circumstances" include "psychiatric problems, lack of usable job skills, and severely limited education." *Roach,* 288 B.R. at 445.

3. Our analysis of the second *Brunner* prong inevitably overlaps to some degree with the third prong, which asks if the debtor has made a good faith effort to repay the loan. *Brunner,* 831 F.2d at 396. However, because we resolve this case under the second prong, it is unnecessary to explore the third prong in depth.

4. This is not meant to be an exhaustive list of possible employment opportunities for Gerhardt, but instead merely seeks to illustrate other viable avenues for income.

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In re: WILLIAM ANTHONY HENSLEE, Debtor(s).
WILLIAM ANTHONY HENSLEE, Plaintiff(s),
v.
EDUCATIONAL CREDIT MANAGEMENT CORPORATION, COLLEGE ASSIST, AND NELNET, Defendant(s).
Case No. 06-35570-H5-7.
Adversary No. 07-3204.
United States Bankruptcy Court, S.D. Texas, Houston Division.
April 1, 2010.
MEMORANDUM OPINION

KAREN K. BROWN, Bankruptcy Judge

Before the Court is the complaint of William Anthony Henslee to discharge his student loans. This Court has jurisdiction over this proceeding pursuant to 28 U.S.C. §§ 1334 and 157. This is a core proceeding.

I. Facts

Henslee filed a voluntary chapter 7 petition on October 16, 2006. Henslee filed this adversary proceeding on April 13, 2007. Henslee's student loans are or were held by Educational Credit Management Corporation, College Assist, NelNet, Inc. and SLM Corporation d/b/a Sallie Mae Services. The holders of Henslee's student loans claim that Henslee owes approximately $ 130,000 on his student loans. Henslee sent a letter to each of the holders of his student loans i September 2007 with an offer of repayment of $5.00 per month based on his financial condition.

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Henslee has inquired about the William D. Ford Federal Direct Loan Program, but does not believe funds are available to him through that program.

William Henslee was born July 10, 1940 and was sixty-seven years old at the time of the filing of the parties' joint pretrial statement. Henslee attended Columbia College and graduated in 1961 with a B.A. in History. From 1965 to 1987 debtor was a licensed insurance agent and owned an agency, Allied Insurance Services.

In 1987, Henslee lost his license due to a felony drug conviction and was incarcerated from 1989 until he was released on parole on July 5, 1991.[1] During his incarceration and after his release, Henslee was enrolled at the University of Houston — Clear Lake ("UHCL"). Henslee seeks to discharge student loans he incurred from 1991 to 2006 while enrolled at UHCL. Hensley used the loan proceeds to pay for tuition, books, room and board, and living expenses. Henslee obtained a Master of Arts in Literature from UHCL in 1999 and a Master of Arts in Humanities in 2000. Henslee was a full-time student on July 21, 2006. Henslee intended to use his degrees to teach or write a book. Henslee discontinued his studies in 2006 while he was working on a Master of Arts in History.

Since 2000, when he held a job as a car salesman, Henslee's income has never exceeded $5,000 annually. Henslee quit his job when he returned to school because the company would not let him work part-time and because Henslee thought the manager was unfairly directing sales to a relative of the manager. In 2001, Henslee worked at the UHCL writing center, the last job he has ever held, making $10 per hour, for a total of $250 per month.

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In the past, Henslee's mother provided him financial assistance, but she has discontinued her assistance. Until Hurricane Ike destroyed it on September 12, 2008, Henslee lived in a condominium in Del Lago, purchased by his aunt. At the time of trial, Henslee was living on a friend's boat that does not have a toilet. The condominium is mortgaged and in arrears and Henslee cannot afford the payments. Henslee has no insurance to cover the hurricane's destruction of his belongings and any insurance proceeds from coverage on the condominium building will either be paid to the condominium homeowners association as beneficiary or to the mortgagee. Should the proceeds be payable to the homeowners association, it will assess unpaid association fees against the proceeds and Henslee will not receive any funds. Henslee applied to FEMA for rental assistance and he lived in a hotel for some time, but the assistance payments ceased. Henslee owns a 1994 Pontiac and a small dog he acquired on the recommendation of his therapist. Henslee spends $6.25 every two months on dog food.

Currently, Henslee's sole source of personal income is his Social Security retirement benefit. At the time of trial, Henslee had begun receiving Texas Medicare payments of $748 per month, representing an increase over the previous payments he had been receiving of $650 per month. Henslee receives food stamps are of $176.00 per month. Debtor's Social Security retirement benefit places him below the poverty line. Henslee relies on the charity of friends and relatives to supplement his Social Security income in order to maintain a minimal standard of living. Henslee has no other assets and no expectancy of an inheritance.

Henslee receives supplemental assistance from the Social Security Administration for Medicare and the Medicare Drug program due to his low income level. Debtor's low income also

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qualifies him for coverage(referred to as the "Gold Card") by the Harris County Health District for assistance on his medical and drug bills.

Henslee suffers from cancer, degenerative joint disease in his knees, high blood pressure, high cholesterol, sleep apnea, vertigo, allergic rhinitis, and depression. In the 1990's, Henslee had an operation for sleep apnea. In 2006, when Henslee qualified for the Gold Card in 2006, lab work was done and he was put on medication for high blood pressure and high cholesterol. Henslee was diagnosed with prostate cancer in December 2007, and, at the time of trial, he had received 47 radiation treatments. Henslee gets hormone injections on a regular basis and if his radiation treatments are not successful, he will have to have surgery. Henslee is on medication for his prostate, vertigo, high cholesterol, depression, high blood pressure, and allergic rhinitis. Henslee also takes ibuprofen for pain and Ambien to sleep.

Henslee is undergoing treatment for depression. Henslee's depression renders him unable to secure work. If Henslee secures work earning an income sufficient to support himself, he will lose the medical coverage currently provided to him by Medicaid and the Harris County Hospital District and will become unable to continue his cancer treatments, which he believes cost $50,000.

II. Law

> Bankruptcy Code section 523(a)(8) provides:
>
> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt—
>
> (8) unless excepting such debt from discharge under this paragraph would impose an undue hardship on the debtor and the debtor's dependents, for—
>
> (A)(1) an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution; or

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> (ii) an obligation to repay funds received as an educational benefit, scholarship, or stipend; or
>
> (B) any other educational loan that is a qualified education loan, as defined in section 221(d)(1) of the Internal Revenue Code of 1986, incurred by a debtor who is an individual...

11 U.S.C. 523(a)(8).

The Fifth Circuit has held that to discharge student loans under 11 U.S.C. 523(a)(8), the debtor must prove:

> (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for [himself] and [his] dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor has made good faith efforts to repay the loans.

In re Gerhardt, 34,8 F.3d 89 (5th Cir. 2003) (quoting Brunner v. New York State Higher Hdnc Serv. Corp.. 831 F.2d 395, 396 (2d Cir. 1987).

Henslee's monthly expenses exceed his monthly income. The Court finds that Henslee cannot maintain, based on current income and expenses, a minimal standard of living for himself if forced to repay his student loans.

The Court finds that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans and that Henslee has a total incapacity in the future to pay his debts for reasons not within his control. Those additional circumstances include, but are not limited to: (1) Henslee's cancer, diagnosed after he had incurred the student loans at issue, (2) Henslee's cancer treatments which are available to him only by virtue of his eligibility for a Harris County Gold Card, which bases eligibility on income, (3) the destruction of Henslee's home and personal belongings by Hurricane Ike in September 2008, and

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(4) Henslee's deteriorated psychiatric condition which renders him unable to work. The Court finds that in light of Henslee's exceedingly low income, his offer to repay his student loans at $5 per month is a good-faith effort to repay his loans. Based on the foregoing, it is

ORDERED that the student loans owed by William Anthony Henslee are **DISCHARGED.**

Notes:

1. Henslee's parole continues through 2011. Subject to good time off, it is anticipated to end on June 25, 2009.

Income Based Repayment Questions and Answers (Q&As)

Prepared by Federal Student Aid
U.S. Department of Education
January 5, 2010

The Questions & Answers (Q&As) that follow provide information about the Income Based Repayment (IBR) Plan that is available to most borrowers of federal student loans. We have grouped the Q&As into six categories: General Information, Eligible Loans, Determination of IBR Monthly Payment Amount, Married Borrowers, Application Process, and Other Information. Note that following each answer is the date when we posted that response. We will include a new date each time we add a question or when we update a previously posted response.

Income Based Repayment – General Information

Q1 What is Income Based Repayment?

A1 Income Based Repayment (IBR) is one of several repayment plan options for borrowers of student loans made under the William D. Ford Federal Direct Loan (Direct Loan) Program or the Federal Family Education Loan (FFEL℠) Program. If you qualify for IBR, your required monthly payment will be capped at an amount that is intended to be affordable based on your income and family size, and will be less than what you would have to pay under a 10-year Standard Repayment Plan. [January 5, 2010]

Q2 What are the major benefits of IBR?

A2 In addition to making your monthly loan payments more affordable, the IBR Plan offers other benefits:

- If your IBR payment amount does not cover the full amount of interest that accrues on your loans each month, the government will pay any unpaid, accrued interest on your subsidized loans for up to three consecutive years from the date you begin repaying the loans under IBR. (You are responsible for paying the interest that accrues on your unsubsidized loans during this 3-year period.)
- If you repay under IBR and meet certain other requirements, any remaining loan balance that you owe will be cancelled after 25 years.
- Payments that you make under IBR count toward the 120 payments that are required for the Direct Loan Public Service Loan Forgiveness (PSLF) Program. [January 5, 2010]

Q3 What is the difference between Income Based Repayment (IBR) and Income Contingent Repayment (ICR)?

A3 IBR and ICR share certain features, but there are also important differences between the two repayment plans.

Similarities between IBR and ICR include the following:

- Both plans are intended to provide borrowers with an affordable monthly payment amount based on income and family size.
- Under both plans, any remaining loan balance is forgiven after 25 years.
- Parent PLUS Loans may not be repaid under either IBR or ICR.

- Payments made by a Direct Loan borrower under both IBR and ICR count toward the 120 payments that are required for Public Service Loan Forgiveness.

- In both IBR and ICR, your monthly payment amount may be adjusted annually based on changes in your income.

These are some of the major differences between IBR and ICR:

- IBR is available under both the FFEL and Direct Loan programs. ICR is available only under the Direct Loan Program^SM.

- To initially qualify for IBR, you must have a "partial financial hardship" as described in Q&A #4. There is no comparable requirement for ICR. Any Direct Loan borrower (other than a parent PLUS borrower) may choose ICR.

- The amount of your loan debt is not considered in determining your IBR payment amount *during any period when you have a "partial financial hardship" (See Q&A #4)*. Your monthly IBR payment amount is determined based only on your income and family size. In contrast, the monthly payment under ICR takes into account your total Direct Loan debt in addition to income and family size. The required monthly payment under ICR is generally higher than under IBR, and in some cases it may be higher than the monthly payment amount under a 10-year standard repayment plan.

- With both IBR and ICR, your calculated monthly payment may not cover the full amount of interest that accrues on your loans each month. Under IBR, the government pays the remaining unpaid accrued interest on your subsidized loans for up to three consecutive years from the date you begin repaying the loans under IBR. This benefit is not available under ICR. Under ICR, you are responsible for paying all of the interest that accrues on your loans.

- Under IBR, unpaid interest is capitalized (added to your loan principal balance) only if you are determined to no longer have a "partial financial hardship", or if you choose to leave the IBR Plan. Under ICR, unpaid interest is capitalized annually. [January 5, 2010]

Q4 How do I qualify for IBR?

A4 To qualify for IBR, you must have a "partial financial hardship." You have a partial financial hardship if the monthly amount you would be required to pay on your IBR-eligible loans (see Q&A #6) under a Standard Repayment Plan with a 10-year repayment period (based on the amount you owed on those loans when they initially entered repayment) is higher than the monthly amount you would be required to repay under IBR.

For example, if you owed a total of $40,000 in eligible student loans when the loans initially entered repayment, your monthly repayment amount under a 10-year Standard Repayment Plan would be $460 (using an interest rate of 6.8%). If your IBR payment amount (calculated as explained in Q&A #11), is less than $460, you would be eligible to repay your loans under IBR. [January 5, 2010]

Q5 How can I determine if I qualify for the IBR Plan? Where can I get an estimated IBR monthly payment amount?

A5 The U.S. Department of Education's Student Aid on the Web Web site at www.studentaid.ed.gov includes an IBR calculator at http://studentaid.ed.gov/PORTALSWebApp/students/english/IBRCalc.jsp. The IBR calculator allows you to determine whether you are likely to qualify for the IBR Plan, and to estimate what your IBR monthly payment would be. However, for an official determination of your eligibility for IBR, or to apply for IBR, you'll need to contact your loan servicer. Direct Loan borrowers may get additional information at www.dl.ed.gov. If you are unsure who holds your loans or who your loan servicer is, you can access the Department of Education's National Student Loan Data System[SM] (NSLDS[SM]) Web site at www.nslds.ed.gov. [January 5, 2010]

Income Based Repayment – Eligible Loans

Q6 Which Direct Loan or FFEL loan types can be repaid under IBR?

A6 All Direct Loan and FFEL loan types *except* PLUS loans made to parents, consolidation loans that repaid PLUS loans made to parents, or defaulted loans may be repaid under IBR. [January 5, 2010]

Q7 Are private loans taken into account when determining eligibility for IBR, and can private loans be paid under IBR?

A7 Only non-defaulted federal loans made through the FFEL Program or the Direct Loan Program (excluding PLUS loans made to parent borrowers or consolidation loans that repaid parent PLUS loans) are used to determine eligibility for IBR and only those types of federal loans may be repaid under IBR. [January 5, 2010]

Q8 I consolidated my Stafford loans together with parent PLUS loans that I took out to pay for my child's education. I know that parent PLUS loans may not be repaid under IBR, but am I eligible for IBR on the portion of the consolidation loan that repaid my Stafford loans?

A8 A consolidation loan that repaid a parent PLUS loan may not be repaid under IBR even if the consolidation loan also repaid one or more Stafford Loans. [January 5, 2010]

Q9 I consolidated my eligible federal student loans with a private lender into a private consolidation loan. Are those loans still considered eligible loans for purposes of determining my eligibility for IBR?

A9 Eligible federal student loans that have been consolidated with a private lender are no longer federal loans and therefore are not considered when determining your eligibility for IBR, and may not be paid under IBR. [January 5, 2010]

Q10 If my loan is in default, can I repay it under IBR?

A10 Defaulted loans are not eligible for repayment under IBR. [January 5, 2010]

Income Based Repayment – Determination of IBR Monthly Payment Amount

Q11 How is the IBR monthly payment amount determined?

A11 The IBR monthly payment amount is based on your annual Adjusted Gross Income (AGI) and family size. Specifically, the maximum annual amount you are required to repay under IBR during any period when you have a "partial financial hardship" (as discussed in Q&A #4 above) is 15 percent of the difference between your AGI and 150 percent of the U.S. Department of Health and Human Services' (HHS) Poverty Guideline amount for your family size. This annual repayment amount is then divided by 12 to determine your monthly IBR repayment amount.

For example, 150 percent of the 2009 HHS poverty guideline amount for a family of three is $27,465. If your AGI was $40,000, the difference would be $12,535. Fifteen percent of that is $1,880; dividing this amount by 12 results in a monthly IBR payment amount of $157. As noted in Q&A #4 above, this compares with a monthly payment amount of $460 under a 10-year Standard Repayment Plan. If the calculated IBR payment amount using this formula is less than $5.00, the monthly payment amount is zero. If the calculated payment is more than $5.00 but less than $10.00, the monthly payment is $10.00. [January 5, 2010]

Q12 Paying less each month under IBR seems like a good thing. Using the above example in Q&A #11, are there any downsides to paying less each month under IBR as compared to repaying under the 10-year Standard Repayment Plan.

A12 As with any loan or credit program, having a lower monthly payment normally means that payments will be made for a longer period of time. This means that you will pay more total interest under IBR than you would pay under a 10-year Standard Repayment Plan. This is why it is important for each borrower to carefully evaluate whether IBR is the best repayment plan. [January 5, 2010]

Q13 I claim my child every other year on my taxes as a dependent, but my ex-spouse has physical custody. I also pay child support and health insurance for my child. Do I count my child when reporting my family size?

A13 The IBR definition of family size specifies that a borrower's children are included if the child receives more than half of their support from the borrower. You may count your child when determining your family size if you provide more than half of the child's financial support, regardless of who claims the child for tax purposes or who has physical custody. If you do not provide more than one-half of your child's support you may not include the child in your family size for IBR purposes. [January 5, 2010]

Q14 Will I always pay the same amount each month under IBR?

A14 Each year, your loan holder will review your current income and family size. If your income or family size has changed from the prior year, your monthly IBR payment amount may increase or decrease as a result of using the new income or family size information in the calculation described in Q&A 11 above. [January 5, 2010]

Q15 What happens if my income increases so much that I no longer have a "partial financial hardship" as described in Q&A #4 above? Do I then lose eligibility to repay under IBR?

A15 If your IBR payment amount increases to the point where it is more than the monthly amount you would be required to repay under a 10-year Standard Repayment Plan, you would no longer be considered to have a "partial financial hardship. In this situation, you may remain on the IBR Plan (to take advantage of some of the other IBR benefits, as described in Q&A #2), but your monthly payment will no longer be based on your income. Instead, you will be required to pay the amount you would have been required to pay under a 10-year Standard Repayment based on the amount of your eligible loans that were outstanding when you began repaying under IBR. Your repayment period based on this recalculated amount may be more than 10 years. [January 5, 2010]

Q16 If I am repaying under IBR and my income increases so that I no longer have a partial financial hardship, but I stay in IBR and make the required, recalculated 10-year standard payment amount, is it still possible for me to receive loan forgiveness after 25 years?

A16 As long as you remain on the IBR Plan (even if you no longer have a partial financial hardship) and you otherwise meet the requirements for loan forgiveness, you will qualify for forgiveness of any remaining loan balance at the end of the 25-year period. [January 5, 2010]

Q17 What happens if, after it is determined that I no longer have a "partial financial hardship" and I am no longer making income-based payments (as explained in Q&A #15), my income goes down?

A17 If your income later decreases so that your calculated IBR payment amount is once again less than what you would be required to repay under a 10-year Standard Repayment Plan, you will return to making income-based payments, as described in Q&A #11 above.

Q18 If my income goes down after I filed my most recent federal tax return (for example, because I lost my job or am now working part time), does my loan holder have discretion to use my current income to determine my IBR payment amount, rather than the higher AGI amount that is shown on my most recent tax return?

A18 If your loan holder believes that your most recent AGI does not reasonably reflect your current income, your loan holder is authorized to use alternative documentation of your income that you provide. You should inform your loan holder of the change in your financial circumstances. [January 5, 2010]

Q19 What happens if my income as reported on my federal tax return changes after I begin repaying under IBR?

A19 As long as you remain on the IBR Plan, your loan holder will annually review your current income to determine whether you continue to have a "partial financial hardship" and, if applicable, to adjust your monthly IBR payment amount. If your income increases or decreases there will generally be a corresponding increase or decrease in your required monthly payment amount. [January 5, 2010]

Q20 What happens if my income significantly decreases well before the regularly scheduled annual review of my income? Do I have to wait until the annual review before my IBR payment can be adjusted?

A20 You should alert your loan holder to your changed circumstances. If your loan holder believes that your AGI does not reasonably reflect your current income, your loan holder is authorized to use alternative documentation of your income that you provide, and may adjust your required monthly IBR payment at any time during the year based on that documentation. [January 5, 2010]

Q21 Do Social Security disability payments count as income for IBR?

A21 Social Security disability payments would be counted as income only if they are included as part of your AGI on your federal tax return in accordance with IRS requirements. [January 5, 2010]

Q22 I have loans with more than one lender. How does each lender determine if I have a partial financial hardship, as discussed in Q&A #2, and if I have a partial financial hardship, how is my IBR payment calculated by each lender?

A22 If you wish to repay all of your loans under IBR, you must apply to each lender/servicer separately. When you apply each lender will use the full amount of all of your eligible loans to determine if you have a partial financial hardship, even if some of the loans are held by other lenders. Each lender will adjust your IBR payment amount by multiplying your calculated IBR payment by the percentage of the total outstanding principal amount of your eligible loans that are held by that loan holder. For example, if 60% of your total outstanding eligible loan balance is held by Lender A and 40% is held by Lender B, and your calculated monthly IBR payment amount is $140, you would be required to pay $84 per month to Lender A and $56 to Lender B. [January 5, 2010]

Income Based Repayment Questions and Answers (Q&As)

Income Based Repayment – Married Borrowers

Q23 Is my spouse's income included in the determination of my eligibility for IBR?

A23 Under the current IBR regulations, if you are married and file a joint federal tax return and you and your spouse both have eligible student loans, your eligibility for IBR will be determined separately based on your joint income. However, only your own individual eligible loan debt will be considered. For married borrowers who file separate federal tax returns, IBR eligibility is determined based on each individual spouse's income and eligible loan debt.

Under changes made to the IBR regulations that will take effect July 1, 2010, married borrowers who file joint tax returns and who both have eligible student loan debt will have their individual IBR eligibility determined based on their joint income and the combined eligible loan debt of both spouses. [January 5, 2010]

Q24 My spouse and I file a joint federal tax return, but my spouse does not have any IBR eligible student loans. Can my spouse's other indebtedness be included in determining my IBR legibility?

A24 Only eligible federal student loan debt is taken into consideration when determining your eligibility for IBR. Private loans and non-loan debt (either yours or your spouse's) are not considered. In addition, if you are married and file a joint federal tax return with your spouse, only your own eligible student loan debt is a factor in determining IBR eligibility under current regulations. See Q&A #23. [January 5, 2010]

Q25 My spouse and I have a joint consolidation loan. My spouse is not employed, but the majority of the joint consolidation loan is attributable to loans that were originally borrowed by my spouse. Will the fact that my spouse has no income be considered when determining our eligibility to repay the joint consolidation loan under IBR?

A25 If you and your spouse file a joint federal tax return, your combined income will be used to determine your eligibility for IBR and your IBR payment amount. Joint consolidation loan borrowers must each request IBR since both individuals are jointly responsible for the full amount of the loan. Each borrower's eligibility for IBR is determined using joint income, the same family size, and the full amount of the joint consolidation loan. [January 5, 2010]

Q26 My spouse and I have separate student loans, and my spouse's calculated IBR monthly payment amount is $40/month. Does that payment also cover my student loans?

A26 Spouses must apply separately for determination of eligibility for IBR and for calculation of each spouse's IBR payment amount. [January 5, 2010]

Q27 My spouse and I want to consolidate our loans together into a single joint consolidation loan and then apply for IBR. Is that possible?

A27 The law no longer allows married borrowers to consolidate their loans together into a single joint consolidation loan. If you want to repay under IBR, you and your spouse must apply separately to your individual loan holders. [January 5, 2010]

Income Based Repayment Questions and Answers (Q&As)

Income Based Repayment – Application Process

Q28 How do I apply for IBR?

A28 You must contact each of the servicers that service your loans to apply for IBR. Direct Loan borrowers can go to www.dl.ed.gov. If you are unsure who holds your loans or who your loan servicer is, you can access the U.S. Department of Education's National Student Loan Data System (NSLDS) Web site at www.nslds.ed.gov. [January 5, 2010]

Q29 How long will it take my loan servicer to process my IBR application and determine if I am eligible to repay my student loans under IBR?

A29 The time varies, but it may take a few weeks since the servicer will need to obtain documentation of your income and family size. If you can't afford to continue making loan payments under your current repayment plan while your IBR application is being processed, contact your loan holder to discuss options such as a deferment or forbearance. [January 5, 2010]

Q30 How will my loan servicer get the income and family size information it will need to determine if I am eligible for IBR, and if I am eligible, how much my monthly payment amount will be?

A30 Each loan servicer will have its own documentation process. However, you will be required to either submit copies of your most recent IRS tax return and/or a release form for the loan servicer to obtain your tax information directly from the IRS. [January 5, 2010]

Q31 If I am providing a tax return to my loan holder, does it have to include an original signature, or is a photocopy of my signed return acceptable?

A31 An original signature is not required. You may provide your loan holder with a photocopy of the original signed tax return that you submitted to the IRS. If your copy of your tax return was not signed (for example, if you submitted an electronic return), you may print a copy of the return, sign it, and then submit the signed return (or a photocopy) to your loan holder. Most lenders will also allow you to submit your return by fax or by e-mailing a scanned copy of the signed return. [January 5, 2010]

Income Based Repayment – Other Information

Q32 Is it true that if I am repaying under IBR and I receive an economic hardship deferment, I will lose eligibility for IBR because I am no longer in repayment?

A32 If you are repaying your loans under IBR and you receive an economic hardship deferment (or any other type of deferment or forbearance), you are still considered to be in repayment under IBR. A deferment or forbearance simply allows you to temporarily stop making payments and does not affect your eligibility to remain on the IBR Plan or any other repayment plan. [January 5, 2010]

Q33 Can I apply for IBR while I am in an economic hardship deferment?

A33 You may apply for IBR during a period of economic hardship deferment, or during a period of any other type of deferment or forbearance. However, you would not begin making payments under IBR until the end of the deferment or forbearance period. [January 5, 2010]

Income Based Repayment Questions and Answers (Q&As)

Q34 Because I was in deferment and forbearance status for a number of years, my outstanding principal balance owed is now much higher than the original amount I borrowed as a student. My income is very low. If I start repaying my loans under IBR, will any of my past payments and periods of deferment or forbearance count toward the 25 years of repayment under IBR that are required to receive forgiveness of my remaining loan balance?

A34 Generally, payments or periods of economic hardship deferment before July 1, 2009 (the date IBR first became available) do not count toward the 25-year period necessary for forgiveness of any remaining loan balance under IBR. However, if you made payments under the Direct Loan Program's Income Contingent Repayment (ICR) Plan at any time before entering IBR, the 25-year period would begin on the date you began making payments under ICR. [January 5, 2010]

Q35 Q&A #2 stated that the government may pay some of the interest on my subsidized loans for the first 3 years. How does this work?

A35 Under the IBR Plan, your monthly payment amount may not cover all of the interest that accrues on your loans each month. (This is called negative amortization.) If this happens, the government will pay the remaining unpaid accrued interest that is due each month on your subsidized loans (including the subsidized portion of a consolidation loan) for up to three consecutive years from the date you begin repaying your loans under IBR. For example, if the monthly interest that accrues on your subsidized loans is $40, but your monthly IBR payment only covers $25 of this amount, the government will pay the remaining $15.

You are responsible for paying all of the interest that accrues on your unsubsidized loans, as well as all of the interest that accrues on your subsidized loans after the end of the 3-year interest subsidy period. Interest that is not covered by your monthly payment will continue to accumulate and will be capitalized (added to your loan principal balance) when you are determined to no longer have a "partial financial hardship", or if you leave the IBR Plan.

The interest subsidy benefit for subsidized loans applies only for the first three consecutive years beginning on the date you enter IBR. Periods of economic hardship deferment are not included in the consecutive 3-year period, but periods of any other type of deferment or forbearance are counted. For example, if you receive the interest subsidy benefit for your first year of repayment under IBR, and then receive an economic hardship deferment for two years, you would still have two consecutive years of remaining eligibility for the interest subsidy benefit when the economic hardship deferment ends. However, if instead of receiving an economic hardship deferment, you return to school and receive an in-school deferment for two years following your first year of repayment under IBR, you would have no remaining eligibility for the interest subsidy benefit at the end of the deferment period. [January 5, 2010]

Q36 Does IBR have any effect on the 6-month grace period for my Stafford Loans?

A36 Choosing IBR (or any other repayment plan) has no effect on your 6-month grace period. You do not enter repayment until after your grace period has ended. If you want to repay your loans under IBR when you enter repayment, you should apply for IBR at least two months before the end of your grace period to allow time for application processing. [January 5, 2010]

Q37 Will my choice to repay my loans under IBR affect the interest rate of my loans?

A37 Your choice of repayment plan, including IBR, does not affect the interest rate of your loans. However, with IBR or any repayment plan that provides for a longer repayment period, you may pay more interest over the life of your loans. [January 5, 2010]

Income Based Repayment Questions and Answers (Q&As)

Q38 If I repay under IBR, will this affect my credit score or show up on my credit report?

A38 The repayment plan that you select is not reported to credit bureaus and has no effect on your credit score. However, your loan will be identified on your credit report as a student loan, and your loan holder will report the status of your loan account (e.g., whether you are repaying on time or are delinquent or in default) to credit reporting organizations. Failure to repay your student loans on time may negatively affect your credit score. [January 5, 2010]

Q39 Can I claim student loan interest that I paid under IBR on my tax return?

A39 Regardless of your repayment plan, under current federal tax law you may deduct interest that you paid on qualified student loans in accordance with IRS rules. Your lender will send you a Form 1098-E showing the amount of interest that you paid. However, you are responsible for monitoring IRS materials and Web sites for any changes in federal tax law. [January 5, 2010]

Q40 I have both Stafford and Graduate PLUS loans. My Stafford loans are in grace and I have been making payments on the Graduate PLUS loans. Should I apply for a deferment on my Graduate PLUS loans until the grace period ends on my Stafford loans before entering IBR? How would this affect payments already made on my Graduate PLUS loans?

A40 If you are having difficulty making payments on your Graduate PLUS loans, you may request a deferment or forbearance on the repayment of those loans. You could then request the IBR Plan for all of your loans at the time when the grace period ends on your Stafford Loans. Note that only payments that you made on your Graduate PLUS Loans after July 1, 2009 will count toward the 25 years of qualifying payments for IBR loan forgiveness.

If you request IBR on your Graduate PLUS loans now and then begin repaying your Stafford Loans under IBR when they enter repayment at the end of the grace period, the 25-year period for IBR loan forgiveness will be tracked separately for the two loan types. [January 5, 2010]

Q41 When I make my required monthly IBR payment, can I specify how I want the payment to be applied between my subsidized and unsubsidized loans? For example, can I specify that I want all of my payment to be applied to my unsubsidized loans?

A41 You may not specify how payments are to be applied. If you have both subsidized and unsubsidized loans, your monthly payments will be applied proportionately to both loan types. [January 5, 2010]

Q42 If I am not making my minimum required monthly payment, am I eligible to remain on the IBR Plan?

A42 As with any other repayment plan, you are required to make the full required IBR payment each month, unless you have received a deferment or forbearance. While failure to make a full required payment will not automatically remove you from IBR, it could result in delinquency or default. Defaulted loans are not eligible for IBR or any other regular repayment plan. [January 5, 2010]

Q43 What are the penalties for late payments in the IBR program?

A43 Regardless of which repayment plan you choose, you are expected to make on-time payments. If you are delinquent in making payments, your loan holder may charge late fees in accordance with the terms and conditions of your promissory note. Late payments will not terminate your eligibility for IBR, but there may be other adverse consequences such as negative reporting to credit bureaus. Also, if you are repaying under IBR and planning to apply for Public Service Loan Forgiveness (PSLF), only on-time payments (made within 15 days of the payment due date) may be counted toward the required 120 PSLF payments. [January 5, 2010]

I

112TH CONGRESS
1ST SESSION

H. R. 2028

To amend title 11 of the United States Code to modify the dischargeability of debts for certain educational payments and loans.

IN THE HOUSE OF REPRESENTATIVES

MAY 26, 2011

Mr. COHEN (for himself, Mr. DAVIS of Illinois, Mr. CONYERS, Mr. GEORGE MILLER of California, Mr. GRIJALVA, Mr. ACKERMAN, Mr. BERMAN, Mr. TOWNS, Ms. MOORE, Mr. BISHOP of New York, Mr. DOYLE, Mr. STARK, Mr. JOHNSON of Georgia, Mr. RYAN of Ohio, Mr. WATT, Ms. CHU, and Mr. POLIS) introduced the following bill; which was referred to the Committee on the Judiciary

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A BILL

To amend title 11 of the United States Code to modify the dischargeability of debts for certain educational payments and loans.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Private Student Loan Bankruptcy Fairness Act of 2011".

SEC. 2. EXCEPTIONS TO DISCHARGE.

Section 523(a)(8) of title 11, United States Code, is amended—

(1) by striking subparagraph (B), and

(2) in subparagraph (A)—

(A) in clause (i)—

(i) by striking "(i)", and

(ii) by inserting "any program for which substantially all of the funds are provided by a" after "unit or", and

(B) in clause (ii)—

(i) by striking "(ii)" and inserting "(B)", and

(ii) by striking "or" at the end.

SEC. 3. EFFECTIVE DATE; APPLICATION OF AMENDMENTS.

(a) EFFECTIVE DATE.—Except as provided in subsection (b), this Act and the amendments made by this Act shall take effect on the date of the enactment of this Act.

(b) APPLICATION OF AMENDMENTS.—The amendments made by this Act shall apply only with respect to cases commenced under title 11 of the United States Code on or after the date of the enactment of this Act.

○

II

112TH CONGRESS
1ST SESSION

S. 1102

To amend title 11, United States Code, with respect to certain exceptions to discharge in bankruptcy.

IN THE SENATE OF THE UNITED STATES

MAY 26, 2011

Mr. DURBIN (for himself, Mr. FRANKEN, and Mr. WHITEHOUSE) introduced the following bill; which was read twice and referred to the Committee on the Judiciary

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A BILL

To amend title 11, United States Code, with respect to certain exceptions to discharge in bankruptcy.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Fairness for Struggling Students Act of 2011".

SEC. 2. EXCEPTIONS TO DISCHARGE.

Section 523(a)(8) of title 11, United States Code, is amended by striking "dependents, for" and all that follows through the end of subparagraph (B) and inserting "dependents, for an educational benefit overpayment or loan made, insured, or guaranteed by a governmental unit or made under any program funded in whole or in part by a governmental unit or an obligation to repay funds received from a governmental unit as an educational benefit, scholarship, or stipend;".

○

National Association of Consumer Bankruptcy Attorneys

STUDENT LOAN DEBT CRISIS SURVEY

February 7, 2012

METHODOLOGY

During January 2012, the National Association of Consumer Bankruptcy Attorneys (NACBA) invited more than 4500 of its members to participate in an online survey. With 860 completed responses tallied, the online survey attracted a high percentage (19 percent) of potential respondents.

The full survey questions and responses are set out in this document.

HIGHLIGHTS OF SURVEY FINDINGS

- More than four out of five (81 percent) bankruptcy attorneys say that potential clients with student loan debt have increased "significantly" or "somewhat" in the last three-four years. Overall, about half (48 percent) of bankruptcy attorneys reported significant increases in such potential clients.
- Nearly two out of five (39 percent) of bankruptcy attorneys have seen potential student loan client cases jump 25-50 percent in the last three-four years. About a quarter (23 percent) of bankruptcy attorneys have seen such cases jump by 50 percent to more than 100 percent.
- Most bankruptcy attorneys (95 percent) report that few student loan debtors are seen as having any chance of obtaining a discharge as a result of undue hardship.
- More than four out of five (82 percent) bankruptcy attorneys see the limited availability of student loan discharge in bankruptcy as "a big problem" barring a fresh start for clients.
- Seven out of 10 bankruptcy attorneys see the lack of ability to separately classify student loans debts for debtors using chapter 13 as a "big problem."
- Nearly two out of three bankruptcy attorneys (65 percent) say that student loan provider debt collections have become "much more" or "somewhat more" aggressive in the last 18 months.
- More than three out of five (61 percent) of bankruptcy attorneys dealing with potential student loan debtor clients have seen cases of debts more than 15 years old still being pursued.

SurveyMonkey

1. During the past 3-4 years, what has been your experience in dealing with potential clients with student loan debt:

	Response Percent	Response Count
Significantly increased	47.5%	404
Somewhat increased	33.3%	283
Somewhat decreased	0.2%	2
Significantly decreased	0.5%	4
Stayed the same	14.8%	126
Don't know, not sure	3.6%	31
Other (please specify)		18
answered question		**850**
skipped question		**10**

2. What is the typical age of potential clients with unmanageable student loan debt?

	0-25%	26-50%	51-75%	75-100%	Response Count
20-25	**60.1% (265)**	28.8% (127)	7.9% (35)	3.2% (14)	441
26-35	17.5% (114)	**51.4% (335)**	27.9% (182)	3.2% (21)	652
36-45	27.7% (165)	**49.4% (294)**	19.7% (117)	3.2% (19)	595
46-55	**55.9% (223)**	30.6% (122)	10.3% (41)	3.3% (13)	399
56-65	**79.4% (220)**	13.0% (36)	5.1% (14)	2.5% (7)	277
65+	**93.0% (200)**	3.7% (8)	0.9% (2)	2.3% (5)	215
Don't know, not sure	**60.0% (30)**	8.0% (4)	0.0% (0)	32.0% (16)	50
				Other (please specify)	24
				answered question	**780**
				skipped question	**80**

3. Among potential clients with unmanageable student loan debt, the percentages who attended the following types of schools are:

	0-25%	26-50%	51-75%	76-100%	Response Count
For-profit schools (cosmetology, truck-driving, on-line etc.)	**42.2% (258)**	31.6% (193)	21.1% (129)	5.1% (31)	611
Not-for-profit colleges and universities	11.8% (77)	28.0% (183)	**38.9% (254)**	21.3% (139)	653
Don't know/not sure	**48.3% (72)**	16.1% (24)	6.7% (10)	28.9% (43)	149
				Other (please specify)	11
				answered question	**781**
				skipped question	**79**

4. Over the past 3-4 years, if you have seen an increase in the number of potential clients with unmanageable student loan debt, would you say it as been:

	Response Percent	Response Count
10-25% increase	20.2%	155
26-50% increase	**39.9%**	**306**
51-100% increase	17.2%	132
Over 100% increase	5.6%	43
Did not see an increase	9.1%	70
Don't know, not sure	7.8%	60
Other (please specify)		15
answered question		**766**
skipped question		**94**

5. How much does the typical potential client with student loan debt have in outstanding student loan debt ?

	0-25% of clients	26-50% of clients	51-75% of clients	76-100% of clients	Response Count
Under $10,000	**85.1% (268)**	12.4% (39)	2.2% (7)	0.3% (1)	315
$10,000 - $25,000	38.4% (188)	**47.6% (233)**	12.4% (61)	1.6% (8)	490
$25,999 - $50,000	23.5% (147)	**51.2% (320)**	21.9% (137)	3.4% (21)	625
$50,999 - $100,000	**45.9% (236)**	33.3% (171)	16.7% (86)	4.1% (21)	514
Over $100,000	**75.4% (270)**	12.3% (44)	7.8% (28)	4.5% (16)	358
Don't know/not sure	**66.7% (18)**	11.1% (3)	0.0% (0)	22.2% (6)	27
				Other (please specify)	8
				answered question	**763**
				skipped question	**97**

6. Please indicate the percentages of potential clients with unmanageable student loan debt by employment status:

	0 - 25% of clients	26 - 50% of clients	51 - 75% of clients	75 - 100% of clients	Response Count
Employed	22.9% (149)	**37.6% (245)**	28.4% (185)	11.1% (72)	651
Unemployed/seeking employment	**53.7% (324)**	37.3% (225)	7.8% (47)	1.2% (7)	603
Underemployed	35.8% (207)	**40.5% (234)**	19.6% (113)	4.2% (24)	578
Still in school	**87.5% (260)**	11.1% (33)	0.3% (1)	1.0% (3)	297
Don't know/not sure	**80.4% (37)**	8.7% (4)	0.0% (0)	10.9% (5)	46
				Other (please specify)	13
				answered question	**748**
				skipped question	**112**

7. Please indicate the percentage of your potential clients who, with or without your help, tried to get an undue hardship discharge of their student loans:

	0-25% of clients	26-50% of clients	51-75% of clients	76-100% of clients	Response Count
Tried	**78.4% (330)**	10.9% (46)	5.7% (24)	5.0% (21)	421
Did Not Try	15.4% (82)	4.5% (24)	19.2% (102)	**60.8% (323)**	531
Don't know/not sure	**57.6% (102)**	10.2% (18)	5.6% (10)	26.6% (47)	177
				Other (please specify)	18
				answered question	**743**
				skipped question	**117**

8. How many of your potential clients who are student loan debtors have a good chance of obtaining an undue hardship discharge?

	Response Percent	Response Count
All or nearly all of them	0.5%	4
Most of them	2.5%	19
Few of them	20.2%	151
None or nearly none of them	**73.8%**	**551**
Don't know/not sure	2.9%	22
Other (please specify)		30
answered question		**747**
skipped question		**113**

9. Have you seen any potential clients being pursued for student loans that are more than 15 years old?

	Response Percent	Response Count
Yes	**60.7%**	**455**
No	19.9%	149
Don't know/not sure	19.4%	145
Other (please specify)		5
answered question		**749**
skipped question		**111**

10. What statement best represents your experience of the collection efforts of student loan providers during the past 18 months:

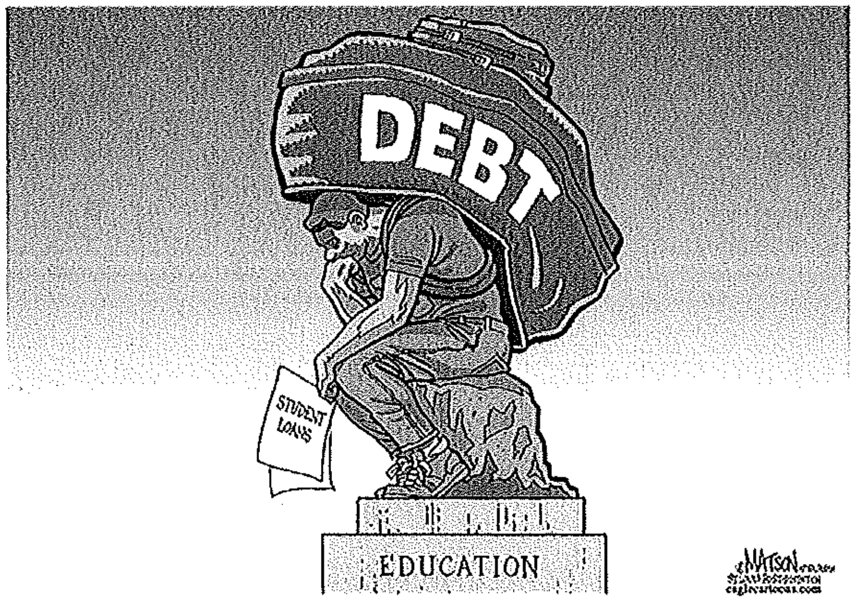
	Response Percent	Response Count
Much more aggressive	32.1%	239
Somewhat more aggressive	**33.2%**	**247**
About the same	25.1%	187
Somewhat less agressive	1.3%	10
Much less aggressive	0.4%	3
Don't know/not sure	7.9%	59
Other (please specify)		10
answered question		**745**
skipped question		**115**

11. How would you rank the limited availability of the student loan discharge in bankruptcy as a barrier to a fresh start for clients?

	Response Percent	Response Count
A big problem	82.3%	612
Somewhat problematic	15.9%	118
Not problematic	1.2%	9
Don't know/not sure	0.7%	5
Other (please specify)		15
answered question		744
skipped question		116

12. How would you rank the lack of ability to separately classify student loans debts for debtors using chapter 13?

	Response Percent	Response Count
A big problem	70.2%	518
Somewhat problematic	22.6%	167
Not problematic	1.8%	13
Don't know/not sure	5.4%	40
Other (please specify)		24
answered question		738
skipped question		122



THE STUDENT LOAN "DEBT BOMB": AMERICA'S NEXT MORTGAGE-STYLE ECONOMIC CRISIS?

A Report Prepared for the
National Association of Consumer Bankruptcy Attorneys (NACBA)

February 7, 2012

EXECUTIVE SUMMARY

Americans now owe more on student loans than on credit cards.

The amount of student borrowing crossed the $100 billion threshold for the first time in 2010 and total outstanding loans and exceeded $1 trillion for the first time last year. The reason: Students and workers seeking retraining are borrowing extraordinary amounts of money through federal and private loan programs to help cover the rising cost of college and training. In many cases, parents responsible for the student loans are in or near retirement years and facing repayment demands.

How big is the danger to the U.S. economy? "Evidence is mounting that student loans could be the next trouble spot for lenders," said Dr. Andrew Jennings, chief analytics officer at FICO and head of FICO Labs.

Consider the facts:

- Individually, college seniors who graduated with student loans in 2010 owed an average of $25,250, up five percent from the previous year.

- Borrowing has grown far more quickly for those in the 35-49 age group, with school debt burden increasing by a staggering 47 percent.

- Students are not alone in borrowing at record rates, so too are their parents. Loans to parents for the college education of children have jumped 75 percent since the 2005-2006 academic year.

- Parents have an average of $34,000 in student loans and that figure rises to about $50,000 over a standard 10-year repayment period. An estimated 17 percent of parents whose children graduated in 2010 took out loans, up from 5.6 percent in 1992-1993.

- Of the Class of 2005 borrowers who began repayments the year they graduated, one analysis found 25 percent became delinquent at some point and 15 percent defaulted. The Chronicle of Education puts the default rate on government loans at 20 percent.

With rising debt comes increased risk, both to borrowers and to the economy in general. Even in the best of economic times when jobs are plentiful, young people with considerable debt burdens end up delaying life-cycle events such as buying a car, purchasing a home, getting married and having children. Piling up student loans in middle age is even more troublesome. Aside from the simple truth that there is less time to earn back the money, it also means facing retirement years still deeply in debt. And, parents who take out loans for children or co-sign loans will find those loans more difficult to pay as they stop working and their incomes decline.

This concern is echoed by bankruptcy attorneys from across the country who report that what they are seeing at the ground level feels too much like what they saw before the foreclosure crisis crashed onto the national scene: more and consumers seeking their help with unmanageable student loan debt, and with no relief available.

UNDERSTANDING THE STUDENT LOAN "DEBT BOMB"

Most Americans see a college degree as the single most important factor for financial success and a place in the middle class. Post-secondary education and training have become essential not only to the individuals hoping to enter or remain in the middle class, but to the nation as a whole. It is widely believed that we need a well-educated workforce to create new opportunities in the United State and to remain competitive internationally.

But, as family incomes, available grant aid, and state investments in higher education have failed to keep pace with college costs, students and families increasingly are turning to student loans to help bridge the college affordability gap.

Today, students and workers seeking retraining are borrowing extraordinary amounts of money through federal and private loan programs to help cover the cost of college and training. Individually, college seniors who graduated with student loans in 2010 owed an average of $25,250, up five percent from the previous year, according to a report from the Project on Student Debt at the Institute for College Access & Success (TICAS).[1] Collectively, the amount of student borrowing crossed the $100 billion threshold for the first time in 2010 and total outstanding loans exceeded $1 trillion for the first time last year.[2] Americans now owe more on student loans than on credit cards, according to the Federal Reserve Bank of New York, the U.S. Department of Education and others. And, because there are fewer people with student loans than there are credit card holders, the debt burden on the individual borrower is considerably higher.

Although educational borrowing is up for every age group over the past three years and young people still carry the biggest student loan debt burden, borrowing has grown far more quickly for those in the 35-49 age group, according to an analysis by the credit score tracking site CreditKarma. That age group saw its school debt burden increase by a staggering 47 percent, according to the analysis.[3] Credit Karma CEO Kenneth Lin said the reason for this increase is obvious: the tough economy has pushed more people to seek mid-career training and education.

And, it is not just students who are borrowing at record rates, so too are their parents. Loans to parents for the college education of children have jumped 75 percent since the 2005-2006 academic year, according to Mark Kantrowitz, publisher of the website FinAid.org. Based on data compiled by Kantrowtiz, federally backed educational loans to parents account for roughly 10 percent – or $100 billion – of the $1 trillion in outstanding educational loans. Parents have an average of $34,000 in student loans and that payback figure rises to about $50,000 over a

[1] *Student Debt and the Class of 2010*, The Institute for College Access & Success, November 3, 2011, http://projectonstudentdebt.org/pub_view.php?idx=791

[2] "Student Loans Outstanding will exceed $1 trillion this year," Dennis Cauchon, USA Today, October 18, 2011 and updated October 25, 2011, http://www.usatoday.com/money/perfi/college/story/2011-10-19/student-loan-debt/50818676/1

[3] "Middle-aged borrowers piling on student debt," Mitch Lipka, Reuters, December 27, 2011, http://www.reuters.com/article/2011/12/27/us-studentdebt-middleage-idUSTRE7BQ0T620111227

standard 10-year loan period. An estimated 17 percent of parents whose children graduated in 2010 took out loans, up from 5.6 percent in 1992-1993, according to Kantrowitz's estimates.[4]

With rising debt comes increased risk, both to borrowers and to the economy in general. While a college education generally is considered to be a very good investment, it does not guarantee a high paying job or freedom from financial difficulties. Even in the best of economic times when jobs are plentiful, young people with considerable debt burdens end up delaying life-cycle events such as buying a car, purchasing a home, getting married and having children. Piling up student loans in middle age is even more troublesome. Aside from the simple truth that there is less time to earn back the money, it also means facing retirement years still deeply in debt. And, parents who take out loans for children will find those loans more difficult to pay as they stop working and their incomes decline.

FICO's quarterly survey of bank risk professionals found growing concern for the stability of the student loan market. "Evidence is mounting that student loans could be the next trouble spot for lenders," said Dr. Andrew Jennings, chief analytics officer at FICO and head of FICO Labs.[5]

The Institute for Higher Education Policy (IHEP) recently examined both delinquency and default rates by studying Class of 2005 graduates five years later. Of borrowers who began repayments the year they graduated, 25 percent became delinquent at some point and 15 percent defaulted. Others took refuge in federal programs that allow students to postpone or reduce their payments. Only 40 percent of borrowers had made payments as agreed. "It really surprised me," said Alisa Cunningham, vice president of research at IHEP. "I didn't realize how many borrowers were having problems."[6] The Chronicle of Education puts the default rate of government loans at 20 percent.

This concern is echoed by the anecdotal experiences of bankruptcy attorneys from across the country who report that what they are seeing at the ground level feels too much like what they saw before the foreclosure crisis crashed onto the national scene: more and consumers seeking their help with unmanageable student loan debt, and with no relief available.

And, as with the mortgage foreclosure crisis, the staggering amounts owed on student loans also will have repercussions for the broader economy. Just as the housing bubble created a mortgage debt "overhang" that absorbs the income of consumers and renders them unable to afford to engage in the consumer spending that sustains a growing economy, so too are student loans beginning to have the same effect, which will be a drag on the economy for the foreseeable future.

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[4] "Parents Snared in $100 Billion College Debt Trap Risk Retirement," Janet Lorin, Bloomberg, February 2, 2012 http://bloomberg.com/news/2012-02-02/parents-snared-in-100-billion-u-s-college-debt-trap-risking-retirement.html

[5] "Student Loans Seen as Next Casualty of Sluggish Economy, FICO Quarterly Survey Finds," FICO.com, January 11, 2012, http://www.fico.com/en/Company/News/Pages/01-11-2012a.aspx

[6] "Delinquency: The Untold Story of Student Loan Borrowing," Alisa Cunningham and Gregory S. Kienzl, Ph.D., Institute for Higher Education Policy, March 2011, http://www.ihep.org/Publications/publications-detail.cfm?id=142

WHAT IS FUELING THE STUDENT LOAN "DEBT BOMB"?

If all goes well, college graduates earn significantly more than those with high school degrees. However, this is not always the case. Some may find their chosen professions are not as lucrative as they thought. Some may find few jobs are available or may lose their job in the current economic environment. Yet others will confront unexpected life traumas such as disability, divorce or death of a family member. Whatever the circumstance, student loan borrowers are allowed very little margin for error and easily can find themselves with unmanageable student loan debt. These borrowers face a lifetime of debt with little or no chance for escape.

Missing just one student loan payment puts a borrower in delinquent status. After nine months of delinquency a borrower is in default. As younger college students, middle aged borrowers and parents all have taken on bigger student loan burdens, the level of defaults has risen. Although the Department of Education's official default rate for 2009 was 8.8 percent, the figure reflects only those debtors who began repayment in fiscal year 2009 and failed to meet the obligation by September 30, 2010, not all the people who defaulted over time.[7]

While any default hurts a borrower's credit, the consequences of a default on a student loan is particularly onerous. Once a default occurs, the full amount of the loan is due immediately. The government also cuts off any future federal financial aid and strips the borrower's eligibility for loan forgiveness.

For those with federal student loans, the government has collection powers far beyond those of most creditors. The government can garnish a borrower's wages without a judgment, seize a tax refund (including an earned income tax credit) or portions of federal benefits such as Social Security, and deny eligibility for new education grants or loans. The government can sue the borrower to place liens on bank accounts and property, and can tack on collection fees of 30 percent of the amount due. There is no discharge in bankruptcy for federal loans except in extremely limited circumstances that require a borrower to file a lawsuit that few bankruptcy debtors can afford, especially because student loan servicers aggressively litigate such cases. Unlike any other type of debt, there is no statute of limitations. The government can pursue borrowers to the grave. And, for those with professional licenses, failure to pay student loan debt can result in the loss of the state-issued license.[8]

Compounding the problem is that a borrower faced with a temporary setback often finds himself quickly in a much deeper hole. Interest accrues, collection fees accrue, and negative credit report notations accrue making it difficult to get out from under the growing loan balance or to find a decent job.

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[7] "Student loan debt now exceeds $1 trillion; more than credit cards," Bartholomew Sullivan, Scripps Howard News Service, January 14, 2012,

[8] For an excellent and comprehensive discussion of the challenges faced by student loan borrowers see "No Way Out: Student Loans, Financial Distress, and the Need for Policy Reform," Deanne Loonin, National Consumer Law Center, June 2006, http://www.studentloanborrowerassistance.org/blogs/wp-content/www.studentloanborrowerassistance.org/uploads/File/nowayout.pdf.

As challenging as government student loans may be for students and parents facing financial hardship, there are at least some protections. Borrowers can count on fixed, affordable interest rates, generally low fees, repayment options, and limited forgiveness programs backed by the federal government. Federal loan terms and conditions are set by Congress, and are the same for all borrowers regardless of their income, credit score, or where they go to school. The same cannot be said for private student loans.

Private student loans are made by lenders to students and families outside of the federal student loan program. They are not subsidized or insured by the federal government and may be provided by banks, non-profits, or other financial institutions. The borrowing limits in the federal loan programs, the skyrocketing cost of higher education and aggressive lender marketing fueled the growth of private student loans. Although still just a portion of the overall volume of student loans, the percentage of undergraduates with private student loans rose from five percent in 2003-04 to 14 percent in 2007-08. During that same period, the volume of student loans rose from \$6.5 billion to \$17.1 billion.[9]

Despite some similarities, there are a number of very important differences between federal and private loans, including:[10]

Underwriting. With the exception of PLUS loans for parents and graduate/professional students, federal loan borrowers do not have to meet creditworthiness standards. Private loans, in contrast, are priced according to credit worthiness standards.

Pricing. All federal loans have interest rate caps. In contrast, nearly all private loans have variable interest rates with no upper limits. Many of these loans are very expensive, with predatory interest rates 15 percent or higher.

Loan Limits. There are loan limits for the various federal loan programs. The only exception is PLUS loans for parents and graduate/professional students. For private loans, there are no regulations setting a maximum dollar amount on how much a student can borrow. Generally, lenders allow students to borrow up to the cost of attendance minus other aid.

Borrower Protections. Federal loans come with a range of borrower protections that are mandated in the federal Higher Education Act, including income-based repayment, deferment and cancellation rights. In contrast, private lenders are not required to offer any particular relief.

Regulation. Federal loans are regulated through the Higher Education Act (HEA). Private loans, in contrast, are regulated (or not) in much the same way as other types of private credit, such as credit card installments or mortgage loans. Oversight largely falls within the jurisdiction of federal regulators. As in the mortgage market, federal enforcement actions to curb problems in the private student loan market have been virtually nonexistent.

Collection. Both federal and private lenders use third party collection agencies to pursue delinquent and defaulted borrowers. Private student lenders have fewer collection powers than

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[9] The Project on Student Debt, The Institute for College Access & Success,

[10] "No Way Out: Student Loans, Financial Distress, and the Need for Policy Reform," NCLC.

federal collectors. This gap is closing, however, as private lenders have fought to obtain many of the same collection rights as the government. They succeeded in persuading Congress in 2005 to make private loans as difficult to discharge in bankruptcy as federal loans.

Despite the disparities in terms and protections for federal government loans and private loans, the private student loan market grew rapidly throughout the 1990's and early 2000's. During this time, many borrowers sought private loans even if they were eligible for federal student loans. There are signs that this rapid growth tapered off with the advent of the credit crisis, but many borrowers hold debt extended by private lenders during the peak years.

RECOMMENDATIONS FOR REFORM: DEFUSING THE DEBT BOMB

It is a widely held view that no qualified student who wants to earn a college degree should be barred due to a lack of money. However, it is precisely this lack of money that converts the promise of higher education into a lifetime of stress and financial hardship. The policy reforms offered here are intended to help build a better and more equitable system for student loan borrowers who encounter financial difficulties.

Restore the bankruptcy discharge for student loans

Student loans are among the few types of debts that generally are not dischargeable in bankruptcy. In contrast to student loans, most other debts are dischargeable in either a Chapter 7 liquidation process or Chapter 13 debt adjustment plan. Other debts singled out as non-dischargeable include child support, alimony, court restitution orders, criminal fines and some taxes.

It wasn't always this way. Prior to 1976, all student loan debt was dischargeable in bankruptcy, just as if it were any other type of unsecured debt. That year, Congress added an exception to the bankruptcy discharge by prohibiting the discharge of education loans made by the government or a non-profit college or university, unless those loans had been in repayment for five years. That exception was continued in the 1978 Bankruptcy Act, but debtors who completed a chapter 13 plan, paying all they could afford over three to five years, were not subject to the five year waiting period. Since 1978, there have been three significant legislative changes in the treatment of student loans in bankruptcy.

First, in 1990, the five year repayment period was extended to seven years and the differential treatment of chapter 13 was eliminated. In 1998, the temporal ground (the seven years) for discharge was eliminated. And finally, in 2005, Congress included most private student loans in the nondischargeability category as part of a comprehensive rewrite of the bankruptcy code.

The only exception to the nondischargeability of student loan debt is if the debtor can persuade the bankruptcy court that repayment of the loan would result in "undue hardship." There is no statutory definition of "undue hardship." This is a court-defined term, usually satisfied only if the debtor can meet the three-pronged test set forth in *Brunner v. New York State Higher Education*

Services Corp.,[11] under which the debtor must demonstrate: (1) she cannot maintain a minimal standard of living for herself or her dependents if forced to repay the loan, (2) circumstances exist indicating this state of affairs is likely to persist for a significant portion of the repayment period, and (3) the debtor has made a good faith effort to repay the loan. In certain courts, a somewhat more flexible "totality of the circumstances" test has been applied.

Regardless of which test is used, most courts are very restrictive in determining which borrowers qualify for discharge. Often only borrowers very close to the poverty level with little or no hope for improvement are considered eligible. And few debtors are able to avail themselves of the opportunity to seek a discharge, because they cannot pay to fund the litigation that is required to prove undue hardship, litigation that has become much more expensive because student loan creditors aggressively defend such cases.

These statutory changes to the bankruptcy discharge for student loans were made despite the lack of any hard evidence that there were abuses of the system. In fact, in 1977, after the original bankruptcy amendments had been adopted but before they went into effect, the House Judiciary Committee issued a report concluding that the nondischargeability provision should be repealed. The Committee found that there was no real problem and that fewer than one percent of all federally insured and guaranteed educational loans were discharged in bankruptcy.[12]

Furthermore, the extension of the preferential treatment for student loans in bankruptcy to private student loans came during the credit industry's feeding frenzy – the 2005 comprehensive rewrite of the bankruptcy code. Amid the chaos of credit card lenders, car financiers and rent-to-own oufits all advancing their self interests in a long and complex series of amendments, an unidentified lawmaker slipped in a provision making private student loans non-dischargable. There were no hearings or public discussion of such a fundamental change in policy on private student loans during the several years the bankruptcy bill was under discussion. Now, private student lenders, despite their lack of protections afforded by government lenders, enjoy the same protection from default.[13]

NACBA agrees with the comments submitted by the National Consumer Law Center to the Consumer Financial Protection Bureau that "bankruptcy is not and should not be the entire safety net, but it is the most organized, recognized, and effective system available offering relief to those who most need it. It is never an easy decision for a consumer to choose bankruptcy. This choice comes with many costs and consequences, including damaged credit that lasts for

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[11] 831 F.2d 395 [2d Cir. 1987]

[12] H. Rept. 95-595, at 132-33 (1977).

[13] Private student loans, on the other hand, are one of the riskiest and most expensive ways to pay for college. These loans are offered by a variety of banks and other lenders and can generate tremendous profits through high variable rates and fees. Private student loans lack the fixed rates, consumer protections, flexible repayment options of federal student loans and generally are extended base on creditworthiness. Indeed, some have observed that these loans are "not financial aid any more than a credit card is when used to pay for textbooks or tuition." See for example, the testimony of Lauren Asher, President, the Institute for College Access & Success, before the Subcommittee on Commercial and Administrative Law, Committee on the Judiciary, U.S. House of Representatives, oversight hearing, "An Undue Hardship? Discharging Educational Debt in Bankruptcy," September 23, 2009, found at http://judiciary.house.gov/hearings/pdf/Asher090923.pdf

years."[14] However, it is now available only through the random, unfair, and costly "undue hardship" system. Effectively, it has become no choice at all for those who most need it.

NACBA calls on Congress to act immediately to eliminate the nondischargeability of private student loans. There simply is no reason to allow private student loans to be treated differently from other types of unsecured credit. In fact, exempting these loans from discharge is likely to cause even more harm for borrowers since there are no interest rate limit or limits on fees charged for private student loans. Furthermore, there are limited repayment options for those borrowers facing financial hardship. Legislation pending in both the House (H.R. 2028, the "Private Student Loan Bankruptcy Fairness Act,") and Senate (S. 1102, the "Fairness for Struggling Students Act,") will restore bankruptcy relief for private student loans.

Congress also should extend greater relief to student loan borrowers by restoring the right to discharge federal student loans in bankruptcy. Congress should retain the undue hardship standard and restore the original five year repayment provision. In this way, borrowers could prove undue hardship at any time to discharge their loans. All borrowers, regardless of hardship, would be allowed to discharge student loans five years after those loans first became due.

Restoring bankruptcy protection for student loan debt is not the same thing as simply forgiving these loans. The 2005 changes to the Bankruptcy Code ensure that debtors who enter bankruptcy with funds to repay debts are not able to simply liquidate them through Chapter 7. For example, there is now a means test to determine if a debtor can repay creditors. In addition, there are significant new barriers to access, including higher filing fees and mandatory counseling and education requirements. Any question about the existence or extent of past abuse of the bankruptcy system should be put to rest by the new system. The discharge should be restored for students who truly need the bankruptcy safety net.

Re-impose a reasonable statute of limitations on student loan collections

Just as student loans are among the few unsecured debts that generally are not dischargeable in bankruptcy, student loan borrowers have the unenviable distinction of holding debt with no statute of limitations. The Higher Education Act Amendments of 1991 eliminated the statute of limitations within which suits could be filed, judgments enforced or offset, garnishment or other actions initiated to collect federal student loans. This lumps student borrowers with very small number of law violations, such as murder and treason. Despite the governmental and societal interest in pursuing criminals, statutes of limitation apply to nearly all federal criminal actions. The rare exceptions exist for those crimes that are punishable by death, including espionage and treason, and now, student loan defaults.

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[14] Comments to the Consumer Financial Protection Bureau on Request for Information Regarding Private Education Loans and Private Educational Lenders, 76 Fed. Reg. 71329 (November 17, 2011), Docket # CFPB 2011-0037, National Consumer Law Center, January 17, 2012, http://www.studentloanborrowerassistance.org/blogs/wp-content/www.studentloanborrowerassistance.org/uploads/2007/03/comments-cfpb-jan2012.pdf

Statutes of limitation are the norm in civil and criminal cases. The primary justifications for statutes of limitation fall into two general categories: those relating to the benefits of repose and finality and those advocating against the adjudication of stale claims. Statutes of limitation recognize that there are very serious problems associated with adjudicating old claims. In the case of student loans, it means loan holders must keep records of government student loans for a borrower's entire life. Borrowers' records must likewise be kept for a lifetime. The limitless pursuit of vulnerable student loan borrowers has serious costs. Disabled and older consumers face collection for loans they may have taken out 30 or 40 years earlier. If they have no other assets or property, the government is permitted to take a portion of their Social Security benefits. There truly is "no way out" for student loan borrowers.

Improve oversight of private collection agencies

The widespread use of private collection agencies to pursue student loan defaulters, combined with a significant expansion in the government's collection tools has led to abuses in student loan collection. There are documented problems with training and oversight of third party private collectors. The use of private collectors adds substantial costs to the collection process and contributes to problems with both the amount of fees charged and when fees are imposed.

NACBA recommends that a rigorous training process for collection agencies instituted; that all aspects of oversight of private collection agencies be improved; and that collection fees meet a test of reasonableness.

366 B.R. 307
In re Patricia HAMAN, Debtor.
No. 06-10857 (BLS).
United States Bankruptcy Court, D. Delaware.
April 20, 2007.
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Tiffany A. Poole, Rahaim & Saints, Wilmington, DE, for Debtor.

William K. Harrington, Wilmington, DE, for United States Trustee.

MEMORANDUM OPINION[1]

BRENDAN LINEHAN SHANNON, Bankruptcy Judge.

Before the Court is the Motion of the United States Trustee ("UST") to Dismiss the chapter 7 case of Patricia Haman (the "Debtor") pursuant to 11 U.S.C. § 707(b)(2) or, alternatively, pursuant to 11 U.S.C. § 707(b)(3) (the "Motion to Dismiss"). The Debtor opposes the Motion to Dismiss, conceding that the presumption of abuse has arisen pursuant to section 707(b)(2)(A) but asserting that the statutory presumption has been rebutted by her demonstration of a special circumstance justifying an additional expense under section 707(b)(2)(B), viz., a non-dischargeable student loan obligation.

For the reasons stated below, the Court concludes that the Debtor has rebutted the presumption of abuse by demonstrating a special circumstance that allows her to deduct the student loan payments. If requested by the UST, the Court will schedule a separate evidentiary hearing to consider whether the filing of the Debtor's case was abusive under section 707(b)(3).

BACKGROUND

On August 15, 2006, the Debtor commenced the above-captioned case (the "Case"), seeking protection under chapter 7 of the Bankruptcy Code (the "Code"). Along with her voluntary petition, the Debtor filed her Schedules, Statement of Financial Affairs, and Statement of Current

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Monthly Income and Means Test Calculation ("Form B22A"). At that time, the Debtor's Form B22A indicated that she did not have sufficient net monthly income for the presumption of abuse to arise under section 707(b)(2). Included in her calculation of monthly deductions was a payment to Key Bank USA, National Association ("Key Bank"), which the Debtor categorized as a "payment on a priority claim." This monthly payment to Key Bank represents a student loan obligation incurred by the Debtor's son in October 2003 for which the Debtor is a co-signor. Following her son's development of psychological disorders, the Debtor has made fifteen monthly payments of $162.12 to Key Bank. As of October 13, 2006, the outstanding loan balance was $22,249.59.

On October 23, 2006, the UST filed its Motion to Dismiss arguing: (1) the presumption of abuse in fact did arise due to the Debtor's improper deduction of the student loan obligation as a "payment on a priority claim"; and (2) even it the Court found the deduction proper, dismissal of the Case under section 707(b)(3) was appropriate because the totality of the circumstances indicated the Debtor's ability to fund a chapter 13 plan.

On November 9, 2006, the Debtor responded to the Motion to Dismiss.[2] She conceded that the student loan obligation did not constitute a "payment on a priority claim" and that the presumption of abuse arose pursuant to section 707(b)(2)(A). Nonetheless, the Debtor argued that because the obligation was non-dischargeable, it constituted a special circumstance "for which there is no reasonable alternative." 11 U.S.C. § 707(b)(2)(B). The Debtor contends this special circumstance would justify an additional expense to rebut the presumption of abuse.

An evidentiary hearing was held on February 1, 2007, at which time the. Debtor testified and was cross-examined. Although initially there was some dispute as to whether the Debtor's signature on the original loan agreement with Key Bank was a forgery, the Debtor testified at the hearing that she knew of and signed the agreement. Hr'g Tr. 37:17-38:3, Feb. 1, 2007.

Also at the hearing, the UST was afforded the opportunity to respond to the Debtor's "special circumstance" argument. According to the UST, the Debtor's student loan obligation could never be a special circumstance rebutting the presumption because it does not fall within the ambit of the examples of special circumstances provided in section 707(b)(2)(B) and because the debtor does have a "reasonable alternative" — to convert the Case to one under chapter 13, modify the rights of Key Bank pursuant to section 1322(b), and make a *pro rata* distribution to Key Bank for the length of a chapter 13 plan.[3]

This matter is ripe for decision.

JURISDICTION

The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334 and 157(a) and (b)(1). Consideration of this matter constitutes a "core proceeding" under 28 U.S.C. § 157(b)(2)(A) and (0).

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DISCUSSION

I. *A Brief Examination of the Mechanics of Section 707*

Dismissal of a chapter 7 case is governed by section 707, which was substantially modified by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA").[4] Pursuant to section 707(b)(1), the Court, after notice and a hearing, "may dismiss a case filed by an individual debtor under [chapter 7] whose debts are primarily consumer debts ... if it finds that the granting of relief would be an abuse of the provisions of [chapter 7]." To determine whether the granting of relief would be an abuse, the Court is guided by the "means, test" of BAPCPA, established by section 707(b)(2)(A)(i). According to section 707(b)(2)(A)(i), "the court shall presume abuse exists if the debtor's current monthly income reduced by the amounts determined under clauses (ii), and (iv), and multiplied' by 60 is not less than the lesser of ... 25 percent of the debtor's nonpriority unsecured claims in the case, or. $6,000, whichever is greater; or ... $10,000."

Fore purposes of this test, a debtor's current monthly income ("CMI"), as defined under section 101(10A), is:

the average monthly income from all sources that the debtor receives (or in a joint case the debtor and the debtor's spouse receive) without regard to whether such income is taxable income, derived during the 6-month period ending on ... the last day of the calendar month immediately preceding the date of the commencement of the case if the debtor files the schedule of current income required by section 521(a)(1)(B)(ii) ... or ... the date on which current income is determined by the court for purposes of [chapter 7] if the debtor does not file the schedule of current income required by section 521(a)(1)(B)(ii)....

11 U.S.C. § 101(10A).

From this amount, certain expenses must be subtracted. Pursuant to section 707(b)(2)(A)(ii), a debtor is entitled to deduct the expense amounts specified under the National and Local Standards, and, in some instances, a debtor may deduct actual expenses. 11 U.S.C. § 707(b)(2)(A)(ii). Finally, a debtor is permitted to deduct average monthly payments for secured debts and priority claims. 11 U.S.C. § 707(b)(2)(A)(iii)-(iv).

If, after performing the calculations under the means test, the presumption of abuse arises, the Court has no discretion and must dismiss the chapter 7 case unless a debtor is able to rebut the presumption by demonstrating special circumstances pursuant to section 707(b)(2)(B) justifying additional expenses or adjustments of the debtor's current monthly income. Under this section, a debtor may rebut the presumption of abuse "by demonstrating special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces, to the extent such special circumstances ... justify additional expenses or adjustments of [the debtor's] current monthly income for which there is no reasonable alternative." 11 U.S.C. § 707(b)(2)(B)(i).

If the presumption of abuse does not arise under the means test or if a debtor successfully rebuts the presumption, a debtor's chapter 7 case still may be dismissed if "the debtor filed the petition in bad faith ... or ... *[if] the totality of the circumstances ... of the debtor's financial situation demonstrates abuse.*" 11 U.S.C. § 707(b)(3)(B) (emphasis added).

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To determine whether a case should be dismissed under the totality of the circumstances testy the Court must consider all of the circumstances of a debtor's financial situation, including the Debtor's ability to fund a chapter 13 plan. *See, e.g., In re Pennington,* 348 B.R. 647, 651 (Bankr. D.Del.2006); *In re Paret,* 347 B.R. 12, 17 (Bankr.D.Del.2006); *In re Henebury,* 361 B.R. 595, 610-12 (Bankr.S.D.Fla.2007); *In re Schoen,* No. 06-20864-7, 2007 WL 643295, at *3 (Bankr.D.Kan. March 2, 2007); *In re Hare,* 06-10924, 2007 WL 201249, at *4 (Bankr.E.D.Cal. Jan. 24, 2007); *In re Pak,* 343 B.R. 239, 244 (Bankr.N.D.Cal.2006).

II. *Does the Debtor's Non-dischargeable Student Loan Obligation Qualify as a Special Circumstance?*

For the Debtor to successfully demonstrate a special circumstance, she must fulfill both the procedural and substantive requirements of section 707(b)(2)(B). To satisfy the procedural requirements, a debtor must "itemize each additional expense or adjustment of income and ... provide ... (I) documentation for such expense or adjustment to income; and (II) a detailed explanation of the special circumstances that make such expenses or adjustment to income necessary and reasonable." 11 U.S.C. § 707(b)(2)(B)(ii). Additionally, a debtor must "attest under oath to the accuracy of any information provided to demonstrate that additional expenses or adjustments to income are required." 11 U.S.C. § 707(b)(2)(B)(iii).

In the instant case, there is no dispute that the Debtor has fulfilled these requirements. On December 20, 2006,. the Debtor submitted her Declaration in Support of Rebutting the Presumption of Abuse Pursuant to Section 707(b)(2)(B)(i) [Docket No. 29], in which she attested under oath and described, in detail, the circumstances necessitating an additional expense and to which she attached the Promissory Note documenting the student loan obligation with Key Bank.

To satisfy the substantive requirement, a debtor must demonstrate "special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces, ... that justify additional expenses or adjustments of [the debtor's] current monthly income *for which there is no reasonable alternative.*" 11 U.S.C. § 707(b)(2)(B)(i) (emphasis added).

Here, in support of her request, the Debtor argues that she has no reasonable alternative but to pay her son's student loan obligation because: (1) she is a cosignor on the loan; (2) her son is unable to make the required monthly payments to Key Bank because of the several psychological disorders from which he suffers; and (3) the debt cannot be discharged because it does not impose an "undue hardship" for her or her dependents as required under section 523(a)(8).

As a threshold argument in opposition, the UST argues that the Debtor's student loan obligation does not fall within the narrow and defined categories of special circumstances described in section 707(b)(2)(B) — "a serious medical condition or a call or order to active duty in the Armed Forces." Although the UST concedes that the examples set forth in section 707(b)(2)(B) are not exclusive, he argues that they are both of an involuntary nature, thereby indicating Congress' intent to limit special circumstances to those incurred or developed outside the control of a debtor. Accordingly, he urges this Court not to extend the application of special circumstances to the current Case where the Debtor voluntarily co-signed for her son's student loan obligation.

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To determine whether the Debtor's monthly student loan obligation constitutes a special circumstance under section 707(b)(2)(B), the Court begins with the language of the statute itself. *Duncan v. Walker,* 533 U.S. 167, 172, 121 S.Ct. 2120, 150 L.Ed.2d 251 (2001). "[W]here ... the statute's language is plain, the sole function of the courts is to enforce it according to its terms.'" *United States v. Ron Pair Enters., Inc.,* 489 U.S. 235, 241, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989) (quoting Caminetti v. *United States,* 242 U.S. 470, 485, 37 S.Ct. 192, 61 L.Ed. 442 (1917)); *see also Conn. Nat'l Bank v. Germain,* 503 U.S. 249, 253-54, 112 S.Ct. 1146, 117 L.Ed.2d 391 (1992) ("[I]n interpreting a statute a court should always turn first to one, cardinal canon before all others. We have stated time and again that courts must presume that a legislature says in a statute what it means and means in a statute what it says there. When the words of a statute are unambiguous, then, this first canon is also the last: `judicial inquiry is complete.'" (quoting *Rubin v. United States;* 449 U.S. 424, 430, 101 S.Ct. 698, 66 L.Ed.2d 633 (1981))). "It is `a cardinal principle of statutory construction' that `a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant.'" *TRW Inc. v. Andrews,* 534 U.S. 19, 31, 122 S.Ct. 441, 151 L.Ed.2d 339 (2001) (quoting *Duncan,* 533 U.S. at 174, 121 S.Ct. 2120).

If the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters'" or if the language of the statute is unclear, courts may resort to legislative history and "the intention of the drafters". *Ron Pair,* 489 U.S. at 242-43, 109 S.Ct. 1026 (quoting *Griffin v. Oceanic Contractors, Inc.,* 458 U.S. 564, 571, 102 S.Ct. 3245, 73 L.Ed.2d 973 (1982)); *see also United States v. E.I. DuPont De Nemours & Co. Inc.,* 432 F.3d 161, 169 (3d Cir.2005) ("Where a statute's text is ambiguous, relevant legislative history, along with consideration of the statutory objectives, can be useful in illuminating its meaning." (citing *Gen. Dynamics Land Sys., Inc. v. Cline,* 540 U.S. 581, 600, 124 S.Ct. 1236, 157 L.Ed.2d 1094 (2004) (examining "the text, structure, purpose, and history" of the relevant statute))).

In applying these principles of statutory interpretation to the instant case, this Court concludes that section 707(b)(2)(B) does not require a debtor to demonstrate special circumstances of an involuntary nature. First, the plain language of section 707(b)(2)(B) is clear — for a debtor to successfully obtain an additional expense or adjustment of CMI, she must demonstrate a special circumstance which leaves her with no reasonable alternative but to incur the expense or cause the income adjustment. "Nothing in the statute suggests or mandates that the `special circumstances' be outside of the control of the debtor. Had

Congress intended to place such a restriction on the nature of special circumstances it envisioned, Congress knows well how to construct appropriate language." *In re Graham,* 363 B.R. 844, 850-51 (Bankr.S.D.Ohio 2007). Moreover, Congress' use of the words "such as" to introduce the examples indicate its intent to provide a non-exhaustive list of illustrations rather than to constrict any application of the statute. *In re Sparks, III,* 360 B.R. 224, 230-31 (Bankr.E.D.Tex.2006); *In re Lenton,* 358 B.R. 651, 661-62 n. 22 (Bankr.E.D.Pa.2006). Finally, it is even open to question whether the examples provided imply circumstances incurred or developed involuntarily. *See, e.g., In re Thompson,* 350 B.R. 770, 777 (Bankr. N.D.Ohio 2006) ("The serious health condition could stem from a self-inflicted injury, and an individual called to active duty

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could have voluntarily enlisted as a reservist.").

Second, even if the language of section 707(b)(2)(B) were ambiguous, the legislative history of. BAPCPA indicates that the examples of special circumstances set forth in subsection (i) were meant to be *expansive* — not limiting. Originally, the language of section 707(b)(2)(B) did not include examples of allowed special circumstances. Senator Jeff Sessions proposed the amendment to clarify "that the special circumstances exception ... includes a debtor with a serious medical condition or a debtor, on active duty in the military...." H.R.Rep. No. 109-31(I), at 9 (2005), *as reprinted in* 2005 U.S.C.C.A.N. 88, 96. According to Senator Sessions, the intent behind the examples was not to limit judicial discretion or to provide a definition of special circumstances, but rather, was to ensure that "those incapable of paying back their debt due to military service or a serious medical condition may not be required to do so." 151 CONG. REC. 51834-01, S1845-46 (2005) (statement of Sen. Sessions). Thus, due to the Congressional intent behind the examples set forth in section 707(b)(2)(B), the Court cannot conclude that special circumstances must be of an involuntary nature. *Contra In re Delunas,* No. 06-43133, 2007 WL 737763, at *2 (Bankr.E.D.Mo. March 6, 2007) (noting that special circumstances "should 'rise to the same level as [the statutorily recognized examples of] a serious medical condition or a call to active duty.' In general, 'special circumstances' are 'circumstances beyond a debtor's reasonable control, such as [the examples given in § 707(b)(2)(B)(i)].'" (quoting *In re Tranmer,* 355 B.R. 234, 251 (Bankr.D.Mont. 2006))).

Finally, in addition to the plain language of the statute and its legislative history, the Court's conclusion is buttressed by existing case law permitting debtors to take additional expenses or adjustments of CMI after demonstrating special circumstances which were not incurred involuntarily. Those special circumstances include: (1) mandatory 401(k) loan repayment obligations, *see Lenton,* 358 B.R. at 661-62; *Thompson,* 350 B.R. at 777-78; (2) unusually high transportation costs, *see In re Batzkiel,* 349 B.R. 581, 586 (Bankr.N.D.Iowa 2006); and (3) failure to find suitable employment, despite diligent search, along with the inability to relocate due to a divorce settlement, *see Graham,* 363 B.R. at 850-51. *See also* 6 COLLIER ON BANKRUPTCY ¶ 707.05[2][d] (Alan N. Resnick et al. eds., 15th ed. rev. 2006) (providing examples of special circumstances, such as "high commuting costs, the increased price of gas, security costs in dangerous neighborhoods, or the cost of infant formula and diapers" and noting: "Indeed, any legitimate expense that is out of the ordinary for an average family, or that may have increased since the IRS guidelines were calculated, could be considered.").

While the Court concludes that the Debtor need not demonstrate special circumstances of an involuntary nature to succeed under section 707(b)(2)(B), the plain language of the statute, along with the applicable case law, require her to demonstrate that her student loan obligation leaves her with no reasonable alternative but to incur the monthly expense to Key Bank. Although the Court is afforded discretion under section 707(b)(2)(B) to effectuate a change in the Debtor's monthly expenses under the means test, it is also mindful that it must interpret the special circumstances exception so as to not frustrate the purpose of BAPCPA:

This exception is not available to justify the approval of expenses incurred merely at a debtor's discretion.... Instead

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this exception to the parameters of acceptable expenses must be strictly construed to allow only those expenses which are truly unavoidable to the debtor. It should be strictly construed so as to coerce the higher income debtor in a Chapter 13 proceeding to adjust his living expenditures to an acceptable level. It should not be viewed as a panaceanic [sic] pathway by which a higher income debtor may achieve the justification of excessive spending patterns which created the necessity to seek Title 11 relief. To interpret it otherwise would undermine some major objectives of the BAPCPA amendments in this area — to preclude the allowance of any improper discretionary spending by higher income debtors in Chapter 13 and to enhance distributions to unsecured creditors as a result.

Sparks, 360 B.R. at 230-31.

In support, the Debtor relies upon *In re Thompson,* in which a debtor successfully demonstrated that his monthly 401(k) loan repayment was a special circumstance. 350 B.R. at 777-78; *see also Lenton,* 358 B.R. at 661-62. In *Thompson,* the Court found significant that the "401(k) loan was not made in contemplation of bankruptcy, but in an effort to address ... continued and worsening financial difficulties." *Thompson,* 350 B.R. at 777. Additionally, the Court found that the debtor had no reasonable alternative but to incur the monthly expense because it would be "financially irresponsible" and "financially impossible" to terminate the repayment obligation. *Id.* at 777-78. More specifically, the debtor would have had either to quit his job or repay the loan in full to rid himself of the obligation. *Id.* at 777.

Here, the record demonstrates that the Debtor's son incurred the student loan obligation in October 2003, almost three years prior to the commencement of this Case. Moreover, there is no dispute that the Debtor is a co-signor for her son's student loan obligation, that her son has been unable to make the required monthly payments to Key Bank, and that the obligation is non-dischargeable. Like the debtor in *Thompson,* the only way the Debtor can stop making the student loan payments would be to pay off the obligation in full, which the record indicates is impossible for this Debtor, or to have her son resume the monthly payments, which the record indicates would be unreasonable to expect at this time due to his medical condition.

The UST has argued that the Debtor does have a reasonable alternative — to convert the Case to one under chapter 13, modify the rights of Key Bank pursuant to section 1322(b), and make a pro rata distribution to Key Bank for the length of a chapter 13 plan. Essentially, the UST is asking this Court to consider in its special circumstances analysis how a debtor could proceed in a case under chapter 13 and what possible return unsecured creditors would receive. The Court cannot apply this approach, however, as it would violate the Congressional intent behind the means test. Rather, consideration of the potential results under a hypothetical chapter 13 plan belongs more properly under the section 707(b)(3) totality of the circumstances test.

An examination of recent case law reveals that only one court has considered, and rejected, the proposition that circumstances in a case under chapter 13 can be examined when determining the existence of special circumstances. *See In re Johns,* 342 B.R. 626 (Bankr.E.D.Okla.2006). In *Johns,* the chapter 7 debtors sought to include additional expenses and adjustments of CMI in an effort to demonstrate special circumstances and rebut the presumption of abuse. *Id.* at 628-29. The

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debtors argued that, unlike their chapter 7 case, in a case under chapter 13, their monthly child support payments would not be included as income and their 401(k) contributions and loan repayments would be deductible expenses. *Id.* Accordingly, the debtors argued that even if their case was converted to one under chapter 13, the distribution to general unsecured creditors would be zero. *Id.* at 628. The court in *Johns* rejected the debtors attempt to examine what would happen in a chapter 13 case, simply noting that:

This Court need not examine what possible return the Debtors' unsecured creditors would receive in a Chapter 13. The Debtors filed for bankruptcy relief under Chapter 7 of the Bankruptcy Code, and this Court will examine their circumstances pursuant to § 707(b)(2)(B) to determine if the Debtors have overcome their burden in rebutting the presumption of abuse in the present case.

Id. at 629.

Despite the lack of case law addressing the issue presented to the Court today, courts throughout the country have addressed a related issue: namely, whether a debtor may include in the means test calculation payments on secured debts if the debtor intends to surrender the collateral after filing the case. Without ruling on this issue (which is not before the Court in this Case), the Court notes that the overwhelming majority of the cases have permitted such action in the context of ruling on a motion to dismiss a chapter 7 case under section 707(b)(2). *See, e.g., In re Longo,* 364 B.R. 161, 164-66 (Bankr. D.Conn.2007); *In re Hartwick,* 359 B.R. 16, 21-22 (Bankr.D.N.H.2007); *In re Sorrell,* 359 B.R. 167, 184-87 (Bankr.S.D.Ohio 2007); *In re Randle,* 358 B.R. 360, 362-66 (Bankr.N.D.Ill.2006); *In re Simmons,* 357 B.R. 480, 483-86 (Bankr.N.D.Ohio 2006); *In re Walker,* No. 05-15010, 2006 WL 1314125, at **2-8 (Bankr.N.D.Ga. May 1, 2006); *see also In re Singletary,* 354 B.R. 455, 458 (Bankr.S.D.Tex.2006) (holding that, although the intent to surrender does not extinguish a debtor's right to deduct secured payments under the means test, the actual surrender of the collateral does do so); *accord In re Nockerts,* 357 B.R. 497, 500-05 (Bankr.E.D.Wis.2006). *But see In re Harris,* 353 B.R. 304, 309 (Bankr. E.D.Okla.2006) (considering the intent of the debtors because "[t]he means test was intended to `ensure that those who can afford to repay some portion of their unsecured debts [be] required to do so.'") (quoting *In re Hardacre,* 338 B.R. 718, 725 (Bankr.N.D.Tex.2006)); *accord In re Skaggs,* 349 B.R. 594 (Bankr.E.D.Mo. 2006).

In support of the conclusion that the intent to surrender does not extinguish a debtor's right to deduct secured payments under the means test, courts have relied upon the Congressional intent animating the means test. The means test was designed to remove judicial discretion by providing "a mechanical estimate of the debtor's abilities to fund a Chapter 13 plan...." *Walker,* 2006 WL 1314125, at *6. To accomplish its goal,

Congress chose to base the means test on historic income and expense figures ..., as opposed to figures that may change with the passage of time or with a change in the debtor's lifestyle. This choice indicates an intent to apply the means test to measure the debtor's need for Chapter 7 relief at the time of the filing, without regard to future events or relief that would be available under Chapter 7.

Id. at *5. Because the means test is based upon historical income and expenses, it was "not intended to ... produce the most accurate prediction of the debtor's actual ability to fund a chapter 13 plan...." *Id.*

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at *6; *accord In re Miller,* 361 B.R. 224, 234-35 (Bankr.N.D.Ala.2007). Rather, that forward-looking analysis belongs in section 707(b)(3)'s totality of the circumstances test, where future or foreseeable circumstances may be considered. *See, e.g., Hartwick,* 359 B.R. at 21-22.

The court in *Hartwick* has accurately summarized the interplay between sections 707(b)(2) and 707(b)(3):

'Congress' intent in adding the Means Test was to create a "mechanical" formula for presuming abuse of Chapter 7.' *Randle,* 358 B.R. at 363-64.... 'Congress' intent to use a standardized or mechanical test and avoid reliance on individualized information as much as possible is demonstrated throughout § 707(b)(2).' *Id.* The major objective of Congress in adding the means test in § 707(b)(2) was to limit judicial discretion from the process of determining abuse by providing an objective standard for establishing a presumption of abuse. *In re Hartwick,* 352 B.R. 867, 870 (Bankr.D.Minn.2006). However, Congress did not remove the ability of bankruptcy courts to consider circumstances, including postpetition developments, in determining abuse. On the contrary, Congress expressly incorporated the formerly judicially created totality of the circumstances test which permits consideration of circumstances both preceding and following the filing of the petition.

. . .

As one court has observed:

'To allow a movant to include the outcome of future events as part of the means test would eliminate the distinction between the presumption of abuse test and the totality of the circumstances test. The constraints of § 707(b)(2)(A) apply equally to the UST and the Debtors. If the Debtors want to present facts that do not appear in the means test, they must argue these facts as special circumstances under § 707(b)(2)(B). Similarly, if the UST wishes to have the court consider facts external to the means test, it must make a motion under § 707(b)(3) based on the totality of the circumstances and will not receive the benefit of the presumption of abuse.' *In re Singletary,* 354 B.R. 455, 465 (Bankr.S.D.Tex.2006).

The application of the plain meaning of § 707(b)(2)(A)(iii) to the circumstances that exist on the petition date in the application of the means test is not demonstrably at odds with Congress' apparent intent in enacting BAPCPA because Congress expressly adopted the totality of the circumstances test in § 707(b)(3) to permit a movant to raise, and the bankruptcy court to consider, a debtor's postpetition financial circumstances.

Id.; see also In re Wilson, 356 B.R. 114, 121 (Bankr.D.Del.2006) ("In sum, this Court finds that Congress has developed a two-step test to detect and deter abusive filers: First, a standardized formula (where the Court has no discretion), and a second, case-by-case analysis designed to address what Congress expected would be the inevitable exceptional cases.").

This analysis applies with equal force here. Calculations under the means test have been purposefully circumscribed by Congress and should not include future or foreseeable circumstances, including what could or would happen to a debtor's income and expenses in a case under chapter 13. If the means test included these circumstances, it would no longer act as a mere "mathematical estimate" using the income and expense figures provided for on Form B22A, but rather, would necessitate a review of a proposed chapter 13

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plan. It would also require the courts not only to determine whether a debtor intends to surrender collateral but also whether a debtor could and would choose either to avoid certain liens impairing entitled exemptions, *see In re Oliver,* No. 06-30076, 2006 WL 2086691, at *2 (Bankr.D. Or. June 29, 2006) (holding that debtors' intent to avoid a lien impairing exemptions may not be considered under the means test) or to modify the rights of a holder of a claim secured by real property, *see* 11 U.S.C. § 506(a). This analysis is more properly conducted under section 707(b)(3).

Accordingly, the Court concludes that the Debtor has no reasonable alternative but to incur the monthly expense for her son's student loan obligation. To the extent that the "UST wishes the Court to consider what would happen to the student loan obligation in a case under chapter 13, the totality of the circumstances test under section 707(b)(3) must be applied.

CONCLUSION

For the foregoing reasons, the Court concludes that the Debtor has rebutted the presumption of abuse by demonstrating a special circumstance that allows her to deduct her monthly student loan repayments. If the UST wishes to proceed with its Motion to Dismiss, the Court will schedule a hearing to consider such evidence and argument as the parties may present on the issue of whether the Debtor's chapter 7 case should nonetheless be dismissed under section 707(b)(3).

An appropriate Order follows.

ORDER

AND NOW, this **20th** day of **APRIL, 2007,** upon consideration of the Motion of the United States Trustee to Dismiss the chapter 7 case of Patricia Haman (the "Debtor") pursuant to 11 U.S.C. § 707(b)(2) or, alternatively, pursuant to 11 U.S.C. § 707(b)(3) (the "Motion to Dismiss"), the response of the Debtor thereto, and for the reasons set forth in the accompanying Memorandum Opinion,

IT IS HEREBY ORDERED that the Motion of the United States Trustee with respect to section 707(b)(2) is **DENIED;**

IT IS FURTHER ORDERED that a hearing to consider evidence and argument on the Motion of the United States Trustee with respect to section 707(b)(3) will be scheduled for a date and time to be determined; and

IT IS FURTHER ORDERED that the parties shall confer and thereafter contact the Court for an appropriate hearing date and time. If the parties agree that the existing record is sufficient to permit the Court to rule on the section 707(b)(3) issue, they should file a Certification of Counsel so stating and the Court will take the matter under advisement.

Notes:

1. This Opinion constitutes the findings of facts and conclusions of law of the Court pursuant to Federal Rule of Bankruptcy Procedure 7052.

2. In addition to her response to the Motion to Dismiss, the Debtor also amended her Form B22A on November 8, November 16, and December 20, 2006 to reflect her assertions.

3. The Trustee also argued that the Debtor had a second alternative — to bring a non-dischargeability action against Key Bank pursuant to section 523(a)(8). The Court will not address this argument given that the Debtor conceded that she could not satisfy the hardship discharge requirements.

4. Pub.L. No. 109-8, 119 Stat. 23 (2005).

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389 B.R. 191
In re Christine Ann CHAMPAGNE, Debtor.
No. 07-10913.
United States Bankruptcy Court, D. Kansas.
April 4, 2008.
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Michael J. Studtmann, Wichita, KS, for Debtor.

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William F. Schantz, Office of U. S. Trustee, Wichita, KS, for U.S. Trustee.

MEMORANDUM OPINION GRANTING MOTION TO DISMISS OR CONVERT BECAUSE DEBTOR'S STUDENT LOAN PAYMENTS MAY NOT BE DEDUCTED FROM CURRENT MONTHLY INCOME AS A SPECIAL CIRCUMSTANCE UNDER 11 U.S.C. § 707(b)(2)(B)(i)

DALE L. SOMERS, Bankruptcy Judge.

The matter before the Court is the United States Trustee's Motion to Dismiss or Convert Pursuant to 11 U.S.C. § 707(b).[1] The United States Trustee for the District of Kansas, Richard A. Wieland (hereafter "UST"), appears by William F. Schantz. The Debtor, Christine Ann Champagne, appears by Michael J. Studtmann. There are no other appearances. The Court has jurisdiction.[2]

The UST moves to dismiss this Chapter 7 case pursuant to § 707(b)(1), alleging that Debtor's debts are primarily consumer debts and the granting of relief would be an abuse of the provisions of Chapter 7. Dismissal is premised upon both presumed abuse under § 707(b)(2)[3] and the totality of the circumstances under § 707(b)(3). The parties agree the UST's motion to dismiss for presumed abuse should be granted unless Debtor's ongoing student loan payments constitute special circumstances pursuant to § 707(b)(2)(B)(i) sufficient to rebut the presumption of abuse. To facilitate resolution of the motion, the Court has taken this issue under advisement. Additional issues relevant to the motion to dismiss or convert are not before the Court. As examined below, the Court concludes that student loan expense is not per se a special circumstance which justifies additional expenses, and the presumption of abuse stands. Therefore, this case must be dismissed, unless the Debtor converts to a Chapter 13 within 30 days of this order.

FINDINGS OF FACT.

The parties have stipulated to the following facts. Debtor filed for relief under Chapter 7 on April 24, 2007. Form 22A, the Chapter 7 Statement of Current Monthly Income and MeansTest Calculations, to be completed by all debtors who debts are primarily consumer debts, was filed with her petition.

The UST filed the motion to dismiss or convert premised upon alleged abuse of Chapter 7 on June 28, 2007, and Debtor filed an amended Form 22A[4] on the same day. Amended Form 22A establishes that Debtor is an above median income debtor, with $257.09 monthly disposable income. The Stipulation provides that "Debtor's non-priority unsecured claims amount to

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no more than $26,300."[5] Schedule F, creditors holding unsecured nonpriority claims, includes $25,100 for two student loans. If debtor is allowed to deduct the student loan payments, her disposable monthly income would be $91.09.

Debtor's student loans were not at the time of filing her petition, or at the time of filing the stipulation, qualified for any deferment or consolidation program.

ANALYSIS AND CONCLUSIONS OF LAW.

A. Issue Presented and Positions of the Parties.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) materially amended § 707(b) to provide new and detailed provisions for the dismissal of Chapter 7 cases. Section 707(b)(2) creates a bright line test applicable to above median income debtors with primarily consumer debt to determine if the Chapter 7 filing is presumed abusive for purposes of § 707(b). Such debtors use form B22 to perform calculations of allowed monthly expenses and deduct them from current monthly income, as defined by the Code. If the monthly disposable income remaining after the deduction of allowed expenses, multiplied by 60 is not less than the lesser of (1) $6,575 or 25% of the debtor's nonpriority unsecured debts, whichever is greater, or (2) $10,950, then the case is presumed to be abusive. However, the presumption of abuse may be rebutted by the debtor showing special circumstances that justify additional expenses or a reduction of income when applying the abuse test, thereby reducing the monthly income below the foregoing standard for abuse. Thus, the special circumstance adjustment allows the courts to "temper the arbitrariness of the means test numbers."[6]

In this case, the parties agree that Debtor's filing is presumed abusive under § 707(b)(2)(A)(i). Debtor's monthly disposable income, after the deduction of all allowed expenses, is $257.09. Sixty times this income is $15,425. The Stipulation provides "Debtor's non-priority unsecured claims amount to no more than $26,300."[7] The filing is therefore presumed abusive under the test of § 707(b)(2)(A)(i) because $15,425 is not less than the lesser of $6,575 (the greater of 25% of the debtor's nonpriority unsecured claims of $26,500[8] or $6,575) or $10,950.

Debtor, to avoid dismissal or conversion, asserts that her student loan obligations constitute special circumstances which justify reduction of her monthly income for purpose of the abuse test. The UST agrees that if Debtor's student loan payment obligation is subtracted from her Form 22A current monthly income, the result is $91.09, 60 times which is $5,465.40, which is less than either $6,575 or $10,950. In other words, the UST and

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Debtor agree that if her student loan payments may be subtracted from her current monthly income for the purpose of applying the test for the presumption of abuse, Debtor's filing will not be presumed to be abusive. To determine if the UST is entitled to rely upon the presumption of abuse the Court must therefore answer the question whether the Debtor's student loan payments are a special circumstance. Based upon the legal arguments presented and because the parties have submitted the issue on stipulated facts which are silent about the student loan details other than the payment amount, the Court understands the parties to be presenting an issue of law-do student loan payments per se constitute special circumstances for the purposes of rebuttal of the presumption of abuse.

The majority of bankruptcy courts addressing the issue have held that payments on a nondischargeable student loan constitute special circumstances, allowing the reduction of current monthly income.[9] Debtor relies primarily upon Templeton,[10] where the court concluded that debtors had no reasonable alternative to the payment of the student loans. The nondischargeable student loans could not be consolidated, and debtors were not eligible for deferment. The court found, "[T]here is nothing within the Debtors' power to reduce or otherwise avoid the additional expense of the student loans." [11] Debtor also cites Knight,[12] where the court defined special circumstance as "one that, if debtor is not permitted to adjust her income or expenses accordingly, results in a demonstrable economic unfairness prejudicial to the debtor." [13] The well known characteristics of student loans-that the cost of higher education is beyond the means of many without financial assistance, that public policy encourages higher education, that student loans are made available to further that purpose, that many students exit education with high debt payable over periods from 10 to 30 years, and that student loans are excepted from discharge—"render student loan debt unique and qualify it for consideration as a special circumstance because of the likelihood that a debtor may have no reasonable alternative to continuation of the payments in order to avoid unfair economic harm."[14] Debtor also cites without discussion Delbecq[15] and Haman.[16]

The student loan case on which the UST relies is Vaccariello,[17] where the court observed that "funding higher education through the use of student loans is becoming ubiquitous" and stated that "Debtor's obligation to repay their student loans, standing alone, cannot constitute special circumstances."[18] The UST also relies upon Thompson,[19] a case where, based

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upon lack of evidence of the circumstances which had led to the debtor's borrowing, the district court reversed a holding that obligations on a loan from the debtors' 401(k) plan constituted a special circumstance sufficient to rebut the presumption of abuse.

Subsequent to the parties' submissions of their briefs, an additional case, Pageau[20] was decided. It held that payments on a student loan taken out in the ordinary course of debtor's education were not special circumstances of the kind sufficient to rebut the presumption of abuse. The court rejected debtor's contention, like the contention made in this case, that "the mere fact that she is required to make monthly payments ... on the nondischargeable Student Loan constitutes 'special circumstances.'"[21]

To resolve the difference between the approaches of Debtor and the UST, the Court first examines the statutory language. Finding it ambiguous, the legislative history and the purpose of the special circumstances provision, as well as the interpretation of other courts, are examined.

B. Legislative History.

The Code in § 707(b)(2)(B)(i) addresses the special circumstances when the presumption of abuse may be rebutted as follows:

(B)(i) In any proceeding brought under this subsection, the presumption of abuse may only be rebutted by demonstrating special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces, to the extent such special circumstances that justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative.

A debtor seeking to establish special circumstances must comply with the procedural requirements of § 707(b)(2)(B)(ii) and (iii).[22]

The phrase special circumstances is not defined by the Code. The Court finds the phrase ambiguous. For example, it could refer to the circumstances which caused the debtor to incur the expense, to the reasons for debtor's financial circumstances at the time of filing, to the debtor's anticipated financial circumstances, or to the consequences of filing for bankruptcy relief. The Court will therefore consider the purpose of the provision, as reflected in the legislative history,[23] and the decisions of other courts.

The legislative history of BAPCPA establishes that the concept of special circumstances was first introduced to the means test in 1999 in Senate Bill 625.[24]

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The Senate Judiciary Report on the bill identified a bankruptcy crisis arising from a record number of filings in 1998, following three consecutive years of increased filings even though consumer confidence was high, there was low unemployment, and wages were high. The need for congressional action was found in the "existence of muitibillion dollar losses attributable to bankrupts who could repay their debts."[25] The recommended solution was a rebuttable presumption of abuse based upon the means test.

It is the strong view of the Committee that the bankruptcy code's generous, noquestions-asked policy of providing complete debt forgiveness under chapter 7 without serious consideration of a bankrupt's ability to repay is deeply flawed and encourages a lack of personal responsibility.

S. 625 responds to the bankruptcy crisis by amending section 707(b) of the bankruptcy code to require bankruptcy judges to dismiss a chapter 7 case, or convert a chapter 7 case to chapter 13 if a bankrupt has a demonstrable capacity to repay his or her debts. Under S. 625, a presumption arises that a chapter 7 bankrupt should be dismissed from bankruptcy or converted to chapter 13 if, after taking into account secured debts and priority debts like child support as well as living expenses, the bankrupt can repay 25 percent or more of his or her general unsecured debts, or $15,000, over a 5-year period. The bankrupt can rebut this presumption by demonstrating "special circumstances" which would show that the bankrupt in fact does not have a meaningful ability to repay his or her debts.[26]

The report further states the following regarding "special circumstances:"

In order to protect debtors from rigid and arbitrary application of a meanstest, section 102 also provides that in some cases where the presumption applies the debtor may be able to demonstrate "special circumstances" that justify additional expenses or an adjustment to the debtor's income. The Committee adopted the "special circumstances" standard, rather than the "extraordinary circumstances" standard included in the Conference Report to accompany H.R. 3150....

... In order to ensure fairness with respect to the consumers who must pay the cost when others discharge debts in bankruptcy, it is essential that the "special circumstances" test establish a significant, meaningful threshold which a debtor must satisfy in order to receive the preferential treatment. The debtor's ability to overcome the presumption of abuse must be based solely on financial considerations (i.e., adjustments to income or expenses required by special circumstances) and not on factors unrelated to a chapter 7 debtor's ability to repay his or her debts.... In addition, special circumstances adjustments must not be used as a convenient way for debtors to choose a more expensive lifestyle. The special circumstances provision must be reserved only for those debtors whose special circumstances require adjustments to income or expenses that place them in dire need of chapter 7 relief.

* * *

The new section 707(b) thus contains a tightly-focused mechanism for identifying bankrupts who have repayment capacity

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and sorting them out of chapter 7. At the same time, the new section 707(b) contains numerous procedural safeguards in order to ensure that the individual circumstances of each bankrupt will be considered before he or she is dismissed or converted to chapter 13.[27]

The statutory examples of special circumstances, medical expenses and active service in the military, were added in 2005 by a special amendment offered by Senator Sessions.[28] That amendment clarified that "the special circumstances exception to the bill's needs-based test includes a debtor with a serious medical condition or a debtor on active duty in the military to the extent these factors justify adjustment to income or expenses...."[29] "According to Senator Sessions, the intent behind the examples was not to limit judicial discretion or to provide a definition of special circumstances, but rather, to ensure that `those incapable of paying back their debt due to military service or a serious medical condition may not be required to do so.'"[30]

From the foregoing, the Court determines that the presumption of abuse test was adopted to cure the perceived problem of debtors electing to file under Chapter 7 when they had the ability to pay a meaningful portion of their unsecured nonpriority debt based upon their current monthly income calculated using the objective criteria of the means test. The focus of the special circumstances factor is financial conditions which justify including additional expenses or reducing income. The burden to establish special circumstances was not set particularly high, making the presumption truly rebuttable. The standard for amendment is special, not extraordinary, circumstances. The procedural requirements impose the condition that the adjustments to income or expenses be shown by affidavit to be reasonable and necessary. The medical expenses and military service circumstances referred to in the statute are mere examples of circumstances where the results of the means test, based primarily on IRS national and local standards, may not accurately demonstrate ability to repay. The statutory requirement that there be no reasonable alternative is linked to the concern that the special circumstances rebuttal not be used as a convenient way for Chapter 7 debtors to select a more expensive life style. The question is whether, given the individual debtor's circumstances, the presumption of abuse has erroneously identified a debtor as having ability to pay a meaningful portion of his or her unsecured debts.

C. Case Law Defining Special Circumstances.

The majority, or perhaps all, of the courts considering the matter have held that "whether special circumstance exist is a fact-specific determination that should be made on a case-by-case basis."[31] There is disagreement about the focus of that inquiry. Those cases finding special circumstances focus upon the characteristics of student loans and the resulting economic hardship. Nondischargeability is the overriding

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factor. For example, in Templeton, Debtor's primary authority, the emphasis was upon the nature of student loans payments—the lack of reasonable alternative to the payment of the student loans because the loans are nondischargeable and debtors were not eligible for deferment or consolidation.[32] Knight, another case relied upon by Debtor, defined a special circumstance as one which, if not accounted for in the abuse test, would result in "demonstrable economic unfairness prejudicial to the debtor."[33] A student loan debt was found to satisfy this definition because student loan debt has unique characteristics, including nondischargeability, which make it likely that, in order to avoid unfair economic circumstances, a debtor may have no reasonable alternative to continuation of the payments, which would be possible if Chapter 7 was available,[34] In Delbecq, the court concluded that because of her nondischargeable student loan, debtor did not have a meaningful ability to repay her other debts either outside of bankruptcy or under Chapter 13.[35] These rationale result in a per se rule that nondischargeable student loan debt which cannot be consolidated or deferred is a special circumstance.

On the other hand, those courts finding student loan debt not to be a special circumstance reject a per se rule based upon Nondischargeability and look to the circumstances under which the debtor incurred the obligation. Vaccariello, rejected a per se rule as follows: This Court is not persuaded that merely because a debt is not dischargeable it can or should constitute a special circumstance. If Congress had wanted to make any or all of the exceptions to discharge a special circumstance, it could have chosen to do so. It did not. This Court does not find any basis in the Bankruptcy Code or case law to support a per se rule that having no reasonable alternative to paying a nondischargeable debt constitutes special circumstances.[36] After having rejected a per se rule, the court found no special circumstances based upon the facts of the case. The Court observed that it cannot be argued that having a student loan is rare or unusual, and debtors had failed to set forth any circumstances to show that their loans had been incurred in other than in the ordinary course of acquiring their educations.

The Pageau[37] court also refused to focus upon the nature of the student loan. It stated:

> It is not the obligation to repay a loan itself that qualifies such an expense as a special circumstance under § 707(b)(2)(B)(i), but rather it is the circumstances that lead to incurring a loan that must be special and justify the inclusion of this additional expense item in the means test, as long as the debtor has no reasonable alternative but to make monthly payments on such loan. For that reason, the Court shall focus on the reasons the Debtor borrowed money for her education and incurred the Student Loan debt.[38]

Under this test, nondischargeability cannot be a special circumstance.[39] Further, loans incurred to secure a "more advantageous income or to enter a different vocation

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are not special circumstances," as they are neither extraordinary nor rare.[40]

D. The Court Concludes that Student Loan Expenses do not per se Constitute Special Circumstances.

Debtor is asking the Court to hold that all student loan debts not subject to deferment, without more, satisfy the special circumstances standard. This the Court declines to do. The Court is not prepared to join the analysis of the Oklahoma Bankruptcy Court in Templeton and finds the analysis of Pageau much more persuasive. If Congress intended to allow inclusion of all student loan expenses when calculating disposable income for purposes of the means test, it would have said so. The validity of this observation is supported by the fact that the IRS Manual, which is the source of many of the expenses permitted under the means test, allows the student loan expense under the category of all necessary expenses, but Congress when enumerating the expenses allowable under the means test by virtue of its exclusion of all "payments for debts" did not include payment for student loan debts in § 707(b)(2)(A)(ii)(I).[41]

It is tempting for the Court to find that student loan debt is "good" nondischargeable debt, as contrasted with "bad" nondischargeable debt, such as that arising from fraud, for example, and to hold that "good" nondischargeable debt constitutes a special circumstance. However, as the Pageau court observed, "there is no suggestion in Section 707(b)(2)(B) that courts have been delegated [this] policy decision."[42]

This Court agrees with the numerous courts which have concluded that whether special circumstances are present is a factual determination made on a case-by-case basis.[43] The circumstances which gave rise to the loan are an important, if not the determinative, factor. Most student loans are incurred in the ordinary course to enhance earning potential or to change to a more desirable field of endeavor. It will be an unusual case where the circumstances of a student loan creates a financial condition which justifies the inclusion of this expense in the means test. It is the nondischargeability of student loans which cause a debtor to be faced with unsatisfactory alternatives, but the flexibility of the special circumstances rebuttal of the presumption of abuse does not have as its purpose the mitigation of economic hardship resulting from nondischargeability. Its purpose is to allow debtors to rebut the presumption of abuse by demonstrating the absence of meaningful ability to repay unsecured debt because of special circumstances which increase expenses above those permitted by the statutory means test. That test seeks to determine whether debtors are seeking Chapter 7 relief when they have sufficient income to make meaningful payments to unsecured creditors, not to be a gate keeper to protect debtors from the adverse consequences of nondischargeable student loan debt, in a Chapter 13 case or otherwise.

The UST presents four specific arguments in opposition to Debtor's position that her student loan payments constitute special circumstances. Although the Court denies Debtor's claim of special circumstances for the reasons stated above, response to the UST's arguments will clarify the Court's position. The first three of these are offered in support of the legal proposition that student loan payments can never constitute an additional expense justified by special circumstances, a proposition

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not presented to the Court for decision and with which it does not agree. First, the UST contends that "Debtor has a reasonable alternative, chapter 13." The Court rejects this argument. Based upon case law and the legislative history, the Court finds the possibility of a Chapter 13 filing not to be a relevant consideration. One court has concluded that consideration of how a debtor could proceed under Chapter 13 as a part of the special circumstances analysis "would violate the Congressional intent behind the means test."[44] This Court agrees. The means test is based upon the debtor's income and expenses, and it is the result of the means test that determines the presumption of abuse. It is a snapshot of debtor's financial condition on the date of filing. To consider a hypothetical Chapter 13 plan would require the Court to stray from the means test, and consider debtor's projected disposable income and obligations.[45] This Court has concluded the requirement that the debtor not have a reasonable alternative serves primarily to foreclose the allowance of additional expenses which result from debtor's selection of a high standard of living. The means test demands "that a debtor commit discretionary income to pay debts rather than to maintain an existing life style."[46] That purpose of the condition is illustrated by Delunas,"[47] where the court disallowed as a special circumstance additional housing expense of $813 per month to fulfill debtors' desire to live in a four bedroom house in an affluent St. Louis suburb where their children would have separate bedrooms and would be bused to the school where they had been enrolled. The decision whether to file under Chapter 7 or Chapter 13 is not a life style choice. The presence or absence of a reasonable alternative is not evaluated by the potential results of a hypothetical Chapter 13 filing.

Second, the UST argues that certain of the cases finding student loan obligations constitute special circumstances are either distinguishable or wrongly decided. The primary basis for this position is that Haman, Templeton, and Delbecq, cited by Debtor, relied in part on In re Thompson,[48] which held that a 401(k) loan payment came within the definition of special circumstances. Thompson was reversed on appeal.[49] It was a 401(k) case, not a student loan case, so the reliance on Thompson by the courts in the cases cited by Debtor was limited. Haman cited Thompson when observing that it is open to question whether the two statutory examples of special circumstances arise involuntarily.[50] Templeton[51] and Delbecq[52] Thompson for the general proposition that special circumstances inquiry is fact-specific. The district court, when reversing the bankruptcy court's finding of special circumstances, actually relied upon the lower court's conclusion that "the language of the `special circumstances' provision implies fact-specific circumstances."[53] When finding the student loan satisfied the definition of special circumstances, the Templeton

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court relied upon In re Lenton,[54] in addition to Thompson.[55] Hence, the reversal of Thompson does not cast serious doubt on the cases cited by Debtor.

Third, the UST asserts that the circumstances of student loan payments do not rise to the level of the two circumstances enumerated in the statute, military service and a serious medical condition. The UST argues that these examples provide clear guidance that the circumstances that qualify as special should be beyond the control of the debtor and immutably impact the debtor's monthly expenses and/or ability to generate income. The Court disagrees. The legislative history indicates the two statutory circumstances are mere examples to assure protection of debtors in the referenced categories from a finding of abuse when, despite the mechanics of the means test, they lack disposable income for the payment of unsecured creditors. "[T]he legislative history does not indicate that the explicit examples included in § 707(b)(2)(B) were intended to define, qualify or otherwise limit the meaning of `special circumstances.'"[56] The purpose of the means test and the presumption of abuse is to "require bankruptcy judges to dismiss a chapter 7 case, or convert a chapter 7 case to chapter 13 if a bankrupt has a demonstrable capacity to repay his or her debts."[57] In recognition that the mechanical test reflected in Form 22A could sweep too broadly, Congress enacted the special circumstances exception whereby the court may allow additional expenses, where the debtor has no reasonable alternative. The Court is not willing to state that student loan payments are so dissimilar to military service and serious medical conditions that such payment will never qualify as special circumstances.

Fourth, the UST argues that Debtor has not satisfied the procedural requirements of § 707(b)(2)(B)(ii) and (iii), quoted in footnote 21 above. The Court agrees the record is deficient in this regard, but finds the UST disingenuous when raising this issue after having agreed to submit the case on stipulated facts. The issue before the Court is the legal question of whether student loan payments per se qualify as a special circumstance within the meaning of § 707(b)(2)(B). Satisfaction of the procedural requirements is not relevant.

CONCLUSION.

For the foregoing reason, the Court finds that Debtor's student loan expenses, standing alone, do not satisfy the special circumstances standard of § 707(b)(2)(B) for justifying additional expenses for the purpose of rebutting the presumption of abuse. The UST's motion to dismiss or convert pursuant to § 707(b)(1) is granted. Debtor's case shall be dismissed, unless within 30 days of this order, Debtor converts to a Chapter 13.

The foregoing constitute Findings of Fact and Conclusions of Law under Rules 7052 and 9014(c) of the Federal Rules of Bankruptcy Procedure which make Rule 52(a) of the Federal Rules of Civil Procedure applicable to this matter. A judgment based upon this ruling will be entered on a separate document as required by Federal Rule of Bankruptcy Procedure 9021 and Federal Rule of Civil Procedure 58.

IT IS SO ORDERED.

Notes:

1. Doc. 13.

2. This Court has jurisdiction pursuant to 28 U.S.C. § 157(a) and §§ 1334(a) and (b) and the Standing Order of the United States District Court for the District of Kansas that exercised authority conferred by § 157(a) to refer to the District's Bankruptcy judges all matters under the Bankruptcy Code and all proceedings arising under the Code or arising in or related to a case under the Code, effective July 10, 1984. A motion to dismiss is a core proceeding which this Court may hear and determine as provided in 28 U.S.C. § 157(b)(2)(A). There is no objection to venue or jurisdiction over the parties.

3. Since filing for initial schedules and forms, Debtor has amended her Form 22A, mooting several allegations of the UST's motion based upon presumed abuse.

4. The UST has not objected to the figures provided on the amended Form 22A, with the exception of the inclusion of the payment to Debtor's student loan lenders as a special circumstance.

5. Doc. 30. Schedule F lists unsecured nonpriority claims in the amount of $72,405. It appears to the Court that the word "no" was erroneously inserted in the stipulation, which should read "Debtor's nonpriority unsecured claims amounts to more than $26,300." However, this apparent error is of no consequence in this case.

6. Collier on Bankruptcy ¶ 707.05[2][d](Alan N. Resnick & Henry J. Sommer eds.-in-chief, 15th ed. rev.2007).

7. Doc. 30. Schedule F lists unsecured nonpriority claims in the amount of $72,405. It appears to the Court that the word "no" was erroneously inserted in the stipulation, which should read "Debtor's nonpriority unsecured claims amounts to more than $26,300." However, this apparent error is of no consequence in this case.

8. If the Court used the figure of $72,405 as the total nonpriority unsecured debts, the result would be the same. Twenty-five percent of $72,405 is $18,101.25.

9. In re Templeton, 36,5 B.R. 213 (Bankr. W.D.Okla.2007); In re Human, 36,6 B.R. 307 (Bankr.D.Del.2007); In re Delbecq, 36,8 B.R. 754 (Bankr.S.D.Ind.2007); In re Martin, 37,1 B.R. 347 (Bankr.C.D.Ill.2007); In re Knight, 37,0 B.R. 429 (Bankr.N.D.Ga.2007); In re Robinette, 200,7 WL 2955960 (Bankr.D.N.M. 2007).

10. In re Templeton, 36,5 B.R. at 213.

11. Id., 365 B.R. at 216.

12. In re Knight, 37,0 B.R. at 429.

13. Id., 370 B.R. at 437-38.

14. Id., 370 B.R. at 439.

15. In re Delbecq, 36,8 B.R. at 754.

16. In re Haman, 36,6 B.R. at 307.

17. In re Vaccariello, 37,5 B.R. 809 (Bankr. N.D.Ohio 2007).

18. Id., 375 B.R. at 816.

19. Eisen v. Thompson, 370 B.R. 762 (N.D.Ohio 2007).

20. In re Pageau, 38,3 B.R. 221 (Bankr.D.N.H. 2008).

21. Id., 383 B.R. at 226-27.

22. The subsections provide:

(ii) In order to establish special circumstances, the debtor shall be required to itemize each additional expense or adjustment of income and to provide—

(I) documentation for such expense or adjustment to income; and

(II) a detailed explanation of the special circumstances that make such expenses or adjustment to income necessary and reasonable.

(iii) The debtor shall attest under oath to the accuracy of any information provided to demonstrate that additional expenses or adjustments to income are required.

23. Burlington N. R.R. Co. v. Oklahoma Tax Comm'n, 481 U.S. 454, 461, 107 S.Ct. 1855, 95 L.Ed.2d 404 (1987) ("Legislative history can be a legitimate guide to a statutory purpose obscured by ambiguity...."); In re Delbecq, 36,8 B.R. at 756-58 (examining legislative history of § 707(b)(2)(B)).

24. In re Delbecq, 36,8 B.R. at 757.

25. S. Rep. 106-49, at 2 (1999) (available at 1999 WL 300934).

26. S. Rep. 106-49, at 3 (1999).

27. S. Rep. 106-49, at 6-8 (1999).

28. In re Delbecq, 36,8 B.R. at 758; In re Human, 36,6 B.R. at 314.

29. H. R Rep. 109-31, pt 1, at 9 (2005) (available at 2005 WL 832198).

30. In re Haman, 36,6 B.R. at 314.

31. In re Pageau, 38,3 B.R. at 225-26 (citing In re Robinette, 200,7 WL 2955960 at *4; In re Turner, 37,6 B.R. 370 (Bankr.D.N.H. 2007); In re Vaccariello, 37,5 B.R. at 813; In re Knight, 37,0 B.R. at 437; In re Pampas, 36,9 B.R. 290 (Bankr.M.D.La.2007); In re Templeton, 36,5 B.R. at 216).

32. In re Templeton, 36,5 B.R. at 216.

33. In re Knight, 37,0 B.R. at 438-439.

34. Id., 370 B.R. at 439.

35. In re Delbecq, 36,8 B.R. at 761.

36. In re Vaccariello, 37,5 B.R. at 815.

37. In re Pageau, 38,3 B.R. 221.

38. Id., at 227-28 (citation omitted).

39. Id., at 228-29.

40. Id, at 227-28.

41. See In re Knight, 37,0 B.R. at 436-37.

42. In re Pageau, 38,3 B.R. at 228-29.

43. See Id., at 225-26 (collecting cases).

44. In re Haman, 36,6 B.R. at 315.

45. In re Pageau, 38,3 B.R. at 229-30.

46. In re Knight, 37,0 B.R. at 439.

47. In re Delunas, 200,7 WL 737763 (Bankr. E.D.Mo.2007).

48. In re Thompson, 35,0 B.R. 770 (Bankr. N.D.Ohio 2006).

49. Eisen v. Thompson, 370 B.R. at 762.

50. In re Haman, 36,6 B.R. at 313.

51. In re Templeton, 36,5 B.R. at 216.

52. In re Delbecq, 36,8 B.R. at 758.

53. Eisen v. Thompson, 370 B.R. at 772, quoting In re Thompson, 35,0 B.R. at 777.

54. In re Lenton, 35,8 B.R. 651 (Bankr. E.D.Pa.2006).

55. In re Templeton, 36,5 B.R. at 216-17.

56. In re Delbecq, 36,8 B.R. at 758.

57. S. Rep. 106-49, at 3 (1999).

In re STEVE D. SANDERS DEBORAH M. SANDERS, Debtors.
Case No. 10-11939-WRS
UNITED STATES BANKRUPTCY COURT FOR THE MIDDLE DISTRICT OF ALABAMA
Done: July 11, 2011

Chapter 7
MEMORANDUM DECISION

This case is before the Court on the Bankruptcy Administrator's Motion to Dismiss Chapter 7 Case Pursuant to 11 U.S.C. § 707(b)(2). (Doc. 24). The Debtors, Steve D. and Deborah M. Sanders, through their attorney Collier H. Espy, orally objected to the motion at a hearing held January 26, 2011 in Dothan, Alabama. The issue underlying the Bankruptcy Administrator's motion is the Debtors' student loan payments and whether those payments constitute special circumstances to get past the presumption of abuse raised under the Means Test. A second hearing was held telephonically on April 6, 2011 to clarify the scope of the Bankruptcy Administrator's objection. For the reasons set forth below, the Bankruptcy Administrator's motion is DENIED.

I. Facts

On September 30, 2010, Steve D. and Deborah M. Sanders ("the Debtors") filed a chapter 7 case, Case No. 10-11939. (Doc. 1). Along with their petition they filed their Chapter 7 Statement of Currently Monthly Income and Means Test Calculation - Form 22A ("Means Test"). Id. On their Means Test they state an annualized current monthly income of $76,264.32. Id. at ln. 13. The Debtors claim their twenty-three year old son as a dependent on their Schedule I and list their household size as three. Id. For a household of three, the applicable median

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family income is $55,433. Id. at ln. 14. The Means Test shows a monthly disposable income of $1,196.91. Id. at ln. 50. The Debtors' 60-month disposable income is $71,814.60. Id. at ln. 51. At line 56, the Debtors list an Additional Expense Claim of $2,041.61 for payments on student loans incurred by their son. The Debtors are either directly or on a guarantor basis responsible for the student loan payments incurred by their son. The total amount to be repaid on the student loans is approximately $236,672.25. Id. at pg. 9.

On December 13, 2010, the Bankruptcy Administrator ("BA") filed her Motion to Dismiss under 11 U.S.C. § 707 because absent the deduction for the student loan payments, the Debtors' income raises a presumption of abuse under the Means Test. (Doc. 24). At a hearing on January 19, 2011, this Court took the issue regarding the student loan payments under advisement. Briefs were submitted by both parties to the issue. A second hearing was held telephonically on April 6, 2011, where the BA waived her right to raise a procedural issue, thus limiting the scope of her objection to the substantive legal issue.

II. Conclusions of Law

A. The Law

Under 11 U.S.C. § 707(b)(2), a chapter 7 debtor's bankruptcy must be dismissed or converted to a chapter 11 or 13 case when a presumption of abuse arises under § 707(b)(2)(A)(i). 11 U.S.C. § 707(b)(2). Under § 707(b)(2)(A)(i)(II), the debtor's current monthly income, reduced by amounts stated in other parts of § 707(b)(2)(A), and multiplied by 60 must be less than $11,725. If it is not, then the court "shall presume abuse exists." 11 U.S.C. § 707(b)(2)(A)(i). However, the presumption of abuse may be rebutted by the debtor's demonstration of "special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces, to the extent such special circumstances that justify additional

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expenses or adjustments of current monthly income for which there is no reasonable alternative:" 11 U.S.C. § 707(b)(2)(B)(i) (emphasis added).

It is the debtor's responsibility to prove there exist "special circumstances . . . for which there is no reasonable alternative." On the procedural side, the debtor must meet the requirements of § 707(b)(2)(B)(ii), which require: (1) documentation for the expense or adjustment; (2) "a detailed explanation of the special circumstances that make the adjustments to income necessary and reasonable;" and (3) such information must be provided by the debtor under oath. In re Hammock, 436 B.R. 343, 352 (Bankr. E.D.N.C. 2010).

Once the procedural burden has been met, the courts then look to whether there exists a special circumstance creating an expense for which there is no reasonable alternative but to pay to rebut the presumption of abuse. This examination must be done on a "case-by-case basis." In re Fonash, 401 B.R. 143, 147 (Bankr. M.D.Pa. 2008); In re Champagne, 389 B.R. 191, 200 (Bankr. D.Kan. 2008). As a result of this fact-specific inquiry, courts have divided largely into three camps when it comes to addressing the issue of whether student loan repayment qualifies as a "special circumstance" under § 707(b)(2)(B).

In the first camp are courts who have found that student loans can never qualify as "special circumstances" and therefore, cannot be considered as an "other necessary expense" for the purposes of determining abuse under the Means' Test. See Id. Those courts reason that a debtor's circumstances need to be "reasonable and necessary" to be similar to the examples provided by Congress in the Code in order to qualify as special. Id. at 354 (citing In re Siler, 426 B.R. 167, 172 (Bankr. W.D.N.C. 2010) (citation omitted). Thus, the expense ultimately needs to be the result of situation that is extraordinary, outside the control of a debtor, or always

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unanticipated. Id. (citing Siler, 426 B.R. at 172). This creates a very high standard for a debtor to achieve.

In applying this high standard, the courts in camp one look at the particulars of student loan repayment. These courts note that debtors often advance the argument that the non-dischargeable nature of student loans is what triggers the special circumstances. Id. at 355. These courts find that simply being classified as non-dischargeable does not meet the high standard intended by Congress. Rather, if a student loan were provided this additional protection, it would essentially give a student loan a priority status not provided for in the Bankruptcy Code. Id. (citing Siler, 426 B.R. at 175; In re Vaccariello, 375 B.R. 809, 815 (Bankr. N.D. Ohio 2007)). These courts concluded that there is nothing "special" about student loans and therefore, they do not qualify as special circumstances.

A second camp of courts suggest that they are open to student loan repayments constituting special circumstances, but did not find special circumstances because of the facts before them or for procedural reasons. See In re Womer, 427 B.R. 334 (Bankr. M.D.Pa. 2010); In re Fonash, 401 B.R. 143 (Bankr. M.D.Pa. 2008). In Womer, the court noted the "exceptional burdens placed on the debtor by reason of the obligation of the student loan" as the crux for other courts finding student loan repayments constitute special circumstances. Id. at 336. However, the debtors in Womer did not provide any evidence of exceptional burdens or an inability to repay; rather they simply stated they had student loan obligations and a general difficulty in paying their expenses. The Womer court concluded that absent something more specific, the court could not find that special circumstances existed. Id. In Fonash, the court did not reach the substantive issue because it found that the debtor had not even met the procedural requirements under § 707(b)(2)(B). Fonash, 401 B.R. at 148. Both courts recognized the need for the debtor

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to document the expense that would constitute special circumstances. Without this minimum showing, the courts did not need to further examine the trickier question of if that situation is a special circumstance.

In the third and final camp, the courts have found that depending on the facts, student loan repayments can constitute special circumstances. See In re Haman, 366 B.R. 307 (Bankr. D.Del. 2007); In re Templeton, 365 B.R. 213 (Bankr. W.D.Okla. 2007); In re Delbecq, 368 B.R. 754 (Bankr. S.D.Ind. 2007); In re Knight, 370 B.R. 429 (Bankr. N.D.Ga. 2007). These courts reasoned that "'special circumstances' requires 'a fact-specific, case-by-case inquiry into whether the debtor has a meaningful ability to pay his or her debts in light of an additional expense or adjustment to income not otherwise reflected in the means test calculation.'" Knight, 370 B.R. at 437 (citing Delbecq, 368 B.R. at 758-59). To these courts, a special circumstance is one that if the additional expense is not taken into consideration it creates a "demonstrable economic unfairness" that prejudices the debtor. Id. at 437-38.

In support of their position, the courts in the third camp look first to the statutory language of § 707(b)(2)(B) itself. See Haman, 366 B.R. at 313 ([W]here . . . the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'" United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989)); Delbecq, 368 B.R. at 756. "[C]ourts must presume that a legislature says in a statute what it means and means in a statute what it says there. When the words of a statute are unambiguous, then . . . 'judicial inquiry is complete.'" Id. (citing Conn. Nat'l Bank v. Germain, 503 U.S. 249, 253-54, 112 S.Ct. 1146, 117 L.Ed.2d 391 (1992) (quoting Rubin v. United States, 449 424, 430, 101 S.Ct. 698, 66 L.Ed.2d 633 (1981))). In the event the statute is ambiguous, then the courts can turn to the legislative history to determine the intention of the drafters. Id. (citing Ron Pair,

489 U.S. at 242-43 (internal citations omitted)). Here, the term "special circumstances" is not defined in the Code, so the courts turn to the legislative intent.

First, these courts have noted that nothing in the plain language of § 707(b)(2)(B) requires that the special circumstances be of an involuntary nature: the only clear requirements under § 707(b)(2)(B) are that the debtor bears the burden to prove a special circumstance that leaves the debtor with no reasonable alternative but to incur the expense or have the income adjustment. Id. (citing In re Graham, 363 B.R. 844, 850-51 (Bankr. S.D. Ohio 2007)). Indeed, some of these courts have noted that even the involuntary nature of the examples provided in § 707(b)(2)(B) is questionable - "[a] serious health condition could stem from a self-inflicted injury, and an individual called to active duty could have voluntarily enlisted as a reservist." Id. (quoting In re Thompson, 350 B.R. 770, 777 (Bankr. N.D. Ohio 2006). The focus is very much on whether circumstances and expenses exist to which the debtor has no reasonable alternative but to pay. The courts also focus on the words "such as." This signal is routinely used as an introduction to a list of examples. Id. (citing In re Sparks, III, 360 B.R. 224, 230-31 (Bankr. E.D.Tex. 2006; In re Lenton, 358 B.R. 651, 661-62 n.22 (Bankr. E.D.Pa. 2006)). Moreover, the words "such as" imply an intent to provide a non-exhaustive list of illustrations and not an intent to limit the application of the statute to just the list. Id.

The legislative history of § 707(b)(2)(B) further supports these courts view of the what the statute's language clearly says. According to the Congressional Record on the amendment, examples of special circumstances were not even provided until Senator Jeff Sessions "proposed the amendment to clarify 'that the special circumstances exception . . . includes a debtor with a serious medical condition or a debtor on active duty in the military.'" Id. at 314 (citing H.R. Rep. No. 109-31(I), at 9 (2005), as reprinted in 2005 U.S.C.C.A.N. 88, 96). Senator Sessions

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did not intend to limit judicial discretion or define special circumstances, but simply to protect those "incapable of paying back their debt due to military service or a serious medical condition" from being required to do so. 151 CONG. REC. S1834-01, S1845-46 (2005) (statement of Sen. Sessions). The court in Haman found that not only did the legislative history show that the examples are non-exhaustive, but also Senator Sessions' intent demonstrates that special circumstances do not have to be of an involuntary nature. Haman, 366 B.R. at 314.

Relying on this view of "special circumstances," three cases stand out for finding that student loan payments constitute "special circumstances." In Haman, the debtor was a co-obligor on her son's student loans and the son was unable to make payments due to a mental illness. The debtor could not discharge the debt because it did not meet the high standard of "undue hardship" and the only other way to stop making payments would be to pay-off the debt in full. Id. at 315. The court found that based on its understanding of "special circumstances" the debtor had met her burden: she had to repay the student loans and there was no other reasonable alternative to paying them. Therefore, they constituted "special circumstances."

In Delbecq, the debtor was a teacher whose monthly student loan payment was greater than her disposable income. Noting no other major factors, the court said the debtor was without a reasonable alternative to pay because the debt was non-dischargeable leaving her with only deferment as an option if the case were dismissed, meaning the debtor would incur even more debt while the interest accrued on the balance of the student loans. Therefore, the debtor had shown that she had no other reasonable alternative but to pay the student loans and therefore, they were "special circumstances." Delbecq, 368 B.R. at 759. Accord, Templeton, 365 B.R. 213 (Holding that student loan debt constituted a "special circumstance" when it could not be discharged, consolidated, or deferred.).

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Knight involved a slightly different scenario - the debtor was contesting the projected disposable income calculated for their chapter 13 plan payments and wanting a finding that their student loan payments constituted "special circumstances." Knight, 370 B.R. 429. The court in Knight noted that "[p]ublic policy encourages the pursuit of higher education because it benefits not only the individual, but society as a whole;" however, many individuals cannot afford higher education, either public or private, without some form of financial assistance. Id. at 438. For that reason, student loans are available to individual of all means and backgrounds. But, the cost can be in the tens or hundreds of thousands of dollars with a structured repayment period ranging from ten to 30 years. Id. at 439. Moreover, student loans are non-dischargeable unless a debtor meets the high burden of showing "undue hardship." For these reasons, the court in Knight, actually found that these characteristics of student loans are what make them unique and therefore "special circumstances." Id.

The Court finds the reasoning of the courts in the third camp more persuasive and determines that depending on the facts of a case, student loans payments may qualify as "special circumstances." In addition, a review of the Senate Judiciary Committee Reports on § 707(b)(2)(B) further convince this Court that student loan payments can constitute "special circumstances." According to the Committee Report,

> In order to protect debtors from rigid and arbitrary application of a means-test, section 102 also provides in some cases where the presumption applies the debtor may be able to demonstrate "special circumstances" that justify additional expenses or an

> adjustment to the debtor's income. The Committee adopted the "special circumstances" standard, rather than the "extraordinary circumstances" standard included in the Conference Report to accompany H.R. 3150 to provide a different standard of when a debtor may overcome the presumption of abuse. . . . The debtor's ability to overcome the presumption of abuse must be based solely on financial consideration (i.e. adjustment to income

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> or expenses required by special circumstances) and not on factors unrelated to a chapter 7 debtor's ability to repay his or her debts. The Committee believes that the relief sought by a debtor who files for bankruptcy is financial in nature and the debtor's right to obtain preferential relief under the special circumstances provision should be assessed based on financial considerations only. In addition, special circumstances adjustments must not be used as a convenient way for debtors to choose a more expensive lifestyle. The special circumstances provision must be reserved only for those debtors whose special circumstances require adjustments to income or expenses that place them in dire need of chapter 7 relief.
>
> . . .
>
> [T]he new section 707(b) contains numerous procedural safeguards in order to ensure that the individual circumstances of each bankrupt will be considered before he or she is dismissed or converted to chapter 13.

S. REP. NO. 106-49, at 6-8 (1999) (emphasis added). The Court notes that the Committee specifically replaced "extraordinary" with "special" because the Committee wanted to apply a different standard to rebut the presumption of abuse. It is clear from the legislative history that the standard is "special" and not "extraordinary" as the courts in the first camp suggest. Under this lower standard, this Court thinks it is possible for student loan obligations be an expense that can rebut the presumption of abuse.

Moreover, if one looks at the definition of "special", it has been defined, in relevant part, as "distinguished by some unusual quality." WEBSTER'S NEW INTERNATIONAL DICTIONARY, UNABRIDGED 2186 (Philip Babcock Gove, Ph.D. et. al. eds., 3rd ed. 1986). As the court noted in Knight, public policy encourages pursuing higher education because of its benefits to the individual and society as a whole. Knight, 370 B.R. 438. As a result, individuals incur debt in the form of student loans in order to have access to higher education, with a repayment period of ten to 30 years. Id. The court described these as unique characteristics and this Court thinks these are unusual qualities and therefore fall under the definition of "special."

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The "unusual quality" of the student loans also addresses the additional concern raised by the courts in the first camp. Some of these courts worried that granting debtors the ability to have their non-dischargeable, general unsecured student loans considered a "special circumstance" would open the flood gates to allow other non-dischargeable, general unsecured debts the same status. See, e.g. In re Hammock, 436 B.R. 343, 355 (Bankr. E.D.N.C. 2010). This Court notes that aside from student loans, other non-dischargeable debts are either already provided for under the Mean's Test (i.e. domestic support obligation) or are not, but have to meet some morally culpable standard to be excepted from discharge. The moral culpability standard for those other non-dischargeable debt is a way of saying that individuals who are morally culpable cannot escape their responsibilities as a result of their wrong doing simply by filing bankruptcy. Student loans are not morally wrong; society encourages education as a means of advancement. Therefore, student loans have an "unusual quality" about them that makes them distinctly different from the other non-dischargeable debts not considered in the Means' Test calculation. An abuse of the system would not occur by considering student loans as special circumstances.

B. The Sanders' Case

Having determined that student loans can constitute "special circumstances," the Court now turns to the facts of the Debtors' case to see if they have carried their burden and rebutted the presumption of abuse. The Debtors are either direct or co-guarantors on these student loans, incurred for the benefit of their son's education. The Debtors have represented to the Court through their pleadings that their son is employed, but making only $35,000 per annum and thus could not afford to make the $2,000 plus payments per month on his own. As such, being also

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obligated for the loans, the Debtors' have been making payments as their son cannot make the payments.

The BA has pointed out that Congress has provided for discharge of student loan debt if the debtor can prove undue hardship under 11 U.S.C. § 523(a)(8). (Doc. 28, pg. 6). However, that would require either the son to enter bankruptcy and prove undue hardship simply on the basis that he cannot pay his student loans or that the parents attempt to get out of paying their main unsecure creditor by trying to meet the incredibly high burden of proving undue hardship.

This burden is high for two reasons: § 523(a)(8) is limited only to government-funded student loans and the body of case law that has developed on the matter has required debtors to prove that their financial state of affairs will continue for a significant portion of the repayment period. E.g., Brunner v. New York State Higher Educ. Services Corp., 831 F.2d 935 (2nd Cir. 1987). The son here is young and with his first job, so proving that over the long term of his loan repayment period he will not ever see a financial increase will be near to impossible. Likewise, this suggests that as his pay increases, he could help his parents pay more in the future, thus undermining their own argument for undue hardship. Therefore, proving undue hardship does not appear to be a reasonable alternative for the Debtors.

Additionally, the Debtors could seek consolidation, forbearance, or deferment of the student loans while in a chapter 13 plan, or have their case dismissed. However, this Court does not think these alternatives are reasonable. If the case were dismissed or the loans placed in forbearance or deferment, the result is the same - the Debtors would see themselves incurring more debt on the student loans as either of these three outcomes would most likely delay or reduce their monthly payments on the student loans, thus dragging out the repayment period and allowing the interest to accrue. The Court does not think that imposing additional debt on a

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debtor is reasonable. See, e.g., In re Knight, 370 B.R. 429 (Bankr. N.D.Ga. 2007); In re Delbecq, 368 B.R. 754 (Bankr. S.D.Ind. 2007).

From these facts, it appears to the Court that the Debtors' have no reasonable alternative but to pay the student loan payments. Moreover, their monthly disposable income is only $1,196.91 with a monthly student loan payment of $2,041.61 (Doc. 1, Form 22A, ln. 50, 56). As the Senate Committee report states, the courts must look only to financial considerations to find special circumstances for a debtor in dire relief of a chapter 7 and the special circumstances exception is not meant to let a debtor live a more expensive lifestyle. See, S. REP. NO. 106-49, at 6-8 (1999). The Debtors' student loan payments are purely a financial consideration and from the facts, one that has strongly contributed to their need for chapter 7 belief. The Court does not think student loans equate to an expensive lifestyle choice, but rather a means to afford an education that few can afford to pay for outright. Public policy supports higher education and student loans. Therefore, the Court thinks that based on the facts in this case the Debtors' have proven their burden of showing that their student loan payments constitute a special circumstance for which there is no reasonable alternative.

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CONCLUSION

For the reasons stated above, this Court finds that the Debtors' have shown that their student loan payments constitute special circumstances under 11 U.S.C. § 707(b)(2)(B) and therefore, rebut the presumption of abuse under the Means' Test. Thus, the Court will DENY the Bankruptcy Administrator's Motion to Dismiss pursuant to 11 U.S.C. § 707(b)(2) by way of a separate order.

William R. Sawyer
United States Bankruptcy Judge

c: Collier H. Espy Jr., Attorney for Debtors
Teresa R. Jacobs, Bankruptcy Administrator
William C. Carn III, Trustee

Law Schools

12 More Law Schools Sued Over Reporting of Law Grad Employment and Salary Stats

Posted Feb 1, 2012 4:39 PM CST
By Martha Neil

Updated: In a gathering storm that apparently may not yet have reached its full strength, lawsuits have been or will be filed today against another 12 law schools over the way they report employment data for their graduates, according to counsel for the plaintiffs.

They say in a press release (PDF) that new litigation is being brought against law schools in California, Delaware, Florida, Illinois and New York, concerning allegations that a number engaged in subterfuges such as hiring their own graduates for temporary jobs and counting law grads working in nonlegal jobs as employed. Links to some of the complaints can be found at plaintiffs lawyer David Anziska's website.

Plaintiffs contend that they were misled by the statistics into taking on a heavy debt burden in pursuit of employment as attorneys that was much harder to find than the job stats provided by the law schools suggested. They also allege that salary figures may have been compiled from a small sample of law grads with fatter-than-average paychecks.

“We believe that some in the legal academy have done a disservice to the profession and the nation by saddling tens of thousands of young lawyers with massive debt for a degree worth far less than advertised,” Anziska said in a statement provided today to New York magazine.

“It is time for the schools to take responsibility, provide compensation and commit to transparency," he continues. "These lawsuits are only the beginning.”

A total of 14 law schools have been sued so far, according to plaintiffs' counsel, including New York Law School and Thomas M. Cooley Law School. Cooley has previously launched a pre-emptive strike, contending in a lawsuit filed against a law firm (which apparently is not involved in the current set of filings) that it has been defamed by false accusations concerning information the law school provided about its graduates' success.

Bloomberg reports that Albany Law School and the Maurice A. Deane School of Law at Hofstra University say they stand by the employment data they provided in compliance with standards set by the ABA and the National Association for Law Placement.

“We have documentation that supports the accuracy of our data,” said Connie Mayer, the interim president and dean at Albany Law School, said in an email to Bloomberg. “Students are well aware of the realities of today’s economy, and we believe the information we provide during the admission process does not mislead our applicants.”

Officials at both schools declined to comment specifically on the litigation.

Leslie Steinberg, associate dean for public affairs at defendant Southwestern Law School told National Law Journal that the school stands by the employment data it has posted on its website and submitted to both the American Bar Association and U.S. News & World Report.

In an email to students Tuesday, Feb. 7, Chicago-Kent College of Law Dean Howard Krent said: "We believe the lawsuit against Chicago-Kent to be without merit and are confident that the courts will agree."

The other targeted schools are Brooklyn Law School, California Western School of Law, DePaul University College of Law, Florida Coastal School of Law, Golden Gate University School of Law, The John Marshall Law School, University of San Francisco School of Law and Widener University School of Law.

Additional and related coverage:

ABAJournal.com: "Law Firms Announce Plans to Sue 15 More Law Schools over Job Stats"

ABAJournal.com: "ABA Committee Approves New Law School Disclosure Requirements"

ABA Journal.com: "Only 26% of Law Schools Report Percentage of Grads with Legal Jobs, Study Finds"

ABAJournal.com: "NY Times Reporter Sounds off on Legal Education, Accreditation and the ‘Crazy’ Race for Rankings"

Updated Feb. 7 to include Chicago-Kent dean's message to students.

Legal Education

How Long Can the Law School Bubble Last?

Posted Dec 27, 2011 10:41 AM CST
By William D. Henderson and Rachel M. Zahorsky

©CJ Burton/Corbis

For Andrea, a past decision to ensure her future in law has left her in a stressed and distressful present. Concerned over how it might affect her job prospects, she would not allow use of her real name. And there is reason for concern: She's been laid off twice since her 2009 law school graduation, including from a position where she earned $20 an hour at a small firm practicing as a licensed attorney. For the 29-year-old, who's supported herself since college, the financial repercussions of law school may amount to the worst investment of her life, despite a degree from a second-tier school and a resumé that boasts a position on law review and coveted summer associate positions.

"I deferred my loans because of economic hardship the first time," says Andrea, who borrowed nearly $110,000 to finance her education. "After that," she falters, "they might be in forbearance ... accruing interest ... I just don't know."

Andrea's situation is far from unique. In 2010, 85 percent of law graduates from ABA-accredited schools boasted an average debt load of $98,500, according to data collected from law schools by *U.S. News & World Report*. At 29 schools, that amount exceeded $120,000. In contrast, only 68 percent of those grads reported employment in positions that require a JD nine months after commencement. Less than 51 percent found employment in private law firms.

The influx of so many law school graduates—44,258 in 2010 alone, according to the ABA—into a declining job market creates serious repercussions that will reverberate for decades to come.

Click here to read the rest of "The Law School Bubble" from the January issue of the ABA Journal.

Helping Your Clients Out of Default on Federal Student Loans
By Mandi Matlock, Texas RioGrande Legal Aid

We've all heard the saying, "If you think education is expensive, try ignorance." In this era of exponentially increasing college tuition and unprecedented outsourcing to private collection agencies, many of us may be wondering whether it's still true, and wishing we had a precise formula to test the theory behind the adage.

Education still may be the ticket out of poverty, but the rising cost of higher education together with a corresponding decrease in federal grants, means that students are increasingly borrowing to fund their education. Federal student loan borrowers are unique among consumer debtors in that there is no statute of limitations on collection and the government has extraordinary collection powers. The government can and will intercept tax refunds, offset federal benefits, and pursue administrative wage garnishments. Forever.

The introduction of the new Income-Based Repayment (IBR) option in mid-2009 finally made it possible for many low-income borrowers to enter affordable repayment plans. Under IBR, payments are capped at 15% of what they earn over 150% of federal poverty guidelines. Thus, borrowers earning less than 150% of federal poverty guidelines may have their payments set at <u>zero</u>. And after 25 years of IBR payments, any remaining debt is cancelled.[1]

But many low-income clients are in default on their student loans, and defaulting borrowers are not eligible for IBR. Enter the plan to help your low-income clients out of default so they can get on the right side of the perpetual federal collection machine!

The first essential task is to determine what type of loan(s) the borrower has: private, federal, or a mix. Whether your client has private loans affects her options for getting out of default. If a borrower is unsure of the type of loan, consult the National Student Loan Data System.[2] The NSLDS is an excellent source for discovering loan amounts, outstanding balances, loan statuses, and disbursements for all federal loans.[3] Unfortunately, there is no corresponding central database for private student loan information.[4] A rule of thumb is that if the loan is not listed at NSLDS, then it is probably a private loan.

If you have determined that your client has at least one federal student loan, the next step is to choose whether to consolidate or rehabilitate to get federal loans out of default.[5]

Many considerations go into deciding which option is best for your client, necessitating a careful, individualized analysis of each client's case. With either option, borrowers have one shot. That is, over the lifetime of the loans, borrowers can only consolidate once and

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[1] IBR payments also count toward the 120 payments required for the Direct Loan Public Service Loan Forgiveness.
[2] Your client must obtain a PIN to use the site. http://www.nslds.ed.gov/nslds_SA/
[3] Borrowers may also contact the Federal Student Aid Information Center at 800-4-FED-AID
[4] The Consumer Financial Protection Bureau has plans to hire a private student loan ombudsman. Stay up to date at http://www.consumerfinance.gov/
[5] Rehabilitation and consolidation programs for private loans may be available from private lenders, but carefully consider the implications of entering any such programs. For example, consolidating federal loans into a private consolidation program strips borrowers of important federal rights, such as eligibility for deferment and flexible payment options.

rehabilitate once. Also with either option, collectors or servicers can add up to 18.5% in fees. Finally, common to both options is the brass ring: eligibility for IBR.[6]

Under rehabilitation, a borrower must timely make 9 of 10 "reasonable and affordable" monthly payments during 10 consecutive months.[7] Each loan must be rehabilitated separately. To complete the rehabilitation, the each loan must then be sold. Because there are no published guidelines on what is "reasonable and affordable," advocates should negotiate what is reasonable and affordable for each client. Be prepared for collectors who work on a commission basis and who may attempt to force borrowers into payments that are not affordable to them. Come to the table armed with substantiation of income and expenses. Advocates should obtain a written agreement that the payments will be made for rehabilitation purposes. At the end of the process, the loans are eligible for IBR.

The other option out of default is consolidation, which is more akin to refinancing. With consolidation, old loans are rolled into one new loan.[8] If available, this option provides the quickest, easiest path out of default. Borrowers with post-2006 fixed-rate loans or who are close to their payoff date have less to gain from consolidation. The minimum requirement for consolidation is for the borrower to elect IBR or ICR. Collectors commonly tell borrowers they must make three payments to qualify, which is not only untrue but a violation of the federal and state Fair Debt Collection Practices Acts. All federal loan consolidation is through the Direct Loan Consolidation program.[9] Once consolidated, borrowers are placed into a flexible payment option.[10]

Because they work on a commission basis, collectors and servicers tend to push rehabilitation over consolidation. Advocates will need to do their own analysis to recommend the best available option for clients. The following resources are indispensible to this work:

The National Consumer Law Center treatise: Student Loan Law

http://www.studentloanborrowerassistance.org/

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[6] The older, less desirable ICR (income contingent repayment) is also available to these borrowers. Compare ICR and IBR at http://www.studentloanborrowerassistance.org/repayment/repayment-plans/#INCOMEBASEDOPTIONS

[7] Payments do not have to be consecutive. Collectors will misapply this rule if not checked.

[8] It is possible to consolidate a single loan.

[9] http://www.loanconsolidation.ed.gov/

[10] Due to a glitch in its system, Direct Loan Servicing is placing all loans into ICR, regardless of whether the borrower elected IBR. Advocates will need to follow up to correct this with Direct Loan Servicing once consolidation is completed.

*** LOAN HOLDER USE ONLY ***
ORIGINAL RECEIPT DATE:

DISCHARGE APPLICATION: TOTAL AND PERMANENT DISABILITY

OMB No. 1845-0065
Form Approved
Exp. Date 12/31/2011

Federal Family Education Loan Program / Federal Perkins Loan Program / William D. Ford Federal Direct Loan Program / Teacher Education Assistance for College and Higher Education Grant Program

WARNING: Any person who knowingly makes a false statement or misrepresentation on this form or on any accompanying documents will be subject to penalties that may include fines, imprisonment, or both, under the U.S. Criminal Code and 20 U.S.C. 1097.

READ THIS FIRST: This is an application for a total and permanent disability discharge of your Federal Family Education Loan (FFEL) Program, Federal Perkins Loan (Perkins Loan) Program, and/or William D. Ford Federal Direct Loan (Direct Loan) Program loan(s), and/or your Teacher Education Assistance for College and Higher Education (TEACH) Grant Program service obligation.

To qualify for this discharge (except for certain veterans as explained below), a physician must certify in Section 4 of this form that you are unable to engage in any substantial gainful activity (see definition in Section 5) by reason of a medically determinable physical or mental impairment that **(1)** can be expected to result in death; **(2)** has lasted for a continuous period of not less than 60 months; or **(3)** can be expected to last for a continuous period of not less than 60 months. This disability standard may differ from disability standards used by other federal agencies (for example, the Social Security Administration) or state agencies. Except as noted below for certain veterans, a disability determination by another federal or state agency does not establish your eligibility for this discharge.

If you are a veteran, you will be considered totally and permanently disabled for purposes of this discharge if you provide documentation from the U.S. Department of Veterans Affairs (VA) showing that you have been determined to be **unemployable due to a service-connected disability**. If you provide this documentation, you are not required to have a physician complete Section 4 of this form or provide any additional documentation related to your disabling condition. You only need to complete Sections 1 and 3.

SECTION 1: APPLICANT IDENTIFICATION

Please enter or correct the following information.

SSN ___ – __ – ____

Name ______________________

Address ______________________

City, State, Zip Code ______________________

Telephone - Home (   ) ______________________

Telephone - Other (   ) ______________________

E-mail Address (Optional) ______________________

SECTION 2: INSTRUCTIONS FOR COMPLETING AND SUBMITTING THIS APPLICATION

- Type or print in dark ink. Enter your name and Social Security Number at the top of page 2 (if not preprinted).
- Have a doctor of medicine or osteopathy complete and sign Section 4, unless you are a qualifying veteran (see the next bullet).
- If you are a veteran who has received a determination from the VA that you are **unemployable due to a service-connected disability**, attach documentation of this determination. You are not required to have a physician complete Section 4. **If you do not have documentation showing that you are unemployable due to a service-connected disability and cannot obtain this documentation, you must have a physician complete Section 4**.
- Sign and date the application in Section 3. A representative may sign on your behalf if you are unable to do so because of your disability.
- Make sure that Sections 3 and (if applicable) 4 include all requested information. Incomplete or inaccurate information may cause your application to be delayed or rejected.
- Send the completed application with any necessary attachments to the address shown below. If no address is shown, send the application and any attachments to your loan holder or, if you are applying for discharge of a TEACH Grant Program service obligation, to the U.S. Department of Education (the Department) at the address shown on correspondence you received related to your TEACH Grant.
- If you are applying for discharge of more than one loan and your loans are held by more than one loan holder, or if you are applying for discharge of both a TEACH Grant service obligation and one or more loans, you must submit a separate discharge application (original or copy) with any necessary attachments to each loan holder and, for TEACH Grants, to the Department. A "copy" means a photocopy of the original application completed by you (or your representative) and your physician. Any copy must include an **original signature** from you or your representative.
- **IMPORTANT: You must submit this application to your loan holder(s) and/or the Department within 90 days of the date of your physician's signature in Section 4. See Section 3 for address and contact information**. (**NOTE TO VETERANS:** This requirement does not apply if you are a veteran who provides the documentation described above under "READ THIS FIRST.")

SECTION 3: APPLICANT'S DISCHARGE REQUEST, AUTHORIZATION, UNDERSTANDINGS, AND CERTIFICATIONS

Before signing, carefully read the entire application, including the instructions in Section 2 and other information on the following pages.

I request that the Department discharge my FFEL, Perkins Loan, and/or Direct Loan program loan(s), and/or my TEACH Grant service obligation.

I authorize any physician, hospital, or other institution having records about the disability that is the basis for my request for a discharge to make information from those records available to the holder(s) of my loan(s) and/or to the Department.

I understand that **(i)** I must submit a separate discharge application to each holder of the loan(s) that I want to have discharged. If I am applying for discharge of both a TEACH Grant service obligation and one or more loans, I must submit a separate discharge application to each loan holder and, for TEACH Grants, to the Department. Unless I am a veteran who provides the documentation described above under "READ THIS FIRST," I must submit a discharge application to each loan holder and/or the Department within 90 days of the date of my physician's signature in Section 4. **(ii)** Unless I am a veteran who provides the documentation described above under "READ THIS FIRST," I may be required to repay a discharged loan or satisfy a discharged TEACH Grant service obligation if I fail to meet certain requirements during a post-discharge monitoring period, as explained in Section 6. **(iii)** If I am a veteran, the certification by a physician on this form (if I am required to obtain such a certification) is only for the purposes of establishing my eligibility to receive a discharge of a FFEL Program loan, a Perkins Loan Program loan, a Direct Loan Program loan, and/or a TEACH Grant service obligation, and is not for purposes of determining my eligibility for, or the extent of my eligibility for, VA benefits.

I certify that: **(i)** I have a total and permanent disability, as defined in Section 5. **(ii)** I have read and understand the information on the discharge process, the terms and conditions for discharge, and the eligibility requirements to receive future loans or TEACH Grants as explained in Sections 6 and 7.

Signature of Applicant or Applicant's Representative	**Date**	Printed Name of Applicant's Representative (if applicable)

Address of Applicant's Representative (if applicable)	Representative's Relationship to Applicant (if applicable)

Send the completed discharge application and any attachments to:	***If you need help completing this form, call:***

Applicant Name: ______________________ Applicant SSN: ___ – __ – ____

SECTION 4: PHYSICIAN'S CERTIFICATION

READ THIS FIRST: The applicant identified above is applying for a discharge of a federal student loan and/or a teaching service obligation for a federal grant on the basis that he or she has a total and permanent disability, as defined in Section 5 of this form. To qualify for a discharge, the applicant must be unable to engage in any substantial gainful activity (as defined in Section 5) by reason of a medically determinable physical or mental impairment that **(1)** can be expected to result in death; **(2)** has lasted for a continuous period of not less than 60 months; or **(3)** can be expected to last for a continuous period of not less than 60 months. This disability standard may be different from standards used under other programs in connection with occupational disability, or eligibility for social service or veterans benefits. A determination that the applicant is disabled by another federal agency (for example, the Social Security Administration) or a state agency does not establish the applicant's eligibility for this loan discharge.

Instructions for Physician:

- Complete this form only if you are a doctor of medicine or osteopathy legally authorized to practice in a state, as defined in Section 5, and only if the applicant's condition meets the definition of total and permanent disability in Section 5.
- **Type or print in dark ink. All fields must be completed. If a field is not applicable, enter "N/A." Your signature date must include month, day, and year (mm-dd-yyyy).**
- Provide all requested information for Items 1, 2, and 3 below, and attach additional pages if necessary. Complete the physician's certification at the bottom of this page. The applicant's loan discharge application cannot be processed if the information requested in this section is missing.
- If you make any changes to the information you provide in this section, you must initial each change.
- **Please return the completed form to the applicant or the applicant's representative**. The holder(s) of the applicant's loan(s) (as defined in Section 5) or the U.S. Department of Education may contact you for additional information or documentation.

1. Ability to Engage in Substantial Gainful Activity. Does the applicant have a medically determinable physical or mental impairment (as explained in Item 2 below) that **(a)** prevents the applicant from engaging in any substantial gainful activity, in any field of work, and **(b)** can be expected to result in death, *or* has lasted for a continuous period of not less than 60 months, *or* can be expected to last for a continuous period of not less than 60 months? ☐ **Yes** ☐ **No**

Substantial gainful activity means a level of work performed for pay or profit that involves doing significant physical or mental activities, or a combination of both. *If the applicant is able to engage in any substantial gainful activity, in any field of work, you must answer "No."*

IF THE ANSWER TO QUESTION 1 IS NO, DO NOT COMPLETE THIS APPLICATION.

2. Disabling Condition. Complete the following regarding the applicant's disabling physical or mental impairment. **Do not use abbreviations or insurance codes**.

(a) Provide the diagnosis: ______________________

(b) Describe the severity of the disabling physical or mental impairment, including, if applicable, the phase of the disabling condition: ______________________

3. Limitations. Explain how the disabling condition prevents the applicant from engaging in substantial gainful activity in *any* field of work by responding to Items (a) through (e) below, as relevant to the applicant's condition. Attach additional pages if more space is needed.

In addition to what is required below, you may include any additional information that you believe would be helpful in understanding the applicant's condition, such as medications used to treat the condition, surgical and non-surgical treatments for the condition, etc.

(a) Limitations on sitting, standing, walking, or lifting: ______________________

(b) Limitations on activities of daily living: ______________________

(c) Residual functionality: ______________________

(d) Social/behavioral limitations, if any: ______________________

(e) Current Global Assessment Function Score (for psychiatric conditions): ______________________

Physician's Certification

- **I certify that, in my best professional judgment, the applicant identified above is unable to engage in any substantial gainful activity in *any* field of work by reason of a medically determinable physical or mental impairment that (1) can be expected to result in death, (2) has lasted for a continuous period of not less than 60 months, or (3) can be expected to last for a continuous period of not less than 60 months.**
- **I understand that an applicant who is currently able to engage in any substantial gainful activity in *any* field of work does not have a total and permanent disability as defined on this form.**

I am a doctor of (check one) ☐ medicine ☐ osteopathy/osteopathic medicine. I am legally authorized to practice in the state of ______________________, and my professional license number is ______________________ (subject to verification through state records).

Physician's Signature (a signature stamp is not acceptable)	**Date (mm-dd-yyyy)**	Printed Name of Physician (first name, middle initial, last name)
Address		City, State, Zip Code
( ) Telephone	( ) Fax	E-mail Address (Optional)

 REVISED 7/2010

SECTION 5: DEFINITIONS

- If you have a **total and permanent disability**, this means that:

  (1) You are unable to engage in any substantial gainful activity by reason of a medically determinable physical or mental impairment that can be expected to result in death, that has lasted for a continuous period of not less than 60 months, or that can be expected to last for a continuous period of not less than 60 months, **OR**

  (2) You are a veteran who has been determined by the VA to be **unemployable due to a service-connected disability**.

  NOTE: This disability standard may differ from disability standards used by other federal agencies (for example, the Social Security Administration) or state agencies. Except in the case of certain veterans, a disability determination by another federal or state agency does not establish your eligibility for a discharge of your loan(s) and/or TEACH Grant service obligation due to a total and permanent disability.

- **Substantial gainful activity** means a level of work performed for pay or profit that involves doing significant physical or mental activities, or a combination of both.
- A **discharge of a loan** due to a total and permanent disability cancels your obligation (and, if applicable, an endorser's obligation) to repay the remaining balance on your FFEL, Perkins Loan, and/or Direct Loan program loans. A **discharge of a TEACH Grant service obligation** cancels your obligation to complete the teaching service that you agreed to perform as a condition for receiving a TEACH Grant.
- The **post-discharge monitoring period** begins on the date the Department grants a discharge of your loan or TEACH Grant service obligation and lasts for three years. If you fail to meet certain conditions at any time during or at the end of the post-discharge monitoring period, the Department will reinstate your obligation to repay your discharged loan or complete your TEACH Grant service obligation. See Section 6 for more information.
- The **Federal Family Education Loan (FFEL) Program** includes Federal Stafford Loans (both subsidized and unsubsidized), Federal Supplemental Loans for Students (SLS), Federal PLUS Loans, and Federal Consolidation Loans.
- The **Federal Perkins Loan (Perkins Loan) Program** includes Federal Perkins Loans, National Direct Student Loans (NDSL), and National Defense Student Loans (Defense Loans).
- The **William D. Ford Federal Direct Loan (Direct Loan) Program** includes Federal Direct Stafford/Ford Loans (Direct Subsidized Loans), Federal Direct Unsubsidized Stafford/Ford Loans (Direct Unsubsidized Loans), Federal Direct PLUS Loans (Direct PLUS Loans), and Federal Direct Consolidation Loans (Direct Consolidation Loans).
- The **Teacher Education Assistance for College and Higher Education (TEACH) Grant Program** provides grants to students who agree to teach full time for at least four years in high-need fields in low-income elementary or secondary schools as a condition for receiving the grant funds. If a TEACH Grant recipient does not complete the required teaching service within eight years after completing the program of study for which the TEACH Grant was received, the TEACH Grant funds are converted to a Direct Unsubsidized Loan that the grant recipient must repay in full, with interest, to the Department.
- The **holder** of your FFEL Program loan(s) may be a lender, a guaranty agency, or the Department. The holder of your Perkins Loan Program loan(s) may be a school you attended or the Department. The holder of your Direct Loan Program loan(s) is the Department. If you received a TEACH Grant, the Department holds your TEACH Grant Agreement to Serve.
- The term **"state"** as used on this application includes the 50 United States, the District of Columbia, American Samoa, the Commonwealth of Puerto Rico, Guam, the U.S. Virgin Islands, the Commonwealth of the Northern Mariana Islands, the Republic of the Marshall Islands, the Federated States of Micronesia, and the Republic of Palau.

SECTION 6: DISCHARGE PROCESS / ELIGIBILITY REQUIREMENTS / TERMS AND CONDITIONS FOR DISCHARGE (continues on next page)

NOTE: If you are applying for discharge of loans that are held by the Department, or are applying for discharge of a TEACH Grant service obligation, the discharge process begins with the review by the Department described below.

For veterans who have been determined by the VA to be unemployable due to a service-connected disability:

1. **Review of discharge application by your loan holder.** Your loan holder will review your completed discharge application and the required documentation you provide from the VA. If the documentation indicates that you are totally and permanently disabled in accordance with paragraph (2) of the definition of "total and permanent disability" in Section 5, your loan holder will refer your application and the accompanying documentation to the Department for further review. If the documentation from the VA does not indicate that you are totally and permanently disabled, you will be notified that you must resume payment of your loan(s). If the documentation from the VA does not indicate that you are totally and permanently disabled in accordance with paragraph (2) of the definition of "total and permanent disability," but it indicates that you may be totally and permanently disabled in accordance with paragraph (1) of the definition, you will be notified that you may reapply for discharge under the process for other applicants, as described below. For FFEL Program loans held by a lender, both the lender and the guaranty agency will review your application and accompanying documentation before sending the application and documentation to the Department.
2. **Review of discharge application by the Department.** The Department will review the documentation from the VA to determine if you are totally and permanently disabled in accordance with paragraph (2) of the definition of "total and permanent disability" in Section 5.
3. **Discharge.** If the Department determines that you are totally and permanently disabled, you will be notified that your loan(s) and/or TEACH Grant service obligation has been discharged. The discharge will be reported to national consumer reporting agencies, and any loan payments received on or after the effective date of the determination by the VA that you are unemployable due to a service-connected disability will be refunded to the person who made the payments. If the Department determines that you are not totally and permanently disabled, you will be notified that you must resume repayment of your loan(s), or if you applied for discharge of a TEACH Grant service obligation, that you must comply with all terms and conditions of your TEACH Grant Agreement to Serve.

For all other applicants:

1. **Review of discharge application by your loan holder.** Your loan holder will review your completed discharge application and any accompanying documentation to determine whether you appear to be totally and permanently disabled in accordance with paragraph (1) of the definition of "total and permanent disability" in Section 5. If applicable, your loan holder may also contact your physician for additional information. For FFEL Program loans held by a lender, this determination will be made by both the lender and the guaranty agency. If the loan holder determines that you do not appear to be totally and permanently disabled, you will be notified of that decision. You must then resume payment of your loan(s). If your loan holder determines that you appear to be totally and permanently disabled, your loan(s) will be assigned to the Department. The Department will be your new loan holder.
2. **Review of discharge application by the Department.** The Department will review the physician's certification in Section 4 and any accompanying documentation to determine if you are totally and permanently disabled in accordance with paragraph (1) of the definition of "total and permanent disability" in Section 5. The Department may also contact your physician for additional information, or may arrange for an additional review of your condition by an independent physician at the Department's expense. Based on the results of this review, the Department will determine your eligibility for discharge.
3. **Discharge.** If the Department determines that you are totally and permanently disabled, you will be notified that a discharge has been granted, and that you will be subject to a post-discharge monitoring period for three years beginning on the discharge date. The notification of discharge will explain the terms and conditions under which the Department will reinstate your obligation to repay your discharged loan or complete your discharged TEACH Grant service obligation, as described in Item 4, below. The discharge will be reported to national consumer reporting agencies, and any loan payments that were received after the date the physician certified your discharge application will be returned to the person who made the payments.

   If the Department determines that you are not totally and permanently disabled, you will be notified of that determination. You must then resume repayment of your loan(s), or if you applied for discharge of a TEACH Grant service obligation, you must comply with all terms and conditions of your TEACH Grant Agreement to Serve.
4. **Post-discharge monitoring period.** If you are granted a discharge, the Department will monitor your status during the 3-year post-discharge monitoring period that begins on the date the discharge is granted. The Department will reinstate your obligation to repay your discharged loan(s) and/or your obligation to complete your discharged TEACH Grant service obligation if, at any time during the post-discharge monitoring period, you:

   - Receive annual earnings from employment that exceed the poverty line amount (see Note below) for a family of two in your state, regardless of your actual family size;
   - Receive a new loan under the FFEL, Perkins Loan, or Direct Loan Program or a new TEACH Grant; or
   - Fail to ensure that a loan or TEACH Grant disbursement was returned to the loan holder or (for a TEACH Grant) to the Department within 120 days of the disbursement date, in the case of a FFEL, Perkins, or Direct Loan program loan or a TEACH grant that was made before the discharge date, but was disbursed during the 3-year post-discharge monitoring period.

   During the 3-year post-discharge monitoring period, you (or your representative) must:

   - Promptly notify the Department if your annual earnings from employment exceed the poverty line amount for a family of two in your state (see Note below), regardless of your actual family size;

SECTION 6: DISCHARGE PROCESS / ELIGIBILITY REQUIREMENTS / TERMS AND CONDITIONS FOR DISCHARGE (continued from previous page)

- Promptly notify the Department of any changes in your address or telephone number; and
- If requested, provide the Department with documentation of your annual earnings from employment.

Note: The poverty line amounts are updated annually and may be obtained at http://aspe.hhs.gov/poverty. The Department will notify you of the current poverty line amounts during each year of the post-discharge monitoring period.

5. **Reinstatement of obligation to repay discharged loans or complete discharged TEACH Grant service obligation.** If you do not meet the requirements described above in Item 4 at any time during or at the end of the post-discharge monitoring period, the Department will reinstate your obligation to repay your discharged loan(s) and/or to complete your discharged TEACH Grant service obligation. If you received a discharge of your loan(s), this means that you will be responsible for repaying your loan(s) in accordance with the terms of your promissory note(s). However, you will not be required to pay interest on your loan(s) for the period from the date of the discharge until the date your repayment obligation was reinstated. The Department will continue to be your loan holder. If you received a discharge of your TEACH Grant service obligation, you will again be subject to the requirements of your TEACH Grant Agreement to Serve. If you do not meet the terms of that agreement and the TEACH Grant funds you received are converted to a Direct Unsubsidized Loan, you must repay that loan in full, and interest will be charged from the date(s) that the TEACH Grant funds were disbursed.

   If your obligation to repay a loan or complete a TEACH Grant service obligation is reinstated, the Department will notify you of the reinstatement. This notification will include:

   - The reason or reasons for the reinstatement;
   - For loans, an explanation that the first payment due date following the reinstatement will be no earlier than 60 days following the notification of reinstatement; and
   - Information on how you may contact the Department if you have questions about the reinstatement, or if you believe that your obligation to repay a loan or complete a TEACH Grant service obligation was reinstated based on incorrect information.

SECTION 7: ELIGIBILITY REQUIREMENTS TO RECEIVE FUTURE LOANS OR TEACH GRANTS

For veterans who receive a total and permanent disability discharge based on a determination by the VA that they are unemployable due to a service-connected disability:

If you are granted a **discharge** based on a determination that you are totally and permanently disabled in accordance with paragraph (2) of the definition of "total and permanent disability" in Section 5, you are not eligible to receive future loans under the FFEL, Perkins Loan, or Direct Loan programs or TEACH Grants unless:

- You obtain a certification from a physician that you are able to engage in substantial gainful activity; and
- You sign a statement acknowledging that the new loan or TEACH Grant service obligation cannot be discharged in the future on the basis of any injury or illness present at the time the new loan or TEACH Grant is made, unless your condition substantially deteriorates so that you are again totally and permanently disabled.

For all other individuals who receive a total and permanent disability discharge:

If you are granted a **discharge** based on a determination that you are totally and permanently disabled in accordance with paragraph (1) of the definition of "total and permanent disability" in Section 5, you are not eligible to receive future loans under the FFEL, Perkins Loan, or Direct Loan programs or TEACH Grants unless:

- You obtain a certification from a physician that you are able to engage in substantial gainful activity;
- You sign a statement acknowledging that the new loan or TEACH Grant service obligation cannot be discharged in the future on the basis of any injury or illness present at the time the new loan or TEACH Grant is made, unless your condition substantially deteriorates so that you are again totally and permanently disabled; and
- If you request a FFEL, Perkins Loan, or Direct Loan program loan or a new TEACH Grant within three years of the date that a previous loan or TEACH Grant was discharged, you resume payment on the previously discharged loan or acknowledge that you are once again subject to the terms of the TEACH Grant Agreement to Serve before receiving the new loan.

SECTION 8: IMPORTANT NOTICES

Privacy Act Notice. The Privacy Act of 1974 (5 U.S.C. 552a) requires that the following notice be provided to you:

The authorities for collecting the requested information from and about you are §421 *et seq.*, §451 *et seq.*,§461 *et seq.*, and §420L *et seq.* of the Higher Education Act of 1965, as amended (the HEA) (20 U.S.C. 1071 *et seq.*, 20 U.S.C. 1087a *et seq.*, 20 U.S.C. 1087aa *et seq.*, and 20 U.S.C. 1070g *et seq.*) and the authorities for collecting and using your Social Security Number (SSN) are §§428B(f) and 484(a)(4) of the HEA (20 U.S.C. 1078-2(f) and 1091(a)(4)) and §31001(i)(1) of the Debt Collection Improvement Act of 1996 (31 U.S.C. 7701(c)). Participating in the Federal Family Education Loan (FFEL) Program, the William D. Ford Federal Direct Loan (Direct Loan) Program, the Federal Perkins Loan (Perkins Loan) Program, and/or the Teacher Education Assistance for College and Higher Education (TEACH) Grant Program and giving us your SSN are voluntary, but you must provide the requested information, including your SSN, to participate.

The principal purposes for collecting the information on this form, including your SSN, are to verify your identity, to determine your eligibility to receive a FFEL, Direct Loan, and/or Perkins Loan program loan or a TEACH Grant, to receive a benefit on a loan (such as a deferment, forbearance, discharge, or forgiveness) or a discharge of a TEACH Grant service obligation, to permit the servicing of your loan(s) or TEACH Grant(s), and, if it becomes necessary, to locate you and to collect and report on your loan(s) if your loan(s) become delinquent or in default. We also use your SSN as an account identifier and to permit you to access your account information electronically.

The information in your file may be disclosed, on a case-by-case basis or under a computer matching program, to third parties as authorized under routine uses in the appropriate systems of records notices.

For a loan or for a TEACH Grant that has not been converted to a Direct Unsubsidized Loan, the routine uses of the information that we collect about you include, but are not limited to, its disclosure to federal, state, or local agencies, to institutions of higher education, and to third party servicers to determine your eligibility to receive a loan or a TEACH Grant, to investigate possible fraud, and to verify compliance with federal student financial aid program regulations.

In the event of litigation, we may send records to the Department of Justice, a court, adjudicative body, counsel, party, or witness if the disclosure is relevant and necessary to the litigation. If this information, either alone or with other information, indicates a potential violation of law, we may send it to the appropriate authority for action. We may send information to members of Congress if you ask them to help you with federal student aid questions. In circumstances involving employment complaints, grievances, or disciplinary actions, we may disclose relevant records to adjudicate or investigate the issues. If provided for by a collective bargaining agreement, we may disclose records to a labor organization recognized under 5 U.S.C. Chapter 71. Disclosures may be made to our contractors for the purpose of performing any programmatic function that requires disclosure of records. Before making any such disclosure, we will require the contractor to maintain Privacy Act safeguards. Disclosures may also be made to qualified researchers under Privacy Act safeguards.

For a loan, including a TEACH Grant that has been converted to a Direct Unsubsidized Loan, the routine uses of this information also include, but are not limited to, its disclosure to federal, state, or local agencies, to private parties such as relatives, present and former employers, business and personal associates, to creditors, to financial and educational institutions, and to guaranty agencies to verify your identity, to determine your program eligibility and benefits, to permit making, servicing, assigning, collecting, adjusting, or discharging your loan(s), to enforce the terms of the loan(s), to investigate possible fraud and to verify compliance with federal student financial aid program regulations, to locate you if you become delinquent in your loan payments or if you default, or to verify whether your debt qualifies for discharge or cancellation. To provide default rate calculations, disclosures may be made to guaranty agencies, to financial and educational institutions, or to federal, state or local agencies. To provide financial aid history information, disclosures may be made to educational institutions. To assist program administrators with tracking refunds and cancellations, disclosures may be made to guaranty agencies, to financial and educational institutions, or to federal or state agencies. To provide a standardized method for educational institutions to efficiently submit student enrollment status, disclosures may be made to guaranty agencies or to financial and educational institutions. To counsel you in repayment efforts, disclosures may be made to guaranty agencies, to financial and educational institutions, or to federal, state, or local agencies.

Paperwork Reduction Notice. According to the Paperwork Reduction Act of 1995, no persons are required to respond to a collection of information unless it displays a currently valid OMB control number. The valid OMB control number for this information collection is 1845-0065. The time required to complete this information collection is estimated to average 0.5 hours (30 minutes) per response, including the time to review instructions, search existing data resources, gather and maintain the data needed, and complete and review the information collection.

If you have comments concerning the accuracy of the time estimate(s) or suggestions for improving this form, please write to: U.S. Department of Education, Washington, DC 20202-4537. ***Do not send the completed loan discharge application to this address.***

If you have comments or concerns regarding the status of *your individual submission* of this form, contact your loan holder (see Section 3).

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831 F.2d 395
42 Ed. Law Rep. 535, Bankr. L. Rep. P 72,025
Marie BRUNNER, Appellant,
v.
NEW YORK STATE HIGHER EDUCATION SERVICES CORP., Appellee.
No. 41, Docket 87-5013.
United States Court of Appeals,
Second Circuit.
Argued Sept. 22, 1987.
Decided Oct. 14, 1987.

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Marie Brunner, pro se.

Frederick J. Schreyer, Albany, N.Y., for appellee.

Before LUMBARD, OAKES and KEARSE, Circuit Judges.

PER CURIAM:

Marie Brunner, pro se, appeals from a decision of the United States District Court for the Southern District of New York, Charles S. Haight, Judge, which held that it was error for the bankruptcy court to discharge her student loans based on "undue hardship," 46 B.R. 752 (Bankr.D.C.N.Y.1985). We affirm.

While this court is obliged to accept the bankruptcy court's undisturbed findings of fact unless they are clearly erroneous, it is not required to accept its conclusions as to the legal effect of those findings. Montco, Inc. v. Glatzer (In re Emergency Beacon Corp.), 665 F.2d 36, 40 (2d Cir.1981) (citing Queens Blvd. Wine & Liquor Corp. v. Blum, 503 F.2d 202 (2d Cir.1974); R.Bankr.P. 810 (current version, see R.Bankr.P. 8013); Bank of Pa. v. Adlman, 541 F.2d 999, 1005 (2d Cir.1976)). Whether not discharging Brunner's student loans would impose on her "undue hardship" under 11 U.S.C. Sec. 523(a)(8)(B) requires a conclusion regarding the legal effect of the bankruptcy court's findings as to her circumstances. Therefore, the bankruptcy court's conclusion of "undue hardship" properly was reviewed by the district court.

As noted by the district court, there is very little appellate authority on the definition of "undue hardship" in the context of 11 U.S.C. Sec. 523(a)(8)(B). Based on legislative history and the decisions of other district and bankruptcy courts, the district court adopted a standard for "undue hardship" requiring a three-part showing: (1) that the debtor cannot maintain, based on current income and expenses, a "minimal" standard of living for herself and her dependents if forced to repay the loans; (2) that additional circumstances exist indicating that this state of affairs is likely to persist for a significant portion of the repayment period of the student loans; and (3) that the debtor has made good faith efforts to repay the loans. For the reasons set forth in the district court's order, we adopt this analysis. The first part of this test has been applied frequently as the minimum necessary to establish "undue hardship." See, e.g., Bryant v. Pennsylvania Higher Educ. Assistance Agency (In re Bryant), 72 B.R. 913, 915 (Bankr.E.D.Pa.1987); North Dakota State Bd. of Higher Educ. v. Frech (In re Frech), 62 B.R. 235 (Bankr.D.Minn.1986); Marion v. Pennsylvania Higher Educ. Assistance Agency (In re Marion), 61 B.R. 815 (Bankr.W.D.Pa.1986). Requiring such a showing comports with common sense as well.

The further showing required by part two of the test is also reasonable in light of the clear congressional intent exhibited in section 523(a)(8) to make the discharge of student loans more difficult than that of other nonexcepted debt. Predicting future income is, as the district court noted, problematic. Requiring evidence not only of current inability to pay but also of additional, exceptional circumstances, strongly suggestive of continuing inability to repay over an extended period of time, more reliably guarantees that the hardship presented is "undue."

Under the test proposed by the district court, Brunner has not established her eligibility for a discharge of her student loans based on "undue hardship." The record demonstrates no "additional circumstances" indicating a likelihood that her current inability to find any work will extend for a significant portion of the loan repayment period. She is not disabled, nor elderly, and she has--so far as the record discloses--no dependents. No evidence

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was presented indicating a total foreclosure of job prospects in her area of training. In fact, at the time of the hearing, only ten months had elapsed since Brunner's graduation from her Master's program. Finally, as noted by the district court, Brunner filed for the discharge within a month of the date the first payment of her loans came due. Moreover, she did so without first requesting a deferment of payment, a less drastic remedy available to those unable to pay because of prolonged unemployment. Such conduct does not evidence a good faith attempt to repay her student loans.

It is true, however, that considerable time has elapsed since the original filing of Chapter 7 proceedings, and even since the hearing before the bankruptcy judge. We note that Judge Haight's order was without prejudice to Brunner's seeking relief pursuant to R.Bankr.P. 4007(a), (b).

Judgment affirmed.

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282 F.3d 868
In the Matter of Daniel G. MURPHY, Debtor.
Daniel G. Murphy, Appellant,
v.
Pennsylvania Higher Education Assistance Agency and Educational Credit Management Corporation, Appellees.
No. 01-10516.
United States Court of Appeals, Fifth Circuit.
March 5, 2002.

Charles R. Chesnutt, III (argued), Dallas, TX, for Appellant.

Donald W. Cothern (argued), Gregory Duane Smith, Ramey & Flock, Tyler, TX, for Educational Credit Management Corp.

Beverly Ann Whitley (argued), John Kendrick Turner, Bell, Nunnally & Martin, Dallas, TX, for Pennsylvania Higher Educ. Assistance Agency.

Appeal from the United States District Court for the Northern District of Texas.

Before SMITH and DeMOSS, Circuit Judges, and LAKE, District Judge.[*]

JERRY E. SMITH, Circuit Judge:

Daniel Murphy borrowed approximately $55,000 in federally guaranteed loans to attend institutions of higher learning. Shortly after receiving an L.L.M. degree,

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he filed for chapter 7 bankruptcy. The bankruptcy court held that 11 U.S.C. § 523(a)(8) bars him from discharging any of those loans in bankruptcy, because he obtained them to finance his education and signed promissory notes reflecting that purpose. The district court affirmed, and, finding no error, we also affirm.

I.

Murphy matriculated at Michigan State University in 1986 and graduated in 1990. He then attended Thomas M. Cooley Law School for three years and received his J.D. degree. In 1997, he obtained an L.L.M. from Wayne State University. He financed his education through approximately $55,000 in student loans issued under the Federal Family Education Loan Program "(FFELP"), 20 U.S.C. §§ 1071 *et seq.*

Murphy describes a uniform procedure for receiving the loans: He appeared at the financial aid office, discussed his needs, and signed a promissory note. The lender disbursed the loan to the school, which withheld tuition and expenses and gave Murphy the remainder for discretionary spending. Murphy used the money to purchase a car, housing, and food and to pay fraternity dues and other ordinary living expenses.

Education Credit Management Corporation ("ECMC") is a non-profit Minnesota corporation that provides financial assistance to students enrolled in higher education programs. ECMC holds nine promissory notes executed by Murphy.[1] As of March 15, 2000, Murphy owed ECMC $64,178.54.

Pennsylvania Higher Education Assistance Agency ("PHEAA") is a government agency organized under the laws of Pennsylvania, that provides financial assistance to students enrolled in higher education programs. PHEAA holds a promissory note dated July 5, 1996 for federal Stafford loans totaling $18,500. The parties stipulated that Murphy spent $7,000 on tuition and related expenses and $11,500 on other living expenses; as of March 10, 2000, he owed PHEAA $22,472.40.

Murphy filed and obtained a consumer chapter 7 discharge, then filed an adversary proceeding against PHEAA and ECMC, alleging that the portion of the student loans spent on living expenses was dischargeable. The bankruptcy court granted summary judgment in favor of PHEAA and ECMC.

II.

The Bankruptcy Code prevents former students from discharging educational loans in bankruptcy. 11 U.S.C. § 523(a)(8). Courts have divided over whether students who use a portion of their student loans for room, board, and living expenses can discharge that portion of the debt in bankruptcy. Some courts have held that when the lender makes the loan available for educational purposes, no part of the loan can be discharged in bankruptcy, regardless of the actual use.[2] Other

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courts have held that when the student spends the money on noneducational items and services, that portion can be discharged.[3] We conclude that the text of the Bankruptcy Code, the Federal Family Education Loan Program ("FFELP"), and Murphy's promissory notes support nondischargeability. In other words, it is the purpose, not the use, of the loan that controls. Treating FFELP guaranteed loans uniformly, regardless of actual use, is true to the text and will prevent recent graduates from reneging on manageable debts and will preserve the solvency of the student loan system.

A.

We review the bankruptcy and district court's interpretation of § 523(a)(8) *de novo.*[4] That section explains that a discharge "does not discharge an individual debtor from any debt — "

for an educational benefit overpayment or loan made, insured or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution, or for an obligation to repay funds received as an education benefit scholarship or stipend, unless excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents.

11 U.S.C. § 523(a)(8). The section exempts "educational ... loan[s] made, insured or guaranteed by a governmental unit." The plain language suggests two limits — the adjective "educational" and the requirement that a governmental or nonprofit body make or guarantee the loan.

At first cut, PHEEA's and ECMC's loans satisfy these two limits. PHEEA and ECMC made the loans to Murphy pursuant to a federal statute that provides for educational loans; the government also insured the loans against Murphy's default.

Murphy insists, however, that we should read another limit into § 523(a)(8). He contends that students may discharge the portion of their educational loans not spent or tuition or books. He points to cases holding that "[t]he test for determining whether a loan is a student loan is whether the proceeds of the loan were used for `educational purposes.'" *E.g., In re Ealy,* 78 B.R. at 898 (citations omitted). None of these cases considers a loan made pursuant to a federal student loan statute, but Murphy would have us extend their reasoning. He variously argues that the word "educational" or phrase "educational benefit" permits students to discharge the portion of student loan proceeds spent on living or social expenses.

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The textual hook for Murphy's argument is puzzling; he reads too much into the adjective "educational." Section 523(a)(8) does not expressly state that only loans "used for tuition" are nondischargeable. Nor does it define educational loans as excluding living or social expenses. *Barth v. Wis. Higher Educ. Corp. (In re Barth),* 86 B.R. 146, 148 (Bankr.W.D.Wis. 1988) ("The language of section 523(a)(8) does not refer to whether the debtor or anyone else derived educational benefits."). Loans for room and board facilitate an education and meet expenses incidental to attending school full-time.[5]

In the alternative, Murphy argues that the phrase "educational benefit" modifies both overpayment and loan. He infers that the resulting phrase "educational benefit loan" requires not only that the lender intend that the funds go towards educational purposes but also that the borrower spend the funds on tuition or books. For three reasons, Murphy's interpretation is strained, at best.

First, the word "educational," rather than "educational benefit," modifies "loan." When Congress amended § 523(a)(8) in 1990, it replaced "educational loan" with "educational benefit overpayment or loan."[6] Courts have interpreted the phrase "educational benefit overpayment" to include a category of governmental programs that pay students for the anticipated cost of future tuition.[7] After the 1990 amendments, courts continued to examine loans to determine whether they were "educational loans";[8] no court has suggested that the word "benefit" should reduce the scope of covered loans.

Additionally, § 523(a)(8)'s second use of the word "educational benefit" before "stipend" creates a serious problem for Murphy's interpretation. The section employs a parallel structure when describing another type of nondischargeable debt as arising from "an education benefit scholarship or stipend."

"Stipend" is defined in part as "a regular allowance paid to defray living expenses; *esp.* a sum paid to a student under the terms of a fellowship or scholarship." Webster's Third New International Dictionary at 2245 (Merriam-Webster 3d

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ed.1986).[9] If "educational benefit" modifies both "scholarship" and "stipend," then Murphy's interpretation of the phrase "educational benefit" would eliminate a core meaning of the word "stipend." If the second "educational benefit" modifies only the word "scholarship" and not the word "stipend," then it is difficult to understand why the second invocation of "educational benefit" should have more limited scope than does the first.

In other words, why would Congress have placed the phrase "educational benefit" before two separate series of items in the same paragraph and intended for it to modify different elements in each series? The inclusion of the word stipend proves either that "educational benefit" includes living expenses or that it describes only the type of overpayment and not the type of loan.

Finally, even if we were to interpret § 523(a)(8) to require an "educational benefit loan," Murphy does not explain why that phrase requires us to look to use rather than purpose. All Stafford loans are intended to convey educational benefits, and a grant of living expenses enables a student to attend school full-time, which certainly has educational benefits. We now turn to the FFELP to examine the unique features of loans made pursuant to that federal statute.

B.

The FFELP includes living expenses in its loans to full-time students for educational purposes. First, the FFELP contemplates that students can use federal loans to finance a full-time education. The statute distinguishes between students who take heavier course loads and those who take lighter loads.[10] Permitting students to take out loans for living expenses enables them to attend school full time.

Second, the FFELP calculates the "costs of attendance" by including allowances for "room and board," 20 U.S.C. § 1087*ll*(3), "miscellaneous personal expenses," 20 U.S.C. § 1087*ll*(2), and child care, 20 U.S.C. § 1087*ll*(8). The FFELP's need analysis assumes that loans must cover a full-time student's living expenses so that he has the time and energy to study and attend classes.

Murphy argues that the Bankruptcy Code and not the FFELP should define dischargeable and nondischargeable loans. First, § 523(a)(8) has a direct link to the Higher Educational Act, because Congress originally included it in the educational act and only later moved it to the Bankruptcy Code. *In re Shipman,* 33 B.R. at 82. Second, we should attempt to give horizontal coherence to the United States Code and ensure that different statutes interact coherently and harmoniously.[11] If Congress

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defined living expense allowances as serving an educational purpose in the student loan statutes, we should assume it also interpreted those living expense allowances as having an educational purpose in the Bankruptcy Code.

The evidence in this particular case confirms that Murphy borrowed money for living expenses as part of his broader effort to obtain an education. In the promissory notes, he acknowledged that he was borrowing the money for educational purposes.[12] He later testified that he borrowed the funds to support his full-time attendance. When a federal student loan statute authorizes the loan, the student signs an agreement to spend the funds on educational expenses, and the government guarantees the loan, then the loan should be nondischargeable.

C.

Permitting students to discharge student loans in bankruptcy because the student spent the money on social uses, alcohol, or even drugs would create an absurd result. Students who used the loan proceeds to finance an education would retain the burden of paying them even after a chapter 7 discharge; irresponsible students who abused the loans would gain the benefits of discharge. Courts have emphasized two purposes when analyzing § 523(a)(8): (1) preventing undeserving debtors from abusing educational loan programs by declaring bankruptcy immediately after graduating;[13] and (2) preserving the financial integrity of the loan system.[14] Murphy's interpretation would create two perverse effects: (1) Dischargeability would reward irresponsible student borrowers and punish responsible borrowers; and (2) the federal government would have to pay out more to cover the costs of defaulting students' loans. Murphy's interpretation would create the type of absurd result that even rigid textualists seek to avoid.[15]

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Murphy argues that private lenders currently receive the benefit of governmental guarantees on these loans, so these lenders have an incentive to expand the scope of "educational loans." Perhaps. If so, then the government has the judicial remedy of suing private lenders directly and the legislative remedy of redefining the needs analysis of the FFELP.

The potential windfalls of private lenders do not provide a persuasive reason for us to rewrite § 523(a)(8). Doing so would affect the private lenders only indirectly, because the governmental insurers, rather than private lenders, would bear the burden of the loss. This remedy also would create perverse incentives for student borrowers, squarely at odds with the only purposes that Congress has ascribed to the FFELP.

Because the bankruptcy and district courts' interpretation of § 523(a)(8) best comports with the text of the Bankruptcy Code and FFELP, the judgment is AFFIRMED.

Notes:

* District Judge of the Southern District of Texas, sitting by designation.

1. The notes reflect the following dates and amounts: (1) May 3, 1993, $7,500; (2) April 18, 1994, $8,500; (3) October 4, 1994, $4,500; (4) April 17, 1995, $2,834; (5) April 17, 1995, $3,334; (6) August 22, 1995, $5,666; (7) August 22, 1995, $6,666; (8) May 3, 1993, $4,000; and (9) April 18, 1994, $5,500.

2. *Constr. Equip. Fed. Credit Union v. Roberts* (*In re Roberts),* 149 B.R. 547, 551 (C.D.Ill. 1993) (finding

it unnecessary to remand to apportion loan proceeds spent on educational expenses and living expenses); *In re Pelzman,* 233 B.R. 575, 580 (Bankr.D.D.C.1999) (finding that university's extension of credit for room and board fell within the scope of an educational loan); *Stevens Inst. of Tech. v. Joyner (In re Joyner),* 171 B.R. 762, 764-65 (Bankr.E.D.Pa.1994) (finding that room, board, and other living expenses serve an educational purpose and refusing to find that portion dischargeable); *United States Dep't of Health and Human Servs. v. Vretis (In re Vretis),* 56 B.R. 156, 157 (Bankr.M.D.Fla.1985) (finding that stipend that provided for rent and living expenses was not dischargeable).

3. *Ealy v. First Nat'l Bank (In re Ealy),* 78 B.R. 897, 898 (Bankr.C.D.Ill.1987) (finding portion of loan that student used to purchase truck, pay off wife's car, and pay for other miscellaneous expenses dischargeable in bankruptcy); *United States Dep't of Health & Human Servs. v. Brown (In re Brown),* 59 B.R. 40, 43 (Bankr.W.D.La.1986) (instructing government to separate portion of stipend spent on tuition and books from portion spent on rent and living expenses); *Dep't of Mental Health, State of Missouri v. Shipman (In re Shipman),* 33 B.R. 80, 82 (Bankr.W.D.Mo.1983) (discharging stipend partially because the debtor spent the proceeds on rent and living expenses).

4. We review a bankruptcy court's legal conclusions *de novo. Texas Lottery Comm'n v. Tran* (*In re Tran*), 151 F.3d 339, 342 (5th Cir.1998). Summary judgment decisions and statutory interpretation questions are legal findings that we review *de novo. Samson v. Apollo Resources, Inc.,* 242 F.3d 629, 633 (5th Cir.) (statutory interpretation), *cert. denied,* ___ U.S. ___, 122 S.Ct. 63, 151 L.Ed.2d 31 (2001); *Herman v. Holiday,* 238 F.3d 660, 663 (5th Cir.2001) (summary judgment).

5. *In re Pelzman,* 233 B.R. at 580; *In re Joyner,* 171 B.R. at 764-65.

6. Before the 1990 amendments, § 523(a)(8) excluded from discharge "an educational loan made, insured or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or nonprofit institution." 11 U.S.C. § 523(a)(8) (1988). To expand § 523(a)(8)'s scope, the 1990 amendments added the categories of (1) overpaying a grant and (2) scholarship funds or stipends. Crime Control Act of 1990, Pub.L. No. 101-647, § 3621(a), 104 Stat. 4964, 4964-65 (1990). *See Santa Fe Med. Servs., Inc. v. Segal (In re Segal),* 57 F.3d 342, 348-49 (3d Cir.1995).

7. "An `educational benefit overpayment' is an overpayment from a program such as the GI Bill under which where students receive periodic payments while they are enrolled in school, but if the students receive payments after they have left the school, that is an educational benefit overpayment." *Cazenovia College v. Renshaw (In re Renshaw),* 229 B.R. 552, 556 & n. 8 (BAP 2d Cir.1999), *aff'd,* 222 F.3d 82 (2d Cir.2000). *New Mexico Inst. of Mining and Tech. v. Coole (In re Coole),* 202 B.R. 518, 519 (Bankr.D.N.M.1996); *Alibatya v. New York Univ. (In re Alibatya*), 178 B.R. 335, 338 (Bankr.E.D.N.Y.1995); *Johnson v. Va. Commonwealth Univ. (In re Johnson),* 222 B.R. 783, 786 (Bankr.E.D.Va.1998).

8. *E.g., In re Renshaw,* 229 B.R. at 559-60 (characterizing question as whether debtor received an "educational loan" and not an "educational benefit loan"); *Shaffer v. United Student Aid Funds (In re Shaffer),* 237 B.R. 617, 618 (Bankr.N.D.Tex.1999) (same); *In re Pelzman,* 233 B.R. at 576-77 (same); *In re Alibatya,* 178 B.R. at 338 ("The term `educational' is merely an adjective describing `loan.'").

9. Other dictionaries contain even broader definitions of "stipend." Black's Law Dictionary at 1426 (West Deluxe 7th ed. 1999) ("A salary or other regular, periodic payment."); XVI Oxford English Dictionary 713 (Oxford 2d ed. 1989) ("A fixed periodical payment of any kind, e.g. a pension or allowance.... Also... *to keep in stipend,* to defray the maintenance of.").

10. As an initial condition for insurance eligibility, a student must take half of the courses necessary for full-time enrollment. 20 U.S.C. § 1077(a). The need analysis then includes larger living expense allowances for full-time students and smaller living expense allowances for part-time or correspondence students. 20 U.S.C. § 1087*ll*(4) (withholding room and board and personal expenses from less than half-time students); 20 U.S.C. § 1087*ll* (limiting the room and board costs of correspondence students to any necessary residential training).

11. *E.g., Pierce v. Underwood,* 487 U.S. 552, 561-63, 108 S.Ct. 2541, 101 L.Ed.2d 490 (1988) (interpreting phrase "justified to a high degree" in the Equal Access to Justice Act as having the same meaning as the same phrase contained in other statutes and the Federal Rules of Civil Procedure); *Lorillard v. Pons,*

434 U.S. 575, 584, 98 S.Ct. 866, 55 L.Ed.2d 40 (1978) (looking to judicial interpretation of identical terms in other statutes).

12. The PHEAA note provides that the loans were (1) issued under the Federal Stafford Loan Program and (2) governed by the Higher Education Act of 1965, 20 U.S.C. § 1070. Murphy represented on the borrower certification of the note that (1) he must return all loan proceeds not reasonably attributed to educational expenses for the cost of attendance on at least a half-time basis; and (2) the total amount of loans received under the note would not exceed his maximum eligibility under the Higher Education Act of 1965. The amount of the PHEAA loans corresponded exactly to the "cost of attendance" certified by Wayne State University on the note.

The ECMC note also included a "borrower certification" that Murphy would "immediately repay any loan proceeds that cannot reasonably be attributed to educational expenses for attendance on at least a half-time basis at the certifying school."

13. *In re Segal,* 57 F.3d at 348-49 (acknowledging that § 523(a)(8) was enacted to "remedy abuses of the educational loan system by restricting the ability of a student to discharge an educational loan by filing for bankruptcy shortly after graduation"); *Andrews Univ. v. Merchant (In re Merchant),* 958 F.2d 738, 740 (6th Cir.1992) (citing a House report and floor statement by Senator DeConcini).

14. *In re Renshaw,* 222 F.3d at 86-87 ("Congress enacted § 523(a)(8) because there was evidence of an increasing abuse of the bankruptcy process that threatened the viability of educational loan programs and harm to future students as well as taxpayers."); *In re Alibatya,* 178 B.R. at 340 (citing a Senate Report, House Report, and Senator DeConcini's statement).

15. *E.g., Green v. Bock Laundry,* 490 U.S. 504, 527, 109 S.Ct. 1981, 104 L.Ed.2d 557 (1989) (Scalia, J., concurring) ("I think it entirely appropriate to consult all public materials, including the background of Rule 609(a)(1) and the legislative history of its adoption, to verify that what seems to us an unthinkable disposition ... was indeed unthought of, and thus to justify a departure from the ordinary meaning of the word `defendant.'").

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442 B.R. 550
264 Ed. Law Rep. 794
In re Fred Wayne SMITH, et al., Debtor(s).Barbara Ann Smith, Plaintiff(s)
v.
Wells Fargo Educational Financial Services, A Division of Wells Fargo Bank, NA, et al., Defendant(s).
Bankruptcy No. 05–92220.
Adversary No. 09–3516.
United States Bankruptcy Court, S.D. Texas, Houston Division.
Dec. 13, 2010.

[442 B.R. 552]

David L. Venable, Attorney at Law, Houston, TX, for Plaintiffs.Billy Bruce Johnson, Jr., The Bruce Johnson Law Firm, Houston, TX, for Defendants.**MEMORANDUM FINDINGS OF FACT AND CONCLUSIONS OF LAWWESLEY W. STEEN, Bankruptcy Judge.**

Barbara Smith ("Debtor") borrowed money to send her daughter to Austin Business College for an Associates Degree in Business Technology. That degree has not enabled her daughter, a single mother, to get a job that would support her and her child, Debtor's grandchild; Debtor's daughter lives in Debtor's home and works at Walmart. Debtor filed a voluntary chapter 7 bankruptcy petition in 2005, but instead of seeking to discharge the student loan, Debtor attempted to combine the three existing loans into a single loan for ease of payment. Debtor did not seek discharge of the consolidated loan while her bankruptcy case was pending or for several years afterwards; she tried to pay the loan. Debtor alleges that she is now unable to pay the consolidated loan and asks the Court to determine that the loan is dischargeable. After trial, for reasons set forth below, judgment is rendered in favor of Debtor discharging the loan.

FINDINGS OF FACTA. Facts Related to The Loans and Loan Documentation

Debtor obtained three loans for her daughter's education under the "Parent Loan for Undergraduate Student" ("PLUS") program. The loans were taken out from July 3, 2003, through August 30, 2005. By September, 2005, the three loans totaled about $18,500.

In September, 2005, Debtor contacted Wells Fargo (the PLUS Loan lender) and asked that the three loans be combined into a single "convenient" payment. Wells Fargo wrote a letter dated September 24 and provided documentation to consolidate the loans.[1] The letter "congratulated" Debtor for having completed the first step toward a consolidation loan, enclosed forms to finish the process, and stated that the forms could be signed online or else

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the enclosed forms should be signed and returned.

Debtor testified that she signed and returned the forms to Wells Fargo. Debtor testified that she has no written acknowledgement that Wells Fargo received the documentation. Wells Fargo contends that it never received that documentation. In fact, in the joint pretrial statement the parties listed, as a contested issue of fact, "Whether Smith applied for a Federal Consolidation Loan on or about September 30, 2005.".[2]

It is undisputed that Wells Fargo sent Debtor a letter on September 24, 2005, congratulating her on completing the first step for loan consolidation, providing the forms for completion of the consolidation, and indicating that signature was all that was required. Debtor testified that she signed and returned the forms. Debtor's testimony was credible. Wells Fargo provided no evidence that it did not receive the forms. The Court concludes from a preponderance of the evidence that Debtor applied for loan consolidation prior to filing her bankruptcy case and that Debtor signed and returned the forms provided for that purpose by Wells Fargo.

Subsequent to Debtor's signing and returning the loan consolidation documentation to Wells Fargo, on October 14, 2005, Debtor filed a voluntary petition commencing this case under chapter 7 of the Bankruptcy Code. Debtor did not seek a determination that the student loan debt was dischargeable.

On December 8, 2005, Wells Fargo wrote to Debtor, stating that it had recently been informed about Debtor's bankruptcy petition, that Wells Fargo was "canceling any pending disbursements on your student loans." The letter further stated that future consideration for student loan benefits would require Debtor to sign a new Master Promissory Note. The letter makes no reference to loan consolidation. The letter appears to be a form letter, simple boilerplate, because neither party contends that there was any agreement for (or any request for) additional advances. Because the letter appears to be merely a formality, any evidentiary conclusion from this letter (as regards to the September 2005 application for loan consolidation) would be speculation, and the Court declines to speculate.

Debtor received a chapter 7 discharge on March 7, 2006. Because the Debtor had not obtained a determination that the student loan debt was dischargeable, the bankruptcy discharge did not include the PLUS loans.

On April 27, 2006, Debtor signed documentation for a consolidation loan under the Federal Family Education Loan Program ("FFELP"). There is no evidence concerning who requested this documentation, when this documentation was requested, or why this new documentation was requested. There is, for example, no cover letter (similar to the September 24 letter) from Wells Fargo indicating that Debtor had sought a post-petition consolidation loan and that documentation for a post-petition consolidation loan had been prepared. Debtor testified that she thought that the April 27 document was a re-documentation of the consolidation that she had asked for, and apparently received, prior to the filing of the bankruptcy case and as to which she had not sought discharge. Wells Fargo supplied no evidence on any of these questions. The Court concludes that Debtor did not apply for a consolidation loan subsequent to filing her bankruptcy petition. The Court could speculate as to what happened to the

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documentation that Debtor sent to Wells Fargo pre-bankruptcy and concerning why Wells Fargo sought new documentation, but the Court declines to speculate.

Whether the agreement to consolidate the loans was effective pre-bankruptcy or post-bankruptcy, the three existing PLUS loans were consolidated into a single loan. Wells Fargo held the loans prior to the consolidation and Wells Fargo held the new consolidated loan after the consolidation. The same guarantor guaranteed the loan both before and after the consolidation. No new money was advanced. The sole consideration for the new note appears to have been the existing indebtedness of the three PLUS loans. The transaction appears to have been a mere bookkeeping entry on Wells Fargo's books.

When Debtor defaulted on the loan, Wells Fargo assigned it to ECMC, the Defendant in this adversary proceeding.[3]

B. Facts Related to "Undue Hardship"

Debtor is a 56 year old female high school graduate who is employed by MD Anderson Hospital as a clerical employee. She earns about $28,000 per year. She has no prospects for a better job or for promotion by her current employer. After taxes (and a $129 mandatory retirement deduction) Debtor takes home about

$1,500 per month. She is married, but her husband is disabled and has no income.

Debtor's daughter is a single mother who works as a cashier at Walmart. Her earnings vary, depending on the number of hours that she works. Typically, Debtor's daughter works 28 to 36 hours per week, and at the rate of $8.70 per hour, earning about $270 per week before OASDI, Medicare, income tax, etc. Debtor's daughter receives no child support. Debtor's daughter pays most of her own living expenses, including car expenses for transportation to and from work, clothing, food, day care, etc.

Debtor's daughter lives in Debtor's home. When able, Debtor's daughter contributes about $300 per month to Debtor in lieu of rent to help with living expenses. Therefore, Debtor's total family income is about $1,800 per month. Debtor's husband will be 62 years old in April and will then begin to receive about $500 per month in social security income.

Debtor, her husband, her daughter, and her granddaughter live in an old mobile home on land (in a non-urban area) that was inherited from Debtor's husband's parents. The mobile home and the land are unencumbered. The mobile home regularly needs repairs. Debtors own two old cars and have old furniture. Debtor needs surgery to remove polyps, but cannot afford the deductible that her health insurance will not pay. Her husband needs dental work that the family is deferring because they do not have dental insurance and cannot afford treatment. Debtor takes medicine regularly for anxiety and depression. Debtor had basal cell carcinoma, but her treatment was apparently effective.

There was considerable testimony concerning Debtor's expenses. The Court concludes that Debtor is able to pay bills as they come due only by postponing medical care, home repairs, car repairs and other expenses when necessary. The Court concludes that after consideration of Debtor's present income and expenses, Debtor cannot maintain a minimal standard of living for herself and her dependents if she were required to repay the student loan. The Court further concludes that the only improvement in prospect is

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Debtor's husband's imminent receipt of social security benefits. But that amount, after consideration of deferred medical expenses, home repairs, and other expenses, is inadequate to allow Debtor to repay the student loan. In addition, in a few years Debtor's income will decrease when she retires. Therefore, the Court concludes that Debtor's inability to pay the student loan is likely to persist for the rest of her life.

In one line of inquiry, ECMC suggested that Debtor had not made a good faith effort to repay the debt because Debtor had not pursued the William Ford program that reduces monthly payments and allows payment over an extended period. The Court concludes that Debtor's having declined that option is not evidence of lack of good faith. Debtor testified that she understood that payments under the program could run for 25 years. Debtor's income is currently inadequate to pay the loan debt, even at materially reduced amounts. Debtor is 56 and her income will decline when she reaches retirement. The Court concludes that attempting repayment over 25 years would be financial folly, and therefore declining that program is not evidence of the lack of good faith.

Debtor tried to pay the student loan after receiving her bankruptcy discharge, but was unable to do so. The loan was in forbearance for much of that time, essentially acknowledging Debtor's inability to pay. The Court concludes that Debtor made a good faith effort to repay the loan.

CONCLUSIONS OF LAWA. "No Jurisdiction Over the Subject Matter."

Defendant argues that the Court has no jurisdiction over the subject matter of this dispute because the loan is a post-petition loan. That argument confuses the law applicable to the determination on the merits of this dispute with the law applicable to subject matter jurisdiction.

The issues in this adversary proceeding are (i) whether Bankruptcy Code § 524(c) applies to the consolidated loan and, (ii) whether it is too late, after execution of a consolidation loan, to determine "undue hardship" under § 523(a)(8). These are matters arising under title 11, the Bankruptcy Code. The district court has jurisdiction by virtue of 28 USC § 1334(b) and that jurisdiction has been allocated to the bankruptcy judges of the district under 28 USC § 157(a).

B. Whether the Loan is a New Loan

Defendant argues that the consolidated loan is a new loan and therefore cannot be discharged because it did not exist prior to the filing of the petition that commenced this bankruptcy case. While it is certainly true that post-petition debts are not dischargeable in a chapter 7 bankruptcy case, this case presents an unprecedented issue: whether the consolidation loan is a reaffirmation agreement.[4]

Even assuming that Wells Fargo did not receive the pre-petition loan consolidation documents and even assuming that Wells Fargo sent the post-discharge documents in good faith, classification of the April 27 note to be a post-petition debt would be elevating form over substance and would violate the plain language restriction in Bankruptcy Code § 524(c).

The consolidated loan is clearly an "agreement." The consideration for that agreement is a debt that predated the

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bankruptcy case. Section 524(c) provides that:

An agreement between a holder of a claim and the debtor, the consideration for which, in whole or in part, is based on a debt that is dischargeable in a case under this title is enforceable ... whether or not discharge of such debt is waived ... only ... if [Emphasis supplied]

The " only if " exception in the statute is not satisfied in this case. It requires satisfaction of six requirements set out in Bankruptcy Code § 524(c)(1)–(6): the agreement must be made prior to the granting of the discharge, debtor's counsel or the court must sign off on the agreement, etc. Because the consolidated loan does not satisfy these requirements, under the plain language of the statute the "agreement" is not enforceable.

Defendant argues that section 524(c) does not apply to a debt that is presumptively not dischargeable. But that is not the language of the statute. The statute says that § 524(c) applies if the debt is "dischargeable" in the bankruptcy case, and it applies whether or not discharge is waived.

Defendant cites In re Clarke, 26,6 B.R. 301 (Bankr.E.D.Pa.2001) for the proposition that consolidation of student loans makes them, as a matter of law, nondischargeable. The Clarke court cites the Higher Education Act 20 USC § 1079–3(e) which states that consolidated loans are treated as new loans. The Clarke court holds that the Higher Education Act trumps Bankruptcy Code § 524(c).

This Court respectfully disagrees, at least within the narrow confines of the fact pattern presented in this adversary proceeding. The Higher Education Act refers to "Loans made ..." In circumstances such as the one under consideration in this memorandum, circumstances in which no additional advances are made, no new lender advances funds to pay off the pre-petition lender, and no material modifications are made to the loan, there is no reason to treat the new note as a "loan made." The financial effect of a bookkeeping entry on Wells Fargo's books is not the creation of a new loan, it is a bookkeeping entry that (in this case) has no effect except (in Defendant's view) to make the loan non-dischargeable. Treating this bookkeeping entry as a new loan would elevate form over substance and give, in this Court's view, unintended effect to the "new loan" language in the Higher Education Act. The conflict that the Clarke court sees between the

Higher Education Act and Bankruptcy Code § 524(c) can be eliminated, at least under these limited circumstances.

C. Were the Three Pre–Bankruptcy Loans "Dischargeable" in this Bankruptcy Case?

As noted, Defendant argues that Bankruptcy Code § 524(c) does not apply if a debt is "presumed non-dischargeable." As the Court notes, that is not the language of the statute. Section 524(c) applies if the debt "is dischargeable." For the following reasons, the Court concludes that the three pre-petition loans, even as they morphed in the new document, are dischargeable.

1. Bankruptcy Code § 523(a)(8)

In their joint pretrial statement, the parties agree that § 523(a)(8) permits discharge of a student loan debt if repayment of that debt would impose an undue hardship on Debtor.[5] The joint pretrial statement then sets out the elements for determination

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of whether repayment of the loan would impose an undue hardship. In the findings of fact above, the Court has concluded that those requirements are met. Therefore, the Court concludes that repayment of the debt would constitute an undue hardship.

2. Discharge Does Not Bar A Subsequent Determination of Dischargeability under § 523(a)(8)

A pre-petition student loan is not automatically discharged, but there is no deadline for seeking a determination that section 523(a)(8) applies and there is no deadline to discharging the debt after the bankruptcy case is closed. Fed. Rule Bankr.P. 4007(b).

For example, a debtor who initially lost a student loan dischargeability determination may reopen the bankruptcy case and may seek a new determination based on changed circumstances; issue preclusion (res judicata) does not apply. In re Sobh, 6,1 B.R. 576–580 (E.D.Mich.1986). "The Seventh and Second Circuits have both suggested that debtors are permitted to reopen their cases to seek a discharge of their student loans based on a post-discharge change in circumstances." In re Walker, 42,7 B.R. 471 (8th Cir. BAP Minn., 2010), citing In re Roberson, 99,9 F.2d 1132 (7th Cir.1993) (suggesting that a debtor reopen his case pursuant to Rule 4007 if his situation had not improved following a two-year deferment of his student loans); In re Brunner, 83,1 F.2d 395 (2nd Cir.1987) suggesting that, because the bankruptcy court's order denying the discharge had been without prejudice, the debtor might reopen the issue of dischargeability of her student loans pursuant to Rule 4007(a) and (b), based on circumstances existing five years after she had filed her case.

3. Is Loan Consolidation an Exception to § 524(c)?

Defendant has cited cases holding that when a post-bankruptcy consolidation loan pays off a prior student debt, then the prior debt no longer exists and therefore it cannot be discharged in bankruptcy.

There is logic and sound public policy in that analysis under the appropriate facts. There must be some point after which a determination of "undue hardship" is no longer possible or appropriate. This might occur, for example, when new advances substantially change the loan or when the consolidation lender is a new entity that has indeed paid off the prior loan. It might also apply if a debtor has so abused the loan consolidation process that he or she is estopped from seeking § 523(a)(8) relief. There are no doubt other circumstances.

But Congress was very clear that a creditor must satisfy the requirements of § 524(c) if the creditor wants to enforce a "dischargeable" debt after bankruptcy. Allowing a creditor to avoid those requirements merely by reciting the mantra of "new consolidation loan" would be elevating form over substance. In this case, there is no material difference between the consolidation loan and the loan that existed pre-bankruptcy. Those loans were dischargeable depending on Debtor's financial circumstances post-discharge.

The Court holds that Bankruptcy Code § 524(c) applies to a student loan consolidation if (i) the consolidation was requested and apparently effected prior to bankruptcy, (ii) all of the loans that were consolidated are dischargeable under § 523(a)(8), (iii) the consolidation is nothing more than a bookkeeping entry on the lender's books, and (iv) there are no new advances, refinancing by a new lender, or other material modification of the loan.

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D. Conclusion

By separate order issued this date, the consolidated loan is discharged.

Notes:

[1] Debtor's Exhibits 3 and 4.

[2] Joint Pre-trial Statement, Docket # 36, page 5.

[3] Joint Pre–Trial Statement, Docket # 36, page 3.

[4] Which the parties in their joint pretrial statement concede constitutes a “unique issue.” Joint Pretrial Statement, docket # 36, second paragraph.

[5] Joint Pre-trial Statement, Docket # 36, page 3.

<u>**Non-Filing Dependents and Their Effect on the Means Test**</u>

Why are a debtor's dependents important?

Dependents can change a consumer debtor's eligibility to file a Chapter 7. Certain dependent expenses and income are included on the means test, potentially tipping the debtor's scales in favor of a Chapter 13 and affecting whether there is a presumption of abuse. In the context of a Chapter 13, the number of dependents determines the debtor's household size, which determines the applicable median family income, which, when compared against the debtor's current monthly income, determines whether the applicable commitment period in a Chapter 13 bankruptcy is three or five years. Dependents also affect a Chapter 13 debtor's disposable income. Despite the importance of dependents to consumer debtors, there is no bright-line rule regarding who is a dependent, leaving the answer up for the interpretation of the courts.

Who is a dependent?

When we think of dependents, our first thought is of minor children and dependent spouses claimed on a person's tax returns, but the definition of dependent is not always so clear. Today, debtors could be supporting family members oversees, adult children, grandchildren, parents of spouses, or families of unmarried partners.

While "dependent" is defined in several statutes,[1] it is not defined for the purpose of the Bankruptcy Code. In fact, the one definition of dependent that appears in the Bankruptcy Code is in Section 522, where it is defined for that section only as including a "spouse, whether or not actually dependent." 11 U.S.C.A. § 522(a)(1). As a result, determining who is a dependent is done a case-by-case basis.

When a term is not otherwise defined, courts construing it must take its "ordinary, contemporary, common meaning." *Perrin v. United States*, 444 U.S. 37, 42, 100 S.Ct. 311, 314, 62 L.Ed.2d 199 (1979). *See also United States v. Locke*, 471 U.S. 84, 95–96, 105 S.Ct. 1785, 1792–1794, 85 L.Ed.2d 64 (1985).

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[1] *See, e.g.*, 10 U.S.C. § 2181(2) (defining "dependent" for purposes of educational assistance for members of the armed forces held as captives); 10 U.S.C. § 1032(d)(1) (disability and death compensation for dependents of members of the armed forces held as captives); 37 U.S.C. § 551 (defining "dependent" for purposes of payments to a missing member of a uniformed service); 30 U.S.C. § 902(a) (Black Lung Benefits Act); 5 U.S.C. § 8110(a) (compensation for dependents of government officers and employees); 5 U.S.C. § 8441(3) (defining "dependent" for purposes of survivor annuities of government officers and employees); 5 U.S.C. § 8901(9) (defining "dependent" for purposes of health insurance for government officers and employees); 42 U.S.C. § 3796b(2) (defining "dependent" for purposes of public safety officers' death benefits); 26 U.S.C. § 152 (the Internal Revenue Code, defining "dependent" for purposes of meeting one of the requirements in order to claim a deduction against gross income).

The *Dunbar* court took a common sense approach when determining whether a debtor's girlfriend's nine children and grandchildren, who lived with the debtor, were dependents for the purposes of the Bankruptcy Code. *In re Dunbar*, 99 B.R. 320, 324-25 (Bankr. M.D. La. 1989). That court defined dependent as "a person who reasonably relies on the debtor for support and whom the debtor has reason to and does support financially." *Id.* at 324. The court broadly construed dependent because the debtor was reasonably supporting people living in his home, even though not legally required to do so, and would not have the money to pay his debts. *Id.* at 324-25. The court rejected the application of the Internal Revenue Code's definition of dependent for bankruptcy purposes, stating that the Bankruptcy Code does not require a dependent to be claimed as a deduction against gross income. *Id.* at 325. Instead, the court considered the fact that the dependents lived with the debtor, they relied on him for basic necessities of life, and the debtor used his income to support them. *Id.*

Whether a person is claimed as a dependent on a debtor's tax return cannot be completely discounted. For some courts, dependent status depends upon whether a person was or could be claimed as a dependent on a debtor's tax return. *In re Duncan*, 201 B.R. 889 (Bankr. W.D. Pa. 1996) (six members of debtors' household were not dependents because they were not declared such on their most recent tax returns); *In re O'Connor,* 2008 WL 4516374 (Bankr. D. Mont. 2008) (court considers whether a person was listed as a dependent on the tax return and evidence as to whether a person could be listed as a dependent). Other courts consider whether a person is claimed as a dependent for tax purposes as one of many factors. *See In re Stebbins-Hopf*, 176 B.R. 784, 787 (Bankr. W.D. Tex. 1994) (debtor's mother, daughter and grandchildren were not dependents because they were not claimed as dependents for tax purposes, the daughter was married, the military provided health care for the daughter's family, and the debtor provided to and accepted from the daughter's family financial assistance).

One court asked the simple question of "whether it is reasonable under the circumstances for the court to permit the debtor to undertake the obligation of supporting the would-be dependent." *In re Gonzales*, 157 B.R. 604, 85 Ed. Law Rep. 83 (Bankr. E.D. Mich. 1993). This approach has been widely accepted in post-BAPCPA decisions. 1 Bankruptcy Practice Handbook § 5:2 (2d ed.). Dependent status is now "determined on a case-by-case basis on the facts of each case." *In re Justice*, 404 B.R. 506 (Bankr. W.D. Ark. 2009). Adding to a list of factors in *Dunbar*, the *Justice* court asked the following questions when determining dependent status:

> (I) How long have the claimed dependents lived in the debtor's household;
> (ii) Why are they living in the debtor's household;
> (iii) Are they in need of the debtor's assistance;
> (iv) How old are they;
> (v) How much income or support from third parties do they receive;
> (vi) Are the claimed dependents in school; and
> (vii) Could they be claimed as a dependent on the debtor's tax returns or qualify as a dependent in another legally cognizable way, such as for the purpose of medical insurance?

In re Justice, 404 B.R. at 516; *see also* 1 Bankruptcy Practice Handbook § 5:2 (2d ed.). The debtor must have reason to provide support, and the claimed dependent must have reason to rely on the debtor. *In re Justice*, 404 B.R. at 516.

Dependents:

- Debtor's girlfriend's nine children and grandchildren, who lived with the debtor. *In re Dunbar*, 99 B.R. 320, 324-25 (Bankr. M.D. La. 1989).

- Debtor's twenty-four-year-old, unemployed daughter and her infant son, where daughter was living in debtor's household and financially dependent on him for support for nearly one year prior to commencement of his bankruptcy case and for about one year afterward. *In re Justice*, 404 B.R. 506 (Bankr. W.D. Ark. 2009).

- Debtor's family members in the Philippines. *In re Dowleyne*, 400 B.R. 840 (Bankr. M.D. Fla. 2008).

- Debtors' adult daughter and her three minor children, who resided in their home, and were dependent upon debtors for their support, having no income to contribute after paying her other expenses, and where the living arrangement was not temporary and the group functioned as economic unit. *In re Jewell*, 365 B.R. 796 (Bankr. S.D. Ohio 2007).

Not Dependents:

- Debtor's mother, daughter and grandchildren, where they were not claimed as dependents for tax purposes, the daughter was married, the military provided health care for the daughter's family, and the debtor provided to and accepted from the daughter's family financial assistance. *In re Stebbins-Hopf*, 176 B.R. 784, 787 (Bankr. W.D. Tex. 1994).

- Debtors' adult son living at their home, where he was employed and paid most of his expenses, he did not ask for or receive regular financial assistance from the debtors, the debtors did not provide him with other support, such as meals or clothing, and the debtors did not claim him as dependent on recent tax returns. *In re Jewell*, 365 B.R. 796 (Bankr. S.D. Ohio 2007).

Chapter 7 Debtors Depending on Dependents

Chapter 7 debtors must complete the means test, which determines whether a presumption of abuse arises such that a bankruptcy case should be dismissed. A dependent's expenses and income can steer a debtor toward or away from the presumption of abuse by subtracting from or adding to a debtor's monthly income.

Dependent Expenses

Section 707 provides that a debtor's expenses include the expenses of the debtor's dependents. "Such expenses shall include reasonably necessary health insurance, disability insurance, and health savings account expenses for the ... dependents of the debtor...." 11 U.S.C.A. § 707(b)(2)(A)(ii)(I); *see also In re Williams*, 424 B.R. 207 (Bankr. W.D. Va. 2010) (adding that the expenses must be a continuation of actual expenses paid by debtor and that the dependent could be a household member or a member of the debtor's immediate family).

Dependent expenses deducted from the debtor's monthly income in the means test do not necessarily stop there. Here are more examples in which dependent expenses are deducted from the debtor's monthly income:

- Expense of $200 per month for prescriptions of debtor's father, who lived in a nursing home. *In re Vansickel*, 309 B.R. 189 (Bankr. E.D. Va. 2004).

- Expense of $509.60 per month for debtor's family members in the Philippines, based upon totality of circumstances of their financial situation. 11 U.S.C.A. § 707(b)(3)(B). *In re Dowleyne*, 400 B.R. 840 (Bankr. M.D. Fla. 2008).

- Monthly expenses of debtors' adult daughter and her three minor children, who resided in the debtors' home, where the daughter depended on the debtors for the support of her and her children, the daughter was unable to contribute any income to the household after paying other expenses, and there was no evidence that living arrangement was temporary or that group did not function as economic unit. 11 U.S.C.A. § 707(b). *In re Jewell*, 365 B.R. 796 (Bankr. S.D. Ohio 2007).

On the contrary, the following are examples of dependent expenses that were ***not*** deducted from the debtor's monthly income:

- Monthly expense of $200 for the care of debtors' 40-year-old daughter who was not shown to be chronically ill or impaired by any disability. *In re Williams*, 424 B.R. 207 (Bankr. W.D. Va. 2010) (citing 11 U.S.C.A. § 707(b)(2)(A)(ii)(II)) (evidence that daughter could not function at level sufficient for her to live apart from debtors was insufficient).

- Monthly expense of $250 for five mobile telephones for debtors, their two resident grandchildren, and their nonresident adult son under mobile telephone package that allowed unlimited text messaging and fourteen hundred minutes per month, was excessive and had to be reduced in performing means test calculation. *In re Meade*, 420 B.R. 291 (Bankr. W.D. Va. 2009).

- Child support payment made by debtor on behalf of her unemployed, non-filing spouse's children from a prior marriage. *In re Urban*, 432 B.R. 302 (Bankr. D. Wyo. 2010) (reasoning that debtor's creditors should not be sacrificed to the payment of obligations for which debtor was not legally responsible).

Dependent Income

Chapter 7 debtors must also be aware that their monthly income is increased by the income of their dependents. In *Justice* a creditor moved to dismiss the debtor's Chapter 7 case based on the means test presumption of abuse. *In re Justice*, 404 B.R. 506 (Bankr. W.D. Ark. 2009). Even though the creditor did not present any evidence regarding how much money the debtor's dependent, college-age daughter received from a single parent scholarship fund to pay for household expenses including her car, car insurance and day care for her infant, the court presumed that the dependent's income was more than the $18.61 per month, the amount needed to trigger "means test" presumption of abuse.

99 B.R. 320
United States Bankruptcy Court,
M.D. Louisiana.

In re William DUNBAR, Debtor.
LESLIE WOMACK REAL ESTATE, INC., Plaintiff,
v.
William DUNBAR, Defendant.

Bankruptcy No. 87–01726. | Adv. No. 88–0007. | April 21, 1989.

Creditor objected to Chapter 7 debtor's discharge. The Bankruptcy Court, Louis M. Phillips, J., held that: (1) listing of dependents was not false, and (2) understatement of income was not result of fraudulent intent.

Relief denied.

West Headnotes (6)

1 **Bankruptcy** False Oath or Account

In order to warrant denial of discharge on ground debtor made false oath, court must find that debtor made statement containing material matter which he knew to be false, and that statement was made willfully with intent to defraud creditors. Bankr.Code, 11 U.S.C.A. § 727(a)(4)(A).

1 Cases that cite this headnote

2 **Bankruptcy** Errors on and Omissions from Schedules

Untruth or omission in debtor's schedule of income and current expenditures may relate to material matter sufficient to bar debtor's discharge. Bankr.Code, 11 U.S.C.A. § 727(a)(4)(A).

1 Cases that cite this headnote

3 **Bankruptcy** Schedules and Statement of Affairs

"Dependents" which debtor is required to list on schedule of expenditures refers to persons reasonably relying upon debtor for support and whom debtor has reason to and does support financially, even though not legally required to do so.

15 Cases that cite this headnote

4 **Bankruptcy** False Oath or Account

Debtor's schedule, in which he listed cohabitant's children and grandchildren as dependents, was not false, such as would warrant denial of discharge, in that children resided with debtor, relied on debtor for basic necessities of life, and debtor utilized his income to provide support. Bankr.Code, 11 U.S.C.A. § 727(a)(4)(A).

7 Cases that cite this headnote

5 **Bankruptcy** False Oath or Account

Understatement of debtor's income in schedule did not warrant denial of discharge where it appeared that mistake was result of carelessness or ignorance on part of debtor or his attorney, rather than a fraudulent act. Bankr.Code, 11 U.S.C.A. § 727(a)(4)(A).

6 **Bankruptcy** Dischargeability Determinations; Consumer Debt Issues

Bankruptcy Code section providing for award of attorney fees in actions to determine dischargeability of consumer debts did not provide basis for award of fees to debtor who prevailed in creditor's challenge to his entitlement to discharge. Bankr.Code, 11 U.S.C.A. § 523(d).

Attorneys and Law Firms

***321** Kenneth S. Womack, Baker, La., for plaintiff.

C. Glenn Westmoreland, Baton Rouge, La., for defendant.

Opinion

REASONS FOR DECISION

LOUIS M. PHILLIPS, Bankruptcy Judge.

Jurisdiction of the Court

This is a proceeding arising under Title 11 of the United States Code. The United States District Court for the Middle District of Louisiana has original jurisdiction pursuant to 28 U.S.C. § 1334(b). By Local Rule 29, under the authority of 28 U.S.C. § 157(a), the United States District Court for the Middle District of Louisiana referred all such cases to the Bankruptcy Judge for the district and ordered the Bankruptcy Judge to exercise all authority permitted by 28 U.S.C. § 157.

This is a core proceeding as defined in 28 U.S.C. § 157(b)(2)(J). Pursuant to 28 U.S.C. § 157(b)(1) and the general reference by the District Court, the Bankruptcy Judge for this district may hear and determine all core proceedings arising under Title 11 or in a case under Title 11 and may enter appropriate orders and judgments thereupon.

No party has objected to the exercise of jurisdiction by the Bankruptcy Judge. No party has filed a motion for discretionary abstention pursuant to 28 U.S.C. § 1334(c)(1) or pursuant to 11 U.S.C. § 305. No party filed a timely motion for mandatory abstention under 28 U.S.C. § 1334(c)(2). No party has filed a motion under 28 U.S.C. § 157(d) to withdraw all or part of the case or any proceeding thereunder, and the District Court has not done so on its own motion.

The Proceeding

The defendant, William Dunbar, filed a voluntary Chapter 7 bankruptcy petition on October 13, 1987. Plaintiff, Leslie Womack Real Estate, Inc., is a creditor of Mr. Dunbar for the total sum of $5,890 plus interest and costs. The plaintiff filed this complaint objecting to the debtor's discharge under 11 U.S.C. § 727(a)(4)(A) on January 13, 1988, alleging that the debtor knowingly and fraudulently made false statements in his schedule of current income and current expenditures (which 11 U.S.C. § 521 and Bankruptcy Rule 1007(b)(1) require to be filed in Chapter 7 liquidation cases).

The false oaths allegedly sworn by Mr. Dunbar are: (i) the representation that his monthly take-home pay was $650.00, when, in fact, his gross wages as of the date of the § 341(a) meeting of creditors were some $480.00 per week; and (ii) the claim of nine dependents though all were either children or grandchildren of Ms. Joyce Roberson, with whom Mr. Dunbar had been living without the benefit of marriage for some years. Trial of this proceeding took place on July 1, 1988, with the parties proceeding upon a stipulated record consisting of documentary evidence and a transcript of the § 341(a) meeting of creditors in this case.

Facts

The debtor's schedule of current income and expenses indicates that his monthly take-home pay is $650 per month. At the § 341(a) meeting of creditors, Mr. Dunbar testified that as of that date his gross wages were approximately $480.00 per week. According to plaintiff's Exhibit 8, the debtor's take-home pay for the week preceding the date of the schedule of current income and expenses (which was signed on October 9, 1987) was $181.83 per week.

Regarding the claim of dependents, the debtor lists the following dependents on the schedule of current expenses:

(1) Van Roberson—18 years old;

(2) Lisa Roberson—17 years old;

(3) Tina Roberson—16 years old;

(4) Shalot Roberson—23 years old;

(5) Gregory Roberson—22 years old;

(6) Michael Roberson—20 years old;

(7) Alvin Roberson—19 years old;

(8) Candy Roberson—3 years old;

(9) Yolanda Roberson—1 year old.

At the § 341(a) meeting, the debtor testified that four of the children were in high school, two were working (Michael— ***322** $3.75/hr.; Shalot—$3.45/hr.), one was unemployed, and the remaining two minor dependents were the grandchildren of Ms. Joyce Roberson. The debtor testified that he was not married. As an introduction to the § 341(a) meeting, the debtor's attorney explained that Mr. Dunbar and Joyce Roberson were and had been living together for some time in a relationship which would likely be considered a common law marriage in any other state (in fact, the § 341(a) meeting in this case was held contemporaneously with the § 341(a) meeting in Ms. Roberson's case (case no. 87–01727), with Ms. Roberson answering some questions and Mr. Dunbar answering some questions). While the record is not clear, apparently none of the children are actual bloodline relations of Mr. Dunbar. However, it is undisputed that all of the children resided with the debtor and Ms. Roberson at the time the petition was filed. Likewise, there is no evidence to dispute the assertion that Mr. Dunbar in fact utilized his income to provide actual support for the claimed dependents.

Applicable Law

1 Section 727(a)(4)(A) provides in part as follows:

> (a) The court shall grant the debtor a discharge, unless ... the debtor knowingly and fraudulently, in or in connection with the case ... made a false oath or account;

11 U.S.C. § 727(a)(4)(A). "The primary purpose of Section 727(a)(4)(A) of the Bankruptcy Code, and its predecessor, Section 14(c)(1) of the Bankruptcy Act, is to ensure that dependable information is supplied for those interested in the administration of the bankruptcy estate on which they can rely, without the need for the trustee or other interested party to dig out the true facts in exhaustive examinations or investigations." *In re Gonday,* 27 B.R. 428, 432 (Bankr.M.D.La.1983). However, as "the statutory right to discharge should ordinarily be construed liberally in favor of the debtor," *In re Tully,* 818 F.2d 106, 110 (1st Cir.1987), "[t]he reasons for denying a discharge to a bankrupt must be real and substantial, not merely technical and conjectural." *Dilworth v. Boothe,* 69 F.2d 621, 624 (5th Cir.1934). Therefore, the Court must find that the debtor made a statement containing matter which he knew to be false, and that the statement was made willfully with the intent to defraud creditors. *Humphries v. Nalley,* 269 F. 607 (5th Cir.1920).

The requirement that the false oath be knowingly and willfully made with intent to defraud, in light of the policy embraced by the jurisprudence of construing the right to discharge liberally in favor of the debtor, has led courts to place something of a judicial gloss on the statute and to require that the false oath relate to a "material fact" or "material matter." *See, e.g., Tully,* 818 F.2d at 110 ("Under § 727(a)(4)(A), the debtor can be refused his discharge only if he (i) knowingly and fraudulently made a false oath, (ii) relating to a material fact."); *In re Agnew,* 818 F.2d 1284, 1290 (7th Cir.1987) ("false oath under section 727(a)(4)(A) must relate to a material matter before it may bar a discharge"); 4 *Collier on Bankruptcy,* para. 727.04[1], at 727–57 (15th Ed.1988) ("The false oath must have related to a material matter."). While the jurisprudence is replete with single-phrase reiterations of the material fact or matter requirement, the attempts at defining just what a "material fact" or "matter" is reveal that the "materiality requirement" is probably surplusage.

A leading bankruptcy commentator has described the determination of materiality as follows:

> In determining whether or not an omission is material, the issue is not merely the value of the omitted assets or whether the omission was detrimental to creditors. Even if the debtor can show that the assets were of little value or that a full and truthful answer would not have directly increased the estate assets, a discharge may be denied if the omission adversely affects the trustee's or creditors' ability to discover other assets or to fully investigate the debtor's pre-bankruptcy dealing and financial condition.

Collier on Bankruptcy, supra, at 727–58. A circuit court has stated that "[t]he subject ***323** matter of a false oath is 'material,' and thus sufficient to bar discharge, if it bears a relationship to the bankrupt's business transactions or estate, or concerns the discovery of assets, business dealings, or the existence and disposition of his property." *In re Chalik,* 748 F.2d 616, 618 (11th Cir.1984) (citations omitted).[1] These definitions show that the "materiality" requirement, though providing the *appearance* of increasing the plaintiff's burden of proof and restricting situations in which discharge will be denied for false oaths, is basically not limiting. By requiring that an omission or untruth be "material," the courts are merely enforcing the persuasion that discharge not be denied on the basis of mere technicality or matters of form and have established the plaintiff's burden as the demonstration that the defendant possessed the intent at the time the statement was made to knowingly and fraudulently hinder the administration of the bankruptcy estate. To be simple and blunt (or bluntly simplistic), if a false oath can have no effect on the administration of the estate, it is difficult to impute fraudulent intent (as the false oath will doubtless be related simply to matters of technicality or form).

1 It is generally accepted that a creditor does not have to show that it was detrimentally affected by a false oath in order to bar the debtor's discharge. For example, the *Chalik* court upheld a debtor's denial of discharge for failing to list information pertaining to twelve corporations in which he had been an officer, director or major stockholder, notwithstanding that the concealed information may not have revealed assets available for creditors or otherwise increased the value of the estate. Therefore, the actual financial consequence to the estate which would have resulted if there had been no false oath need not be materially favorable. Rather, the Court is charged with the duty of determining whether the false oath concerned a matter which was material to the efficient, reliable and complete administration of the estate of the debtor.

2 The plaintiff, Leslie Womack Real Estate, Inc., filed the complaint in this proceeding upon allegedly false statements made in the debtor's schedule of current income and expenditures. Before addressing the issue of whether the statements were false, and made "knowingly and fraudulently," the Court must first find that an untruth or an omission in a debtor's schedule of income and current expenditures can be material so as to give rise to a denial of discharge under § 727(a)(4)(A). Although an untruth in this particular statement would rarely, if ever, affect the trustee's ability to discover assets or investigate the debtor's pre-bankruptcy dealings and financial condition, this Court finds that an untruth within this schedule can relate to a material matter sufficient to bar a debtor's discharge. This conclusion is based upon the underlying purpose of the schedule:

> The duty of the debtor to file a schedule of current income and current expenditures, unless the court orders otherwise, was added to section 521(1) by the Bankruptcy Amendments and Federal Judgeship Act of 1984. Section 707(b), also added by the 1984 Act, authorizes the court on its own motion to dismiss a chapter 7 case filed by an individual with primarily consumer debts if it finds that the granting of relief would be a "substantial abuse" of the provisions of chapter 7. "Substantial abuse" is not defined. However, the schedule of current income and current expenditures should be of assistance to the court in determining whether a debtor is likely to be able to pay a substantial portion of the debts out of future income without difficulty. If the court found that to be the situation, it would dismiss the case under section 707(b).

Collier on Bankruptcy, supra, para. 521.06[4] (footnote omitted). The problematic § 707(b)[2] can only serve its espoused purpose if the schedule of income and expenses contains truthful information. Therefore, as the U.S. Trustee or the Court (not on the suggestion of any other party) are dependent upon the schedule, false statements therein can constitute false oaths relating to material facts or matters sufficient to bar discharge under ***324** § 727(a)(4)(A) in the event they are made knowingly and fraudulently, as they can materially impair the ability of the Court or the U.S. Trustee to make a determination as to whether a § 707(b) motion is appropriate.

2 For lyrical expression of the confusion shared by at least this Court and one other, *see In re Love,* 61 B.R. 558 (Bankr.S.D.Fla.1986).

Discussion

The Claim of Dependents

As noted above, the plaintiff has made two allegations of false statements with respect to Mr. Dunbar's schedule of current income and expenditures. The first allegation concerns the debtor's listing of the nine dependents. The plaintiff makes much of the fact that these same nine dependents are listed on the bankruptcy petition of Joyce Roberson (recall the almost joint nature of the petitions). However, the plaintiff has not disputed the fact that all nine persons actually reside in the home of the debtor and Joyce Roberson.

Bankruptcy Rule 1007(b)(1) requires that a Chapter 7 debtor file a schedule of current income and expenditures, prepared as prescribed by Official Form No. 6A. Subsection A(3) of the form requires the debtor to list the dependents which "the debtor supports." However, neither the form, nor Bankruptcy Rule 1007, nor § 521 of the Code (which gives rise to the requirement that this information be disclosed) define the term "dependent." Furthermore, "dependent" is not defined in the general definitional section of the Code. *See* 11 U.S.C. § 101.

Congress has formulated various definitions of the term "dependent" throughout numerous areas of federal legislation in accordance with whatever policy it had in mind when it enacted the items of legislation. *See, e.g.,* 10 U.S.C. § 2181(2) (defining "dependent" for purposes of educational assistance for members of the armed forces held as captives); 10 U.S.C. § 1032(d)(1) (disability and death compensation for dependents of members of the armed forces held as captives); 37 U.S.C. § 551 (defining "dependent" for purposes of payments to a missing member of a uniformed service); 30 U.S.C. § 902(a) (Black Lung Benefits Act); 5 U.S.C. § 8110(a) (compensation for dependents of government officers and employees); 5 U.S.C. § 8441(3) (defining "dependent" for purposes of survivor annuities of government officers and employees); 5 U.S.C. § 8901(9) (defining "dependent" for purposes of health insurance for government officers and employees); 42 U.S.C. § 3796b(2) (defining "dependent" for purposes of public safety officers' death benefits); 26 U.S.C. § 152 (the Internal Revenue Code, defining "dependent" for purposes of meeting one of the requirements in order to claim a deduction against gross income).

Thus, it is clear that Congress has specifically defined the term when the term was to be used in a particular manner for a particular purpose or in a manner other than its plain and usual meaning. As mentioned, though, Congress has not chosen to specifically define "dependent" in the Bankruptcy Code. "A fundamental canon of statutory construction is that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning." *Perrin v. United States,* 444 U.S. 37, 42, 100 S.Ct. 311, 314, 62 L.Ed.2d 199 (1979). *See also United States v. Locke,* 471 U.S. 84, 95–96, 105 S.Ct. 1785, 1792–1794, 85 L.Ed.2d 64 (1985) (When interpreting statutory language, absent convincing evidence that Congress intended something different, the Court should give the words their ordinary meaning.).

3 Guided by this remarkably common sense approach, this Court interprets the reference to "dependents" in Official Form 6A to mean a person who reasonably relies on the debtor for support and whom the debtor has reason to and does support financially. Furthermore, given the cited underlying purpose of requiring the preparation and filing of the schedule of current income and expenses (so that the Court and the U.S. Trustee will have some document to analyze for purposes of making a § 707(b) determination), it makes sense that the term "dependent" be broadly construed, because a debtor who is reasonably supporting persons living in his household (even though not legally required to do so) ***325** simply will not have that money available to pay consumer debt. [3]

3 This is not to say that there can never be a claim of dependents based on the fact of support without the usual legal or bloodline ties which would rise to the level of a false oath. This Court's definition of the term "dependent" requires that the debtor have reason to provide support and that the claimed dependent have reason to rely on the debtor. A case by case analysis is necessary in order to determine, for example, the length of time the claimed dependents have resided in the household (here, a number of years), the reason the claimed dependents are residing in the household (here, because they were either children or grandchildren of the woman with whom Mr. Dunbar had been living—as husband and wife—for a number of years), and whether the claimed dependents were in fact necessitous (here there has been no dispute as to the fact of support by the debtor, and the Court concludes, that in this case, offering support to the minor children (either babies or high school students) and to the major children (two of whom were barely making minimum wage, if that, and one who is unemployed) is reasonable).

4 The first ground for denial of discharge must fail because plaintiff has not proven that the listing of the nine dependents is false, much less a knowing and fraudulent untruth. As noted above, the plaintiff has not disputed that the listed dependents reside with the debtor, that they rely on the debtor for the basic necessities of life, or that the debtor utilized his income to provide support. The plaintiff relies solely on the definition of "dependent" in the Internal Revenue Code, interprets this definition to limit the debtor's claims of dependents for tax purposes to himself only, and argues that since the debtor is limited to himself as a dependent for tax purposes he is limited to himself as a dependent for bankruptcy purposes. [4] The Court finds nothing in the Bankruptcy Code that suggests that the criteria that must be met before a "dependent" can be claimed as a deduction against gross income are to be applied in determining whether a person is a "dependent" for bankruptcy purposes. Therefore, in light of this Court's use of a broad definition of the term "dependent," and the fact that the only allegation regarding the false claim of dependents is the debtor's failure to heed plaintiff's conclusion that a person cannot be an Official Form 6A dependent unless he or she qualifies as a dependent for deduction-from-income purposes, the Court finds that the oath regarding the nine dependents was not false. [5]

4 The definition of "dependent" found in the Internal Revenue Code states in pertinent part:

> (a) For purposes of this subtitle, the term "dependent" means any of the following individuals over half of whose support, for the calendar year in which the taxable year of the taxpayer begins, was received from the taxpayer (or is treated under subsection (c) or (e) as received from the taxpayer): ...
>
> (9) An individual (other than an individual who at any time during the taxable year was the spouse, determined without regard to section 7703, of the taxpayer) who, for the taxable year of the taxpayer, has as his principal place of abode the home of the taxpayer and is a member of the taxpayer's household.
>
> 26 U.S.C. § 152(a)(9). As is apparent from the general definition of "dependent" in § 152, the Internal Revenue Code also adopts a broad definition of the term. However, in order to be eligible to deduct the dependency exemption in computing taxable income, the "dependent" must meet certain other tests. For example, the "dependent" must be a child of the taxpayer who has not made the age of 19 (or who is a student), or the "dependent's" gross income for the year must be less than the exemption amount. *See* 26 U.S.C. § 151(c)(1).

Plaintiff has introduced the 1987 tax returns of Alvin and Shalot Roberson (showing net, after tax, income of $1,202.47 and $3,164.30) as additional evidence that these persons were not claimable as dependents for income tax purposes. The Court will not opine as to the effect of the Internal Revenue Code as regards the debtor's right to claim Ms. Roberson's children and grandchildren as dependents on his federal income tax return.

5 In absence of any facts whatsoever which would tend to establish fraudulent intent regarding the claim of dependents, this Court is precluded from finding that Mr. Dunbar should be denied discharge even if it is possible that the Court's definition of "dependent" might be found to be incorrect, since in the absence of specific statutory guidance, Mr. Dunbar and this Court are in agreement as to who his dependents are for bankruptcy purposes.

Understatement of Income

5 The second ground alleged as a basis for denying Mr. Dunbar's discharge is the statement that his take-home pay was $650.00 per month, as of the date the voluntary ***326** petition and schedule of current income and expenses was prepared (October 9, 1987). The plaintiff has submitted the debtor's 1986 Federal Income Tax Return, which shows annual net income after taxes of $14,746, and the 1987 payroll records of the debtor, which show net take-home pay of $9,623 from his employment at Cribbs, Inc. Mr. Dunbar testified at his § 341(a) meeting of creditors that he was at that time receiving $480.00 per week in gross wages. Plaintiff's Exhibit 8 shows that during the months of September through December, 1987, Mr. Dunbar averaged $287.51 per week and $1,249.24 per month in after tax wages exclusive of a Christmas bonus, but that during the week of October 1–8, 1987, his take-home pay was $181.83. Exhibit 8 shows an average of 4.5 pay weeks per month and therefore, as of the date the schedule was prepared (October 9, 1987), it would have been reasonable to project a monthly take-home pay of $818.25. The 1987 payroll records recap, submitted by the plaintiff as part of Exhibit 8, show net wages for the year after taxes (and miscellaneous "other" deductions totalling $2,417.27 for union dues, garnishments, *etc.*), to have been $9,623.55, which translates into take-home pay of $801.96 per month for the entirety of 1987. The discrepancy, therefore, from the evidence submitted, appears to have been $168.25 per month based upon the week preceding the preparation of the schedule or approximately $200.00 per month on a 12–month average (the last four months of the year were somewhat better for Mr. Dunbar). Plaintiff relies upon the § 341(a) meeting testimony (that as of *that date* Mr. Dunbar admitted that he was making about $480.00 per week in gross wages) as establishing the broad discrepancy from which to impute fraudulent intent. As mentioned, however, the size of the false oath is not what the materiality requirement is about; but even if it were, plaintiff has failed to consider that the schedule is of *current* income (as of the date of the schedule). Even assuming for discussion that the $168.25–$200.00 per month discrepancy could constitute a false oath relating to a material matter, analysis of the evidence as to intent to defraud or make a false oath establishes that, for purposes of this decision, there has been no fraudulent intent on the part of Mr. Dunbar.

The transcript of the § 341(a) meeting makes it clear that Mr. Dunbar's lawyer was somewhat confused when preparing the schedules for Mr. Dunbar and Ms. Roberson. As mentioned, the two debtors were and had been living together as husband and wife for years (a situation which, in Louisiana, does not evolve into a relationship upon which the law confers the status of marriage). Because they were not married, their attorney filed two individual cases on their behalf. (*See* 11 U.S.C. § 302). When asked by the estate administrator during the § 341(a) meeting to explain the expenses listed on the schedule, Mr. Dunbar's attorney, at one point, indicated that the expenses listed on each debtor's schedule represented the total expenses of the household, but later corrected himself and stated that he listed one-half of the total household expenses on each schedule. The discussion at the § 341(a) meeting about the schedule and the true income picture, however, is virtually incomprehensible. At one point Mr. Dunbar's attorney states that he believes he split the income of Mr. Dunbar, puting half in his schedule and half in Ms. Roberson's schedule, but, finally, he does not appear to be sure of just what he did. Furthermore, there is no indication that Mr. Dunbar intended to conceal his true income. Although he testified (in response to a question by his own attorney) that his take-home pay *according to the schedule* was $650 per month, he testified in response to questioning by the plaintiff's counsel that his gross wages at the time of the meeting were $480 per week. There was no questioning at the § 341(a) meeting by counsel for plaintiff herein as to what the take-home wages actually were as of the date of preparation of the schedule or as to why the schedule of income differed from the wages apparently earned as of the § 341(a) meeting date. Based upon the § 341(a) testimony as transcribed, the Court is convinced that neither Mr. Dunbar nor his attorney knew why the income figure listed in the schedule was $650.00.

There is no indication that Mr. Dunbar knew what his attorney had done, and ***327** there is no concrete indication that his attorney had any idea what he had done. The Court further notes that Mr. Dunbar was not subpoenaed by the plaintiff, and, therefore, the only items of evidence as to intent are the payroll records, the tax returns and the § 341(a) meeting transcript. Based upon the evidence before it (which, to reiterate, does not include even *one* question put to Mr. Dunbar about why the schedule says what it says), this Court finds that the debtor's schedule of net income, while apparently inaccurate, was the result of carelessness or ignorance on the part of Mr. Dunbar (or on the part of his attorney) and was not a fraudulent act. *See In re Fischer,* 4 B.R. 517, 518 (Bankr.S.D.Fla.1980).[6] This case is not one in which the debtor maintained a "reckless and cavalier disregard for the truth serious enough to supply the necessary fraudulent intent required by Section 727(a)(4)(A)." *Gonday,* 27 B.R. at 433. Mr. Dunbar's forthright, though somewhat befuddled, testimony at the § 341(a) meeting further belies any indication of fraudulent intent. *See Humphries v. Nally,* 269 F. 607, 608–609 (5th Cir.1920) (where the court found no evidence of fraudulent intent when the bankrupt made a full and true disclosure through testimony at the meeting of creditors.)

6 Counsel for the debtor is admonished to pay particular attention in the future to the requirement of collecting accurate information in preparation of the required bankruptcy pleadings, schedules and statements.

Request for Attorney's Fees

6 In his answer to the complaint, the defendant requests attorney's fees and costs in accordance with 11 U.S.C. § 523(d) which provides:

> (d) If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

11 U.S.C. § 523(d). An award of attorney's fees pursuant to this section is limited to a determination of dischargeability of a consumer debt under § 523(a)(2). This action was brought under § 727(a)(4)(A). Because § 523(d) does not provide a statutory basis for an award of attorney's fees and costs for actions under § 727, the Court denies the debtor's request for fees and costs.

A separate order will be entered this date.

ORDER

For written reasons separately entered this date,

IT IS ORDERED that the relief requested in plaintiff's complaint to deny the debtor's discharge on the grounds that debtor knowingly and fraudulently made false statements be and hereby is DENIED, and that plaintiff's complaint be and hereby is DISMISSED with prejudice, at plaintiff's cost.

IT IS FURTHER ORDERED that defendant's request for attorney's fees and costs pursuant to 11 U.S.C. § 523(d), and otherwise, be and hereby is DENIED.

Parallel Citations

19 Bankr.Ct.Dec. 446

End of Document

404 B.R. 506
United States Bankruptcy Court,
W.D. Arkansas,
Fayetteville Division.

In re Orin Bret JUSTICE, Debtor.

No. 5:06–bk–71631. | April 15, 2009.

Synopsis

Background: Creditor moved to dismiss debtor's Chapter 7 case based on “means test” presumption of abuse, and the Bankruptcy Court denied motion on theory that, even if “means test” presumption were triggered and not rebutted, decision whether to dismiss was discretionary with court. Creditor appealed. The District Court, Jimm Larry Hendren, J., 2008 WL 4368668, reversed and remanded.

Holdings: The Bankruptcy Court, Ben T. Barry, J., held that:
1 24-year-old, unemployed daughter with infant son, who was living in same household with Chapter 7 debtor and financially dependent on him for support for nearly one year prior to commencement of his bankruptcy case and for about one year afterward, qualified as “dependent” of debtor's, along with her infant child, such that debtor, in performing “means test” calculation, could take larger deductions allowed under Internal Revenue Service (IRS) guidelines for household of five;
2 sum that Chapter 7 debtor paid to enable his minor daughter to go on school-related trip to Europe was not “reasonable and necessary” educational expense, such as debtor could deduct; and
3 while creditor failed to present evidence as to how much money debtor's dependent, college-age daughter had received from single parent scholarship fund to pay for her motor vehicle and vehicle insurance and for day-care for her infant child, it was inconceivable that these amounts, which daughter regularly received and used for payment of these household expenses, was less than the $18.61 per month that was needed, along with debtor's other monthly income, to trigger “means test” presumption of abuse.

Case conditionally dismissed, unless converted.

West Headnotes (12)

1 **Bankruptcy** Proceedings; Motion or Sua Sponte Action

Term “family size,” as used on “means test” form in directing Chapter 7 debtor to take deductions allowed under Internal Revenue Service (IRS) standards based on his applicable “family size,” was potentially more inclusive than term “dependents,” as used in “means test” provision itself in authorizing debtor to take deductions specified under IRS standards for area in which debtor resided for the debtor, debtor's spouse, and dependents of debtor; accordingly, in deciding whether Chapter 7 debtor who resided in same home with his wife, their minor daughter, their adult daughter and her infant son was limited, in performing “means test” calculation for determining whether presumption of abuse exists, to deductions provided under IRS standards for household of three or whether he could take larger deductions authorized for household of five based on fact that his adult daughter and her son were living with him, court had to determine whether adult daughter and her son were “dependents” of debtor, as term was used in “means test” provision, rather than whether they were part of debtor's “family,” as used in “means test” form. 11 U.S.C.A. § 707(b)(2)(A)(ii)(I); Official Bankruptcy Form 22A, 11 U.S.C.A.

2 **Bankruptcy** Rules

When official bankruptcy form is in conflict with statutory language, court cannot choose to defer to official form.

3 **Statutes** Meaning of Language

Unless otherwise defined, words in statute will be interpreted as taking their ordinary, contemporary, common meaning.

4 **Bankruptcy** Proceedings; Motion or Sua Sponte Action

In deciding whether adult daughter and infant grandson living in same household with debtor, his wife, and their minor daughter qualified as "dependents" of debtor, so as to entitle debtor, in performing "means test" calculation for determining whether presumption of abuse exists, to take larger deductions allowed under Internal Revenue Service (IRS) guidelines for household of five, bankruptcy court had to remember purpose of "mean test" provision, i.e., to ensure that debtors who could afford to repay some portion of their unsecured debts were required to do so, and could not interpret term "dependent" too broadly, as requiring mere reliance on debtor for support, as this broad construction would conflict with purpose of "mean test" provision. 11 U.S.C.A. § 707(b)(2)(A)(ii)(I).

5 **Bankruptcy** Proceedings; Motion or Sua Sponte Action

Bankruptcy Claims and Assets; Propriety and Feasibility in General

At some point in time, under some circumstances, debtor's moral obligation to provide support for his or her children becomes sufficiently tenuous that it must yield to countervailing interest of debtor's creditors in receiving payment.

6 **Bankruptcy** Proceedings; Motion or Sua Sponte Action

In order for individual to qualify as "dependent" of debtor, as that term is used in "means test" calculation for determining whether presumption of abuse exists, debtor must have reason to provide support, and claimed dependent must have reason to rely on debtor. 11 U.S.C.A. § 707(b)(2)(A)(ii)(I).

7 **Bankruptcy** Proceedings; Motion or Sua Sponte Action

To determine whether individual qualifies as "dependent" of debtor, as that term is used in "means test" calculation for determining whether presumption of abuse exists, court must engage in case-by-case analysis based on factors such as length of time the claimed dependent resided in debtor's household, reason the claimed dependent is residing in debtor's household, and whether the claimed dependent was, in fact, necessitous. 11 U.S.C.A. § 707(b)(2)(A)(ii)(I).

8 **Bankruptcy** Proceedings; Motion or Sua Sponte Action

Among factors pertinent to whether individual qualifies as "dependent" of debtor, as that term is used in "means test" calculation for determining whether presumption of abuse exists, are age of alleged dependent, how much income or support from third parties he or she receives, and whether alleged dependent is still in school. 11 U.S.C.A. § 707(b)(2)(A)(ii)(I).

9 **Bankruptcy** Proceedings; Motion or Sua Sponte Action

Important factor for court to consider in deciding whether individual qualifies as “dependent” of debtor, as that term is used in “means test” calculation for determining whether presumption of abuse exists, is whether alleged dependent could be claimed as dependent on debtor's federal income tax returns, or whether he or she could qualify as dependent in another legally cognizable way, such as for purpose of medical insurance. 11 U.S.C.A. § 707(b)(2)(A)(ii)(I).

10 **Bankruptcy** Proceedings; Motion or Sua Sponte Action

Twenty-four-year-old, unemployed daughter with infant son, who was living in same household with Chapter 7 debtor and financially dependent on him for support for nearly one year prior to commencement of his bankruptcy case and for about one year afterward, qualified as “dependent” of debtor's, along with her infant child, such that debtor, in performing “means test” calculation for determining whether presumption of abuse exists, could take larger deductions allowed under Internal Revenue Service (IRS) guidelines for household of five, and was not limited to lesser deductions allowed for household of three, based solely on presence in household of debtor, his spouse and their minor daughter. 11 U.S.C.A. § 707(b)(2)(A)(ii)(I).

11 **Bankruptcy** Proceedings; Motion or Sua Sponte Action

Sum that Chapter 7 debtor paid to enable his minor daughter to go on school-related trip to Europe was not “reasonable and necessary” educational expense, such as debtor could deduct in performing “means test” calculation for determining whether presumption of abuse exists, where debtor acknowledged that participation in trip was not required and failed to show that he had provided any written documentation or detailed explanation, as required by “means test” provision. 11 U.S.C.A. § 707(b)(2)(A)(ii)(IV).

12 **Bankruptcy** Proceedings; Motion or Sua Sponte Action

While creditor, as party moving to dismiss debtor's Chapter 7 case based on “means test” presumption of abuse, failed to present evidence as to how much money debtor's dependent, college-age daughter had received from single parent scholarship fund to pay for her motor vehicle and vehicle insurance and for day-care for her infant child, it was inconceivable that these amounts, which daughter regularly received and used for payment of these household expenses, was less than the $18.61 per month that was needed, along with debtor's other monthly income, to trigger “means test” presumption of abuse; accordingly, absent evidence of any special circumstances sufficient to rebut presumption, bankruptcy case had to be dismissed as abuse of provisions of Chapter 7. 11 U.S.C.A. §§ 101(10A), 707(b)(2).

1 Cases that cite this headnote

Attorneys and Law Firms

***508** Todd P. Lewis, Conner & Winters, LLP, Fayetteville, AR, for Advanced Control Solutions, Inc.

Jack L. Martin, Steven Travis Robbins, Jack & Holly Martin, PA, Springdale, AR, for the debtor.

William M. Clark, Jr., chapter 7 trustee.

Opinion

ORDER

BEN T. BARRY, Bankruptcy Judge.

Before the Court is a Motion to Dismiss filed on April 24, 2007, by creditor Advanced Control Solutions, Inc. [Advanced Control], remanded to this Court by the United States District Court for further proceedings consistent with its Order of September 22, 2008. A hearing was held on the motion to dismiss January 14, 2009, at the conclusion of which the Court took the motion under advisement. For the reasons stated below, the Court grants Advanced Control's motion; the debtor has 20 days from the date of this order to convert or the case will be dismissed.

Jurisdiction

This Court has jurisdiction over this matter under 28 U.S.C. § 1334 and 28 U.S.C. § 157, and it is a core proceeding under 28 U.S.C. § 157(b)(2)(A). The following ***509** order constitutes findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052, made applicable to this proceeding under Federal Rule of Bankruptcy Procedure 9014.

Procedural History

On August 1, 2006, the debtor filed a chapter 13 bankruptcy petition. On December 20, 2006, the chapter 13 case was converted to a case under chapter 7. On January 16, 2007, the case was dismissed for failure to file a chapter 7 statement of current monthly income, or means test. The next day, the debtor filed a chapter 7 means test [Means Test] indicating a 60–month disposable income of $28,203.60, a household size of three persons, expenses calculated based on a family size of three, that the debtor is an above-median income debtor, and that a presumption of abuse arises. On January 23, 2007, the debtor filed a Motion to Set Aside Dismissal Order, to which the chapter 7 trustee and Advanced Control responded. The Court held a hearing on March 6, 2007, and took the matter under advisement. On March 15, 2007, the Court granted the debtor's motion and set aside the dismissal order.

On April 24, 2007, Advanced Control filed a Motion to Dismiss the debtor's case arguing for dismissal under 11 U.S.C. § 707(b)(2), alleging an unrebutted presumption of abuse existed, and under § 707(b)(3), alleging that the totality of the circumstances of the debtor's financial situation demonstrated abuse. The Court held a hearing on July 24, 2007, at which time the motion to dismiss was denied. In its ruling, the Court stated that it was in the best interests of creditors to neither dismiss or convert the case, that it relied on § 707(b), and that the language of § 707(b) is "permissive, it's not mandatory—the court may dismiss a case...." [1] The Court also found that the totality of the circumstances of the debtor's financial situation did not warrant dismissal under § 707(b)(3) and that the debtor did not file his petition in bad faith. Advanced Control moved for leave to take an interlocutory appeal of the order denying its Motion to Dismiss, but leave was denied by the district court.

1 Section 707(b)(1) states, "After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, trustee (or bankruptcy administrator, if any), or any party in interest, *may dismiss a case* filed by an individual debtor under this chapter whose debts are primarily consumer debts, or, with the debtor's consent, convert such a case to a case under chapter 11 or 13 of this title, *if it finds that the granting of relief would be an abuse* of the provisions of this chapter." 11 U.S.C. § 707(b)(1) (emphasis added).

On August 30, 2007, the debtor filed an amended chapter 7 means test; on September 5, 2007, the debtor filed a second amended means test [Amended Means Test]. The Amended Means Test indicated a 60–month disposable income of $1383.60, a household size of five persons, expenses calculated based on a family size of five, that the debtor is an above-median income debtor, and that a presumption of abuse *does not* arise.

On September 25, 2007, the debtor filed a Motion for Discharge, requesting that the Court grant him a discharge pursuant to § 727(a). On October 15, 2007, Advanced Control responded, and on November 7, 2007, the Court held a hearing on the motion and response. The Court granted the motion for discharge on November 13, 2007. At the hearing, the Amended Means Test was not introduced into evidence,[2] and the Court stated, in ***510** ruling on the motion for discharge, that the Amended Means Test should not be considered because it was not relevant to the motion before the Court. The issue before the Court was whether the debtor was entitled to a discharge under § 727(a).

2 Both attorneys referenced the Amended Means Test during the hearing. Counsel for Advanced Control referenced the filing of the Amended Means Test in his opening as a reason the Court should not grant the debtor's discharge, though he later argued that the Court should not consider the Amended Means Test at all. Counsel for the debtor referenced that the Means Test had been amended to reflect the debtor's living situation. When asked whether either party wished to introduce evidence, Advanced Control stated that it relied "on the record of the Court as far as the filing of pleadings and the orders that have been already entered ....", but introduced no stipulations or evidence and did not ask the Court to take judicial notice of anything. Likewise, the debtor's counsel did not introduce the Amended Means Test or provide stipulations relating to it. Therefore, at most, the only evidence before the Court at that hearing about the Amended Means Test was that one had been filed.

On November 19, 2007, Advanced Control filed a Notice of Appeal, appealing this Court's Order Overruling Motion to Dismiss and Order Granting Debtor's Motion for Discharge. In its appeal to the United States District Court, Advanced Control argued that this Court erred in its view that dismissal or conversion under § 707(b)(1) is discretionary when an unrebutted presumption of abuse exists. The district court agreed with Advanced Control and concluded "that the Bankruptcy Court had only two options when faced with the unrebutted presumption of abuse in Justice's Means Test (to dismiss his petition or convert it back to a Chapter 13)," and reversed this Court's order granting the debtor's discharge. *Justice v. Advanced Control Solutions, Inc.*, 2008 WL 4368668, at *5 (W.D.Ark. Sept.22, 2008). The district court declined to reverse this Court's order denying the motion to dismiss because "[t]he Bankruptcy Court is the proper court to determine, in the first instance, whether dismissal or conversion to Chapter 13 is the proper step to be taken based on Justice's presumed abuse of Chapter 7." *Id.* at *6. The district court remanded the case to this Court "for further proceedings consistent with [its] opinion." *Id.*

Consideration of the Motion to Dismiss on Remand

Pursuant to the district court's order of remand, the motion to dismiss was reset for hearing in this Court on November 13, 2008. Prior to the hearing, the debtor filed an Amended Motion for Hearing on Consideration of Means Test Filed September 5, 2007, requesting that this Court consider the Amended Means Test in the November 13 hearing. Advanced Control responded and the amended motion and response were also set for hearing on November 13.

At the November 13 hearing, Advanced Control argued that the law of the case doctrine prevented the Court from considering the Amended Means Test relying, in part, on dictum in this Court's ruling at the November 7 hearing. However, the Court disagreed and granted the debtor's motion. The Court stated that the law of the case doctrine did not prohibit the Amended Means Test from being considered in the context of the motion to dismiss on remand because the issue was not before the Court at the November 7, 2007, hearing and the district court did not consider the Amended Means Test on appeal. In its order overruling this Court's Order granting the debtor a discharge, the district court recognized that this Court did not consider the debtor's Amended Means Test. *Justice*, 2008 WL 4368668, at * 1, *4. The Court then continued the hearing on the motion to dismiss to January 14, 2009.

***511** On December 3, 2008, the debtor filed a response to the motion to dismiss and a request that the Court dismiss the motion as untimely. Advanced Control responded on December 30, 2008, and both responses were also set for hearing on January 14, 2008. At the January 14 hearing, the Court first heard, and denied, the debtor's motion to dismiss Advanced Control's motion to dismiss; it then proceeded to consider Advanced Control's motion to dismiss. The Court admitted the Means Test and the Amended Means Test into evidence, as well as certain pages of Mr. Justice's deposition, taken on October 10, 2007. At the conclusion of the hearing, the Court took the motion to dismiss under advisement. Because this Court previously ruled at the November 13 hearing that consideration of the Amended Means Test did not violate the law of the case doctrine, this Court will consider the Amended Means Test and determine, in accordance with the directives from the United States District Court, whether an unrebutted presumption of abuse exists, which would require this Court either to convert or dismiss the debtor's case under § 707(b)(2).

The Debtor's Amended Means Test

Line 14 of the Amended Means Test states that the debtor has a "household size" of five and that the applicable median family income in Arkansas for a household size of five is $57,778.00. Mr. Justice's income appears to be his sole source of income, and no other person or entity contributes income to the household expenses on a regular basis, according to line 8. The debtor's current monthly income is $7246.81 and his annualized income is $86,961.72. Because his annualized income is greater than the applicable median family income for the state of Arkansas, the debtor is an above-median income debtor and is required to complete the balance of the means test.

Part V calculates deductions allowed under § 707(b)(2), and line 19 in this section allows a deduction for Allowable Living Expenses using IRS National Standards. On line 19 of his Amended Means Test, the debtor took a deduction of $1762.00, which would be the applicable amount under the IRS National Standards for a family size of five. [3] Line 20A allows a deduction for "housing and utilities; non-mortgage expenses" using IRS Housing and Utilities Standards. On line 20A of his Amended Means Test, the debtor took a deduction in the amount of $404.00, which is the applicable local standard for a family size of more than four living in Benton County, where the debtor resides. Line 20B allows a deduction for "housing and utilities; mortgage/rent expense" using IRS Housing and Utilities Standards. On line 20B, the debtor stated that his housing and utilities for mortgage expense deduction is $805.00, which is also the applicable local standard for a family size of more than four persons living in Benton County. Line 38 allows a deduction for the debtor's actual average monthly expenses incurred in providing elementary and secondary education for his minor child. On line 38, the debtor stated an expense of $125.00 per month.

3 The debtor's Official Form B22A uses the term "family size" in lines 19, 20A, and 20B; however, these lines on Official Form B22A have since been amended, and "family size" is replaced with "household size." This change does not affect the outcome of this Court's decision.

Position of the Parties

On page 1 of the Amended Means Test, the debtor checked a box indicating that a presumption of abuse does not arise. However, Advanced Control disagrees and argued that the debtor erred in completing his Amended Means Test by choosing applicable ***512** Local and National Standards based on a family size of five instead of a family size of three. [4] Advanced Control asserts that the debtor should have chosen National and Local Standards based on a family size of three, in part, because the debtor's adult daughter and her son were not claimed as dependents on the debtor's IRS tax returns and, therefore, cannot be "dependents of the debtor" under § 707(b)(2)(A)(ii)(I). If the debtor's expense calculations were based on a family size of three, an unrebutted presumption of abuse would exist. The debtor's position is that claiming his adult daughter and her son on his IRS tax returns is not determinative of whether they are his dependents for purposes of § 707(b)(2)(A)(ii)(I), and he urges the Court to adopt a more common definition of the term "dependent."

4 At the hearing, Advanced Control did not allege that the debtor erred in choosing his applicable median family income based on a household size of five because under either scenario, the debtor is above the median family income for the state of Arkansas.

Advanced Control also argued that the educational expense of $125.00 claimed on line 38 of the Amended Means Test should not be allowed. Advanced Control's position is that this expense was not a reasonable or necessary expense and should be removed from the debtor's allowed expenses.

Findings of Fact and Conclusions of Law

There are two issues before the Court, the resolution of which may result in a presumption of abuse on the debtor's Amended Means Test. The first issue is whether the debtor completed his Amended Means Test correctly by using a family size of five, which removes the presumption of abuse that would otherwise exist. If in resolving this issue, the debtor's adult daughter, Arrin, and her son are considered dependents of the debtor, the debtor may be required to add certain financial assistance to his Amended Means Test calculations. The second issue is whether the debtor may claim the $125.00 educational expense. The resolution of either issue could change the outcome of the Amended Means Test.

Whether the Debtor May Choose Applicable Standards Based on a Family Size of Five

Preliminarily, the Court must address the relationship between the term "dependent," as used in § 707(b)(2)(A)(ii)(I), and the phrase "family size," as used on the means test form, to determine which term controls for the purpose of choosing applicable local and national standards.

Because the debtor's annualized income is greater than the debtor's applicable median family income, the debtor must complete the calculations set forth in § 707(b)(2) to determine whether his chapter 7 bankruptcy case is presumed to be an abuse under the code. 11 U.S.C. § 707(b)(2), (7). The calculations required under § 707(b)(2) allow debtors to deduct various monthly expenses from their current monthly income, including certain expenses specified in the collection standards of the Internal Revenue Service. Specifically, § 707(b)(2)(A)(ii)(I) states,

> The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides, as in effect on the date of the order for relief, *for the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case, if the* ***513** *spouse is not otherwise a dependent.* Such expenses shall include reasonably necessary health insurance, disability insurance, and health savings account expenses for the debtor, the spouse of the debtor, or the dependents of the debtor.

11 U.S.C. § 707(b)(2)(A)(ii)(I) (emphasis added). The computation required by § 707(b)(2), also referred to as the means test, is made on Official Form B22A in accordance with Federal Rule of Bankruptcy Procedure 1007(b)(4). Lines 19, 20A, and 20B of the debtor's Amended Means Test directed him to use IRS Standards based on his applicable *family size* for the allowed expenses on those lines.[5]

5 *See supra* note 3.

1 **2** Although the term family size is used on the means test form, the bankruptcy code expressly limits the debtor's monthly expenses to those for the debtor, the spouse of the debtor, and *dependents* of the debtor, with exceptions not relevant in this case. Presumably, family size would be a more inclusive term, but because Congress chose to limit debtors' expenses to their dependents, the form must defer to the language of the code. As the court in *In re Law* stated,

> [W]hen an official form is in conflict with statutory language, the court cannot choose to defer to the official form. The statute controls over the official form.... Congress did not create Form 22C. Congress drafted and passed BAPCPA,[6] while the Judicial Conference of the United States created Form 22C. This Court thus rejects the notion that any instructions on that form can be used to divine congressional intent-especially when the language on the form directly conflicts with clear statutory language....

6 Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

In re Law, 2008 WL 1867971, at *7 (Bankr.D.Kan. Apr.24, 2008)(disagreeing with the court in *In re Plumb,* which deferred to the form's instructions because the instructions were more specific, reflect the actual living situation of many families, and Congress used the term "dependents" elsewhere on the means test form. *In re Plumb,* 373 B.R. 429, 437–38 (Bankr.W.D.N.C.2007)); *see also In re Napier,* 2006 WL 4128358, at *2 (Bankr.D.S.C. Sept.18, 2006)(holding "[t]o the extent that Official Form B22C indicates that Debtors may include the boarders in the means test calculation, it must yield to the plain language of § 707(b)(2), which only allows Debtors to include dependents."). Accordingly, the Court finds that the term "dependents" controls in determining the family size the debtor uses to choose applicable local and national standards.

Whether the Adult Daughter is a Dependent Under the Code

Therefore, the question before the Court becomes whether the debtor's adult daughter and grandson are within the definition of “dependents” under § 707(b)(2)(A)(ii)(I). Mr. Justice testified that at the time of the bankruptcy filing, August 1, 2006, his wife, minor daughter, adult daughter (Arrin) and Arrin's infant son lived with him in his and his wife's home. Arrin had moved back in around September 2005, when she was 23 years old. Mr. Justice testified that Arrin moved in with them because she was pregnant, unemployed, and could not afford a place to live. Arrin's son was born February 28, 2006. When Mr. Justice filed his bankruptcy petition, Arrin was unemployed and a full-time student attending community college classes. Arrin received some state aid to pay for daycare, and Ms. Justice also watched her grandchild while Arrin was at school. The ***514** debtor testified that Arrin received no income and received no child support. She received some assistance from the Single Parent Scholarship Fund, which helped pay for her car payment, insurance, and gasoline. Arrin also received money from scholarships and other aid to pay for school and books. Mr. Justice testified that she contributed none of this support to the household and paid no rent. The debtor and his wife paid for Arrin's food, supplies for the baby, and home utilities. At the hearing, Mr. Justice did not know the dollar amounts of how much assistance Arrin received from any source, and his deposition does not contain this information. Mr. Justice also testified that Arrin could not have “gotten by” without help and that her stay was open-ended. Arrin and her son moved out of her parents' home in September 2007.

The debtor testified that he did not claim Arrin on his 2005 or 2006 tax returns and did not claim Arrin's son, who was born in early 2006, on his 2006 tax returns. He stated that no one told him he could not claim them, he just did not think he could. This Court takes judicial notice that the debtor did list Arrin and her son as his dependents on Schedule I of his bankruptcy schedules.[7] According to his deposition, the debtor amended his Means Test to include Arrin and her son as household members because his lawyers believed they found case law supporting his right to add them.

7 A court may take judicial notice of its own orders and records in a case before the court. Fed.R.Evid. 201.

Definition of Dependent

3 “Dependent” is defined in several areas of federal legislation. *Leslie Womack Real Estate, Inc. v. Dunbar (In re Dunbar),* 99 B.R. 320, 324 (Bankr.M.D.La.1989)(citing at least six federal statutes defining dependent in various legal contexts). Congress could have defined “dependent” for purposes of the bankruptcy code, but did not. *In re Dunbar,* 99 B.R. at 324 (noting that “Congress has specifically defined [dependent] when the term was to be used in a particular manner for a particular purpose or in a manner other than its plain and usual meaning”). In the absence of a definition provided by Congress, this Court will defer to the “fundamental canon of statutory construction ... that, unless otherwise defined, words will be interpreted as taking their ordinary, contemporary, common meaning.” *Dunbar,* 99 B.R. at 324 (quoting *Perrin v. United States,* 444 U.S. 37, 42, 100 S.Ct. 311, 62 L.Ed.2d 199 (1979)); *see also Rousey v. Jacoway,* 544 U.S. 320, 330, 125 S.Ct. 1561, 161 L.Ed.2d 563 (2005)(looking to the “ordinary meaning” of terms used, but not defined, in the bankruptcy code). This approach was taken by one court that concluded, in the context of completing the debtor's schedules, that “dependent” meant “a person who reasonably relies on the debtor for support and whom the debtor has reason to and does support financially.” *Dunbar,* 99 B.R. at 324. Black's Law Dictionary provides a similar, but broader, definition: “[o]ne who relies on another for support; one not able to exist or sustain oneself without the power or aid of someone else.” Black's Law Dictionary (8th ed.2004).

A review of case law reflects that, despite analysis by several courts, there is no consensus among bankruptcy courts as to who is a dependent for purposes related to the means test. In at least one case, whether the alleged dependents were claimed as dependents on the debtor's IRS ***515** tax returns was determinative.[8] *United States Trustee v. Duncan (In re Duncan),* 201 B.R. 889, 897 (Bankr.W.D.Pa.1996)(stating that “[b]ecause respondent and his wife do not presently have any dependents, as evidenced by their most recent income tax returns and respondent's Schedule I, the Court must find that any support that they provide to the other six members of their present household is necessarily voluntary in nature.”).

8 For IRS purposes, a dependent is either a qualifying child or a qualifying relative. 26 U.S.C. § 152.

Other courts have considered whether the debtor *could* have claimed the alleged dependent on the IRS tax returns as one factor among others. In one case, the court held that the debtors' 18 year-old nephew living with them at the time of the bankruptcy filing was not a dependent because he was not listed on the debtors' tax returns and no evidence was presented as to the debtors' expenditures on his behalf. *In re O'Connor,* 2008 WL 4516374, at *10–11 (Bankr.D.Mont. Sept.30, 2008). In a case out of Missouri, the fact that the debtors would be entitled to claim their adult 20–year–old daughter on their IRS tax return was a factor the court considered, along with the fact that under applicable state law, the debtors' parental support obligation continued until their child completed either college or post-secondary vocational education, or reached the age of 22. *In re Smith,* 269 B.R. 686, 689–90 (Bankr.W.D.Mo.2001).

In the context of a pre-BAPCPA chapter 13 plan confirmation, one court defined dependent as a person supported financially by a debtor and who reasonably relies on that support, but clarified that "[o]ne could certainly argue that it is always 'reasonable' for the recipient of financial assistance to rely on such assistance: the more pertinent question is whether it is reasonable under the circumstances for the court to permit the debtor to undertake the obligation of supporting the would-be dependent." *In re Gonzales,* 157 B.R. 604, 609 (Bankr.E.D.Mich.1993). In *Gonzales,* the adult children in question were still considered dependents of their parents by the IRS and by the debtors' medical and hospitalization insurer. *Id.* at 610. The court considered the adult children to be dependents for purposes of § 1325(b), because "society is prepared in this day and age to accept the notion that a 19–year old and a 21–year old undergraduate college students are still their parents' dependents," and the "[d]ebtors' children, although above the age of majority, have within society's current expectations reasonably not yet left the nest." *Id.* at 610–11.

4 When a term is not defined, and without legislative intent to the contrary, "statutory terms are given their plain, ordinary, and commonly understood meaning." *Schumacher v. Cargill Meat Solutions Corp.,* 515 F.3d 867, 871 (8th Cir.2008). However, the definition of dependent must require more than mere reliance. Section 707(b)(2) was enacted as part of BAPCPA, the purpose of which, in part, was to "curb abuse of the bankruptcy system by implementing a means test to ensure that those who can afford to repay some portion of their unsecured debts are required to do so." 151 Cong. Rec. S2462, 2470 (2005)(statement of Sen. Nelson). The means test was intended to "ensure that debtors repay creditors the maximum they can afford." H.R.Rep. No. 109–31, pt. 1 (2005). When adult children qualify as dependents under § 707(b)(2)(A)(ii)(I), debtors apply standards based on a larger family size, and, therefore, subtract a greater amount of expenses from their ***516** current monthly income. Depending on the resulting figure, more dependents may result in an amount of disposable income that does not trigger the presumption of abuse, which may in turn allow chapter 7 debtors to avoid dismissal or conversion of their cases under § 707(b)(2).

5 **6** **7** **8** **9** In the light of the purpose of § 707(b)(2), the ordinary meaning of the term "dependent" as defined by Black's Law Dictionary is too broad; it could conceivably include persons who live outside the debtor's home and who are only somewhat dependent on the debtor. This would clearly be an abuse and manipulation of the means test. This Court agrees with the *Gonzales* court that "at some point in time, under some circumstances, the debtor's moral obligation to provide support for her children becomes sufficiently tenuous that it must yield to the countervailing interest of the debtor's creditors in receiving payment." *In re Gonzales,* 157 B.R. at 609–11; *see also In re Mastromarino,* 197 B.R. 171, 178 (Bankr.D.Me.1996)(stating that "[t]o grant such voluntary expenditures priority over existing legal obligations would be to permit Mastromarino unilaterally to subordinate his creditors to his personal lifestyle choices. That he may not do."). However, that point in time must be determined on a case-by-case basis on the facts of each case. In applying the ordinary meaning of dependent, this Court is also guided by the *Dunbar* court's analysis:

> This Court's definition of the term "dependent" requires that the debtor have reason to provide support and that the claimed dependent have reason to rely on the debtor. A case by case analysis is necessary in order to determine, for example, the length of time the claimed dependents have resided in the household ..., the reason the claimed dependents are residing in the household ..., and whether the claimed dependents were in fact necessitous....

In re Dunbar, 99 B.R. at 325 n. 3. Other facts to consider include the age of the alleged dependents, how much income or support from third parties they receive, and whether they are in school. Additionally, an important inquiry is whether the alleged dependent could be claimed as a dependent on the debtor's IRS tax returns [9] or could qualify as a dependent in another legally cognizable way, for example, for the purpose of medical insurance.

9 The Court is mindful of the Bankruptcy Appellate Panel's decision in *In re Wilson,* in which the court overruled the bankruptcy court's decision to allow the debtors to claim a vehicle ownership expense deduction even though the debtor owned the car outright under § 707b(2), because the ruling was "inconsistent with how the IRS applies its own standards" in the Internal Revenue Manual [IRM]. *Babin v. Wilson (In re Wilson),* 383 B.R. 729, 733 (8th Cir. BAP 2008).

To the extent the bankruptcy appellate court's decision in *Wilson* may be interpreted to require the number of dependents for purposes of § 707(b)(2) to correspond with the number of dependents claimed on debtor's IRS tax returns, this Court notes that the IRM does not *require* the number of persons allowed for National Standard expenses to be the same as those claimed on their IRS tax returns for their own purposes of determining a taxpayer's necessary expenses—

> Generally, the total number of persons allowed for national standard expenses should be the same as those allowed as exemptions on the taxpayer's current year income tax return.... There may be reasonable exceptions.... For example, foster children or children for whom adoption is pending.

IRM, Financial Analysis Handbook § 5.15.1.7, no. 8; *see also* IRM, Financial Analysis Handbook § 5.15.1.9, no. 1A (applying same language to determination of family size under Local Standards).

Application

10 On the facts presented, this Court finds that Arrin and her son qualify as ***517** dependents under § 707(b)(2). Arrin's reliance on the debtor, financially and otherwise, began almost a year before he filed his bankruptcy petition and continued until about a year afterward. At the time of the bankruptcy filing, Arrin was 24 years old, had an infant son, was unemployed, and a full-time student. She only received financial assistance from outside sources to pay for a portion of her vehicle, childcare, and education expenses. It is unclear whether her financial assistance paid for all of these expenses because the Court does not know how much assistance she received or how much her expenses were. Nonetheless, she remained dependent upon the debtor for shelter, utilities, food for her and her child, and supplies for her child. [10] Arrin's son is also a dependent of the debtor, because he had lived with the debtor from birth and was completely reliant upon the debtor for his and his mother's support. Additionally, Arrin received no child support payment with which to take care of him.

10 From testimony, it appears Arrin relied on Ms. Justice for some childcare and for some of her child's clothes. However, Ms. Justice has no income and is also a dependent of the debtor.

While such reliance and familial relationship does not automatically qualify a person as a dependent under § 707(b)(2), there are additional facts in this case that cause the Court to find that Arrin and her son are dependents. Although there was testimony that the debtor did not claim Arrin on his 2005 or 2006 tax returns or her son on his 2006 tax returns, the debtor testified that he did not know whether he could have and no one told him he could not. Therefore, the Court does not know whether Arrin and her son *could* have qualified under the IRS tax code as dependents of Mr. Justice. Further, although Mr. Justice waited more than seven months to amend his Means Test, there is no evidence that the debtor amended his Means Test in order to manipulate the results of the calculation. It appears from the debtor's deposition that he added Arrin and her son on his counsel's advice that case law existed supporting that change. In addition, the debtor considered Arrin and her son dependents on Schedule I of his bankruptcy schedules. While adding two household members did remove a presumption of abuse, this Court had already denied Advanced Control's motion to dismiss in the face of a presumption of abuse. The amendment had no practical effect on the outcome of his case until the Court's Order Granting Debtor's Motion for Discharge was reversed and Order Overruling Motion to Dismiss was vacated, which occurred after the debtor filed his Amended Means Test.

Allowing the debtor to claim as dependents his college-aged, unemployed daughter who was a full-time student and her infant son under the facts and evidence stated above is not at odds with the purposes of § 707(b)(2). Because the plain, ordinary meaning of the term "dependent" as used in § 707(b)(2) is not so narrow as to exclude Arrin and her son, the Court finds that the debtor properly chose the applicable local and national standards based on a family size of five.

Whether the Debtor May Also Claim the $125.00 Educational Expense

11 Section 707(b)(2) states that the debtor's monthly expenses—

> may include the actual expenses for each dependent child less than 18 years of age, not to exceed $1,650 per year per child, to attend a private or public elementary or secondary school *if the debtor provides documentation of such expenses and a detailed explanation of* ***518** *why such expenses are reasonable and necessary*, and why such expenses are not already accounted for in the National Standards, Local Standards, or Other Necessary Expenses referred to in subclause (I).

11 U.S.C. § 707(b)(2)(A)(ii)(IV)(emphasis added). This allowed expense is reflected on line 38 of the means test form, which directs the debtor to state his actual average monthly education expenses for minor children, not to exceed $125.00 per child. The debtor listed an expense of $125.00. At the hearing, the debtor testified this monthly expense was for a school-related trip to Europe for his minor daughter. He testified that she was not required to go on the trip and, in fact, did not. However, the debtor did not receive a refund of the funds paid. The debtor also testified that he did not remember providing the trustee any documentation regarding this expense.

This expense was also listed on the debtor's Means Test, and Mr. Justice testified about this expense at the hearing on the Motion to Dismiss on July 24, 2007. At the conclusion of the July 24, 2007, hearing, Advanced Control argued this expense should not be allowed, and, if subtracted from the debtor's expenses, would result in an even greater presumption of abuse. At that hearing, the Court denied Advanced Control's motion to dismiss under § 707(b)(2) and (b)(3). In denying the motion to dismiss under § 707(b)(2), the Court did not reach the issue of whether the educational expense was properly claimed because it declined to dismiss the case based on a preliminary determination that it was not in the creditors' best interests to dismiss or convert the case despite the presumption of abuse.

The Court finds that the expense for the minor daughter's trip to Europe was not reasonable and necessary, and the debtor provided no evidence or testimony to the contrary. Section 707(b)(2)(A)(ii)(IV) states that the debtor *may* include the educational expense *if* the debtor provides documentation and a detailed explanation of why the expense is reasonable or necessary. At the hearing, the debtor did not show that he had done either and testified that the trip was not required. Because the debtor did not meet the requirements of § 707(b)(2)(A)(ii)(IV), the debtor may not include the educational expense, and the educational expense is disallowed.

Excluding the educational expense on the debtor's Amended Means Test results in a monthly disposable income of $148.06 and a 60–month disposable income of $8883.60. According to line 52, because the debtor's 60–month disposable income is more than $6000.00 but less than $10,000.00, the debtor would have to complete the remainder of Part VI of the Amended Means Test to determine whether his 60–month disposable income is less than 25% of his total non-priority unsecured debt. According to the debtor's Amended Schedule F, filed on November 6, 2006, the debtor has $247,883.51 in total non-priority unsecured debt, 25% of which is $61,970.88. Because this amount is greater than his 60–month disposable income of $8883.60, a presumption of abuse does not arise as a result of adding $125.00 to the debtor's current monthly income. An additional $18.61 in current monthly income would be necessary for this to be a presumption of abuse case.

Effect on the Debtor's Current Monthly Income of Arrin and Her Child as Dependents under § 707(b)(2)(A)

12 Because Arrin and her son are dependents of the debtor, Mr. Justice may be required to include additional amounts in his current monthly income calculation on his Amended Means Test. Current monthly income—

> ***519** (A) 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) ...; 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), but excludes benefits received under the Social Security Act, payments to victims of war crimes or crimes against humanity on account of their status as victims of such crimes, and payments to victims of international terrorism (as defined in section 2331 of title 18) or domestic terrorism (as defined in section 2331 of title 18) on account of their status as victims of such terrorism.

11 U.S.C. § 101(10A). As the objecting party, Advanced Control had the burden of proving that a portion of the amounts Arrin or her son received were paid on a regular basis and paid for the household expenses of the debtor and his dependents. *In re Roll*, 400 B.R. 674, 676 (Bankr.W.D.Wis.2008).

There was no testimony that the debtor received any income from Arrin or her son, but Arrin did receive some amount of financial assistance for some of her expenses from the Single Parent Scholarship Fund, educational scholarships, and some state childcare assistance. The debtor's current monthly income must only contain the amounts that were paid on a regular basis for household expenses of the debtor's dependents, which now include Arrin and her son. The Court has evidence that Arrin received assistance for her vehicle costs, education, and her son's childcare, but cannot determine how much she received exactly. The best evidence the Court has regarding whether any amount she received was paid regularly are the following excerpts from Mr. Justice's deposition and testimony. At his deposition, the following exchange took place—

Advanced Control: Does Arrin-how does Arrin support herself?

Debtor: She is going to school. She has some grants and the Single Parent Scholarship Fund is helping her get through college. She's going to college, a full-time student right now.

Advanced Control: Does the State pay or give her any kind of equivalent to child support?

Debtor: Not that I know if. The only thing I know the State does is they pay for daycare.

...

Advanced Control: From December of 2006 until she moved out, how did she get spending money during that time frame?

Debtor: She has gotten scholarships and support from the Single Parent Scholarship Fund.

Advanced Control: Do they give her money?

Debtor: I guess so. I know they made her car payment and her auto insurance payment, but I do not know what else they did. But she did not contribute money to the household.

Advanced Control: What do you mean when you say those words?

Debtor: She didn't pay any bills

Advanced Control: When did she start getting that scholarship money?

Debtor: I do not know.

Advanced Control: Was she going to school in the spring of 2007?

Debtor: Yes.

Advanced Control: Was she on that scholarship then?

***520** Debtor: Yes.

Advanced Control: Was she on that scholarship in the fall of 2006?

Debtor: I would assume, yes.

...

Advanced Control: And the way she got by when she lived with you all is she was getting these scholarships for being a single parent; correct?

Debtor: Correct.

At the January 14, 2009, hearing, Mr. Justice testified—

Advanced Control: Was it true that you told me that they, being the Single Parent Scholarship Fund, paid for her car payment and auto insurance payment while she was lived with you?

Debtor: Yes.

Advanced Control: And that is still true today?

Debtor: That is a true statement yes.

Advanced Control: And that is while she was living with you

Debtor: That is while she was living with us.

Advanced Control: The amount of that car payment and car insurance that was being paid for, was that, how much was that, $200 or?

Debtor: I don't know.

Advanced Control: More than $100?

Debtor: I don't know.

Advanced Control: ... Any reason why you think it would be less than $100?

Debtor: I don't know what it would have been.

...

Advanced Control: So you don't know the total amount of child support, car insurance, car payments that she received from third parties while she was living with you?

Debtor: No, I do not know the totals of any of that.

Mr. Justice testified that the state *pays* for Arrin's daycare, the Single Parent Scholarship fund *paid* her car payment and auto insurance payment *while* Arrin lived with the debtor, and the scholarship payments were still being made as of the January 14 hearing. His testimony indicates that the financial assistance Arrin received was ongoing throughout her stay with him. And, Arrin's car insurance, car payment, and daycare expenses are household expenses of the debtor's dependents. But, there is no testimony or evidence as to how much assistance Arrin was receiving monthly. Two courts have faced a similar lack of evidence regarding current monthly income calculations. In the context of the U.S. Trustee's motion to dismiss under § 707(b)(2), the court in *In re Roll* could not determine how much income of two separate, cohabitating debtors should be attributed to each other's current monthly income calculation, and lamented that although "surely [each debtor] use[s] a portion of their income to pay household expenses of the other, the record is insufficient to draw any meaningful conclusion about the correct amount to attribute to each debtor." *In re Roll,* 400 B.R. 674, 676–77. Likewise, in *In re Quarterman,* the objecting party did not meets in burden in proving that the debtor's spouse regularly contributed toward household expenses of the debtor or the debtor's dependents. *In re Quarterman,* 342 B.R. 647, 652 (Bankr.M.D.Fla.2006). Consequently, the debtor was left with no disposable income to contribute to his chapter 13 plan. *Id.* Regarding the outcome, the court stated that "the Court cannot presume that the Debtor's spouse regularly contributed nearly two-thirds of her income toward household expenses of the Debtor." *Id.*

The Court cannot determine the exact amount of money paid by third party entities ***521** while Arrin lived with the debtor for her vehicle payment, car insurance payment, and daycare for her son. But the purpose of the means test calculation in a chapter 7 case is to determine whether a presumption of abuse exists. This Court does not have to know the exact amounts to find that Arrin received *some* amount on a regular basis for the payment of her car insurance, car payment, and childcare. Unlike the court in *Quarterman*, this Court will not have to presume that two-thirds of the dependents' assistance was paid regularly for household expenses for a presumption of abuse to exist. If Arrin received just $18.61 a month, a presumption of abuse would exist in this case. It is inconceivable the assistance Arrin received that covered her car insurance, car payment, and daycare was less than $18.61 a month. Further, unlike the problem the *Roll* court faced, based on the debtor's testimony, this Court can reasonably conclude that Arrin regularly received at least $18.61 a month from entities to pay her car insurance, car payment, and daycare expense while she and her son were living with the debtor. After adding this minimum amount of $18.61 plus $125.00, which was previously subtracted as an educational expense, to the debtor's current monthly income of $23.06 on line 50 of his Amended Means Test, the debtor has a current monthly income of $166.67, and a 60–month disposable income of $10,000.20. Accordingly, the Court finds that a presumption of abuse arises in this case.

Conclusion

Based on the facts of this case, the Court makes three findings. First, this Court finds that the debtor's adult daughter, Arrin, and her son are dependents of the debtor under § 707(b)(2)(A)(ii)(I), and that the debtor completed his Amended Means Test correctly by choosing applicable standards based on a family size of five. Second, the $125.00 educational expense is disallowed. And third, Arrin and her son received at least $18.61 in financial assistance that must be included in the debtor's current monthly income. After making adjustments to the debtor's Amended Means Test based on these findings, a presumption of abuse exists in this case, and Advanced Control's motion to dismiss is granted. The debtor shall have 20 days to convert his case, or the case will be dismissed.

IT IS SO ORDERED.

End of Document

1 Bankruptcy Practice Handbook § 5:2 (2d ed.)

Bankruptcy Practice Handbook
Database updated June 2011

Rosemary E. Williams

Chapter 5. Representing the Debtor in a Chapter 7 Case
I. Preparing for Filing

References

§ 5:2. Dismissal for “abuse” of Chapter 7 and the means test

BAPCPA includes major amendments to the Bankruptcy Code intended to make it much more difficult for a consumer debtor to obtain relief under Chapter 7. Two of the most significant of those amendments are reflected in amended Code § 707(b) and are referred to respectively as the “abuse” test and the “means” test. The first amendment made by BAPCPA to Code § 707(b), which directs dismissal of a bankruptcy case if the debtor is found to be “abusing” Chapter 7 relief, is the removal of the pre-BAPCPA word “substantial” immediately before the term “abuse” in the test. The second portion of the amendment to Bankruptcy Code § 707(b) sets out an elaborate “means” test under which every consumer case under Chapter 7 is tested to see whether the presumption of abuse set out in Bankruptcy Code § 707(b)(2) applies.

The “means test” interposed by BAPCPA acts as a strait gate for Chapter 7 debtors, requiring them to demonstrate the dire nature of their financial stresses to avoid the presumption that their bankruptcy filing is an “abuse” of bankruptcy relief. In BAPCPA, Congress authorized a bankruptcy court, if it found abuse, to dismiss a case outright, or to offer the debtor a choice between dismissal or, with the debtor's consent, a conversion of the case to a proceeding under Chapter 13.[1] Thus the “voluntary” nature of Chapter 13 is said to be preserved.

In the first step of the means test, the debtor's annualized current monthly income is compared to what the Bureau of the Census claims is the “median” family income of a similarly sized family in the debtor's state of residence.

Practice Tip:

A “median” number is no more than the middle value of an ordered set of values (or the average of the middle two in a set with an even number of values). This means that in 1 2 3 4 5, 3 is the median. Another way of stating this is that 50% of the incomes in the geographic area fall below the median, and the rest above. Median income is not “average” income; mean income would be a number approximately the statistical norm, or the “average.”

If the debtor's current monthly income is equal to or below the median income for her or his geographic area, as determined by the Census Bureau based on self-reported data, then the presumption of abuse does not arise[2] and the debtor need complete only the income portion of the Official Form. If, however, the debtor's CMI exceeds the median, the debtor must complete the second half of Official Form B22A to deduct certain expenses specified by the Bankruptcy Code and taken from the approach of the Internal Revenue Service to delinquent taxpayers.[3] These deductions are derived from the national and local standards contained in the Internal Revenue Service's Financial Analysis Handbook.[4]

As a result of the way these eligibility requirements are established, the result is determined, at least in part, by the state and county where the debtor resides. The housing expense deduction, for example, is governed by the county, borough or parish where the debtor resides. Although the national standards, which identify amounts for “food, housekeeping supplies, apparel and services, and personal care products and services,” and a fixed “miscellaneous” amount are said to be uniform throughout the United States, the local standards, which define amounts for housing and transportation, vary greatly.[5] BAPCPA also permits a debtor to deduct additional expenses for food, clothing, housing, utilities, health insurance, disability insurance, health savings accounts, and certain educational expenses, so as long as the debtor demonstrates that those additional allowances are “reasonable” and “necessary.” [6]

Practice Tip:

For above-median debtors, these Code provisions place allowable expenses into five general categories: (1) those that fit into the IRS' National Standards, which include food, clothing, household supplies, personal care, and miscellaneous expenses; (2) those that fit into the IRS' Local Standards, which include housing and transportation; (3) actual expenses for items categorized by the IRS as “Other Necessary Expenses,” including such items as taxes, mandatory payroll deductions, health care, and telecommunications services; (4) actual expenses for certain other expenses specified by the Code, such as care for disabled family members and tuition; and (5) payments on secured and priority debts.

A. Disposable income and the means test

After BAPCPA, “disposable income” is defined as “currently monthly income received by the debtor … less amounts reasonably needed to be expended.” [7] The calculation of the debtor's disposable income, compared with median income for the debtor's geographical region, divides debtors into two groups: those above, and those below, the median income for the area. If a debtor's annualized monthly income exceeds the median family income for a similarly sized family in the applicable state, the Code requires that the debtor calculate “amounts reasonably necessary to be expended” in accordance with the IRS Handbook's national and local standards used in Chapter 7. [8] If a debtor is below the median income, the “amounts reasonably necessary to be expended” are instead determined, as they were prior to BAPCPA, by assessing whether the expenses listed by the debtor in Schedule J are reasonably necessary for the maintenance and support of the debtor and the debtor's dependents. [9] If the debtor's income still exceeds the median after recalculation, the Code imposes an “applicable commitment period” for a Chapter 13 plan payout of “not less than 5 years” [10] and the debtor's Chapter 7 case is presumed to be abusive. If the debtor's annualized income is less than the median, then the applicable commitment period is three years. [11]

In addressing the concept of "projected disposable income" as it pertains to Chapter 13 plans, the Supreme Court spent some time on the shorter phrase, "disposable income," relating it to the means test applicable to Chapter 7 consumer debtors. [12] The Court noted that if a Chapter 7 petition discloses that the debtor's disposable income, as calculated by the means test, exceeds a certain threshold, the petition is presumptively abusive. [13]

The existence or absence of a presumption of abuse is evidenced by the completion of mandatory Official Bankruptcy Form B22A. Where the presumption arises, the Official Form required to be prepared and filed by every consumer debtor will, if prepared using commercial software, have a check mark at the top to that effect. This acts as a judicial admission by the debtor, ensuring a dismissal motion and shifting the burden of proof from the trustee or creditor moving for dismissal to the debtor, and all but ensures that a motion to dismiss the debtor's case as "abusive" of Chapter 7 relief. While the debtor can, and should, include an attachment setting out the reasons why, despite the admission, that the debtor is not abusing Chapter 7 relief, it is unlikely to change any potential opponent's willingness to ask for dismissal. The theory behind this form is that an individual consumer debtor should be compelled to pay all of her or his “disposable” income (current monthly income less deductions) to the holders of unsecured claims; the practice is another thing altogether which has led to much litigation. The Court of Appeals for the Ninth Circuit [14] analyzed a debtor's private disability insurance benefits and held them to be a wage substitute which had to be included in the debtor's current monthly income. In reaching its conclusion, the Court rejected the debtors' argument that the definition of “income” in CMI should be consistent with “gross income” as defined in the Internal Revenue Code. In that statute, gross income excludes monies received through accident or health insurance for personal injuries or sickness. [15] The Court stated that the “plain language” of the Bankruptcy Code did not support that because the phrase “without regard to whether such income is taxable income” in 11 U.S.C.A. § 101(10A)(A) “reflects Congress' judgment that the Internal Revenue Code's method of determining taxable income does not apply to the Bankruptcy Code's calculation of CMI.”

B. Presumption of abuse and the means test

If after deducting the allowable expenses, the debtor's current monthly income exceeds certain mathematical benchmarks set by the Code, then a presumption of abuse arises. [16] This presumption may be rebutted only if the debtor demonstrates "special circumstances" justifying any additional expenses or adjustments to the debtor's income for which there is no reasonable alternative, and further shows that those special circumstances reduce the debtor's income below the specified benchmark. [17] Where the debtor claims special circumstances, the debtor must itemize each expense and provide (i) documentation, and (ii) a "detailed explanation" of the circumstances that make the expenses necessary and reasonable. [18] Further, the presumption of abuse may only be rebutted if the additional expenses or adjustments to income (i) cause the product of the debtor's current monthly income, reduced by amounts for other expenses allowed in the means test, [19] multiplied by 60, is the lesser of 25% of the debtor's nonpriority unsecured claims, or $7,025 whichever is greater, or $11,725. [20]

Courts sometimes refer to the IRS publications regarding "other necessary expenses" found in the IRS Financial Analysis Handbook. [21] In sum, that publication describes necessary expenses as:

(i) accounting and legal fees;

(ii) charitable contributions;

(iii) child care;

(iv) court-ordered payments (alimony, restitution);

(v) dependent care;

(vi) education;

(vii) health care;

(viii) involuntary deductions;

(ix) life insurance;

(x) secured or legally perfected debts;

(xi) taxes;

(xii) telephone services

(xiii) internet/email;

(xiv) repayment of loans made for payment of federal taxes; and

(xv) student loans. [22]

The House committee report on this section states:

> In addition to other specified expenses [§ 707(B)(2)(A)(ii), (iii) and (iv)], the debtor's monthly expenses-exclusive of any payments for debts (unless otherwise permitted-must be the applicable monthly amounts set forth in the Internal Revenue Service Financial Analysis Handbook [pt. 5.15.1] as Necessary Expenses [pt. 5.15.1.7] under the National [pt. 5.15.1.8] and Local Standards [pt. 5.15.1.9] categories and the debtor's actual monthly expenditures for items categorized as Other Necessary Expenses [pt. 5.15.1.9]. [23]

Section 707(b)(2)(B)'s “special circumstances,” as described by Congress, contemplates circumstances beyond a debtor's reasonable control, such as a “serious medical condition, or a call or order to active duty in the Armed Forces.[24] Courts generally conclude that whether a special circumstance exists must be made on a case-by-case basis, particularly because of the fact-specific nature of each issue.[25] The phrase “such as” in Code § 707(b)(2)(B)(I) is, for the majority of courts, not limiting, so that the two circumstances listed in the statute are not the only ones that would justify an adjustment.[26] At the same time, several courts have determined that Congress intended “to set this bar extremely high, placing it effectively off limits for most debtors.”[27]

Courts have held that, where debtors are supporting an adult relative who is not chronically ill, disabled, or unable to pay, the expenses of that support are not special circumstances.[28] A Montana bankruptcy court refused to permit debtors to deduct their actual expenses for property taxes due to a second mortgage on their home because this was in addition to the IRS standard expense for these taxes, notwithstanding that the amount in those standards was less than the debtors had to pay.[29]

The issue of who is and who is not a “dependent” for purposes of the means test continues to divide courts. Some courts view the status of a dependent as defined by whether the alleged dependents were,[30] or could be,[31] claimed as such on the debtor's federal tax return. In one thoughtful, but pre-BAPCPA decision, the court suggested that “the more pertinent question [in determining the existence of a dependent] is whether it is reasonable under the circumstances for the court to permit the debtor to undertake the obligation of supporting the would-be dependent.”[32] This concept is prevalent in post-BAPCPA decisions. In a post-BAPCPA decision with reasoning similar to that pre-BAPCPA case, the court held that the point in time at which adult children of a debtor cease to be dependent on the debtor for financial support “must be determined on a case-by-case basis on the facts of each case.”[33] This court included a list of factors to determine dependent status:[34]

(i) The length of time the claimed dependents have resided in the household;

(ii) The reason the claimed dependents are residing in the household;

(iii) Whether the claimed dependents are in fact necessitous;

(iv) The age of the alleged dependents;

(v) How much income or support from third parties they receive;

(vi) Whether they are in school; and

(vii) Whether the alleged dependent could be claimed as a dependent on the debtor's IRS tax returns or could qualify as a dependent in another legally cognizable way.

Courts generally agree that student loans constitute special circumstances because they are nondischargeable, and the debtors have no reasonable alternative other than to pay them in full.[35] However, not all courts agree, with some holding that nondischargeability alone was not a special circumstance.[36] As one court[37] explained, if no more than nondischargeability was all that was necessary to constitute special circumstances, debts including those related to fraud, willful and malicious injury, and death or personal injury resulting from operation of a vehicle while intoxicated would all constitute special circumstances that overcome the presumption of abuse. The court further argued that if nondischargeability were the standard for special circumstances, Congress would have said so in BAPCPA. Since “funding higher education through the use of student loans is becoming ubiquitous,” the court concluded the debtors failed to rebut the presumption of abuse. A Wisconsin bankruptcy court agreed, holding that student loans taken out in the 1990s did not meet the test, making them what the court described as “very old, long-term obligations, not special circumstances.”[38]

Many professional persons or business owners who marry utilize pre or postnuptial agreements to stipulate a division of income and expenses, prevent the creation of community property, and other matters. A Florida court [39] held that a postnuptial agreement that a Chapter 7 debtor claimed prevented her from relying upon the income of her nondebtor spouse in proposing a hypothetical Chapter 13 plan was not a special circumstance of a kind sufficient to rebut a presumption of abuse. The Court found that, in requiring the debtor-wife to pay half of household expenses, the spouses had ignored the terms of the prenuptial agreement under which neither spouse had any obligation to pay expenses relating to the assets of the other. In general, the Court held, prenuptial agreements were "commonplace" in most jurisdictions and "private, voluntary contracts" between spouses. Therefore, the consequences were not exceptional or extraordinary, nor was the result of the agreement an unexpected or involuntary event, justifying an additional expense claim or constituting a special circumstance.

Another debtor alleged that her loss of overtime compensation warranted an adjustment to the means test. Even though this event was beyond the debtor's control, the Court [40] held that, apart from the Chapter 13 debtor's failure to satisfy the procedural requirements for demonstrating "special circumstances," her alleged loss of opportunity to work overtime did not constitute a "special circumstance," given the complete lack of evidence that any loss of overtime was likely to be permanent, let alone that it was an uncommon or unusual occurrence. Further, there was no evidence to show that the debtor had no reasonable alternative to mitigate any loss of take-home pay, such as by obtaining second job.

C. Presumption of abuse and ability to pay

Even if the presumption of abuse created by completion of Official Form B22 does not apply, or has been rebutted by the debtor, BAPCPA empowers a bankruptcy court to consider whether "the totality of the circumstances … of the debtor's financial situation demonstrates abuse." [41] This concept of abuse codifies pre-BAPCPA cases holding that abuse exists if the court finds that a debtor has some level of ability to pay prepetition debts out of future income and is not proposing a Chapter 13 case to do so. [42] These decisions generally arise in the context of the debtor's surrender, after the case is commenced, of one or more interests in encumbered property, with a resultant increase in disposable income, [43] or because the debtor obtains a new income source before the case is concluded.

The Court of Appeals for the Seventh Circuit [44] took up an appeal from denial of a motion for dismissal of a Chapter 7 case based on the presumption of abuse that allegedly arose from application of the means test, or in the alternative, that the debtors' ability to pay their debts from future income rendered their Chapter 7 filing abusive when the totality of circumstances was considered. The central argument by the trustee was that the debtors were not entitled to deduct the Local Standard vehicle deduction because the debtors had no monthly loan or lease obligation. The Court of Appeals held that an above-median-income Chapter 7 debtor who has no monthly vehicle loan or lease payment could claim a vehicle ownership expense deduction when calculating disposable income, and affirmed denial of the trustee's motion. [45]

A California Bankruptcy Court [46] reached the same result (denial of the motion to dismiss) by articulating the theory in a different manner. The Court held that the means test functions as an initial screen to weed out those Chapter 7 petitions that are most clearly abusive, and that the totality of the circumstances test serves as a backstop to eliminate unusual cases that the means test does not demonstrate. The Court gave as an example of abuse under the totality of the circumstances test a debtor who recently changed jobs for an increase in income, and whose current monthly income determined by the means test then bore no resemblance to the debtor's actual income. In the instant case, the U.S. Trustee was not requesting that the court estimate a more accurate income figure for the debtor or substitute a more reasonable expense for one taken by the debtor, but rather to eliminate a deduction allowed by the means test. The California court found that this wholesale denial of an expense permitted by the means test is not "fine-tuning" to prevent abuse in a case that might otherwise slip through the cracks, but rather a complete disregard of a policy implicit in the test.

A bankruptcy court in Wisconsin [47] considered the case of a debtor who owned a duplex in which he lived and rented, and a vacant lot on which he intended to build a house. The debtor had some medical problems, but spent little money for anything other than necessities. The trustee brought a motion to dismiss based on abuse, although the debtor was not presumed to be abusing bankruptcy relief under the means test. The bankruptcy court stated the generally accepted test as:

(A) whether the debtor filed the petition in bad faith; or

(B) whether, under the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse.

The trustee argued that the debtor's ability to fund a plan is the factor which the courts should consider;[48] however, the bankruptcy court pointed out that the name “totality of circumstances” suggested more than one factor, holding that if the ability to pay is the only factor, the case should not be dismissed. To the trustee's argument that the debtor should stop making payments on the vacant lot to fund a plan, and discontinue retirement contributions, the bankruptcy court followed the California court, holding that the means test determined whether or not obligations with regard to secured debt were abusive. The Court found that the debtor had been making contributions to a retirement plan for several years, while living modestly, and concluded that no abuse was shown.[49] “Special circumstances” basically has to be something so unusual that it is not met routinely by a bankruptcy judge or dealt with in the Code. The Court of Appeals for the Ninth Circuit has held that a debtor's repayment of a loan taken from the debtor's retirement account was not a special circumstance rebutting the presumption of abuse.[50]

While the primary factor in abuse litigation is the debtor's ability to pay,[51] the totality of the circumstances test sweeps even more facts into consideration. One court made a list of events to be considered in addition to a debtor's ability to pay:[52]

(1) whether unforeseen or catastrophic events, such as sudden illness, disability or unemployment, propelled the debtor into bankruptcy;

(2) whether a debtor's standard of living has substantially improved as a result of the bankruptcy filing or essentially remained the same;

(3) the debtor's age, health, dependents, and other family responsibilities;

(4) the debtor's eligibility for Chapter 13 relief and whether creditors would receive a meaningful distribution in a Chapter 13 case;

(5) the age of the debts for which the debtor seeks a discharge, and the period over which the debts were incurred;

(6) whether the debtor incurred cash advances and made consumer purchases far in excess of the debtor's ability to repay;

(7) whether the debtor made any payments toward the debts, or attempted to negotiate with creditors; and

(8) the accuracy of a debtor's schedules and statement of current income and expenses.

Practice Alert:

Courts are holding that if a debtor obtains additional income (such as from a new job) after commencing a case under Chapter 7, but before issuance of the discharge, the case may be dismissed as an abuse of Chapter 7. This view discards the line of cases holding that postpetition property belongs to the debtor clear of claims from the Chapter 7 unless specifically included in property of the estate by Code § 541.[53] The split in rationale is this: it is inconsistent to have a means test that uses the historical “current monthly income” shown on the Official Form, and at the same time considers future income or expenses.[54]

The means test is complex, and most, if not all, consumer debtors will be unable to meet it without the assistance of an attorney, despite BAPCPA's suggestions to the contrary. BAPCPA amends 18 U.S.C.A. § 2075 to state that the bankruptcy rules shall prescribe a form for the statement of monthly income required by Code § 707(b)(2)(C). The Judicial Conference's

Rules Committee has proposed, and the forms have been adopted, to implement the means test through Official Forms B22A "Statement Of Current Monthly Income And Means Test Calculation (Chapter 7)." [55]

Some courts have been granting dismissal where the debtor's income increases after the petition date, but before discharge, or where the debtor's expenses are reduced because of the Chapter 7 filing. The theory that courts could reach forward in time to consider postpetition changes in the Chapter 7 debtor's financial condition finds its leading decision in a pre-BAPCPA decision from the Court of Appeals for the Fifth Circuit, in which the court held that a debtor, who had been unemployed before initiating the bankruptcy case, was substantially abusing Chapter 7 relief because of he found employment after the petition date, but before issuance of the discharge. [56] There is nothing in the statute that characterizes the means test, as it applies to Chapter 7, as forward or backward-looking as to income and expenses, nor is there any authority in the Code for treating postpetition income in a Chapter 7 as "property of the estate." Nonetheless, the prevailing judicial position is that under Code 707(b), the debtor must pass two separate tests to determine whether she or he is abusing Chapter 7 relief. The first is the statutory means test in Code § 707(b), while the second is the "totality of the circumstances" test judicially created under Code § 707(b) as it existed prior to BAPCPA. The postpetition increases in income, or deceases in expenses, generally are cited as arising under the latter, subjective test for abuse. [57] Not all courts agree that the means test is forward-looking, but this is a minority position. [58]

Debtors who try to scale back their expenses by returning one or more items of encumbered property after the petition is filed can, in some jurisdictions, find themselves being catapulted by virtue of the surrender into a presumption that they are abusing bankruptcy relief—a presumption that did not exist as of the petition date. Some courts hold that the resultant reduction of expense raises a presumption of abuse after the petition date, so that the debtor must face the choice of dismissal or conversion to Chapter 13. [59] However, the majority of courts disagree that the resultant reduction of expense must be distributed to creditors. [60] The Court of Appeals for the Seventh Circuit [61] held that, as a first impression, an above-median income debtor who had no monthly vehicle loan or lease payment could still claim a deduction for vehicle ownership as described in Official Form B22 when calculating his disposable income, so that the presumption of abuse did not arise. This decision represents the view a majority of courts take on this issue, [62] but it is by no means a substantial majority. [63]

The Court of Appeals for the Fifth Circuit's leading opinion to the contrary [64] held that, although a Chapter 7 debtor's earnings after the commencement of the case were not "property of the estate," a court "can and should take them into account" when determining whether to dismiss a case for abuse. This decision was made under the Code prior to its amendment by BAPCPA, but its extension and re-incorporation into post-BAPCPA law came about when the courts determined that the means test did not, in itself, limit consideration of other issues and evidence in determining whether a debtor was abusing Chapter 7 relief. [65] However, one court has held that if the U.S. Trustee wants the court to consider postpetition events as bearing on whether a Chapter 7 case should be dismissed as an abuse of the provisions of that chapter, the Trustee may not rely on presumption of abuse under the "means test," but must bring motion to dismiss under one of the other paragraphs of the dismissal provision, and satisfy the burden of proof without the benefit of any presumption.

The judicial disputes over the allowance or disallowance of a deduction for obligations secured by surrendered property are echoed, and reflect, the larger controversy over whether postpetition changes in a Chapter 7 debtor's financial situation are relevant and properly considered in a challenge based upon alleged abuse of Chapter 7 relief. One court, [66] in finding postpetition changes relevant, cited the "totality of the circumstances" test for deciding whether to dismiss, as abuse, a Chapter 7 case in which no presumption of abuse arose or was rebutted. The Court described the test as a "flexible, equitable test, under which court was not restricted to snapshot of debtor's financial circumstances as they existed on petition date, but could consider income that became available to debtors postpetition, after they surrendered mortgaged property."

Footnotes

1 11 U.S.C.A. § 707(b)(1). Ransom v. FIA Card Services, N.A., 131 S. Ct. 716, 178 L. Ed. 2d 603, 64 Collier Bankr. Cas. 2d (MB) 1123, Bankr. L. Rep. (CCH) P 81914 (2011) (if a Chapter 7 debtor cannot rebut the presumption of abuse, the court may dismiss the case or, with the debtor's consent, convert it into a Chapter 13 proceeding).

2 11 U.S.C.A. § 707(b)(7). This does not mean, however, that the debtor will not face any inquiry into whether he or she is abusing bankruptcy relief. See 11 U.S.C.A. § 707(b).

3 11 U.S.C.A. § 707(b)(2)(A)(ii).

4 Financial Analysis Handbook at http://www.irs.gov/irm/part 5/ch15s01.html.

5 A debtor challenged the means test as a violation of the uniformity requirement of the Bankruptcy Clause of the United States Constitution. The Court of Appeals for the Sixth Circuit held that BAPCPA was a uniform law on the subject of bankruptcy even though, the Court admitted, its operation "may result in debtors receiving different bankruptcy relief based upon the state or county in which they reside." Schultz v. U.S., 529 F.3d 343, 50 Bankr. Ct. Dec. (CRR) 26, 59 Collier Bankr. Cas. 2d (MB) 1405, Bankr. L. Rep. (CCH) P 81255 (6th Cir. 2008), cert. denied, 129 S. Ct. 742, 172 L. Ed. 2d 730 (2008).

6 11 U.S.C.A. § 707(b)(2)(A)(ii).

7 11 U.S.C.A. § 1325(b)(2).

8 11 U.S.C.A. § 1325(b)(3).

9 11 U.S.C.A. § 1325(b)(2).

10 11 U.S.C.A. § 1325(b)(4)(A)(ii).

11 11 U.S.C.A. § 1325(b)(4)(A)(i).

12 Ransom v. FIA Card Services, N.A., 131 S. Ct. 716, 178 L. Ed. 2d 603, 64 Collier Bankr. Cas. 2d (MB) 1123, Bankr. L. Rep. (CCH) P 81914 (2011).

13 11 U.S.C.A. § 707(b)(2)(A)(i).

14 Blausey v. U.S. Trustee, 552 F.3d 1124, Bankr. L. Rep. (CCH) P 81405 (9th Cir. 2009). See In re Prigge, 441 B.R. 667 (Bankr. D. Mont. 2010), in which a trustee, citing Blausey as authority, argued that because Code § 707(b)(2)(A)(iii) does not include language allowing repayment of secured debts, the omission is purposeful and deductions of payment of secured debt should not be allowed. This argument was politely but firmly rejected by the bankruptcy court.

15 26 U.S.C.A. § 104(a)(3).

16 11 U.S.C.A. § 707(b)(2)(A)(i).

17 11 U.S.C.A. § 707(b)(2)(B).

18 11 U.S.C.A. § 707(b)(2)(B)(ii).

19 Specifically those in 11 U.S.C.A. § 707(b)(2)(A)(ii) to (iv).

20 Under 11 U.S.C.A. § 104(a), certain amounts are increased every three years, including those amounts in 11 U.S.C.A. § 707(b). The amounts in the text are the current figures.

21 Available at http://www.irs.gov/irm/part5/irm_05-015-001.html (last accessed 02/06/10).

22 See Internal Revenue Service Financial Analysis Handbook [pt. 5.15.10] (last accessed 02/06/10).

23 H.R. Rep. No. 109-31, at 13–15. (2005).

24 In re O'Connor, 2008 WL 4516374 (Bankr. D. Mont. 2008); In re Zahringer, 59 Collier Bankr. Cas. 2d (MB) 1744, 2008 WL 2245864 (Bankr. E.D. Wis. 2008).

25 In re Turner, 376 B.R. 370, 378, 2007 BNH 32 (Bankr. D. N.H. 2007); In re Knight, 370 B.R. 429, 437 (Bankr. N.D. Ga. 2007). But see In re O'Connor, 2008 WL 4516374 (Bankr. D. Mont. 2008).

26 In re Vaccariello, 375 B.R. 809, 813 (Bankr. N.D. Ohio 2007).

27 In re Haar, 360 B.R. 759, 760 (Bankr. N.D. Ohio 2007), subsequent determination, 373 B.R. 493, 57 Collier Bankr. Cas. 2d (MB) 247 (Bankr. N.D. Ohio 2007); see also In re Martin, 371 B.R. 347, 352, 58 Collier Bankr. Cas. 2d (MB) 428 (Bankr. C.D. Ill. 2007) (stating that "special circumstances" must be construed as "uncommon, unusual, exceptional, distinct, peculiar, particular, additional or extra conditions or facts").

28 In re O'Connor, 2008 WL 4516374 (Bankr. D. Mont. 2008); In re Law, 2008 WL 1867971 (Bankr. D. Kan. 2008).

29 In re O'Connor, 2008 WL 4516374 (Bankr. D. Mont. 2008). See In re Bermann, 399 B.R. 213 (Bankr. E.D. Wis. 2009) citing the O'Connor decision and pointing out that if the debtors do not pay the taxes, the lender adds the amount to the mortgage debt, and when the debtors pay that, it is an allowable payment to a secured creditor.

30 In re Duncan, 201 B.R. 889 (Bankr. W.D. Pa. 1996) (as debtors do not presently have any dependents on their most recent tax returns and on Schedule I, the court must find that "any support that they provide to the other six members of their present household is necessarily voluntary in nature."). See 26 U.S.C.A. § 152 for the statutory definition of dependent for tax purposes (a qualifying child or relative, basically). But see In re Attanasio, 218 B.R. 180 (Bankr. N.D. Ala. 1998) expressly disagreeing.

31 In re O'Connor, 2008 WL 4516374 (Bankr. D. Mont. 2008) (no listing of dependent on tax return and no evidence as to whether could be deducted).

32 In re Gonzales, 157 B.R. 604, 85 Ed. Law Rep. 83 (Bankr. E.D. Mich. 1993).

33 In re Justice, 404 B.R. 506 (Bankr. W.D. Ark. 2009).

34 In re Justice, 404 B.R. 506 (Bankr. W.D. Ark. 2009). The first three factors are taken from In re Dunbar, 99 B.R. 320, 19 Bankr. Ct. Dec. (CRR) 446 (Bankr. M.D. La. 1989).

35 In re Haman, 366 B.R. 307 (Bankr. D. Del. 2007) (Chapter 7 debtor's obligation as co-signer on her son's student loans qualified as "special circumstance" sufficient to rebut presumption of abuse); In re Martin, 371 B.R. 347, 58 Collier Bankr. Cas. 2d (MB) 428 (Bankr. C.D. Ill. 2007) (Chapter 7 debtors' obligation to pay their nondischargeable student loan debt constituted a "special circumstance"); In re Delbecq, 368 B.R. 754 (Bankr. S.D. Ind. 2007) (same); In re Templeton, 365 B.R. 213, Bankr. L. Rep. (CCH) P 80961 (Bankr. W.D. Okla. 2007) (same); In re Knight, 370 B.R. 429 (Bankr. N.D. Ga. 2007) (same).

36 In re Pageau, 383 B.R. 221, 2008 BNH 01 (Bankr. D. N.H. 2008); In re Vaccariello, 375 B.R. 809 (Bankr. N.D. Ohio 2007) (Chapter 7 debtors' nondischargeable student loan debt was not "special circumstance"sufficient to rebut statutory presumption of abuse); In re Lightsey, 374 B.R. 377 (Bankr. S.D. Ga. 2007) (finding nondischargeable nature of student loan obligations did not warrant classifying them as "special circumstances" to rebut Chapter 7 presumption of abuse). Accord In re Carrillo, 421 B.R. 540 (Bankr. D. Ariz. 2009) holding that a Chapter 7 debtors' nondischargeable student loan debt did not constitute a "special circumstance," of a kind sufficient to rebut a "means test" presumption that their Chapter 7 case should be dismissed as abusive. According to this holding, a bankruptcy court could consider a Chapter 7 debtors' ability to pursue a hypothetical adjustment of their debts in Chapter 13 when deciding whether the debtors' nondischargeable student loans constituted a "special circumstance" sufficient to rebut a "means test" presumption of abuse.

37 In re Vaccariello, 375 B.R. 809 (Bankr.N.D.Ohio 2007).

38 In re Zahringer, 59 Collier Bankr. Cas. 2d (MB) 1744, 2008 WL 2245864 (Bankr. E.D. Wis. 2008).

39 In re Stocker, 399 B.R. 522 (Bankr. M.D. Fla. 2008).

40 In re Parulan, 387 B.R. 168 (Bankr. E.D. Va. 2008).

41 11 U.S.C.A. § 707(b)(3). Blausey v. U.S. Trustee, 552 F.3d 1124, 61 Collier Bankr. Cas. 2d (MB) 333, Bankr. L. Rep. (CCH) P 81405 (9th Cir. 2009) (bankruptcy court may still find abuse under Code § 707(b)(3) even if presumption does not arise); Accord In re Perelman, 419 B.R. 168 (Bankr. E.D. N.Y. 2009). And see In re Smith, 2009 WL 4262842 (Bankr. N.D. W. Va. 2009) calling the means test "unduly generous."

42 In re Ross-Tousey, 549 F.3d 1148, Bankr. L. Rep. (CCH) P 81376 (7th Cir. 2008).

43 In re Ross-Tousey, 549 F.3d 1148, Bankr. L. Rep. (CCH) P 81376 (7th Cir. 2008). See a discussion of the effect of surrendering property infra. And see In re Ralston, 400 B.R. 854 (Bankr. M.D. Fla. 2009) (collecting cases).

44 In re Ross-Tousey, 549 F.3d 1148, Bankr. L. Rep. (CCH) P 81376 (7th Cir. 2008).

45 But see In re Wells, 2009 WL 159663 (Bankr. E.D. Cal. 2009) finding abuse where, because the debtor proposed to surrender all of his secured property, including a home and cars, the resulting money of more than $4,000 could be used to fund a plan under Chapter 13. The lesson in jurisdictions following this line is simple: surrendering property gets the debtor nowhere.

46 In re Jensen, 2008 WL 5746903 (Bankr. C.D. Cal. 2008).

47 In re Le Roy, 2009 WL 357923 (Bankr. E.D. Wis. 2009).

48 The debtor's ability to pay is always at least one factor in cases involving allegations of abuse. See In re Calhoun, 396 B.R. 270 (Bankr. D. S.C. 2008); In re Roll, 400 B.R. 674 (Bankr. W.D. Wis. 2008); In re Pak, 343 B.R. 239 (Bankr. N.D. Cal. 2006) (all courts consider the debtor's ability to pay to be an important factor in this context).

49 The outcome might be different if the debtor is making large payments on encumbered property which the court deems to be luxury items. See, e.g., In re Brenneman, 397 B.R. 866 (Bankr. N.D. Ohio 2008) (debtors' acquisition of two new automobiles with secured payments totaling over $1,200 monthly immediately before filing required dismissal under § 707(b)(3)); In re Oot, 368 B.R. 662 (Bankr. N.D. Ohio 2007) (case dismissed under totality of the circumstances where debtors made over $3,000 monthly mortgage payments on home, and reaffirmed debts for newer luxury vehicles and pop-up camper).

50 In re Egebjerg, 574 F.3d 1045 (9th Cir. 2009). Nor was the loan payment deductible as an "other necessary" expense.

51 In re Booker, 399 B.R. 662, Bankr. L. Rep. (CCH) P 81627 (Bankr. W.D. Mo. 2009).

52 In re Norwood-Hill, 403 B.R. 905 (Bankr. M.D. Fla. 2009).

53 In re Cortez, 457 F.3d 448, Bankr. L. Rep. (CCH) P 80655 (5th Cir. 2006) (previously unemployed debtor obtained employment after petition date; Court of Appeals held that in determining whether to dismiss Chapter 7 case as "substantial abuse," bankruptcy court can and should consider postpetition events up until date of discharge, including any postpetition improvements in debtor's earnings.). Accord, In re Hartwick, 359 B.R. 16, 57 Collier Bankr. Cas. 2d (MB) 957, Bankr. L. Rep. (CCH) P 80912, 2007 BNH 14

(Bankr. D. N.H. 2007) (As part of its totality-of-the-circumstances inquiry in deciding whether to dismiss debtors' Chapter 7 case as abuse of provisions of Chapter 7, bankruptcy court was not limited to considering debtors' financial situation only as of date petition was filed, but was required to also consider debtors' financial situation at time U.S. Trustee's motion to dismiss was heard.). But see In re Nockerts, 357 B.R. 497, Bankr. L. Rep. (CCH) P 80871 (Bankr. E.D. Wis. 2006) agreeing with the result in *Cortez*, but pointing out that its rationale was based on the pre-BAPCPA statute. But see In re Singletary, 354 B.R. 455 (Bankr. S.D. Tex. 2006) treating *Cortez* as precedent for a post-BAPCPA test of abuse; accord, In re Hartwick, 359 B.R. 16, 57 Collier Bankr. Cas. 2d (MB) 957, Bankr. L. Rep. (CCH) P 80912, 2007 BNH 14 (Bankr. D. N.H. 2007); In re Krause, 357 B.R. 7, 2006 BNH 27 (Bankr. D. N.H. 2006). And see In re Brooks, 2006 WL 3519050 (Bankr. D. Del. 2006) citing *Cortez* as authority for considering a postpetition decrease in income as a response to the U.S. Trustee's motion to dismiss for Chapter 7 abuse.

54 In re Walker, 2006 WL 1314125 (Bankr. N.D. Ga. 2006), subsequent determination, 383 B.R. 830 (Bankr. N.D. Ga. 2008) (“The means test is a backward looking test, which is designed to measure the debtor's financial health at the time of the filing and to determine whether the debtor is in need of bankruptcy relief.”). In re Cortez, 457 F.3d 448, Bankr. L. Rep. (CCH) P 80655 (5th Cir. 2006) (“The Debtors would have this Court adopt a snapshot approach such that all debts “scheduled as contractually due” on the date of the petition should be included under § 707(b)(2)(A)(iii) without regard to any subsequent events. On the other hand, the UST argues that all postpetition events should be considered under the test for presumption of abuse based upon a recent Fifth Circuit decision interpreting the pre-BAPCPA version of § 707(b).”). Accord with Cortez, In re Norwood-Hill, 403 B.R. 905 (Bankr. M.D. Fla. 2009); In re Goble, 401 B.R. 261, 61 Collier Bankr. Cas. 2d (MB) 712 (Bankr. S.D. Ohio 2009) (in deciding whether to dismiss, based on totality of circumstances of debtor's financial situation, a Chapter 7 case in which presumption of abuse never arose or has been rebutted, court should include in its analysis an evaluation of debtor's postpetition financial situation, including circumstances as they exist at time of hearing on dismissal motion); In re Seeburger, 392 B.R. 735 (Bankr. N.D. Ohio 2008).

55 The form is reproduced in the Forms Appendix in Volume 3 and may also be viewed online at http://www.uscourts.gov/rules/BK_Forms_06_Official/Form_22A_1006.pdf (last visited 02/6/10).

56 In re Cortez, 457 F.3d 448, Bankr. L. Rep. (CCH) P 80655 (5th Cir. 2006) (previously unemployed debtor obtained employment after petition date; Court of Appeals held that in determining whether to dismiss Chapter 7 case as “substantial abuse,” bankruptcy court can and should consider postpetition events up until date of discharge, including any postpetition improvements in debtor's earnings.). But see In re Nockerts, 357 B.R. 497, Bankr. L. Rep. (CCH) P 80871 (Bankr. E.D. Wis. 2006) agreeing with the result in Cortez, but pointing out that its rationale was based on the pre-BAPCPA statute. But see In re Singletary, 354 B.R. 455 (Bankr. S.D. Tex. 2006) treating Cortez as precedent for a post-BAPCPA test of abuse; accord, In re Hartwick, 359 B.R. 16, 57 Collier Bankr. Cas. 2d (MB) 957, Bankr. L. Rep. (CCH) P 80912, 2007 BNH 14 (Bankr. D. N.H. 2007); In re Krause, 357 B.R. 7, 2006 BNH 27 (Bankr. D. N.H. 2006). And see In re Brooks, 2006 WL 3519050 (Bankr. D. Del. 2006) citing *Cortez* as authority for considering a postpetition decrease in income as a response to the U.S. Trustee's motion to dismiss for Chapter 7 abuse.

57 See In re Love, 350 B.R. 611, 56 Collier Bankr. Cas. 2d (MB) 1135 (Bankr. M.D. Ala. 2006) (term “scheduled” in § 707(b)(2)(A)(iii) contemplates forward-looking approach); In re Harris, 353 B.R. 304 (Bankr. E.D. Okla. 2006) (no deductions for encumbered property being surrendered; no constitutional right to file under Chapter 7); In re Skaggs, Richard & Connie, 349 B.R. 594 (Bankr. E.D. Mo. 2006) (debtors could not deduct expenses for surrendered vehicle). And see In re Singletary, 354 B.R. 455 (Bankr. S.D. Tex. 2006) having it both ways in holding that “the means test is neither exclusively backward-looking, nor forward-looking, but a combination of both.”

58 See In re Walker, 2006 WL 1314125 (Bankr. N.D. Ga. 2006), subsequent determination, 383 B.R. 830 (Bankr. N.D. Ga. 2008) (“The means test is a backward looking test, which is designed to measure the debtor's financial health at the time of the filing and to determine whether the debtor is in need of bankruptcy relief.”); accord, In re Oliver, 2006 WL 2086691 (Bankr. D. Or. 2006).

59 In re Naut, 59 Collier Bankr. Cas. 2d (MB) 305, 2008 WL 191297 (Bankr. E.D. Pa. 2008); In re Ray, 362 B.R. 680, 57 Collier Bankr. Cas. 2d (MB) 1024 (Bankr. D. S.C. 2007); In re Masur, 2007 WL 3231725 (Bankr. D. S.D. 2007); In re Burden, 380 B.R. 194, 59 Collier Bankr. Cas. 2d (MB) 52 (Bankr. W.D. Mo. 2007); In re Harris, 353 B.R. 304 (Bankr. E.D. Okla. 2006); In re Skaggs, Richard & Connie, 349 B.R. 594 (Bankr. E.D. Mo. 2006); In re Smith, 418 B.R. 359 (B.A.P. 9th Cir. 2009) (above-median-income Chapter 13 debtors, in calculating “projected disposable income” available for payment of unsecured claims, were not entitled to deduct as “amounts scheduled as contractually due to secured creditors” the payments which they were contractually obligated to make, on petition date, on two homes and motor vehicle that they intended to surrender; prior to performing “means test” calculation to determine amount of debtors' reasonably necessary expenses, court first had to find that expense was reasonably necessary for debtors and/or their dependents, a finding that it could not make for phantom expenses, such as payments that debtors had no intention of making on assets that were to be surrendered); In re Rahman, 400 B.R. 362 (Bankr. E.D. N.Y. 2009) (in calculating “projected disposable income” available for payment of unsecured claims, above-median-income Chapter 13 debtor could not deduct, as “amounts scheduled as contractually due to secured creditors,” secured debt payments that debtor did not intend to make on assets

that the debtor proposed to surrender). Accord In re Martin, 417 B.R. 354 (Bankr. M.D. N.C. 2009); In re Ralston, 400 B.R. 854, Bankr. L. Rep. (CCH) P 81493 (Bankr. M.D. Fla. 2009).

60 Most jurisdictions hold that the surrender of property after commencement of a case does not result in a presumption. See In re Ross-Tousey, 549 F.3d 1148, Bankr. L. Rep. (CCH) P 81376 (7th Cir. 2008); In re Booker, 399 B.R. 662 (Bankr. W.D. Mo. 2009); In re Parada, 391 B.R. 492, 59 Collier Bankr. Cas. 2d (MB) 459 (Bankr. S.D. Fla. 2008); In re Makres, 380 B.R. 30 (Bankr. N.D. Okla. 2007); In re Hayes, 376 B.R. 55 (Bankr. D. Mass. 2007); In re Zak, 361 B.R. 481 (Bankr. N.D. Ohio 2007); In re Mundy, 363 B.R. 407, 57 Collier Bankr. Cas. 2d (MB) 1267 (Bankr. M.D. Pa. 2007); In re Scarafiotti, 375 B.R. 618 (Bankr. D. Colo. 2007); In re Simmons, 357 B.R. 480 (Bankr. N.D. Ohio 2006); In re Nockerts, 357 B.R. 497, Bankr. L. Rep. (CCH) P 80871 (Bankr. E.D. Wis. 2006); In re Randle, 358 B.R. 360, Bankr. L. Rep. (CCH) P 80829 (Bankr. N.D. Ill. 2006), judgment aff'd, 58 Collier Bankr. Cas. 2d (MB) 641, Bankr. L. Rep. (CCH) P 81038, 2007 WL 2668727 (N.D. Ill. 2007). See In re Benedetti, 372 B.R. 90 (Bankr. S.D. Fla. 2007) ("[I]f Congress intended to limit secured debt payments contractually due from debtors on the petition date to those where actual future payments will be made in Form B22C calculations, it knew how to do so, as reflected by the inclusion of the terms 'actual monthly expenses' and 'actual expenses' elsewhere within 11 U.S.C.A. § 707(b)(2)(A)(ii)(I) and (II).") (quoting In re Oliver, 2006 WL 2086691 (Bankr. D. Or. 2006)); In re Walker, 2006 WL 1314125 (Bankr. N.D. Ga. 2006), subsequent determination, 383 B.R. 830 (Bankr. N.D. Ga. 2008); In re Hartwick, 352 B.R. 867, Bankr. L. Rep. (CCH) P 80776 (Bankr. D. Minn. 2006), order aff'd in part, rev'd in part on other grounds, 373 B.R. 645, Bankr. L. Rep. (CCH) P 81023 (D. Minn. 2007) ("Application of the means test is not left by the BAPCPA legislation to judicial discretion.") ("[T]he plain language of § 707(b)(2)(A)(iii) dictates that a debtor must be permitted to deduct secured payments on property even if that debtor intends to surrender that property post-petition."); In re Dionne, 402 B.R. 883 (Bankr. E.D. Wis. 2009) (above-median-income Chapter 13 debtors, in applying "means test" to determine "projected disposable income" available for payment of unsecured claims, were entitled to deduct from their CMI their monthly payment on motor vehicle that they intended to surrender; debtors' intent to surrender vehicle did not alter fact that motor vehicle payments were "amounts scheduled as contractually due" on petition date, the critical date in performing this "means test" calculation both in Chapter 7 context, to determine whether case was presumptively abusive, and in context of Chapter 13, to determine whether above-median-income debtors' proposed plan satisfied "projected disposable income" requirement); In re Burbank, 401 B.R. 67 (Bankr. D. R.I. 2009), certification granted, 2009 WL 6325526 (Bankr. D. R.I. 2009) (in calculating "projected disposable income" available for payment of unsecured claims, above-median income Chapter 13 debtors were entitled to deduct, as "amounts scheduled as contractually due to secured creditors," mortgage payments that they were contractually obligated to make on date petition was filed on property that they intended to surrender, though debtors would not actually be making such secured debt payments if mortgaged property were surrendered); accord In re Tonti, 406 B.R. 265 (Bankr. M.D. Pa. 2009).

61 In re Ross-Tousey, 549 F.3d 1148, Bankr. L. Rep. (CCH) P 81376 (7th Cir. 2008).

62 In re Booker, 399 B.R. 662 (Bankr. W.D. Mo. 2009); In re Parada, 391 B.R. 492, 59 Collier Bankr. Cas. 2d (MB) 459 (Bankr. S.D. Fla. 2008); In re Makres, 380 B.R. 30 (Bankr. N.D. Okla. 2007); In re Hayes, 376 B.R. 55 (Bankr. D. Mass. 2007); In re Zak, 361 B.R. 481 (Bankr. N.D. Ohio 2007); In re Mundy, 363 B.R. 407, 57 Collier Bankr. Cas. 2d (MB) 1267 (Bankr. M.D. Pa. 2007); In re Scarafiotti, 375 B.R. 618 (Bankr. D. Colo. 2007); In re Simmons, 357 B.R. 480 (Bankr. N.D. Ohio 2006); In re Nockerts, 357 B.R. 497, Bankr. L. Rep. (CCH) P 80871 (Bankr. E.D. Wis. 2006); In re Randle, 358 B.R. 360, Bankr. L. Rep. (CCH) P 80829 (Bankr. N.D. Ill. 2006), judgment aff'd, 58 Collier Bankr. Cas. 2d (MB) 641, Bankr. L. Rep. (CCH) P 81038, 2007 WL 2668727 (N.D. Ill. 2007). See In re Benedetti, 372 B.R. 90 (Bankr. S.D. Fla. 2007) ("[I]f Congress intended to limit secured debt payments contractually due from debtors on the petition date to those where actual future payments will be made in Form B22C calculations, it knew how to do so, as reflected by the inclusion of the terms 'actual monthly expenses' and 'actual expenses' elsewhere within 11 U.S.C.A. § 707(b)(2)(A)(ii)(I) and (II).") (quoting In re Oliver, 2006 WL 2086691 (Bankr. D. Or. 2006)); In re Walker, 2006 WL 1314125 (Bankr. N.D. Ga. 2006), subsequent determination, 383 B.R. 830 (Bankr. N.D. Ga. 2008); In re Hartwick, 352 B.R. 867, Bankr. L. Rep. (CCH) P 80776 (Bankr. D. Minn. 2006), order aff'd in part, rev'd in part on other grounds, 373 B.R. 645, Bankr. L. Rep. (CCH) P 81023 (D. Minn. 2007) ("[T]he plain language of § 707(b)(2)(A)(iii) dictates that a debtor must be permitted to deduct secured payments on property even if that debtor intends to surrender that property post-petition.").

63 In re Naut, 59 Collier Bankr. Cas. 2d (MB) 305, 2008 WL 191297 (Bankr. E.D. Pa. 2008); In re Ray, 362 B.R. 680, 57 Collier Bankr. Cas. 2d (MB) 1024 (Bankr. D. S.C. 2007); In re Masur, 2007 WL 3231725 (Bankr. D. S.D. 2007); In re Burden, 380 B.R. 194, 59 Collier Bankr. Cas. 2d (MB) 52 (Bankr. W.D. Mo. 2007); In re Harris, 353 B.R. 304 (Bankr. E.D. Okla. 2006); In re Skaggs, Richard & Connie, 349 B.R. 594 (Bankr. E.D. Mo. 2006). And see In re Budig, 387 B.R. 12, 59 Collier Bankr. Cas. 2d (MB) 1500 (Bankr. N.D. Iowa 2008) (dismissal of debtors' Chapter 7 case for abuse warranted under totality of the circumstances of debtors' financial situation, given that, following debtors' postpetition surrender of their home, debtors no longer had $2,228.35 monthly mortgage payment, and instead were renting apartment for $1000 per month with no plans to move, and that, adjusting for such changes, debtors had monthly disposable income of $1,793.95, so had ability to fund hypothetical Chapter 13 plan, and could provide for their state and federal tax liabilities in their plan.)

64 In re Cortez, 457 F.3d 448, Bankr. L. Rep. (CCH) P 80655 (5th Cir. 2006).

65 In re Perrotta, 390 B.R. 26, 2008 BNH 09 (Bankr. D. N.H. 2008).

66 In re Haar, 373 B.R. 493, 57 Collier Bankr. Cas. 2d (MB) 247 (Bankr. N.D. Ohio 2007); accord as to test and inquiry into postpetition changes, In re Vogeler, 393 B.R. 240 (Bankr. D. Kan. 2008); In re Maya, 374 B.R. 750 (Bankr. S.D. Cal. 2007); In re Henebury, 361 B.R. 595 (Bankr. S.D. Fla. 2007); In re Pier, 310 B.R. 347 (Bankr. N.D. Ohio 2004).

End of Document

Effective:[See Text Amendments]

Vernon's Texas Statutes and Codes Annotated Currentness
Texas Probate Code (Refs & Annos)
Chapter XII. Durable Power of Attorney Act (Refs & Annos)
§ 490. Statutory Durable Power of Attorney

(a) The following form is known as a "statutory durable power of attorney." A person may use a statutory durable power of attorney to grant an attorney in fact or agent powers with respect to a person's property and financial matters. A power of attorney in substantially the following form has the meaning and effect prescribed by this chapter. The validity of a power of attorney as meeting the requirements of a statutory durable power of attorney is not affected by the fact that one or more of the categories of optional powers listed in the form are struck or the form includes specific limitations on or additions to the attorney in fact's or agent's powers.

The following form is not exclusive, and other forms of power of attorney may be used.

STATUTORY DURABLE POWER OF ATTORNEY

NOTICE: THE POWERS GRANTED BY THIS DOCUMENT ARE BROAD AND SWEEPING. THEY ARE EXPLAINED IN THE DURABLE POWER OF ATTORNEY ACT, CHAPTER XII, TEXAS PROBATE CODE. IF YOU HAVE ANY QUESTIONS ABOUT THESE POWERS, OBTAIN COMPETENT LEGAL ADVICE. THIS DOCUMENT DOES NOT AUTHORIZE ANYONE TO MAKE MEDICAL AND OTHER HEALTH-CARE DECISIONS FOR YOU. YOU MAY REVOKE THIS POWER OF ATTORNEY IF YOU LATER WISH TO DO SO.

I, __________ (insert your name and address), appoint __________ (insert the name and address of the person appointed) as my agent (attorney-in-fact) to act for me in any lawful way with respect to all of the following powers except for a power that I have crossed out below.

TO WITHHOLD A POWER, YOU MUST CROSS OUT EACH POWER WITHHELD.

Real property transactions;

Tangible personal property transactions;

Stock and bond transactions;

Commodity and option transactions;

Banking and other financial institution transactions;

Business operating transactions;

Insurance and annuity transactions;

Estate, trust, and other beneficiary transactions;

Claims and litigation;

Personal and family maintenance;

Benefits from social security, Medicare, Medicaid, or other governmental programs or civil or military service;

Retirement plan transactions;

Tax matters.

IF NO POWER LISTED ABOVE IS CROSSED OUT, THIS DOCUMENT SHALL BE CONSTRUED AND INTERPRETED AS A GENERAL POWER OF ATTORNEY AND MY AGENT (ATTORNEY IN FACT) SHALL HAVE THE POWER AND AUTHORITY TO PERFORM OR UNDERTAKE ANY ACTION I COULD PERFORM OR UNDERTAKE IF I WERE PERSONALLY PRESENT.

SPECIAL INSTRUCTIONS:

Special instructions applicable to gifts (initial in front of the following sentence to have it apply):

I grant my agent (attorney in fact) the power to apply my property to make gifts, except that the amount of a gift to an individual may not exceed the amount of annual exclusions allowed from the federal gift tax for the calendar year of the gift.

ON THE FOLLOWING LINES YOU MAY GIVE SPECIAL INSTRUCTIONS LIMITING OR EXTENDING THE POWERS GRANTED TO YOUR AGENT.

UNLESS YOU DIRECT OTHERWISE ABOVE, THIS POWER OF ATTORNEY IS EFFECTIVE IMMEDIATELY AND WILL CONTINUE UNTIL IT IS REVOKED.

CHOOSE ONE OF THE FOLLOWING ALTERNATIVES BY CROSSING OUT THE ALTERNATIVE NOT CHOSEN:

(A) This power of attorney is not affected by my subsequent disability or incapacity.

(B) This power of attorney becomes effective upon my disability or incapacity.

YOU SHOULD CHOOSE ALTERNATIVE (A) IF THIS POWER OF ATTORNEY IS TO BECOME EFFECTIVE ON THE DATE IT IS EXECUTED.

IF NEITHER (A) NOR (B) IS CROSSED OUT, IT WILL BE ASSUMED THAT YOU CHOSE ALTERNATIVE (A).

If Alternative (B) is chosen and a definition of my disability or incapacity is not contained in this power of attorney, I shall be considered disabled or incapacitated for purposes of this power of attorney if a physician certifies in writing at a date later than the date this power of attorney is executed that, based on the physician's medical examination of me, I am mentally incapable of managing my financial affairs. I authorize the physician who examines me for this purpose to disclose my physical or mental condition to another person for purposes of this power of attorney. A third party who accepts this power of attorney is fully protected from any action taken under this power of attorney that is based on the determination made by a physician of my disability or incapacity.

I agree that any third party who receives a copy of this document may act under it. Revocation of the durable power of attorney is not effective as to a third party until the third party receives actual notice of the revocation. I agree to indemnify the third party for any claims that arise against the third party because of reliance on this power of attorney.

If any agent named by me dies, becomes legally disabled, resigns, or refuses to act, I name the following (each to act alone and successively, in the order named) as successor(s) to that agent: __________.

Signed this ______ day of __________, 19___

____

(your signature)

State of ________________________

County of _______________________

This document was acknowledged before me on

_______________(date) by

____

(name of principal)

____

(signature of notarial officer)

(Seal, if any, of notary)

____

(printed name)

My commission expires: ___________

THE ATTORNEY IN FACT OR AGENT, BY ACCEPTING OR ACTING UNDER THE APPOINTMENT, ASSUMES THE FIDUCIARY AND OTHER LEGAL RESPONSIBILITIES OF AN AGENT.

(b) A statutory durable power of attorney is legally sufficient under this chapter if the wording of the form complies substantially with Subsection (a) of this section, the form is properly completed, and the signature of the principal is acknowledged.

(c) Repealed by Acts 1997, 75th Leg., ch. 455, § 7, eff. Sept. 1, 1997.

CREDIT(S)

Added by Acts 1993, 73rd Leg., ch. 49, § 1, eff. Sept. 1, 1993. Amended by Acts 1997, 75th Leg., ch. 455, § 4, eff. Sept. 1, 1997; Acts 1997, 75th Leg., ch. 455, § 7, eff. Sept. 1, 1997.

<The Texas Probate Code is repealed and the Estates Code is enacted, effective January 1, 2014, by Acts 2009, 81st Leg., ch. 680, Acts 2011, 82nd Leg., ch. 823 (H.B. 2759) and Acts 2011, 82nd Leg., ch. 1338 (S.B. 1198).>

Current through the end of the 2011 Regular Session and First Called Session of the 82nd Legislature

END OF DOCUMENT

United States Court of Appeals,
Fifth Circuit.
UNITED STATES of America, Plaintiff–Appellee,
v.
Brian Scott SPURLIN; Debra Fogleman Spurlin,
Defendants–Appellants.

No. 10–31128.
Dec. 15, 2011.

Background: Defendants were convicted in the United States District Court for the Western District of Louisiana, Donald E. Walter, J., of fraudulently withholding their interests in certain properties from their bankruptcy filings, among other offenses, and they appealed.

Holdings: The Court of Appeals, Jerry E. Smith, Circuit Judge, held that:
(1) defendant could be held criminally liable for concealment of bankruptcy assets, but
(2) evidence was insufficient to sustain conviction for knowingly making false statements.

Affirmed in part, vacated in part, and remanded.

West Headnotes

[1] Bankruptcy 51 ⚷3861

51 Bankruptcy
51XX Offenses
51k3861 k. In general. Most Cited Cases

Defendant could be held criminally liable for concealment of bankruptcy assets, even though her joint bankruptcy petition was filed by her husband on her behalf using a general power of attorney; general power of attorney could be used to file petition on defendant's behalf, practice of attorney who prepared petition was to call potential debtors whenever he was presented with a power of attorney, and defendant did not object to petition at meeting with their creditors. 18 U.S.C.A. § 152(1).

[2] Criminal Law 110 ⚷1144.13(2.1)

110 Criminal Law
110XXIV Review
110XXIV(M) Presumptions
110k1144 Facts or Proceedings Not Shown by Record
110k1144.13 Sufficiency of Evidence
110k1144.13(2) Construction of Evidence
110k1144.13(2.1) k. In general. Most Cited Cases

Criminal Law 110 ⚷1159.2(7)

110 Criminal Law
110XXIV Review
110XXIV(P) Verdicts
110k1159 Conclusiveness of Verdict
110k1159.2 Weight of Evidence in General
110k1159.2(7) k. Reasonable doubt. Most Cited Cases

When considering the sufficiency of the evidence supporting a conviction, the Court of Appeals asks whether, viewing the evidence in the light most favorable to the verdict, a reasonable trier of fact could have found each element established beyond a reasonable doubt.

[3] Bankruptcy 51 ⚷3861

51 Bankruptcy
51XX Offenses
51k3861 k. In general. Most Cited Cases

Bankruptcy 51 ⚷3863

51 Bankruptcy
51XX Offenses
51k3863 k. Evidence and fact questions. Most Cited Cases

Evidence was sufficient to sustain conviction for concealment of bankruptcy assets; defendant never revealed inaccuracies in bankruptcy petition, which was filed by her husband, regarding their interests in two corporations, and she was aware that several properties they owned were sold before a meeting with their creditors. 18 U.S.C.A. § 152(1).

[4] Bankruptcy 51 ⚷3863

51 Bankruptcy
51XX Offenses
51k3863 k. Evidence and fact questions. Most Cited Cases

Evidence was insufficient to sustain conviction for knowingly making false statements in bankruptcy; bankruptcy trustee's questionnaire, which asked whether defendant's parents had left any property at their respective times of death, could reasonably have been interpreted as asking whether parents left any property specifically to defendant, and, thus, his negative response was not knowingly false, even though his father did leave property in his will to his wife. 18 U.S.C.A. § 152(3).

[5] Bankruptcy 51 ⚷3861

51 Bankruptcy
51XX Offenses
51k3861 k. In general. Most Cited Cases

In order to sustain a conviction for knowingly making false statements in bankruptcy, the government must show that: (1) there was a bankruptcy proceeding; (2) defendant made a declaration or statement under penalty of perjury in relation to the proceeding; (3) the declaration concerned a material fact; (4) the declaration was false; and (5) defendant made the declaration knowingly and fraudulently. 18 U.S.C.A. § 152(3).

[6] Bankruptcy 51 ⚷3861

51 Bankruptcy
51XX Offenses
51k3861 k. In general. Most Cited Cases

Bankruptcy 51 ⚷3863

51 Bankruptcy
51XX Offenses
51k3863 k. Evidence and fact questions. Most Cited Cases

Evidence was sufficient to sustain conviction for bankruptcy fraud; defendant withheld money from a company with which he contracted to obtain financing for real estate development, he falsely told company that money had been stolen, and he attempted to conceal his fraud by filing for bankruptcy. 18 U.S.C.A. § 157(1).

[7] Indictment and Information 210 ⚷129(1)

210 Indictment and Information
210VI Joinder
210k126 Joinder of Counts; Multiplicity
210k129 Different Offenses in Same Transaction
210k129(1) k. In general. Most Cited Cases

Indictment charging defendant with concealment of bankruptcy assets and knowingly making false statements in bankruptcy was not multiplicitous; defendant's omissions from bankruptcy filings and her false answer to trustee's questionnaire were separate events, each of which was a violation of its respective provision of bankruptcy fraud statute. 18 U.S.C.A. § 152(1, 3).

[8] Indictment and Information 210 ⚷127

210 Indictment and Information
210VI Joinder
210k126 Joinder of Counts; Multiplicity
210k127 k. In general. Most Cited Cases

The standard for determining whether two charges render an indictment multiplicitous is whether each charge requires proof of an element that the other does not.

***956** Josette Louise Cassiere, Asst. U.S. Atty.

(argued), Cytheria Jernigan, Shreveport, LA, for Plaintiff–Appellee.

William Gold Whatley (argued), (Court–Appointed), Marksville, LA, Christopher Albert Aberle (argued), (Court–Appointed), Mandeville, LA, for Defendants–Appellants.

Appeals from the United States District Court for the Western District of Louisiana.

Before SMITH, BARKSDALE and BENAVIDES, Circuit Judges.

JERRY E. SMITH, Circuit Judge:

Brian and Debra Spurlin were convicted of concealment of bankruptcy estate assets, 18 U.S.C. § 152(1), for knowingly and fraudulently withholding their interests in certain properties from their bankruptcy filings, and false oaths and statements in bankruptcy, 18 U.S.C. § 152(3), for a false answer they gave on a bankruptcy questionnaire. Mr. Spurlin was also convicted of bankruptcy fraud, 18 U.S.C. § 157(1), for filing for bankruptcy to effect and conceal a fraudulent scheme whereby he took money he was supposedly holding in escrow for a company with whom he was doing business.

Mr. Spurlin does not appeal his conviction of concealment, but the Spurlins appeal all other convictions. Because there was insufficient evidence to convict Mr. Spurlin of false oaths and statements in bankruptcy, we reverse that conviction but affirm the remainder of the judgment as to him and vacate the sentence and remand for resentencing in light of the partial reversal. We affirm as to Mrs. Spurlin.

I.

On September 5, 2005, Mr. and Mrs. Spurlin filed a joint petition for bankruptcy, claiming assets of $3,364 that included only one company, Spurlin and Associates, Inc., formed by the Spurlins with Mr. Spurlin as general manager. That company declared bankruptcy the next day, because it owed a large debt to a client. Despite not listing them on their bankruptcy forms, the Spurlins were involved with several other companies and held other assets.

Golden Athletics, LLC (“Golden Athletics”), held title to the three cars that the Spurlins drove: a 2002 H2 Hummer, a 2002 Cadillac Escalade ESV, and a 2001 Mercedes. Additionally, Mrs. Spurlin sold the Tennyson Oaks Property to Golden Athletics, which then gave it to Mr. Spurlin, who sold it to Golden Choice Financial (“Golden Choice”), another company the Spurlins had created and that continued to own the property while the Spurlins lived there. Mr. Spurlin then sold Golden Choice to Yvonne Fogleman, Mrs. Spurlin's elderly mother, and sold the Tennyson Oaks Property for the company. Another relevant company was International Oil, Gas, and Mineral Management, Inc. (“International Oil”), an oil brokerage firm. Mr. Spurlin wrote multiple checks from that company to Mrs. Spurlin, which were then deposited into their undisclosed joint accounts. The Spurlins disclosed only one checking account, with Peoples State ***957** Bank, containing $157, even though they had additional accounts.

Though the Spurlins did not claim ownership of any cars or properties, they did claim a debt from James Hill for funds he allegedly had embezzled. The major debt listed on the bankruptcy petition was $705,000 owed to South Michigan Avenue, LLC (“SMA”), a company with which Mr. Spurlin had had a business relationship. Mr. Spurlin contracted to help SMA obtain $200 million in financing for real estate development in Chicago. SMA gave Mr. Spurlin money to hold in escrow, because Mr. Spurlin said potential funding sources needed to see that SMA had capital and equity in the project.

Mr. Spurlin never obtained the financing, and when SMA demanded the money back, he told SMA it had been transferred to Hill, his corporate attorney. SMA representatives never spoke to Hill; they traveled to Dallas but could not find his office. During that trip, Spurlin called them and said he knew they were there and that they should come see him, which they did. Two days after that trip, Spurlin told SMA that he had secured the funds, but before he could realize them, Hill had died. Spurlin claimed Hill had also taken $125,000 from Spurlin, but died without insurance, so the money could not be found, and suing the estate was too expensive.

Mr. Spurlin met with attorney Laramie Henry to prepare for filing joint bankruptcy with Mrs. Spurlin. Mrs. Spurlin never came to the office, but Mr. Spurlin presented Henry with a power of attorney executed between the spouses. Henry did not remember Mrs. Spurlin's ever supplying information directly to him or his staff or specifically talking to her on the phone. He testified that it was his policy to call potential bankruptcy debtors when presented with a power of attorney to make sure they knew about and agreed with what their spouse was doing.

On November 8, 2005, Mr. and Mrs. Spurlin attended a section 341 creditors' meeting, at which the trustee required them to complete an individual questionnaire. That form, prepared by the trustee, said it was completed under penalty of perjury. The form asked whether the debtors' parents were living or dead, and if dead, whether they had left any property. It also reminded debtors that any inheritance within the next six months must be reported. Both Mr. and Mrs. Spurlin signed that form; their answers acknowledged that Mrs. Spurlin's father, Cade Fogleman, had died, but the form indicated he had left no property.

To the contrary, however, Fogleman did leave property, just not to the Spurlins. Mr. and Mrs. Fogleman bought the Mohon Property jointly in 2000 before Mr. Fogleman died, although the closing agent from the sale testified that there may have been intrafamily transactions. The property was listed as Fogleman's address at his death. Mrs. Spurlin also testified that her father had given the Mohon Property to her mother in his will. The Mohon Property was eventually sold by Mr. Spurlin on behalf of Mrs. Fogleman for $149,000, leaving $57,697.59 after the mortgage was satisfied. Mrs. Spurlin did not sign any documents relating to that sale.

Mrs. Fogleman also owned another asset—the Elliot Street Property. Mr. Spurlin sold it on her behalf in September 2005 for $47,000, resulting in a $756.59 profit. The government's witness could not remember whether the Elliot Street Property was listed in the succession when Mr. Fogleman died, and Mrs. Spurlin insisted it was not owned by her parents at her father's death.

At the creditors' meeting, the Spurlins were informed that in joint debtor filings, ***958** an answer given by one joint debtor is assumed to be given for both unless the other person objects. Mr. Spurlin did most of the talking. The trustee asked whether they had read the bankruptcy information sheet, petition, and schedules and whether everything was true, correct, and included all their assets. All those questions were answered in the affirmative; if either party had said “no” to the mandatory questions, the trustee would have stopped the proceeding.

But many assets were not in the filings. At the time, the Spurlins were living in the Tennyson Oaks Property, which was initially purchased by Mrs. Spurlin for $229,167. She sold it to Golden Athletics for $38,167, which distributed the house to Mr. Spurlin, who sold it to Golden Choice for $200,000 after taking out a $200,000 loan on the property. Golden Choice was sold to Mrs. Fogleman for $125,000, and the property was then sold for $330,000, most of which went to pay off the loan. Both Mr. and Mrs. Spurlin signed the act-of-cash-sale agreement for the property on October 5, 2005. The proceeds from the sale of the Tennyson Oaks Property were split between paying off a loan at Red River Bank for Golden Athletics, a check to Hilltop Productions, LLC, a check payable to the Spurlin children's school, and a check to International Oil. The Spurlins also drove three cars titled to Golden Athletics, over which they had exclusive use and control.

Finally, although the Spurlins disclosed only their bank account at Peoples State Bank, they had accounts at Landmark Bank, Union Bank, and Red River Bank. Multiple checks were written by Mr. Spurlin to Mrs. Spurlin from International Oil and deposited into the Spurlins' joint checking account at Landmark Bank. Additionally, though proceeds from the sale of the Mohon Property were initially deposited in Mrs. Fogleman's account, that account was later closed and most of the money transferred to the Spurlin's joint Landmark Bank account. Some transfers from Mrs. Fogleman's account also went to International Oil's accounts. Even though some of these transfers went to International Oil, and Mrs. Spurlin wrote on one check that she was employed there, International Oil was not listed anywhere in the bankruptcy filings.

II.

Mr. and Mrs. Spurlin were indicted for (1) concealment of bankruptcy estate assets, 18 U.S.C. § 152(1), for not listing an interest in the Tennyson Oaks Property and the proceeds from its sale, the cars they drove, or Golden Choice or Golden Athletics; and (2) false oaths and statements in bankruptcy, 18 U.S.C. § 152(3), for answering Question 5 on the individual questionnaire at the creditors' meeting that Fogleman had left no property, despite knowing he had done so. Mr. Spurlin was also indicted for bankruptcy fraud, 18 U.S.C. § 157(1), for receiving $705,000 from SMA pursuant to escrow agreements, never completing the deal he had agreed to perform, not returning the money despite promising to, and then filing for bankruptcy, after SMA had sued him, to effect and conceal his scheme.

III.

[1][2] Mrs. Spurlin argues that she cannot be convicted of concealment of bankruptcy assets, because the joint bankruptcy petition was filed on her behalf using a general power of attorney and because she did not supply any information for the petition. When considering the sufficiency of the evidence, we ask whether, viewing the evidence in the light most favorable to the verdict, a reasonable trier of fact could have found each element established beyond a reasonable doubt. ***959** *United States v. Daniels,* 247 F.3d 598, 600 (5th Cir.2001). Questions of law are reviewed *de novo. Hartford Underwriters Ins. Co. v. Found. Health Servs., Inc.,* 524 F.3d 588, 592 (5th Cir.2008).

Mrs. Spurlin is not free of criminal liability just because her husband applied for the joint bankruptcy on her behalf using a general power of attorney. There is a split in the caselaw regarding when a general power of attorney can be used to file for bankruptcy on behalf of another person. On one hand, *In re Raymond,* 12 B.R. 906 (Bankr.E.D.Va. July 29, 1981), declared bankruptcy to be a highly personal privilege, similar to divorce or enlistment in the armed forces, that could not be effected by a power of attorney. The court feared misuse of the power. *Id.* at 908. Other precedent, such as *In re Sullivan,* No. 82–04323G, 30 B.R. 781 (Bankr.E.D.Pa. June 23, 1983) (citing *Raymond* with approval), provides an exception to that holding, determining that a power of attorney can be used to file for bankruptcy on another's behalf if the power of attorney specifically authorizes the holder to file for bankruptcy.

The other side is presented by *In re Ballard,* No. I–87–00718, 1987 WL 191320 (Bankr.N.D.Cal. Apr. 30, 1987), in which a wife was permitted to sign a joint bankruptcy filing for her husband, who was serving in the military, pursuant to a general power of attorney. *Ballard* disagrees with *Raymond*' s analogy between bankruptcy and divorce or enlistment, arguing that bankruptcy is far less personal. Rather, *Ballard* considers bankruptcy to be primarily about preservation of one's property, which is not "so personal that it cannot ever be done by proxy." *Id.* at *1. *Ballard* requires that when a general power of attorney is used to file for bankruptcy, the person on whose behalf the power is used must be notified. If that person says that he does not authorize the filing, the bankruptcy proceedings are dismissed.

The decision in *In re Brown,* No. 93–04473, 163 B.R. 596 (Bankr.N.D.Fla. Oct. 27, 1993), further supports the *Ballard* position. In *Brown,* a debtor's wife signed a bankruptcy filing for her husband using a power of attorney; the husband died six days later. The court declared the petition a legal nullity because the signature was forged, the power of attorney did not specifically authorize bankruptcy filings, and, as a result of his death, there was no opportunity for the debtor to ratify the filing. *Id.* at 598. The specific mention that there was no opportunity for ratification after the court noted that the power of attorney was general suggests that *Brown* recognizes that a party's ratification can validate a bankruptcy filed under a general power of attorney.

We conclude, agreeing with *Ballard,* that a general power of attorney may be used to file for bankruptcy on another's behalf. General powers of attorney allow someone to manage another person's affairs. Although certain matters are too personal to be entrusted to another, bankruptcy is primarily for property protection and is not as profoundly personal as divorce or enlistment. Declaring voluntary bankruptcy is about saving a person's assets where all else fails, and entrusting management of one's property to that someone includes giving him the tools to protect as much as he can if the worst happens. *Ballard* allows the holder of the power of attorney to declare bankruptcy but prevents abuse by requiring the debtor to be informed and dismissing if the debtor feels bankruptcy is improper. This gives the holder of the power of attorney flexibility to protect and manage that person's assets, while including a failsafe to prevent abuse.

***960** Under the *Ballard* rule, Mrs. Spurlin's bankruptcy petition is valid, because there is enough evidence for a jury to infer ratification. Henry testified that it was his practice to call the potential debtor whenever he was presented with a power of attorney, to make sure the debtor knows what his agent is doing. Though he could not remember having made the call to Mrs. Spurlin, the jury could have determined that he called her in accordance with his regular business practice. Additionally, she came to the creditors' meeting with the trustee, never objecting to the bankruptcy's going forward. The trustee testified that she did not appear angry at that meeting, in contradiction to her argument that she was dragged there reluctantly. Thus, under the *Ballard* approach, Mrs. Spurlin can be liable for the bankruptcy filing.

[3] In light of that, there is sufficient evidence to convict Mrs. Spurlin of concealment of bankruptcy assets. Under § 152(1), there are four elements to the crime of concealing property in connection with a bankruptcy case: (1) There is a bankruptcy hearing; (2) certain property or assets belonged to the estate of the debtor; (3) defendant concealed that property from creditors, custodians, trustees, or someone else charged with control of its custody; and (4) defendant did so knowingly and fraudulently. 5TH CIR. PATTERN CRIMINAL JURY INSTRUCTIONS § 2.10 (West 2001). For that crime, “conceal” means “to secrete, falsify, mutilate, fraudulently transfer, withhold information or knowledge required by law to be made known, or to take any action preventing discovery.” *Id.* Concealment is a continuing offense, so acts of concealment can commence after the bankruptcy proceedings have begun. *Id.* Because no one disputes the first element, only the other three need to be examined.

The property at issue includes the Spurlins' interest in two corporations. First is Golden Choice, including its main asset: the Tennyson Oaks Property at which the Spurlins resided. Second is their interest in Golden Athletics, which holds as its assets the three cars used by the couple. None of the bankruptcy forms listed the Spurlins as having any interest in Golden Choice or Golden Athletics or as owning any cars or properties. When the Spurlins attended the creditors' meeting, Mrs. Spurlin did not object to any of the answers Mr. Spurlin gave, nor did she reveal the inaccuracies in the filings. Additionally, their multiple savings and checking accounts were not disclosed. Only one account was disclosed in the bankruptcy filings, despite that the Spurlins drew on, and deposited into, many others.

Mrs. Spurlin's first argument—that she cannot have concealed information without providing information used in the bankruptcy petition—is unavailing. Even if she never supplied false information for the filings, withholding information constitutes concealment, and as a continuing violation, concealment can begin after the bankruptcy proceedings have started. Mrs. Spurlin attended the creditors' meeting, where the trustee asked Mr. and Mrs. Spurlin whether they had read all the documents in their bankruptcy filing and whether all the schedules and the statement of financial affairs were accurate. If either of them had answered "no," the trustee would have stopped the meeting; he explained at the beginning that in a joint bankruptcy, unless one of the parties says otherwise, any answers given are assumed to be from both parties.

Such an assumption creates an obligation on the parties to speak out when they know some of the information is false. That is reasonable, eliminating the inefficiency***961** from forcing each party to answer each question individually. Therefore, the jury reasonably could find that Mrs. Spurlin concealed assets by not informing the trustee that the documents were incomplete, even if she did not supply information to create the bankruptcy paperwork.

The evidence is also sufficient to support that Mrs. Spurlin knew assets were being concealed. First, she was involved in an unusual pattern of transactions pertaining to the Tennyson Oaks Property. She bought the house for $229,167, then shortly afterward sold it to Golden Athletics for $38,167, far less than its worth. Golden Athletics then distributed the house to Mr. Spurlin, who sold it to Golden Choice for $200,000 after taking out a $200,000 loan on the property. Golden Choice was sold to Mrs. Fogleman for $125,000, and the property was then sold for $330,000, most of which went to pay off the loan. Mrs. Spurlin signed the act-of-cash-sale agreement on October 5, 2005, which effected sale of the Tennyson Oaks Property for $330,000. Though she did not hold title to the property at the time, having previously sold it to Golden Athletics, this shows Mrs. Spurlin was aware of the final sale before the creditors' meeting.

The proceeds from the sale of the Tennyson Oaks Property were split into four parts: The sum of $26,228.09 was used to pay off a loan at Red River Bank for Golden Athletics. Mr. Spurlin used another $40,000 for a check payable to Hilltop Productions, LLC. Another $9,215 was used to buy a check payable to Redemptorist High School ("RHS") for $9,215. Finally, $19,108.82 was used to buy a check payable to Golden Choice, which was changed later into a check for $19,108.82 payable to International Oil.

The evidence could allow a reasonable jury to infer Mrs. Spurlin's knowledge that she was benefiting from the proceeds of the sale of the Tennyson Oaks Property. As explained above, she was aware, before the creditors' meeting, that the property had been sold. Agent McCarthy testified to checks she had written, even after bankruptcy was filed, payable to RHS, where her children went to school. One check includes "For International Oil" on the memo line. Other checks were written to her from International Oil's accounts by Mr. Spurlin, which were then deposited into their joint account at Landmark Bank—an account they maintained and that was not reported during the bankruptcy.

Mrs. Spurlin also later endorsed a check to buy groceries, listing her employer as International Oil. Her participation in the purchase and sale of the property, knowledge of its eventual sale, and involvement in both spending funds from, and claiming employment by, International Oil (where a significant amount of the profit from the sale of the Tennyson Oaks Property was deposited), along with the fact that one of the checks paying for her children's school came from the profits from the property's sale, suggest she knew she was benefiting from the sale of the property. Thus, not disclosing that to the trustee was knowing and fraudulent concealment.

Mrs. Spurlin's knowledge that she had benefited from the sale of the Mohon Property is more easily demonstrated. The proceeds were initially deposited into Mrs. Fogleman's account, then transferred mostly to Mr. and Mrs. Spurlin's undisclosed joint checking account with Landmark Bank. The signature card for the account contained the signatures of both defendants. Multiple checks payable to Mrs. Spurlin were also deposited into this account. Her knowledge and use of the Landmark Bank account shows the jury could reasonably infer she noticed over $43,000 being added to the account. No evidence contradicted her knowledge and use of this account.

***962** Additionally, there is enough information in the record for the jury to infer Mrs. Spurlin had knowledge of their undisclosed interest in the cars she and Mr. Spurlin drove and in Golden Athletics. First, the trustee directly asked, during the creditors' meeting, whether they had a vehicle, and Mr. Spurlin answered that they had one that was loaned to them to take care of Mrs. Spurlin's mother. Mrs. Spurlin knew at the time that they had three cars they controlled and had exclusive use of.

Furthermore, Mrs. Spurlin knew of her husband's interest in Golden Athletics. She had sold the Tennyson Oaks Property to Golden Athletics, represented by Mr. Spurlin, and when she signed the paperwork for the sale, Mr. Spurlin signed on behalf of Golden Athletics as the sole member. The jury could have considered that ownership in light of the suspiciously low price for which Mrs. Spurlin sold the Tennyson Oaks Property to Golden Athletics and recognized that the Spurlins had used that company as a means of hiding assets.

This is bolstered by the fact that Mrs. Fogleman bought Golden Choice, the other shell company in the transaction, for $125,000 when no benefit inured to her from the purchase. It instead is a reasonable inference that the action was done, through a power of attorney for Mrs. Fogleman in favor of Mr. Spurlin, as part of a scheme to hide assets. Altogether, this leaves the jury reasonably able to infer that Mrs. Spurlin knew of an interest in the cars and in Golden Athletics that should have been disclosed and that she failed to disclose. Thus, there was enough evidence for a reasonable juror to find Mrs. Spurlin guilty on count one.

IV.

[4][5] Mr. and Mrs. Spurlin appeal their convictions under count 2, false statement under penalty of perjury, arguing that there is insufficient evidence. The government must show that (1) there was a bankruptcy proceeding; (2) defendant made a declaration or statement under penalty of perjury in relation to the proceeding; (3) the declaration concerned a material fact; (4) the declaration was false; and (5) defendant made the declaration knowingly and fraudulently.

The declaration at issue is the answer to Question 5 on the trustee's questionnaire. That question (with Questions 4 and 6 included for context) reads as follows:

> 4. Are your parents living? Father _______ Mother _______
>
> Are your spouses' parents living? Father _______ Mother ____
>
> 5. If not, was any property left by your parent(s) at the time of death? _________
>
> 6. Do you understand that should you inherit anything during the next 6 months it will be necessary for you to advise me (your Trustee) in writing within 10 days? ______

The Spurlins answered that Mrs. Spurlin's father was dead, and they put “no” for Question 5. Because the form includes a statement that the answers are given under penalty of perjury, element two is satisfied.[FN1] What assets are available or potentially accessible to the estate is certainly important in a bankruptcy proceeding, so the declaration regarding whether the dead parents left property is material.[FN2]

FN1. Mrs. Spurlin repeatedly mentions that this is a “homemade” form, not an official bankruptcy form. But the statute makes no distinction between official and unofficial forms. The form was completed in the course of the bankruptcy proceedings, and it plainly stated it is completed under penalty of perjury.

FN2. The court described a material fact as one that “has a natural tendency to influence or is capable of influencing the decision of the decision maker to whom it was addressed.” The assets available in bankruptcy will influence how the trustee handles the bankruptcy, because bankruptcy is about distributing the available assets.

***963** Mr. and Mrs. Spurlin argue that under their interpretation of Question 5, this answer is true. They argue that the question asks whether the parents left any property *to the debtor*. Because Mr. Fogleman did not leave any property to Mr. or Mrs. Spurlin, they argue the answer was correct. The government argues that this reasoning is unreasonable, because the question does not say “to you.”

Either interpretation, however, is reasonable in this case. The trustee explained that the purpose of the question is to find out about any interest the debtor may have, even if he has not chosen to exercise it, because the trustee would be in the debtor's shoes to attack whatever happened to the assets. The trustee, however, testified that “the real thrust of if [the parents] are deceased is Question 5, which is: If they are not alive, did they leave you anything?” Additionally, the context supports the Spurlins' reading. Question 6 explains that if you “inherit” something in the next six months, you must advise the trustee. The same reasoning about the trustee's wanting to attack improper dispositions of assets from a deceased parent would apply if the parent died, irrespective of whether he left anything specifically to the debtor.

Thus, if the questions strive to make the trustee aware of all possible assets over which he can exercise an interest, even by attacking possibly improper succession, one would expect Question 6 to require informing the trustee merely upon the death of a parent. Finally, if the interpretation were as the government claims, almost no one would answer “no.” Very few people die with absolutely no property. That would result in Question 5's providing meaningful information in few situations.

In her trial testimony, Mrs. Spurlin conceded that the answer on the form was false,[FN3] relying on the defense that she did not fill it out. Yet, she signed the statement under penalty of perjury at the creditors' meeting and did not object when the trustee asked whether everything was correct. As we have said, she was responsible for objecting to information she knew was untrue. Thus, whether she did fill out the form is irrelevant.

FN3. She and the government's attorney had the following exchange:

Q. And the question did not ask whether or not you owned any property following your parents' death, did it?

A. No.

Q. It simply asked: Was there any property left by your parents at the time of death?

A. Correct.

Q. And the answer given here is no?

A. Correct.

Q. And that wasn't accurate, was it?

A. No. I did not fill this out, ma'am.

Additionally, Mrs. Spurlin admitted the answer was wrong without contesting that she interpreted the question differently, explaining her knowledge of her father's will. Even though in her reply brief she attempts to adopt all the arguments Mr. Spurlin makes, she cannot succeed on his argument, because her admission on the stand allows a reasonable jury to conclude that she understood the question the way the trustee intended it, while keeping the false answer.

Considering that Mr. Spurlin's interpretation of Question 5 comports with what the trustee noted was the real thrust of the question, best fits the context, and leads to a more useful result, no reasonable jury could have found beyond a reasonable doubt that he knowingly and ***964** fraudulently made a false statement when answering “no” to Question 5. Because, however, Mrs. Spurlin admitted that the answer was wrong without ever contesting the interpretation of that question advanced by the prosecutor, a reasonable jury could have determined that she knew the answer was false when given. Thus, there is sufficient evidence to affirm her conviction but not sufficient evidence to affirm her husband's.

V.

[6] Mr. Spurlin was convicted of bankruptcy fraud, which occurs where a person “having devised or intending to devise a scheme or artifice to defraud and for the purpose of executing or concealing such a scheme or artifice or attempting to do so ... files a petition under title 11 ....” 18 U.S.C. § 157(1). Thus, the elements are (1) a specific intent to defraud; (2) a scheme to defraud; and (3) filing a bankruptcy petition to conceal or execute that scheme.

Mr. Spurlin was convicted of fraud as a result of his dealings with SMA. He agreed to find, for SMA, financing for a real estate venture. Pursuant to those agreements, SMA gave him $705,000 to hold in escrow. When he failed to obtain funding, SMA asked him to return the money, but he never did; instead, he said it had been stolen by Hill, whom SMA had never heard about. SMA sent people to Dallas, where Hill's office was supposedly located, but could not find him. Then, shortly after telling SMA about Hill, Spurlin called to tell them that Hill had died. Combined, the facts that (1) as soon as SMA asked Spurlin to return the money in escrow, his previously unheard-of corporate attorney suddenly absconds with the funds; (2) the attorney and his office cannot be found in the city where they were supposedly located; and (3) the attorney then dies shortly after his introduction and disappearance, allowed the jury reasonably to infer that the financing arrangement was in truth a scheme by Spurlin to defraud SMA.

Mr. Spurlin argues that even if he did defraud SMA, he did not execute or conceal that fraud through filing for bankruptcy, because it was already completed by then. In so arguing, he seeks the restrictive reading of the statute from *United States v. Lee*, 82 F.Supp.2d 384 (E.D.Pa.2000). There, the alleged scheme was that after a bankruptcy court had limited how much compensation the defendant could receive from certain activities, he had his partner hire his wife as a consultant on those activities and pay her substantial sums. *Id.* at 386–87. Allegedly, these were to avoid the compensation cap. Three months after her consultations stopped, he filed for bankruptcy, and the court determined that the filing could not have effected the scheme, because she already had the money. *Id.* at 388. The court also determined that his failure to disclose that he was receiving additional compensation through his wife was not enough to charge him with filing for the purpose of concealment. *Id.* Finally, the court refused to read the scope of § 157 as analogous to the mail fraud statute. *Id.* at 388–89.

The first step in statutory interpretation—and the only step needed here—is to look at the plain meaning of the statutory language. The relevant provision describes a crime when someone, “having devised ... a scheme ... to defraud ... and for the purpose of ... concealing such a scheme ... or attempting to do so ... files a petition under title 11

....” 18 U.S.C. § 157(1). Mr. Spurlin devised a scheme, and there is no need to resort to legislative history when the ordinary meaning of concealment is sufficient here.

***965** “Concealing” something means to hide or keep it from notice.[FN4] The jury heard testimony regarding how thoroughly SMA was investigating Mr. Spurlin's claims to retrieve the money he took. If SMA kept looking, sooner or later it could have discovered that the money had not been stolen and hidden by a lawyer who suddenly disappeared and died. But if the debt were discharged, there would be no need to keep investigating Mr. Spurlin, because he would not be liable for the money. Pouring extra effort into investigating him would just waste SMA's resources, so SMA would likely cut its losses. Waiting around for SMA to catch him would not work, so he attempted to conceal everything by using bankruptcy and blaming Hill.

FN4. *Conceal,* OXFORD ENGLISH DICTIONARY, http:// www. oed. com (last visited Sept. 26, 2011).

Mr. Spurlin's argument that the bankruptcy just gave SMA a forum to claim fraud as a defense to discharge, and thus could not be concealment, is unavailing. SMA already thought he had fraudulently taken the money. If he succeeded in discharging the debt, that would conceal the scheme, because SMA would stop investigating him, and the scheme would not be fully uncovered. Just because he failed does not mean he did not try.

VI.

[7][8] Mrs. Spurlin argues that convicting her of both concealment of bankruptcy estate assets and false oaths and statements in bankruptcy is multiplicitous. Even though multiplicity issues usually get *de novo* review, here the issue was not raised at trial, but was instead first mentioned in Mrs. Spurlin's motion not to be incarcerated pending appeal, so plain-error review is appropriate. *See United States v. Pok Seong Kwong,* 237 Fed.Appx. 966, 968 (5th Cir.2007). In *United States v. Cluck,* 143 F.3d 174 (5th Cir.1998), this court addressed whether charging the same conduct under both § 152(1) and § 152(3) was multiplicitous. The standard for determining whether two charges render an indictment multiplicitous is whether each charge requires proof of an element that the other does not. *United States v. Nguyen,* 28 F.3d 477, 482 (5th Cir.1994). In *Cluck,* 143 F.3d at 179, we determined that the words of the statute make it plain that the two provisions require different elements: Section 152(1) requires that property be concealed from creditors, whereas § 152(3) does not, and § 152(3) requires a false declaration, certificate, or statement under penalty of perjury, whereas § 152(1) does not.

This case is more straightforward than *Cluck,* because different conduct by Mrs. Spurlin is alleged under each provision. For § 152(3), she is charged with her admittedly false answer to Question 5. For § 152(1), she is charged with concealing the various assets not reported in the bankruptcy filings, because she was informed that because she was a joint debtor, her answers would be assumed the same as her husband's unless she objected. The trustee explained that if she protested at any time, the the proceeding would stop, but she did not, including to questions about whether she had read the filed materials and whether they were accurate. The omissions from bankruptcy filings and the false answer to the trustee's questionnaire under penalty of perjury are different events, each of which is a violation of its respective provision of the statute. Therefore, because each claim requires different elements, and Mrs. Spurlin was convicted using different facts, there was no error, plain or otherwise, in convicting her of both.

In summary, we AFFIRM the conviction of Mrs. Spurlin on all counts. We AFFIRM Mr. Spurlin's convictions of concealment***966** of bankruptcy estate assets and of bankruptcy fraud and REVERSE, for insufficient evidence, his conviction of false oaths and statements in bankruptcy. In light of the partial reversal, we VACATE his sentence and REMAND for resentencing.

C.A.5 (La.),2011.
U.S. v. Spurlin
664 F.3d 954

END OF DOCUMENT

Medical Issues in Bankruptcy

Dischargeability of Medical Bills

- Generally, like all unsecured debt, medical bills are completely dischargeable in bankruptcy.
- The rules vary between chapter 7 and 13 since chapter 13 debtors receive a discharge only after completing all payments required by the court-approved repayment plan.
    - This may affect the debtor by forcing payment of at least a portion of the outstanding medical bills unless a "hardship discharge" is granted.

ObamaCare ("The Patient Protection and Affordable Care Act")

- Public Policy: passed in order to resolve many inefficiencies in the health care system.
    - Such as the dramatic increase in medical bankruptcies by mandating coverage for all citizens.
- Harvard Study shows
    - In 1981, only 8% of families filing for bankruptcy cited serious medical problems
    - In 2001 illness or medical bills contributed to 50% of all filings.
    - In 2007 medical problems caused 62% of all personal bankruptcies.
        - Surprisingly, 78% of those filers had medical insurance at the start of their illness, including 60.3% who had private coverage.
    - Conclusion
        - This study underscores ObamaCare
        - Reflects that covering the uninsured is not enough
        - Actual policy reform is needed to aid families with pre-existing insurance by upgrading their coverage and assuring that it is never lost.
            - Since most policies have many loopholes, co-payments, and deductibles
- Critics of this study
    - Dispel the emergence of reformation to cure medical bankruptcies
    - Unveil discrepancies in statistics; however, agree with policy reform and upgrading coverage.
        - Critics stats suggest: Medical bills are a contributing factor in just 17% of personal bankruptcies (not 54.5%)

<u>Articles</u>:
"Study Links Medical Cost and Personal Bankruptcy," Business Week
"Medical Bankruptcy: Myth Versus Fact," David Dranove and Michael L. Millenson
"The Impact of Health Care Reform on Personal Bankruptcy," Sarah Miller

Texas Health Care Reform

- President Obama's priority translated in Texas terms
    - Domestic priority is to overhaul the US healthcare system and expand coverage to most of the 46 million uninsured Americans.

    - This means 6 million Texans, including the one in six US uninsured children who live there, could get health insurance for the first time if the plan succeeded.
- Opponents of reformation
    - The $1 trillion healthcare reform bill faces opposition in Congress, as well as in Texas, which has the highest uninsured rate in the nation - about 25%.
    - Even without national action, several states are moving toward universal health coverage on their own (e.g. Connecticut, Vermont, Main, and Massachusetts)
    - But, it is unlikely to come to Texas without federal action. Texas Gov. Rick Perry opposes ObamaCare as a federal intrusion on his state's right to set healthcare priorities.
- Texas' Current Goals
    - Senate Bill 10
        - Sets stage for a comprehensive package of Medicaid reforms designed to increase the % of Texans with health care coverage, focus on prevention, and emphasize individual choice.
        - Aim to change the rate of uninsured by creating a Texas Health Opportunity Pool Trust Fund.
            - Bill provides premium subsidies to eligible Texans and improving the effectiveness of the state's Medicaid program.
- Opposing perspectives
    - Texas can't do without the feds
        - As much as Rick Perry bashes the federal government in his campaign speeches, Texas gets a lot of money from the federal government, and a lot of it is going to the health care system he insists Texas can handle on its own
            - > $380 million in early grants and other aid from the federal health law have already gone to businesses and agencies in Texas
            - Texas ended up with $17 billion from the stimulus
            - Awaiting final approval of a new waiver yielding an additional $12B
    - Texas receives more aid than other states
        - If law survives its upcoming review by Supreme Court, its expansion of Medicaid alone could cost the government anywhere from $53 billion to $67 billion in aid to Texas by 2019.

Articles:
"Healthcare reform looms large in Texas," www.reuters.com
"Texas Health Care Reform Goals," Health and Human Services Commission
"Senate Bill 10 Sets Stage for Health Care Reform," Health and Human Services Commission
"Biggest recipient of 'Obamacare'? Texas," www.lasvegassun.com

Dischargeability of Heal Loans

- Heal Loans defined
    - The Health Education Assistance Loan (HEAL) program is a program of Federal insurance of educational loans to graduate students in the fields of medicine, osteopathic medicine, dentistry, veterinary medicine, optometry, podiatric medicine, pharmacy, public health, chiropractic, health administration and clinical psychology.

    - Even without national action, several states are moving toward universal health coverage on their own (e.g. Connecticut, Vermont, Main, and Massachusetts)
- Purpose
    - To make loans to students in these fields who desire to borrow money to pay for their educational costs.
- Obligations
    - To borrower is obligated to repay the lender the full amount of the money borrowed, plus all interest which accrues on the loan.
- Dischargeability
    - Heal Loans are governed by 42 U.S.C. Sec. 294f(g). Under this section, a Heal loan is not dischargeable in bankruptcy **unless**:

        - Five years have passed from the date that repayment begins;
        - The bankruptcy court finds that nondischarge would be unconscionable; and
        - The Secretary has waived certain rights. (See In re Johnson, 787 F.2d 1179, 1181 (7th Cir. 1986).

Case Law:
United States v. Wood, 925 F.2d 158 (7th Cir. 1991).
In re Johons, 787 F.2d 1179, 1181 (7th Cir. 1986).

Statute:
42 U.S.C. Sec. 294f(g)

Reference Material

42 C.F.R § 60.1

42 U.S.C. Sec. 294f(g)

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https://netfiles.uiuc.edu/smille36/www/Bankruptcy.pdf

The Impact of Health Care Reform on Personal Bankruptcy

Sarah Miller *

August 18, 2011

Abstract

In 2006, Massachusetts enacted a health reform that mandated all state residents purchase health insurance. The differential impact of this reform across counties generated by pre-reform insurance rates creates a natural experiment that I use to identify the effect of health insurance coverage on the personal bankruptcy rate. I find that the reform reduced personal bankruptcy rates, with the most pronounced declines occurring in the most affected counties. In these counties, personal bankruptcy rates decreased by 0.41 per 1000 residents, a reduction of approximately 20% relative to other counties with similar characteristics. The magnitude of the estimated effect increases with exposure to the reform: a one percentage point increase in pre-reform insurance rate decreases the personal bankruptcy rate by 0.06 bankruptcies per 1000 residents. I do *not* find significant improvements in other measures of economic activity, such as the unemployment rate or the business bankruptcy rate, and the results are robust to alternative control states and model specifications.

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1 Introduction

When surveyed, a significant fraction of bankruptcy filers report that medical expenses played a significant role in their bankruptcy decision.[1] Advocates for comprehensive health care reform have used medical bankruptcy to justify legislation designed to expand health insurance coverage, under the assumption that insurance can alleviate the catastrophic health care costs driving these bankruptcies. This argument relies on a causal relationship between personal bankruptcy and health insurance coverage that, despite the supposed prevalence of medical bankruptcy, is poorly understood. I examine this relationship by analyzing the 2006 health reform in Massachusetts and its effect on the personal bankruptcy rate.

In 2006, Massachusetts enacted health care reform aimed at achieving universal health insurance coverage within the state. This reform mandated that all state residents must purchase health insurance, and coupled this mandate with subsidies for low- and middle-income families. This law induced an exogenous change in insurance coverage that allows me to bypass the common empirical problem that medical insurance coverage may be endogenously determined with the bankruptcy decision. For example, the poor may forego health coverage and small shocks of any form may lead to bankruptcy, but the root cause of bankruptcy may be poverty rather than health insurance coverage.

Following the identification strategy in Miller (2010), I leverage the differential impact of the reform across Massachusetts to identify the causal effect of insurance on personal bankruptcies. First, I compare the growth in the per capita bankruptcy rate in Massachusetts to that in states that did not enact such a reform. Second, because the new legislation required almost all residents purchase insurance, counties that had a larger fraction of uninsured residents before the reform were more intensively impacted by the mandate than counties with near-universal health insurance coverage prior to the reform. I estimate the relative effect of the reform in the most-affected counties using a "difference-in-difference-in-difference" model. I supplement these results by focusing only on Massachusetts and comparing counties in Massachusetts with each other.

[1] See Dranove and Millenson (2006), Himmelstein et al. (2005), and Himmelstein et al. (2009)

I find that the personal bankruptcy rate declined in Massachusetts relative to other counties after the 2006 reform, and the most-affected Massachusetts counties experienced markedly slower growth in the personal bankruptcy rate between 2006 and 2009 than similar counties in other states. A one percentage point increase in 2006 uninsurance rate reduces the annual per-capita personal bankruptcy rate by about 0.06 bankruptcies per 1000 residents. The most-affected counties had 0.41 fewer bankruptcies per 1000 residents, a reduction of about 20% compared to similar counties in other states. Using data on only counties within Massachusetts, I find that the most-affected counties experienced slower growth in personal bankruptcies than other Massachusetts counties, resulting in approximately 23% fewer bankruptcies than if these counties had grown at the same rate.

I find no significant effect of other indicators of economic activity, such as the unemployment rate or the business bankruptcy rate, indicating that this result is driven by the impact of health insurance on bankruptcy rather than an unrelated concurrent improvement in the economic environment. The results do not meaningfully change when controls for county characteristics are added, when alternative comparison states are used, or when the "post reform" period is restricted to only 2007.

Other papers have examined the role of health insurance in the bankruptcy decision. Mathur (2006) uses the Panel Study of Income Dynamics and finds that medical debt is a significantly positively correlated with the probability of declaring bankruptcy, although unsurprisingly, a dummy variable indicating health insurance coverage in the same regression has no significant effect. Gross and Notowidigdo (2010) use the expansion of Medicaid in the 1990s to explore the causal relationship between insurance coverage and bankruptcy, using simulated Medicaid eligibility as an instrument for Medicaid coverage. They estimate that increasing Medicaid eligibility by 10% in a state reduced the bankruptcy rate by about 8.4%. Their simulations suggest that among low-income households, lack of insurance is responsible for approximately 26% of personal bankruptcies.

My paper contributes to this literature in several ways. First, my paper is the first to explore the causal impact of a universal individual mandate for health insurance on bankruptcy rates. By analyzing the impact of a reform that applies to all state residents, rather than a program exclusively targeted at low-income families, I estimate the average effect of expanding insurance to the current uninsured population, instead of a subset of that population. Recent federal legislation, the 2010 Patient Protection and Affordable Care Act, also uses an individual mandate to increase insurance coverage. My results contribute to this ongoing debate concerning insurance mandates and enhance the overall understanding of the relationship between health insurance coverage and personal bankruptcy.

2 Determinants of Personal Bankruptcy

Bankruptcy allows debtors to discharge or restructure their debts. One economic justification for bankruptcy is that it allows for smoother lifetime consumption if borrowers face substantial uninsurable risk. When insurance markets are limited, a bankruptcy system can be welfare-improving (see Zame (1993), Zha (2001)). However, like other types of insurance, bankruptcy creates ex-ante moral hazard. Consumers who do not have to bear the full cost of their decisions may be more willing to take risks and reduce precautionary savings. Athreya (2005) offers a complete survey of equilibrium models of personal bankruptcy.

Several empirical studies have documented the factors that are associated with personal bankruptcy. When surveyed, bankruptcy filers often refer to an unexpectedly severe drop in their income as the precipitating cause of bankruptcy, and evidence suggests that bankruptcy filers are indeed more likely to have recently experienced an adverse shock, such as a job loss, than the general population. Sullivan et al. (2000) find that the unemployment rate is three to four times higher among bankrupt debtors than the national average. Agarwal and Liu (2003) find that fluctuations in county unemployment rates have a significant impact on credit card delinquency behavior. The authors also find that family-related adverse events, such as divorces, are associated with high delinquency rates.

Bankrupt debtors also respond strategically to the costs associated with bankruptcy, both the formal costs imposed by state bankruptcy laws, and informal social costs, such as social stigma. Researchers have found empirical evidence of the salience of both types of costs. Agarwal et al. (2003), for example, find that states with lax bankruptcy laws experience higher delinquency rates. Fay et al. (1998) and Gross and Souleles (1998) find evidence that changes in the social stigma associated with declaring bankruptcy play an important role in explaining the evolution of bankruptcy rates over time.

Negative health outcomes may also lead to lost income, through high medical bills or foregone wages. These costs can potentially stress a household budget to the point of bankruptcy. Himmelstein et al. (2005), analyzing a national survey of bankruptcy filers, estimate that over half of all bankruptcies were a result of medical problems. Using the same data but a more conservative definition of medical bankruptcy, Dranove and Millenson (2006) find that 17% of those filing for bankruptcy did so for medical reasons.

Gross and Notowidigdo (2010) illustrate how medical insurance and other forms of social insurance (such as bankruptcy) may function as substitutes for consumers. If medical insurance for a consumer were to increase exogenously, the propensity to file for bankruptcy would decline, as the consumer is protected from adverse health events that may be driving the bankruptcy decision. Gross and Notowidigdo (2010) use this framework to estimate the elasticity of substitution between health insurance and bankruptcy protection using the expansion of Medicaid as a natural experiment. The authors find that increasing Medicaid coverage by 10% causes an 8 percentage point drop in state bankruptcy rates.

My paper builds on the existing empirical work by providing the first estimates of the effect of an individual mandate for health insurance on the personal bankruptcy rate. Individual health insurance mandates are becoming a widely-used health policy instrument, but their effect on financial outcomes remains largely unexplored. The reform in Massachusetts may impact bankruptcies differently from the Medicaid expansion explored by Gross and Notowidigdo (2010) because it expanded insurance to the entire population of uninsured state residents, rather than focusing on low-income residents and children, and because it required residents making over 300% of the federal poverty line to purchase insurance out of their own income, rather than providing it for free.

3 The Reform

In April of 2006, Massachusetts enacted a major health reform act with the goal of achieving universal health insurance coverage within the state. The law, called "Chapter 58," mandates that all Massachusetts residents must purchase health insurance that meets a minimum standard of coverage if such coverage is affordable, or pay a non-compliance fee. Standards of affordability and coverage are set forth by the Commonwealth Health Insurance Connector Authority. Failure to purchase health insurance results in the loss of the personal exemption to the income tax, which was $219 for an individual in 2007. In 2008, monthly penalties for not having insurance coverage were added, up to half the the monthly cost of the least-expensive available plan.

The reform combines the individual mandate with an expansion of the Massachusetts Medicaid program, called "MassHealth," and new subsidies for individuals earning up to 300% of the federal poverty line. The MassHealth expansion includes children in families earning up to 300% of the federal poverty line and some low-income workers, and removes caseload caps on people living with HIV, the long-term unemployed, and the disabled. The law also restores vision and dental benefits that had been cut from MassHealth in 2002. In addition to the expansion of MassHealth, a new program, "Commonwealth Care," provides free insurance to families earning up to 150% of the federal poverty line, and tiered subsidies for insurance for families earning up to 300% of the poverty line. MassHealth and Commonwealth Care enrolled a combined 122,000 low-income residents within the first year of implementation, approximately 100,000 of which were below the poverty line (Raymond (2007)). In addition to offering low-income plans, the Connector Authority offers special low-cost plans for young adults between the age of 19 and 26 and requires that private health insurance providers allow young adults to remain on their parents' plan for up to two years after they cease to be dependents.

The new law also requires employers to participate in providing health care. All employers with over 10 employees are required to contribute to their employees' health insurance either by providing an insurance plan of their own, or by paying at least 33% of their employees' health insurance premium costs. Employers who fail to do either must pay a "fair share" assessment of up to $296 per uninsured employee. For residents not enrolled in a group health plan, a new small-group market was created by merging the non-group and small-group insurance markets. This reform permits such residents to purchase insurance coverage from less expensive small-group plans. Raymond (2007) and Gruber (2008) provide details on the health reform act.

The combination of personal mandate and insurance subsidies induced a substantial change in the uninsurance rate in Massachusetts. Figure 1 plots the uninsurance rate in Massachusetts as well as the national uninsurance rate from the Current Population Survey (CPS). Prior to the reform (2004-2006), the uninsurance rate was about 10.3 percent in Massachusetts and about 15.3 percent nationally. By 2009, the uninsurance rate in Massachusetts had fallen to 4.4 percent, but the national uninsurance rate had risen to 16.7 percent. Long and Phadera (2009) estimate a post-reform uninsurance rate of 2.6 percent using data from the Massachusetts Health Insurance Survey, a survey fielded by the Massachusetts Division of Health Care Finance and Policy, and other estimates include a 3.0 percent (National Health Interview Survey) and a 4.1 percent (American Community Survey). Kolstad and Kowalski (2010) and Long et al. (2009) find similar rates of uninsurance after the reform. These estimates suggest that the reform reduced the uninsurance rate by more than half, and the largest estimates find the reform reduced the uninsurance rate by as much as 75 percent.

4 The Effect of the Massachusetts Reform on Personal Bankruptcy Rates

To evaluate the effect of the reform on personal bankruptcies, I compare the change in the personal bankruptcy rate in Massachusetts with that of other states and, using county-level data, compare this effect among counties that were more- and less-affected by the reform because of their pre-reform conditions. I use data from the U.S. Department of Justice on the number of total bankruptcies by chapter from 2006 to 2009 by both state and county to analyze the effect of the Massachusetts reform on personal bankruptcy. County-level data are available by calendar year and state-level data are available by quarter. Debtors whose county of residence is outside of the U.S. are excluded from the analysis. State-level counts of bankruptcy are based on the number of bankruptcies filed within the state, whereas county-level counts are based on the county of residence of the first named debtor in the bankruptcy petition. This count is then divided by the total population of the state or county, provided by the U.S. Census Bureau. For convenience, I multiply this figure by 1000 to obtain the number of bankruptcies per 1000 residents.

The county-level uninsurance rate in 2006 is taken from the Small Area Health Insurance Estimates provided by the Census. These model-based estimates use health insurance coverage data from the Current Population Survey, administrative Medicaid data, and population demographics to estimate insurance coverage for all U.S. counties. In some specifications, I employ further data on median income and poverty rates by geographic area from the American Communities Survey, conducted by the U.S. Census Bureau, as well as the unemployment rate from the Local Area Unemployment Statistics provided by the Bureau of Labor Statistics. The Bureau of Labor Statistics did not produce county-level unemployment rate estimates for Louisiana in 2006, so counties in Louisiana are excluded from analysis that uses the unemployment rate.[2]

In 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act dramatically altered the rules concerning bankruptcy filings. This reform restricted bankruptcy in several ways. The law introduced a "means test" for Chapter 7 bankruptcy that prevented families with income above the state median from declaring Chapter 7 bankruptcy. Additionally, it required that filers participate in debt counseling and increased the fees associated with bankruptcy. This reform had a substantial impact on the decision to file for bankruptcy, and when to file for it, and the associated repercussions represent a potential problem in identifying the effect of the Massachusetts reform one year later. I take several steps to prevent the bankruptcy reform from confounding my analysis. First, I restrict the sample period to only

[2]Bankruptcy data are available for download at http://www.uscourts.gov/Statistics/BankruptcyStatistics.aspx, small area health insurance, income, and poverty estimates are available at http://www.census.gov/did/www/sahie/ and http://www.census.gov//did/www/saipe/. Local area unemployment statistics are found at http://www.bls.gov/lau/.

bankruptcies filed after this reform was enacted; that is, I consider bankruptcies filed in the calendar year of 2006 and later. The federal law applied uniformly to all states, but states that had relatively generous bankruptcy laws prior to the reform may have been disproportionately affected (Morgan et al. (2009)). Furthermore, because the Chapter 7 "means test" is based on median state income, states with higher or lower income may have been affected differently by the bankruptcy reform. To reduce the influence of these effects, I control for state and county median income. I further evaluate the extent to which the bankruptcy reform affects my results by evaluating the results using comparison states with similar median income and exemption levels. The results are largely unchanged across comparison groups, indicating that the estimates are likely capturing the effect of the Massachusetts health care reform, rather than the federal 2005 bankruptcy reform.

Table 1 provides summary statistics of the data used. Counties in Massachusetts had higher insurance coverage and lower bankruptcy rates than other counties in the U.S. even prior to the reform. Counties in both Massachusetts and other states experienced an increase in the bankruptcy rates from 2006 to 2009.

4.1 State-level variation

I first estimate a difference-in-difference model that compares the growth rate of personal bankruptcy in Massachusetts to that of all other states over the period of the reform. Specifically, I model the per capita bankruptcy rate in state j at year t as

$$bankruptcyrate_{jt} = \alpha_0 + \alpha_q + \alpha_1 MA_j + \alpha_2 Post_t + \alpha_3 Post_t * MA_j + \alpha_4 X_{jt} + \epsilon_{jt}, \qquad (1)$$

where $MA_i = 1$ if state j is Massachusetts and 0 otherwise and $Post_t = 1$ if year t is above 2006, 0 otherwise. To account for seasonality, I include quarter fixed effects, α_q. In some specifications, I include state-level characteristics: the unemployment rate for state j in quarter t and the 2006 poverty rate and median income. The parameter of interest in α_3, which measures the change in the personal bankruptcy rate in Massachusetts relative to other states. If α_3 is negative, then the personal bankruptcy rate fell (or grew less quickly) in Massachusetts relative to all other states in the US. I estimate similar models for the of

Chapter 7 and Chapter 13 personal bankruptcy rates.

Figure 2 plots quarterly personal bankruptcy rates for Massachusetts and all other states by chapter, as well as the business bankruptcy rate and the unemployment rate. While there is no obvious reduction in the overall personal bankruptcy rate, Chapter 13 bankruptcies appear to have fallen in Massachusetts relative to other states. This chapter of bankruptcy comprises only a small fraction of total personal bankruptcies. Business bankruptcies and the unemployment rate also evolve similarly in Massachusetts and other states.

Table 2 presents estimates of the difference-in-difference model of equation (1) and confirm the trends in Figure 2. In specifications both with and without covariates, Massachusetts experienced a statistically insignificant reduction in the personal bankruptcy rate relative to all other states (Columns 1 and 2). The point estimate indicates that the reform induced a reduction in the personal bankruptcy rate by between 0.04 and 0.01 bankruptcies per 1000 residents, between 0.8 and 3 percent relative to the 2006 bankruptcy rate of 1.2 bankruptcies per 1000 residents. Because the reform reduced the uninsurance rate from about 10.3 percentage points to between 2.6 and 4.4 percentage points, these estimates represent a "treatment effect" of insurance on the probability of bankruptcy for an individual of between $\frac{0.001}{7.7} = 0.0001$ and $\frac{0.004}{5.9} = 0.0007$, a reduction of 10 to 56 percent relative to the Massachusetts statewide 2006 per-capita insurance rate of 0.0012.

I find no significant effect of the reform on Chapter 7 bankruptcies relative to other states, but I do find that Chapter 13 bankruptcies decreased significantly. The estimated reduction in Chapter 13 bankruptcies is between 0.02 and 0.03 bankruptcies per 1000 people per quarter; approximately a 16.5% lower than if the Massachusetts personal bankruptcy rate had grown at a similar rate as that of other states in the U.S. Chapter 13 bankruptcies represent only about one quarter of total personal bankruptcies in Massachusetts.

Identification in this model is based on the assumption that, in the absence of the reform, the personal bankruptcy rate in Massachusetts would have followed a similar trend as the personal bankruptcy rate in other states. In the next section, I relax this assumption by using the pre-reform uninsurance rate as an additional source of variation in the effect of the reform. It is not surprising that I find no significant effect at the state level because most residents in Massachusetts were covered by insurance even before the 2006 health reform. In the next section, I look at the effect of the reform in counties that experienced substantially larger changes in insurance coverage because of their greater number of uninsured residents.

4.2 County-level variation

Massachusetts had relatively high statewide insurance rate even prior to the reform, but significant variation in insurance coverage at the county level. The map of insurance coverage in Massachusetts in 2006, presented in Figure 3, illustrates the differences in pre-reform conditions across the state. Due to this variation in ex-ante exposure, the 2006 health reform did not affect all counties in Massachusetts uniformly: a county with a large uninsured population prior to the health insurance mandate was more affected by the law than a county where only a small number of people were uninsured. If a causal link exists between insurance coverage and personal bankruptcy, the effect should be largest in areas that had higher exposure to the health insurance mandate.

Using the approach implemented in Miller (2010), I model the per capita bankruptcy rate in county i, in state j at year t ($bankruptcyrate_{ijt}$) as a function of the 2006 county non-elderly uninsurance rate interacted with the "post reform" indicator and an indicator that the county is in Massachusetts. This approach is similar to the difference-in-difference-in-difference model found in, e.g., Gruber (1994) and Chetty et al. (2009), but with a continuous measure of exposure to the reform as the "third" difference. I estimate

$$\begin{aligned} bankruptcyrate_{ijt} =& \gamma_0 + \gamma_1 + \gamma_2 MA_i + \gamma_3 Post_t + \gamma_4 Uninsured2006_{ij} \\ &+ \gamma_5 MA_i * Uninsured2006_{ij} + \gamma_6 Post_t * Uninsured2006_{ij} \\ &+ \gamma_7 MA_i * Post_t * Uninsured2006_{ij} + \gamma_8 X_{ijt} + \upsilon_{it}. \end{aligned} \tag{2}$$

The coefficient γ_7 captures the relationship between the increase in insurance coverage induced by the reform and the reduction in the personal bankruptcy rate. If the increase in insurance coverage results in a reduction in the personal bankruptcy rate, then γ_7 is negative. In some models, I also include controls for county characteristics, X_{ijt}: the unemployment rate, the 2006 poverty rate and the 2006 median income. I fix a county's poverty rate and median income at its 2006 level to avoid endogenous changes in these variables caused by the health reform itself.

Table 4 presents the estimates of (2). Column 1 presents results without additional controls for county characteristics and Column 2 presents estimates with controls.[3] The models both with and without controls result in very similar estimates.

Consistent with a causal relationship between insurance coverage and personal bankruptcy rate, I find that the effect of the reform is significantly larger in counties that experienced a greater increase in insurance coverage. A one percentage point increase in the pre-reform uninsurance rate in Massachusetts corresponds to a decline in total personal bankruptcy rate of about 0.06 per 1000 residents in both the model with and without controls (Columns 1 and 2). The estimated effect is significantly different from zero at the 0.05 level. Because the reform reduced the uninsurance rate by between 7.7 and 5.9 percentage points, this implies a total reduction of between 0.46 and 0.35 bankruptcies per 1000 residents, a reduction of between 38 and 29 percent relative to the pre-reform level of 1.2 visits per 1000 residents.

If we assume the compliance rate is constant across Massachusetts, these estimates can also be interpreted as the "treatment effect" of insurance on an individual's probability of declaring bankruptcy. Bankruptcies decreased by 0.006 per 100 residents when insurance increased by roughly 1 person per 100 residents. This result implies that giving that individual insurance lowered the probability that they would declare bankruptcy by 0.6 percentage points.

Columns 3 and 4 of Table 3 presents estimates with Chapter 7 bankruptcies per 1000 residents as the dependent variable. Chapter 7 bankruptcies experienced a decline of 0.05 per 1000 residents, with an associated p-value of 0.02. I also find a small, negative effect for Chapter 13 bankruptcies, although it is not statistically significant.

In addition to estimating a model with a continuous measure of the ex ante exposure to

[3]These estimates exclude counties in Louisiana from the control group, as county level estimates of unemployment were not produced in 2006 due to disruptions caused by Hurricane Katrina.

the reform, I also create a binary variable, $Treated_i$, equal to one if the 2006 uninsurance rate is greater than 10.3, the third quartile for Massachusetts. I estimate a standard difference-in-difference-in-difference model ,

$$\begin{aligned} bankruptcyrate_{it} = \beta_0 + \beta_1 + \beta_2 MA_i + \beta_3 Post_t + \beta_4 Treated_i + \beta_5 MA_i * Treated_i + \\ \beta_6 Post_t * Treated_i + \beta_7 MA_i * Post_t * Treated_i + \beta_8 X_{it} + \upsilon_{it}. \end{aligned} \tag{3}$$

The coefficient on the three way interaction between MA, $Post$, and $Treated$ estimates the impact of the reform on the counties with the highest pre-reform uninsurance rates.

Table 4 presents estimates of the model in equation (3). In Columns 1 and 2, I find that the counties with the highest uninsurance rates prior to the reform experienced a reduction in the personal bankruptcy rate of 0.41 bankruptcies per 1000 residents. The model predicts that if the effect of the reform had been zero (i.e., $\beta_7 = 0$), the expected bankruptcy rate in the treated counties would have been about 20% higher. This result is significant at the 5% level with an associated p-value of 0.02. I find that counties in Massachusetts with pre-reform uninsurance rates of below 10.3 ($Treated_i = 0$) also saw a reduction in the personal bankruptcy rate, although this effet is much smaller and not statistically significant.

Looking at bankruptcy by chapter, I find a decline in Chapter 7 bankruptcies of about 0.20 per 1000 residents, representing a 17.6% reduction, although this estimate is only marginally significant. Chapter 13 bankruptcies declined by about 0.19 per 1000 residents, a 30% reduction. Chapter 7 bankruptcy is almost exclusively available only to families making less than the median income. The result that both Chapter 7 *and* Chapter 13 bankruptcies experienced a reduction suggests that the health reform in Massachusetts not only affected bankruptcies among low income families, but also affected the personal bankruptcy rate for a wide segment of the population. I find that non-treated counties in Massachusetts experienced a small reduction in the personal bankruptcy rate as well, although this estimate is not statistically significant.

I also estimate a model that includes controls for the poverty rate and median income of the counties in 2006 as well as the unemployment rate, reported in the second, fourth, and sixth columns in Table 4. Adding these controls does not meaningfully alter the results. The reform is estimated to significantly reduce the personal bankruptcy rate by approximately 0.34 per 1000 residents in the most-affected counties, with small but statistically insignificant reductions estimated in the Massachusetts counties that had relatively high insurance coverage prior to the reform. Chapter 7 and Chapter 13 bankruptcies decline by 0.19 and 0.14 per 1000 residents, respectively.

4.3 Within Massachusetts Variation

Because the reform had a differential impacted on counties within Massachusetts, the effect of the reform can be measured using the relative change in bankruptcy rates within the state. The advantage of looking within Massachusetts is that any economic or policy changes specific to the state are constant, and if the state is relatively homogeneous then counties within the same state can function as appropriate controls. The disadvantage is that counties that vary by an observable characteristic (pre-reform uninsurance rate, in this case) may also vary by unobserved characteristics that affect the growth in the bankruptcy rate.

Using only the subsample of Massachusetts counties, I estimate

$$\begin{aligned} bankruptcyrate_{it} =& \gamma_0 + \gamma_1 + \gamma_2 Uninsured2006_i + \gamma_3 Post_t \qquad (4) \\ & + \gamma_4 Uninsured2006_i * Post_t + \gamma_8 X_{it} + \upsilon_{it} \quad \text{and} \\ bankruptcyrate_{it} =& \gamma_0 + \gamma_1 + \gamma_2 Treated_i + \gamma_3 Post_t \qquad (5) \\ & + \gamma_4 Treated_i * Post_t + \gamma_8 X_{it} + \upsilon_{it}, \end{aligned}$$

where $Uninsured2006_i$ is the county's pre-reform non-elderly uninsurance rate, $Treated_i = 1$ if the county had over 10.3% of residents uninsured in 2006, and X_{it} are controls for county characteristics included in some specifications. There are 14 counties in Massachusetts, resulting in 56 county-year observations.

I find that counties in Massachusetts that had high levels of pre-reform uninsurance experienced a significant decline in per capita personal bankruptcy relative to other counties in the same state. The first column of Table 5 presents the results for equation 4. For every percentage point increase in the 2006 uninsurance rate, I find bankruptcies decreased significantly by about 0.11 per 1000 residents. When I add controls, the estimated reduction is about 0.10 per 1000 residents. This result is larger than the estimate discussed in the previous section because it does not account for the differential trend in high insurance counties over the period considered.

The first column of Table 5 presents estimates of (5) without additional covariates. The treated counties experienced a reduction in the personal bankruptcy rate of approximately 28% relative to the untreated counties. This estimate is significantly different from zero at the 0.01 level. Adding controls decreases the magnitude of the coefficient slightly, from a reduction of 0.59 bankruptcies per 1000 residents to a reduction of 0.52 bankruptcies per 1000 residents, but the effect remains precisely estimated at the 0.01 level.

5 Robustness Checks

5.1 Alternative Control Groups and the 2005 Bankruptcy Abuse Reform Act

The results presented above compare the growth in personal bankruptcy rates of the most-affected counties in Massachusetts with similar counties in other states. The "control group" is all other counties in the United States with similar uninsurance rates. To confirm that my results are not sensitive to which states are included in the control group, I re-estimate the models using different comparison states.

I first use alternative control states to address the possible impact of the 2005 bankruptcy reform act on the results. Because Massachusetts had relative generous home exemption laws prior to the bankruptcy reform act, the restrictions introduced by the law may have affected Massachusetts differently from other states. To test this assumption, I re-estimate the models 2 and 3 using states with similar home exemptions as a control group. Table 6 reports the results.

In 2005, the home exemption in Massachusetts was $500,000. Columns 1 through 4 report the effect of the reform using states with similarly generous, but finite, exemptions - Nevada (that has a home exemption of $350,000), Rhode Island ($200,000), and Minnesota ($200,000). Columns 5 through 8 report the same models but use comparison states with an unlimited home exemption (Arkansas, D.C., Florida, Iowa, Kansas, Oklahoma, South Dakota and Texas). Both groups of comparison states find that the health reform reduced personal bankruptcies by between 0.17 to 0.60 bankruptcies per 1000 residents.

The 2005 reform also restricted Chapter 7 bankruptcy using a "means test" based on state median income. Although I control for state median income, the bankruptcy law may have altered the trend in states differently based on their median income. To control for this potential effect, I estimate models 2 and 3 but limit the sample to only states with median incomes similar to that in Massachusetts at the time of the bankruptcy reform. Table REF presents the results. Median income in Massachusetts in 2005 was $48,775 for an individual. In Columns 1-4 I include only states with 2005 median income closest to Massachusetts - Maryland (median income for the individual of $48,205) and Hawaii ($47,056). Columns 5-8 extend the comparison group to include Alaska ($45,191), Virginia ($43,195), Washington ($43,891), Illinois ($43,012), California ($43,436) and New Hampshire ($52,120). Results are similar as those using all states as a comparison group, and similar exemption states as a comparison group.

Finally, Table 8 presents estimates of models (3) and (2) using only other states in the Northeast census region as controls. Specifically, I include New York, Pennsylvania, New Jersey, Connecticut, Rhode Island, Vermont, New Hampshire and Maine, resulting in 868 county-year observations. Limiting the sample to states within the same region is preferable if region-specific economic shocks affect bankruptcy.

My main findings are not affected by the use of an alternative control group; in fact, the magnitude of the effect is even larger when I only use states in the same region of Massachusetts. Using both the triple difference estimate and the "continuous treatment intensity" estimate, I find reductions in the personal bankruptcy rate that are significant at the 0.01 level. I find similar results when I include controls for county characteristics.

5.2 Concurrent Macroeconomic Improvement

Results estimated with the difference-in-difference-in-difference model in equation (3) are robust to Massachusetts-specific shocks to the personal bankruptcy rate as well as shocks to "treated" counties, but they would not be robust to shocks that only occur in counties with high uninsurance rates within Massachusetts (for example, an increase in local demand for employment). To investigate whether the decline in the personal bankruptcy rate in these counties could reflect a concurrent improvement in the economic climate, rather than the health care reform, I estimate equation (3) again twice: with the the county-level business bankruptcy rate as the dependent variable as in Gross and Notowidigdo (2010) and with the county-level unemployment rate. Table 9 presents the results. In both instances, I do not find a statistically significant improvement in either economic indicator in Massachusetts counties relative to similar counties in other states, suggesting that my findings are not driven by coinciding improving economic conditions.

I also examine whether the results from the model that includes a continuous measure of the impact of reform are driven by an economic improvement in Massachusetts over this period that is correlated with the 2006 uninsurance rate. Again, I use the unemployment rate and the business bankruptcy rate as the dependent variable in the model described by equation (2). I do not find a concurrent improvement in these economic indicators associated with the pre-reform uninsurance rate; in fact, the unemployment rate increases slightly with the pre-reform uninsurance level, although the change is not statistically significant. This result supports the hypothesis that the health reform *caused* a reduction in the personal bankruptcy rate in these counties, and is not merely *correlated* with a reduction in the personal bankruptcy rate.

5.3 Effects of the Recession

The turbulent economic conditions in 2008-2009 may have caused changes to the local economy that corresponded with the reform both in terms of timing and intensity. Although I have shown that business bankruptcies per capita and the unemployment rate are not correlated with the reform, due to the severity of the recession, the concern exists that some other, unobservable measure of economic activity is driving the relationship between the 2006 health care reform and the decline in the personal bankruptcy rate.

To limit the impact of the 2007-2009 recession on these results, I drop the years 2008 and 2009 from the sample and estimate a model where only 2007 is included in the "post-reform" period. [4] I estimate both the model with a binary third difference (treated counties vs untreated counties; equation (3)) and the model with a continuous third difference (pre-reform uninsurance rate; equation (2)).

Table 11 presents the results. All previous results hold when I only use 2007 as the post-reform period, although in the triple difference model, the precision is slightly lower and the results are only significant at the 0.10 level. This imprecision likely reflects the reduction in sample size. The estimated magnitudes are nearly identical: in the estimates which use only 2007 as the "post" period, the reform is estimated to reduce bankruptcies by about 26% relative to other counties with similar characteristics, compared to a 20% estimated reduction when 2008 and 2009 are included in the estimation.

6 Conclusion

This paper provides the first estimates of the effect of an individual mandate for health insurance on personal bankruptcy rates. In 2006, Massachusetts undertook a major health care reform whose goal was to achieve universal insurance coverage within the state. I use the variation generated by pre-reform conditions at the county level to identify the impact of this reform on the bankruptcy rate.

I find that the Massachusetts health care reform reduced personal bankruptcy rates by approximately 20% in the most-affected counties relative to other counties with similar characteristics, a reduction of about 0.41 bankruptcies per 1000 residents. The estimated effect grows with the county's exposure to the reform as measured by its pre-reform uninsurance

[4] The National Bureau of Economic Research business cycle dating committee puts the beginning of the recession at December 2007.

rates, with the largest reduction in bankruptcy rates estimated in counties that were most intensively affected by the reform. The findings are robust to alternative control states and model specifications. I found no concurrent improvement for the business bankruptcy rate or the unemployment rate. This supports the causal interpretation that the increase in health insurance coverage induced by the Massachusetts reform reduced personal bankruptcy rates.

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Figure 1: Percentage Uninsured in Massachusetts and the United States, 1999-2008

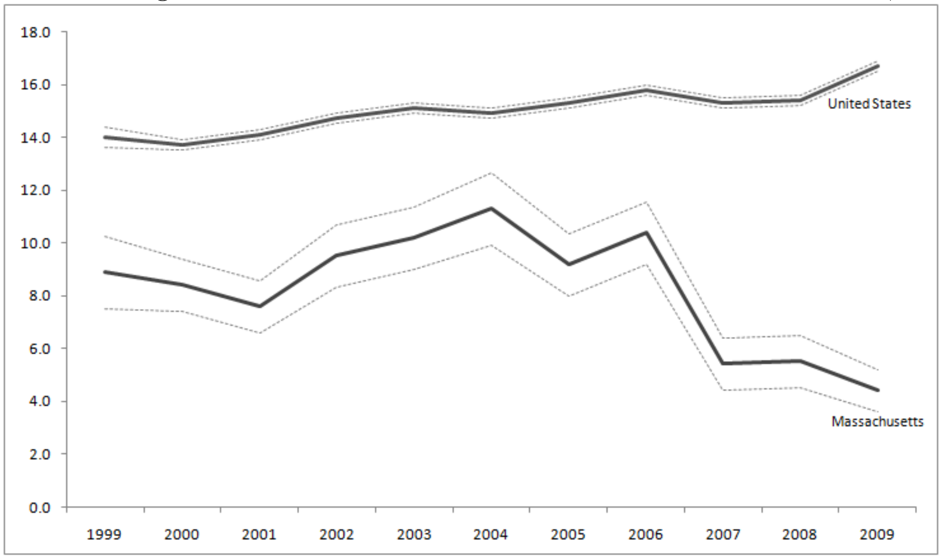
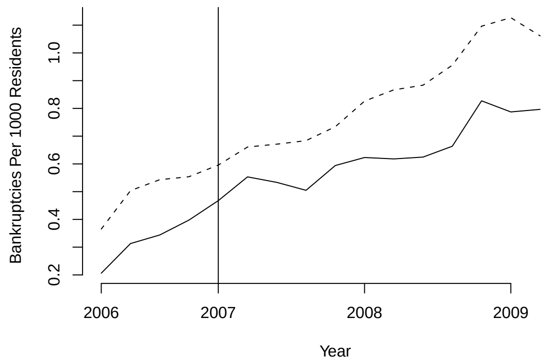
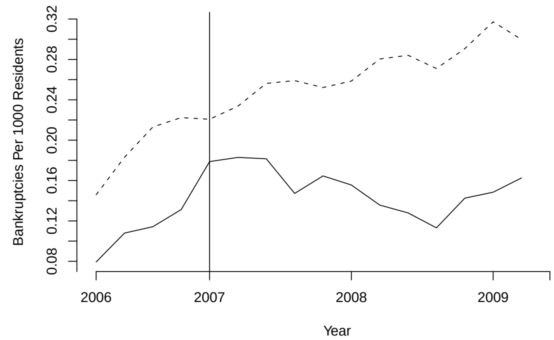


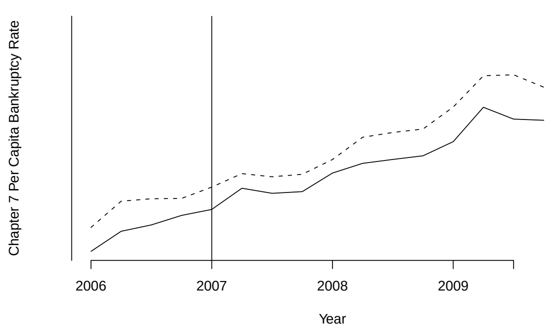
Figure 2: Bankruptcy Rates and Unemployment Rate by Quarter, for Massachusetts (solid) vs. Average for Other States (dashed)



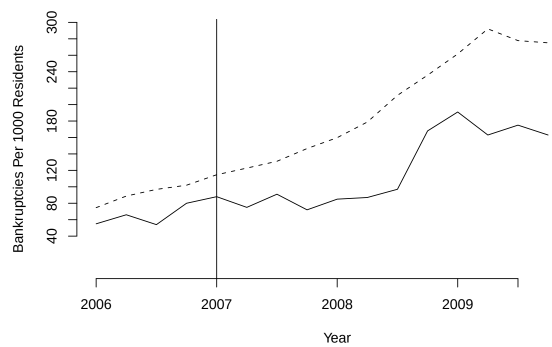
All Personal Bankruptcies per 1000 Residents



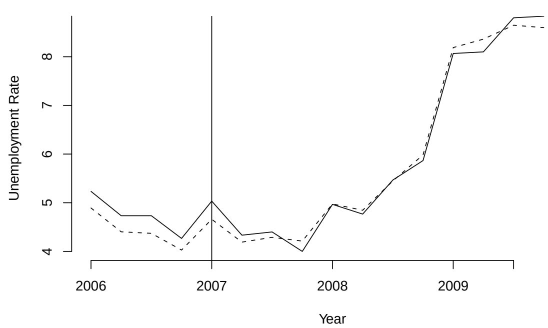
Chapter 13 Personal Bankruptcies per 1000 Residents



Chapter 7 Bankruptcies per 1000 Residents



Business Bankruptcies per 1000 Residents



Unemployment Rate

Figure 3: Percent Uninsured by County in Massachusetts, 2006

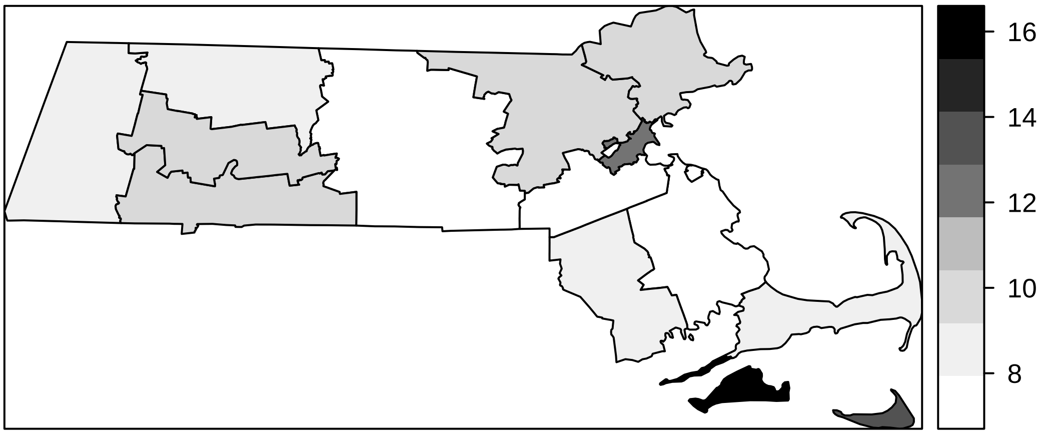


Table 1: Descriptive Statistics : Mean (Std. Error)

	Counties in Massachusetts		Other U.S. Counties	
	2006	2007-2009	2006	2007-2009
# of Personal Bankruptcies	581.4 (123.3)	1182.0 (150.2)	186.8 (10.2)	357.3 (13.4)
# of Personal Bankruptcies per 1000 Residents	1.2 (0.1)	2.4 (0.1)	2.0 (0.02)	3.9 (0.02)
# of Business Bankruptcies	17.21 (4.9)	34.1 (5.2)	6.0 (0.4)	13.8 (0.6)
# of Business Bankruptcies per 1000 Residents	0.04 (0.01)	0.07 (0.01)	0.06 (0.001)	0.13 (0.002)
Unemployment Rate*	4.6 (0.3)	5.9 (0.3)	4.9 (0.03)	6.6 (0.03)
Percent Uninsured 2006	10.1 (0.7)	–	18.3 (0.1)	–
Median Income 2006 (In $1000s)	56.42 (2.4)	–	40.6 (0.2)	–
Poverty Rate 2006	9.9 (1.0)	–	15.4 (0.1)	–

Number of Obs: 12548

*Counties in Louisiana excluded; Number of Obs: 12292

Table 2: Difference in Difference Estimates: State Level

Dependent Variable:	Personal Bankruptcies Per Capita		Chapter 7 Bankruptcies Per Capita		Chapter 13 Bankruptcies Per Capita	
(Intercept)	0.53 (0.04)***	1.28 (0.61)	0.33 (0.01)***	1.34 (0.32)***	0.21 (0.03)***	-0.06 (0.36)
Post	0.36 (0.03)***	0.19 (0.02)***	0.28 (0.02)***	0.15 (0.01)***	0.08 (0.01)***	0.04 (0.01)***
MA	-0.18 (0.03)***	-0.07 (0.06)	-0.10 (0.01)***	-0.06 (0.03)**	-0.08 (0.02)***	-0.01 (0.04)
Post*MA	**-0.04 (0.03)**	**-0.01 (0.02)**	**-0.01 (0.02)**	**0.01 (0.02)**	**-0.03 (0.01)*** **	**-0.02 (0.01)*** **
Quarter Fixed Effects?	Yes	Yes	Yes	Yes	Yes	Yes
Controls?*	No	Yes	No	Yes	No	Yes
No. obs:	816	816	816	816	816	816

Standard Errors Clustered by State; Significance Levels: *** = 1%, ** = 5%, *=10%.

*Controls included are: 2006 poverty rate, 2006 median income in $1000s, unemployment rate.

Table 3: Continuous "Treatment Intensity" Measure Estimates

Dependent Variable:	All Personal Bankruptcies Per Capita		Chapter 7 Bankruptcies Per Capita		Chapter 13 Bankruptcies Per Capita	
(Intercept)	2.93 (0.06)***	4.04 (0.35)***	1.91 (0.04)***	2.87 (0.21)***	1.03 (0.05)***	-0.83 (0.17)***
Post	2.16 (0.05)***	1.50 (0.05)***	1.80 (0.04)***	1.31 (0.04)***	0.37 (0.02)***	0.18 (0.02)***
MA	-0.81 (0.41)*	-0.84 (0.31)***	-0.51 (0.25)**	-0.54 (0.22)**	-0.30 (0.19)	-0.58 (0.29)**
% Uninsured 2006	-0.05 (0.00)***	-0.06 (0.00)***	-0.04 (0.00)***	-0.01 (0.00)***	-0.01 (0.00)***	-0.02 (0.00)***
Post*MA	0.18 (0.38)	0.37 (0.34)	0.31 (0.31)	0.45 (0.30)	-0.10 (0.14)	-0.06 (0.13)
Post* % Uninsured 2006	-0.05 (0.00)***	-0.04 (0.00)***	-0.05 (0.00)***	-0.04 (0.00)***	-0.00 (0.00)***	-0.00 (0.00)***
% Uninsured 2006*MA	-0.04 (0.04)	0.03 (0.03)	-0.02 (0.02)	-0.02 (0.02)	-0.02 (0.02)	0.01 (0.02)
Post*MA* % Uninsured 2006	**-0.06 (0.03)****	**-0.06 (0.03)****	**-0.06 (0.02)****	**-0.06 (0.02)*****	**-0.01 (0.01)**	**-0.01 (0.01)**
Controls?*	No	Yes	No	Yes	No	Yes
No. obs:	12548	12292	12548	12292	12548	12292

Standard Errors Clustered by County; Significance Levels: *** = 1%, ** = 5%, *=10%

*Controls included are: 2006 poverty rate, 2006 median county income in $1000s, state median income used for Chapter 7 "means test" for 2006 bankruptcies, unemp

Counties in Louisiana excluded from specifications with controls.

Table 4: Triple Difference Estimates

Dependent Variable:	All Personal Bankruptcies Per Capita		Chapter 7 Bankruptcies Per Capita		Chapter 13 Bankruptcies Per Capita	
(Intercept)	1.64 (0.06)***	1.65 (0.34)	1.27 (0.04)***	1.67 (0.15)***	0.38 (0.03)***	-1.86 (0.22)***
Post	1.42 (0.05)	0.91 (0.05)***	1.27 (0.05)***	0.93 (0.04)***	0.15 (0.01)	-0.02 (0.02)
MA	-0.35 (0.12)***	-0.14 (0.12)	-0.41 (0.07)***	-0.46 (0.07)***	0.06 (0.07)	0.25 (0.08)***
Treated	0.35 (0.06)***	0.38 (0.06)***	-0.09 (0.04)**	0.17 (0.04)***	0.44 (0.04)***	0.22 (0.04)***
Post*MA	-0.08 (0.13)	-0.01 (0.12)	-0.09 (0.11)	-0.05 (0.11)	0.02 (0.04)	0.04 (0.04)
Post*Treated	-0.20 (0.06)***	-0.22 (0.05)***	-0.36 (0.05)***	-0.35 (0.04)***	0.15 (0.02)***	0.14 (0.02)***
Treated*MA	-0.86 (0.24)***	-0.42 (0.19)**	-0.27 (0.14)*	-0.22 (0.19)	-0.58 (0.11)***	-0.21 (0.15)
Post*MA*Treated	**-0.41 (0.19)****	**-0.33 (0.15)****	**-0.24 (0.14)***	**-0.20 (0.12)**	**-0.19 (0.07)*****	**-0.15 (0.05)*****
Controls?*	No	Yes	No	Yes	No	Yes
No. obs:	12548	12292	12548	12292	12548	12292

Standard Errors Clustered by State; Significance Levels: *** = 1%, ** = 5%, *=10%

*Controls included are: 2006 poverty rate, 2006 median county income in $1000s, state median income used for Chapter 7 "means test" for 2006 bankruptcie

Counties in Louisiana excluded from specifications with controls.

Table 5: Within Massachusetts Estimates

	Continuous Treatment		Triple Difference	
(Intercept)	2.13 (0.41)***	1.18 (1.20)	1.34 (0.10)***	-0.10 (0.53)
Post	2.34 (0.38)***	1.73 (0.32)***	1.38 (0.13)***	0.90 (0.11)***
% Uninsured 2006	-0.09 (0.04)**	-0.03 (0.02)*	–	–
Post*% Uninsured 2006	-0.11 (0.03)***	-0.10 (0.02)***	–	–
Treated	–	–	-0.54 (0.19)***	-0.16 (0.10)*
Post*Treated	–	–	-0.59 (0.17)***	-0.52 (0.14)***
Controls?*	No	Yes	No	Yes
No. obs:	56	56	56	56

Standard Errors Clustered by County; Significance Levels: *** = 1%, ** = 5%, *=10%.

*Controls included are: 2006 poverty rate, 2006 median county income in $1000s, state median income used for Chapter 7 “means test” for 2006 bankruptcies, unemployment rate.

Table 6: Dependent Variable: Per Capita Personal Bankruptcies

Comparison States:	NE, RI, MN				NE, RI, MN, AR, DC, FL, IA, KS, OK, SD, TX			
(Intercept)	1.55 (0.15)***	15.57 (6.07)**	1.36 (0.07)***	6.28 (3.64)*	2.26 (0.10)***	8.45 (0.85)***	1.56 (0.08)***	7.03 (0.86)***
Post	1.06 (0.27)***	0.41 (0.27)	1.46 (0.09)***	0.73 (0.09)***	1.26 (0.07)***	0.96 (0.07)***	1.09 (0.08)***	0.78 (0.08)***
MA	0.58 (0.43)	1.26 (0.76)*	-0.06 (0.13)	0.87 (0.59)	-0.14 (0.42)	1.35 (0.41)***	-0.27 (0.13)**	1.44 (0.29)***
Post*MA	1.28 (0.47)***	1.26 (0.41)***	-0.12 (0.15)	0.07 (0.13)	1.08 (0.38)***	0.88 (0.34)***	0.25 (0.15)*	0.15 (0.14)
% Uninsured 2006	-0.03 (0.01)**	-0.10 (0.03)***	–	–	-0.04 (0.003)***	-0.04 (0.00)***	–	–
Post*% Uninsured 2006	0.03 (0.03)	0.03 (0.02)	–	–	-0.03 (0.00)***	-0.02 (0.00)***	–	–
% Uninsured 2006*MA	-0.07 (0.04)	0.10 (0.04)**	–	–	-0.05 (0.04)	0.02 (0.03)	–	–
Post*MA*%Uninsured 2006	-0.15 (0.04)***	-0.12 (0.03)***	–	–	-0.09 (0.03)***	-0.08 (0.03)***	–	–
Treated	–	–	-0.23 (0.10)**	-0.36 (0.15)**	–	–	-0.22 (0.09)**	-0.12 (0.09)
Post*Treated	–	–	0.01 (0.18)	-0.04 (0.15)	–	–	-0.42 (0.08)***	-0.38 (0.08)***
Treated*MA	–	–	-0.29 (0.25)	0.45 (0.25)*	–	–	-0.29 (0.25)	0.07 (0.27)
Post*MA*Treated	–	–	-0.62 (0.26)***	-0.50 (0.20)**	–	–	-0.19 (0.20)	-0.17 (0.17)
Controls?*	No	Yes	No	Yes	No	Yes	No	Yes
No. obs:	492	492	492	492	3032	3032	3032	3032

Standard Errors Clustered by State; Significance Levels: *** = 1%, ** = 5%, *=10%

*Controls included are: 2006 poverty rate, 2006 median county income in $1000s, state median income used for Chapter 7 "means test" for 2006 bankruptcies, unemployment rate.

Table 7: Dependent Variable: Per Capita Personal Bankruptcies

Comparison States:		MD, HI				MD, HI, AK, VA, WA, CA, NH		
(Intercept)	0.64 (0.39)	-39.34 (13.72)***	0.83 (0.00)***	-34.65 (11.64)***	3.23 (0.19)***	11.23 (1.30)***	2.24 (0.50)***	10.85 (1.48)***
Post	1.59 (0.61)**	0.73 (0.66)	0.66 (0.00)***	0.05 (0.04)	2.11 (0.19)***	1.70 (0.20)***	1.44 (0.35)***	1.12 (0.38)***
MA	1.48 (0.57)***	-1.51 (0.96)	0.47 (0.10)***	-1.64 (0.42)***	-1.11 (0.45)**	-0.82 (0.40)**	-0.94 (0.51)*	-0.65 (0.50)
Post*MA	0.75 (0.72)	0.90 (0.75)	0.68 (0.12)	0.74 (0.11)***	0.23 (0.42)	0.33 (0.39)	-0.10 (0.37)	-0.03 (0.40)
% Uninsured 2006	0.05 (0.03)*	-0.04 (0.05)	–	–	-0.09 (0.01)***	-0.10 (0.01)***	–	–
Post*% Uninsured 2006	0.00 (0.04)	0.02 (0.04)	–	–	-0.04 (0.01)***	-0.03 (0.01)***	–	–
% Uninsured 2006*MA	-0.14 (0.05)***	0.03 (0.05)	–	–	-0.00 (0.04)	0.04 (0.04)	–	–
Post*MA*%Uninsured 2006	-0.11 (0.05)	-0.11 (0.05) **	–	–	-0.07 (0.03)**	-0.07 (0.03)**	–	–
Treated	–	–	0.53 (0.10)***	-0.75 (0.25)***	–	–	-0.52 (0.50)	-0.82 (0.49)*
Post*Treated	–	–	1.00 (0.10)***	0.98 (0.12)***	–	–	0.04 (0.35)	0.01 (0.38)
Treated*MA	–	–	-1.04 (0.25)***	0.76 (0.27)***	–	–	0.01 (0.55)	0.58 (0.61)
Post*MA*Treated	–	–	-1.61 (0.21)***	-1.51 (0.18)***	–	–	-0.65 (0.40)	-0.60 (0.41)
Controls?*	No	Yes	No	Yes	No	Yes	No	Yes
No. obs:	168	168	168	168	1636	1636	1636	1636

Standard Errors Clustered by State; Significance Levels: *** = 1%, ** = 5%, *=10%.

*Controls included are: 2006 poverty rate, 2006 median county income in $1000s, state median income used for Chapter 7 “means test” for 2006 bankruptcies, unemployment rate.

Table 8: Robustness Checks: Alternative Treatment Groups
Dependent Variable - Personal Bankruptcy Rate Per 1000 Residents

	States: NY, PA, NJ, VT, RI, NH, CT, ME			
	Triple Difference		Continuous Treatment	
(Intercept)	1.71 (0.18)***	2.00 (0.47)***	1.45 (0.21)***	1.80 (0.53)***
Post	1.06 (0.17)***	0.67 (0.15)***	1.10 (0.09)***	0.76 (0.09)***
MA	0.41 (0.45)	0.14 (0.30)	-0.15 (0.24)	-0.16 (0.21)
Post*MA	1.28 (0.41)***	1.28 (0.38)***	0.29 (0.40)*	-0.70 (0.40)*
% Uninsured 2006	-0.00 (0.01)	0.00 (0.01)	–	–
Post*% Uninsured 2006	-0.00 (0.01)	0.00 (0.01)	–	–
% Uninsured 2006*MA	-0.09 (0.04)**	-0.06 (0.03)**	–	–
Post*MA*%Uninsured 2006	**-0.11 (0.03)*** **	**-0.10 (0.03)*** **	–	–
Treated	–	–	0.28 (0.22)	0.27 (0.20)***
Post*Treated	–	–	-0.03 (0.10)	-0.07 (0.10)
Treated*MA	—	–	-0.79 (0.22)**	-0.52 (0.27)*
Post*MA*Treated	–	–	**-0.58 (0.21)*** **	**-0.49 (0.18)*** **
Controls?*	No	Yes	No	Yes
No. obs:	868	868	868	868

Standard Errors Clustered by County; Significance Levels: *** = 1%, ** = 5%, *=10%
*Controls included are: 2006 poverty rate, 2006 median county income in $1000s, state median income used for Chapter 7 “means test” for 2006 bankruptcies, unemployment rate.

Table 9: Robustness Checks - Concurrent Macroeconomic Improvement, Triple Difference

Dependent Variable:	Unemployment Rate		Business Bankruptcies per Capita	
(Intercept)	4.62 (0.09)***	1.71 (0.34)	0.07 (0.00)***	0.01 (0.02)
Post	1.58 (0.06)***	1.58 (0.06)***	0.04 (0.01)***	0.04 (0.01)***
MA	0.15 (0.23)	0.12 (0.21)	-0.04 (0.01)***	-0.05 (0.01)***
Treated	0.31 (0.09)***	-0.39 (0.09)***	-0.01 (0.00)	0.01 (0.00)*
Post*MA	-0.20 (0.09)**	-0.20 (0.09)**	0.00 (0.01)	0.00 (0.01)
Post*Treated	0.05 (0.06)	0.06 (0.06)	0.01 (0.01)	0.01 (0.01)
Treated*MA	-1.35 (0.68)**	-0.82 (0.47)*	0.06 (0.05)	0.06 (0.05)
Post*MA*Treated	**-0.24 (0.28)**	**-0.24 (0.28)**	**-0.07 (0.06)**	**-0.07 (0.06)**
Controls?*	No	Yes	No	Yes
No. obs:	12292	12292	12292	12292

Standard Errors Clustered by State; Significance Levels: *** = 1%, ** = 5%, *=10%.
*Controls included are: 2006 poverty rate, 2006 median county income in $1000s, state median income used for Chapter 7 “means test” for 2006 bankruptcies, unemployment rate.
Counties in Louisiana excluded from specifications with controls.

Table 10: Robustness Checks - Concurrent Macroeconomic Improvement, Continuous "Treatment Intensity" Measure

Dependent Variable:	Unemployment Rate		Business Bankruptcies per Capita	
(Intercept)	5.4 (0.09)***	0.92 (0.48)*	0.05 (0.01)***	-0.02 (0.02)
Post	2.47 (0.06)***	2.47 (0.06)***	0.05 (0.01)*	0.03 (0.01)***
MA	1.00 (0.91)	0.83 (0.88)	-0.12 (0.07)*	-0.14 (0.07)**
% Uninsured 2006	-0.03 (0.00)***	-0.07 (0.00)***	0.00 (0.00)***	0.00 (0.00)***
Post*MA	-0.70 (0.40)*	-0.70 (0.40)*	0.11 (0.09)	0.12 (0.08)
Post*% Uninsured 2006	-0.05 (0.00)***	-0.05 (0.00)***	0.00 (0.00)	0.00 (0.00)
% Uninsured 2006*MA	-0.16 (0.09)*	-0.14 (0.09)	0.01 (0.01)	0.01 (0.01)
Post*MA*% Uninsured 2006	**0.003 (0.04)**	**0.003 (0.04)**	**-0.01 (0.01)**	**-0.01 (0.01)**
Controls?*	No	Yes	No	Yes
No. obs:	12292	12292	12292	12292

Standard Errors Clustered by County; Significance Levels: *** = 1%, ** = 5%, *=10%.
*Controls included are: 2006 poverty rate, 2006 median county income in $1000s, state median income used for Chapter 7 "means test" for 2006 bankruptcies.
Excludes Louisiana counties.

Table 11: Robustness Checks: “Post Reform” Period, 2007 Only
Dependent Variable - Personal Bankruptcy Rate Per 1000 Residents

4	Triple Difference		Continuous Treatment	
(Intercept)	1.64 (0.06)***	1.98 (0.30)***	2.93 (0.06)***	4.56 (0.31)***
Post	0.71 (0.04)***	0.67 (0.04)***	1.12 (0.04)***	1.09 (0.04)***
MA	-0.34 (0.12)***	-0.08 (0.11)	-0.81 (0.41)**	-0.59 (0.36)
Post*MA	0.09 (0.09)	0.19 (0.09)**	0.70 (0.38)*	0.76 (0.37)
Treated	0.35 (0.06)***	0.26 (0.06)***	–	–
Post*Treated	-0.12 (0.04)***	-0.46 (0.17)***	–	–
Treated*MA	-0.86 (0.24)***	-0.46 (0.17)***	—	–
Post*MA*Treated	**-0.45 (0.28)**	**-0.50 (0.27)***	–	–
% Uninsured 2006	–	–	-0.05 (0.00)***	-0.07 (0.00)***
Post*% Uninsured 2006	–	–	-0.03 (0.00)***	-0.03 (0.00)***
% Uninsured 2006*MA	–	–	-0.04 (0.04)	0.01 (0.04)
Post*MA*%Uninsured 2006	–	–	**-0.09 (0.04)****	**-0.09 (0.04)****
Controls?*	No	Yes	No	Yes
No. obs:	868	868	868	868

Standard Errors Clustered by County; Significance Levels: *** = 1%, ** = 5%, *=10%
*Controls included are: 2006 poverty rate, 2006 median county income in $1000s, state median income used for Chapter 7 “means test” for 2006, unemployment rate

MEDICAL BANKRUPTCY REFORM: A FALLACY OF COMPOSITION

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ABSTRACT

Congress is considering adding special provisions to the Bankruptcy Code for individuals with medical debt. The pending legislation creates preferential rules for "medical bankruptcies." The reform is based on a premise that most consumer bankruptcies are caused by medical debt, so that most consumer bankruptcy cases are "medical bankruptcies." The authors analyze this premise and show that, although many debtors have some medical debt, most debtors with medical debt are not "medical bankruptcies." The premise of the pending legislation is shown to be nothing more than a classic case of a "fallacy of composition" and the reform will likely lead to abuse of the relief afforded under the Bankruptcy Code.

INTRODUCTION

Rhetoric is powerful. It is particularly powerful in debates that invoke emotion and anger, and raise serious moral questions. Policymakers often latch on to facts asserted in a policy domain, whether true or not, and characterize them in ways—through an effective use of rhetoric—to propel certain initiatives onto the agenda. This is the case in the healthcare and bankruptcy policy domains. Policymakers in both domains use data from their respective fields to advance reforms in the other domain,[1] often couching their arguments in terms of clear empirical causal connections.[2] The debates often turn into bipolar debates that pit consumer-oriented

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[1] Senator Max Baucus working on a healthcare bill used bankruptcy filing rates to support healthcare reform. He stated, "And, you know, one—if the coverage is at least 65 percent it's going to probably reduce the incidence of bankruptcies." *Sen. Max Baucus Holds a Markup on Health Care Reform*, CQ CAP. TRANSCRIPTS, Sept. 29, 2009, *available at* 2009 WLNR 19277273.

[2] In the bankruptcy policy domain, there has been great progress in empirical research over the last twenty years. *See* Jay Warren Westbrook, *Empirical Research in Consumer* Bankruptcy, 80 TEX. L. REV. 2123, 2124 (2002). The problem lies not in the empirical research done, but in the interpretation of such work and the implementation of sound policies based on that work. As with many areas of empirical research and the law, results are often mixed. Advocates on either side of a debate often point to empirical work to support their conclusion without critically examining the results. Couching the problem and solution as crystal clear based on empirical work leads to distortions of the empirical results found, and can often lead to policies that are misguided. This has occurred in both the healthcare and bankruptcy policy domains.

advocates and business-oriented groups against each other, with each casting blame on the other.[3]

For example, in the context of the healthcare reform debate, consumer bankruptcy reform was a sub-issue. In the 2009 State of the Union address, Barack Obama said, "we must also address the crushing cost of health care. This is a cost that now causes a bankruptcy in America every thirty seconds."[4] The President took the rhetoric a step further when he said, "The crushing costs of health care causes [sic] a bankruptcy in America every 30 seconds. And by the end of this year, it could cause 1.5 million Americans to lose their homes."[5] This assertion that healthcare costs are *the* cause of consumer bankruptcy has been repeated over and over again, to such an extent that it is accepted as fact without any qualification or context placed on the assertion.[6]

The connection between healthcare costs and consumer bankruptcy has been used as a justification for several bills pending in Congress that relax the requirements in the Bankruptcy Code for debtors with medical debts, *i.e.*, "medical bankruptcy." The problem is that the underlying justification—a clear causal connection between medical debts or healthcare costs and most consumer bankruptcy filings—is not as strong as the political rhetoric proclaims. Medical

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[3] For example, Professor Katherine Porter recognized in the consumer bankruptcy debate that "consumer advocates lay blame on the industry, and the industry responds by citing the same data to show consumer misbehavior." Katherine Porter, *Bankrupt Profits: The Credit Industry's Business Model for Postbankruptcy Lending*, 93 IOWA L. REV. 1369, 1369 (2008).

[4] President Barack Obama, State of the Union Address (Feb. 24, 2009), *available at* http://www.whitehouse.gov/the-press-office/remarks-president-barack-obama-address-joint-session-congress.

[5] *White House Spotlights Health Care*, NPR News (Mar. 3, 2009), *available at* http://www.npr.org/templates/story/story.php?storyId=101368678. The Obama Administration repeatedly has relied on this connection. *See, e.g.*, President Barack Obama, Remarks at the White House Forum on Health Reform (Mar. 5, 2009), *available at* http://www.whitehouse.gov/assets/documents/White_House_Forum_on_Health_Reform_Report.pdf.

Many other politicians have asserted the same proposition. Senator Ted Kennedy wrote, "Every 30 seconds in the United States a family is forced into bankruptcy because of unexpected medical expenses." Senator Edward M. Kennedy, *Health Care as a Basic Human Right: Moving from Lip Service to Reality*, 22 HARV. HUM. RTS. J., 165, 166 (2009).

A countless number of scholars have asserted the same connection. *See, e.g.*, David U. Himmelstein, et al., *Medical Bankruptcy in the United States, 2007: Results of a National Study*, 122 AM. J. MED. 741, 741 ("62.1% of all bankruptcies in 2007 were medical"); Melissa B. Jacoby, Teresa A. Sullivan & Elizabeth Warren, *Rethinking the Debates over Health Care Financing: Evidence from the Bankruptcy Courts*, 76 N.Y.U. L. REV. 375, 408–09 (indicating increased correlation between medical and financial distress); Katherine L. Record, Note, *Wielding the Wand Without Facing the Music: Allowing Utilization Review Physicians to Trump Doctors' Orders, But Protecting Them from the Legal Risk Ordinarily Attached to the Medical Degree*, 59 DUKE L.J. 955, 964 (2010) ("Without drastic reductions in health care spending, an unprecedented number of Americans will face bankruptcy merely by seeking necessary treatment.").

[6] Even our own members of Congress assume the clear linkage exists without any question. Senator Max Baucus stated, "I saw figures someplace, every 30 seconds, someone in America goes into bankruptcy due to medical care costs or at least it's medical cost related." *Sen. Max Baucus Holds a Markup on Health Care Reform*, *supra* note 1. Congressman Phil Hare touted the same conclusions on *The Ed Show* recently. Congressman Hare stated, "I care about the price that the people are paying when they lose their home every 30 seconds because of health care. Every 30 seconds in this country, Ed, a bankruptcy." *The Ed Show* (MSNBC News, Jan. 26, 2010), *available at* 2010 WLNR 1682152.

debt does not necessarily lead to bankruptcy. But rather, "[m]edical bankruptcy is at the extreme end of the spectrum of medical debt."[7] Nor does a debtor with medical debt necessarily warrant characterizing it as a medical bankruptcy. Simply because some debtors with medical debt may justifiably be characterized as a medical bankruptcy, it does not mean all debtors with medical debt are medical bankruptcies—a classic case of the "fallacy of composition."[8]

The result is a legislative agenda in the bankruptcy policy domain that does not address the root causes of consumer filings. The medical bankruptcy reform proposed is a relaxation of the requirements for debtors with medical debt to file for bankruptcy relief. Assuming medical debts are the cause of the majority of consumer bankruptcies, the reform does not address the root cause of unpaid medical debt. Likewise, even if medical debt is not the root causal factor, but rather a factor among many others such as divorce and unemployment,[9] of consumer bankruptcy filings, medical bankruptcy reform does nothing to mitigate the incidence of consumer filings.

Following this Introduction is an overview of the current state of consumer bankruptcy in the U.S. and a summary of the medical bankruptcy reform legislation. Part II explores the empirical research on medical bankruptcies, the causal connection between medical debts and consumer bankruptcies, and the validity of that linkage based on empirical research in the field. The recent healthcare reform and its impact on medical bankruptcies, and the adequacy of the current consumer bankruptcy system are also examined. The problems that will likely arise with medical bankruptcy reform are explored in Part III. Part IV provides conclusions and identifies areas of needed research.

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[7] Robert W. Seifert & Mark Rukavina, *Bankruptcy is the Tip of a Medical-Debt Iceberg*, 25 HEALTH AFF. W89, W89 (2006), *available at* http://content.healthaffairs.org/cgi/content/full/25/2/w89.

[8] The fallacy of composition assumes "without proper warrant that what is true for individual members of a group is true for the entire group." Philip Harvey, *Is There a Progressive Alternative to Conservative Welfare Reform?*, 15 GEO. J. ON POVERTY L. & POL'Y 157, 170 (2008); *see also* Donald A. Dripps, *The Fourth Amendment and the Fallacy of Composition: Determinacy Versus Legitimacy in a Regime of Bright-Line Rules*, 74 MISS. L.J. 341, 348 (2004) (citations omitted) ("In his *Sophistical Refutations*, Aristotle described what has come to be known as the fallacy of composition, i.e., confusing the distributive and collective senses of a class. He gives several examples. A sitting man can walk, and a walking man can stand; ergo a man can walk and sit at the same time. A man can carry each of several burdens; ergo he can carry all of them at once."); Einer Elhauge, *Defining Better Monopolization Standards*, 56 STAN. L. REV. 253, 339 (2003) (citations omitted) ("The fallacy of composition is the assertion that, if something is true for individual members of a group, then it must be true for the group as a whole.").

[9] The predominant causes of consumer bankruptcy typically are "medical debts, a divorce, or a job interruption." A. Mechele Dickerson, *Consumer Over-Indebtedness: A U.S. Perspective*, 43 TEX. INT'L L. J. 135, 146 (2008) (citation omitted); *see also* Jay L. Zagorsky & Lois R. Lupica, *A Study of Consumers' Post-Discharge Finances: Struggle, Stasis, or Fresh-Start?*, 16 AM. BANKR. INST. L. REV. 283, 295 (2008) (discussing financial distress and debt typically associated with "divorce, sickness-related expenses, [and] job loss"); Jean Braucher, *Middle-Class Knowledge*, 21 EMORY BANKR. DEV. J. 193, 207 (2004) (book review) ("[T]he 'big three' reasons debtors give for filing [bankruptcy petitions] are job loss, illness, and divorce.").

I. OVERVIEW OF CONSUMER BANKRUPTCY AND PROPOSED MEDICAL BANKRUPTCY REFORM

A. Consumer Bankruptcy in the U.S.

Most consumer bankruptcies are under chapter 7 or chapter 13.[10] In most chapter 7 cases, debtors receive a discharge of their debts, provided they liquidate any non-exempt assets.[11] Under chapter 13, a debtor can retain its non-exempt assets in exchange for repaying a portion of its debts, at least as much as would be paid in a chapter 7 case, through a court approved repayment plan.[12] After completion of the plan, most debtors receive a discharge of the remaining unsecured debts.[13]

On October 17, 2005, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA")[14] went into effect.[15] BAPCPA was the most significant overhaul to the Bankruptcy Code[16] ("Code")[17] since its enactment in

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[10] *See* Marjorie L. Girth, *The Role of Empirical Data in Developing Bankruptcy Legislation for Individuals*, 65 IND. L.J. 17, 18 (1989) (discussing how individuals filing bankruptcy petitions face choice of filing under chapters 7 or 13); Richard M. Hynes, *Why (Consumer) Bankruptcy?*, 56 ALA. L. REV. 121, 127 n.32 (2004) ("Chapter 7 accounts for approximately seventy percent of all non-business bankruptcy filings with almost all of the remaining non-business bankruptcies filed in Chapter 13."); *see also Annual Non-Business Bankruptcy Filings by Chapter (2007-09)*, ABIWORLD.ORG, http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=60257 (last visited Jan. 17, 2011) (showing how majority of consumer bankruptcies are filed under chapters 7 or 13). A very small number of consumer bankruptcy cases are filed under chapter 11. *See id.* (highlighting relatively few number of bankruptcy cases filed under chapter 11 annually); *see also* Richard H.W. Maloy, *"She'll Be Able to Keep Her Home Won't She?"—The Plight of a Homeowner in Bankruptcy*, 2003 MICH. ST. L. REV. 315, 335 (2003) (discussing how, although chapter 11 is used mainly by businesses, individuals are also permitted to file under chapter 11); Elijah M. Alper, Note, *Opportunistic Informal Bankruptcy: How BAPCPA May Fail to Make Wealthy Debtors Pay Up*, 107 COLUM. L. REV. 1908, 1913–14 & n.35 (2007) (discussing rarity of chapter 11 filings).

[11] *See* 11 U.S.C. § 727 (2006); Lars Lefgren & Frank McIntyre, *Explaining the Puzzle of Cross-State Differences in Bankruptcy Rates*, 52 J.L. & ECON. 367, 370–71 (2009) (describing chapter 7 bankruptcy procedures).

[12] *See* 11 U.S.C. §§ 1322, 1328; Lefgren & McIntyre, *supra* note 11, at 370–71.

[13] *See* 11 U.S.C. § 1328; Lefgren & McIntyre, *supra* note 11, at 370–71 (discussing when debts are discharged under chapter 13); *see also In re* Patton, 261 B.R. 44, 47–48 n.3 (Bankr. E.D. Wash. 2001) ("Discharge is not entered in Chapter 13 cases until completion of plan payments . . . If the debtors fail to complete the plan payments no discharge will be entered in their cases."); Maloy, *supra* note 10, at 331–32 (discussing discharge in chapter 13 and noting how chapter 13 "discharge is of all debts 'provided for by the plan' after the plan has been completed").

[14] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005) (codified as amended in scattered sections of 11 U.S.C.) [hereinafter BAPCPA].

[15] For a discussion of the history and road to the legislation, see generally Susan Jensen, *A Legislative History of the Bankrutpcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 485 (2005).

[16] *See* Rafael I. Pardo, *An Empirical Examination of Access to Chapter 7 Relief by Pro Se Debtors*, 26 EMORY BANKR. DEV. J. 5, 5 (2009) [hereinafter Pardo, *An Empirical Examination*] ("The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ('BAPCPA') represents the most significant overhaul of federal bankruptcy law since the Bankruptcy Code's enactment in 1978."). *See generally* Dorothy Hubbard Cornwell, *To Catch a KERP: Devising A More Effective Regulation Than § 503(c)*, 25 EMORY BANKR. DEV. J. 485, 486 (2009) (citation omitted) (noting how passage of BAPCPA was one of "the most comprehensive

1978.[18] BAPCPA did not modify the two primary avenues for consumers to seek relief: chapter 7 or chapter 13. However, BAPCPA created procedural hurdles designed to limit the number of chapter 7 filings by driving more individual consumer debtors to chapter 13 through a means test.[19] Prior to BAPCPA, individuals largely chose between chapter 7 or chapter 13 based on the circumstances and legal consequences of the choice. Most consumer filings were under chapter 7, and, in most chapter 7 cases, there was no return to unsecured creditors.[20] Debtors now must qualify for the relief they request.[21] In effect, the system prior to BAPCPA was an income-tax type of system with debtors largely self-reporting, but was transformed into a welfare type system that requires documentation to qualify for the relief requested.[22] The primary tool to steer debtors from chapter 7 to chapter 13 is the statutory means test.[23] The presumption in favor of debtors under the law prior to BAPCPA was eliminated and replaced with "an emphasis on repaying creditors as much as possible."[24] Most view the reform as favoring creditor interests.[25]

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overhauls of the Bankruptcy Code in more than 25 years"); Rafael I. Pardo, *Eliminating the Judicial Function in Consumer Bankruptcy*, 81 AM. BANKR. L.J. 471, 478–79 (2007) [hereinafter Pardo, *Eliminating the Judicial Function*] (highlighting major changes resulting from passage of BAPCPA in 2005).

[17] 11 U.S.C. §§ 101–1527. Unless otherwise noted, all references to the Bankruptcy Code, Code, or section are to title 11 of the United States Code, including amendments made by BAPCPA.

[18] Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978). The Bankruptcy Reform Act of 1978 took effect on October 1, 1979. *See id.* § 402(a), 92 Stat. 2682.

[19] *See* 11 U.S.C. § 707(b); Bud Stephen Tayman, *After BAPCPA: New Challenges for Chapter 13 Filers and their Attorneys*, *in* BEST PRACTICES FOR FILING CHAPTER 13 (2010), *available at* 2010 WL 3934, at *2; *see also* Andrew P. MacArthur, *Pay to Play: The Poor's Problems in the BAPCA*, 25 EMORY BANKR. DEV. J. 407, 419 (2008) (listing procedural requirements); Tally M. Wiener & Nicholas B. Malito, *On the Nature of the Chapter 7 Trustee Fee*, 18 NORTON J. BANKR. L. & PRAC. 211, 211 (2009) (describing effects of new procedures).

[20] *See* Pardo, *An Empirical Examination*, *supra* note 16, at 13 (noting unsecured creditors frequently received nothing simply because debtor filed chapter 7); *see also In re* Dumas, 419 B.R. 704, 707 (Bankr. E.D. Tex. 2009) (describing one goal of BAPCPA is to generate return to unsecured creditors not available under chapter 7); *In re* Krohn, 78 B.R. 829, 833 (Bankr. N.D. Ohio 1987) (noting potential for abuse of chapter 7 in avoiding payment to unsecured creditors).

[21] *See, e.g.*, *In re* Dionne, 402 B.R. 883, 887 (Bankr. E.D. Wis. 2009) (recognizing means test intended to standardize qualification for relief under chapter 7); *see also* Margaret Howard, *Bankruptcy Bondage*, 2009 U. ILL. L. REV. 191, 217 (2009) (describing effect of qualification); MacArthur, *supra* note 19, at 419 (listing procedural requirements).

[22] *See, e.g.*, 11 U.S.C. §§ 109(h)(1), 342(b), 521(a)(1)(B)(iv)–(vi), 521(b), 521(e)(2) (requiring various documentation and describing debtor's duties); *see also* MacArthur, *supra* note 19, at 419 (listing documents); Pardo, *An Empirical Examination*, *supra* note 16, at 14–15 (discussing self-reporting and new procedures).

[23] *See* 11 U.S.C. § 707(b)(2) (enumerating situations where court may force conversion of chapter 7 to chapter 11 or 13); *In re* Carrillo, 421 B.R. 540, 545 (Bankr. D. Ariz. 2009) ("Congress intended the means test as a mechanical formula for determining whether Chapter 7 debtors have the means to repay a portion of their debts and should therefore be required to do so by filing a Chapter 13 in order to obtain a discharge."); *In re* Littman, 370 B.R. 820, 828 (Bankr. D. Idaho 2007) (citing *In re* Mundy, 363 B.R. 407, 413 (Bankr. M.D. Pa. 2007)) (noting means test adopted to identify debtors who could repay debts and "steer them away from chapter 7 into chapter 13").

[24] *In re* Stubblefield, 430 B.R. 639, 645 (Bankr. D. Or. 2010), which wrote as follows:

The means test requires an examination of the chapter 7[26] debtor's monthly income in comparison with the median income in the state they reside.[27] If the debtor's income is higher, then the debtor must complete a detailed analysis of the debtor's expenses to determine if the debtor has sufficient funds to repay creditors.[28] If the debtor has sufficient funds, the case is presumed an abuse.[29] Absent the debtor rebutting the presumption of abuse, the case is due to be dismissed.[30] In effect, the means test "closes the chapter 7 door to individual debtors able to repay a certain amount of consumer debts, and restricts them to a choice between filing chapter 13

> Prior to BAPCPA, there was a presumption "in favor of granting the relief requested by the Debtor." 11 U.S.C. § 707(b) (2004). This presumption could be overcome if the court found that "granting of relief would be a substantial abuse" of Chapter 7. . . . BAPCPA produced a sea change. There is now no presumption favoring Chapter 7 relief, but an emphasis on repaying creditors as much as possible. H.R. REP. No. 109-31, pt.1 at 2 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 89.

Id. (emphasis omitted) (quoting Egebjerg v. Anderson (*In re* Egebjerg), 574 F.3d 1045, 1048 (9th Cir. 2009)).

[25] *See, e.g.*, Porter, *supra* note 3, at 1371 (stating reform of bankruptcy law favored creditors' interests and obtaining consumer bankruptcy relief is now "more expensive, time-consuming, and difficult"); *see also* Arruda v. Sears, Roebuck & Co., 273 B.R. 332, 347 (D.R.I. 2002) (indicating Congress sought to strengthen protection for creditor in Bankruptcy Reform Act of 1978); *In re* Ott, 343 B.R. 264, 266 n.4 (Bankr. D. Colo. 2006) (emphasizing BAPCPA's creditor-friendly language serves to remedy "imbalance in the Code favoring debtors").

[26] The means test is employed in chapter 13 for above-median debtors as well. *See* 11 U.S.C. § 707(b)(2) (listing additional requirements for debtors eligible for chapter 13); 11 U.S.C. § 1325(b)(3)(A) (providing for adjustment of debts of individuals with regular incomes under chapter 13).

[27] *See* Lauren E. Tribble, Note, *Judicial Discretion and the Bankruptcy Abuse Prevention Act*, 57 DUKE L.J. 789, 800–01 (2007) (stating first step of means test is to determine if current monthly income is greater than median income in state in which debtor resides); *see also* 11 U.S.C. § 1325(b)(3)(A) (relying on section 707(b)(2) to calculate amounts reasonably necessary to be expended if debtor's current monthly income, multiplied by twelve, is greater than median family income for one earner); *In re* Louis, No. 07-13019-SSM, 2008 WL 1777461, at *1 (Bankr. E.D. Va. Apr. 16, 2008) (explaining means test applies to consumer debtors whose household income exceeds statewide median for household of same size).

[28] *See* Tribble, *supra* note 27, at 800–01 (discussing mechanics of means test and stating it allows deduction of certain expenses from current monthly income to determine disposable income, which dictates whether or not debtor passes means test); *see also* 11 U.S.C. § 1325(b)(2)(A)(i) (defining "disposable income" and directing debtor to subtract "amounts reasonably necessary to be expended for the maintenance or support of debtor or a dependent of the debtor" from debtor's current monthly income); *In re Louis*, 2008 WL 1777461, at *1 (stating means test computation is current monthly income–average of income, with certain exclusions, received in six months pre-petition–minus specified living expenses).

[29] *See* Tribble, *supra* note 27, at 802 (stressing debtor is presumed to be abusing bankruptcy system if debtor is able to pay creditors); *see also* 11 U.S.C. § 707(b)(2)(A)(i) (stating judges "shall presume abuse exists" if income reduced by expenses and multiplied by sixty is not less than lesser of $6,000 or $10,000).

[30] *See* Tribble, *supra* note 27, at 802 (indicating "judges have no choice but to presume abuse" when debtor fails means test, and stressing difficulty of rebutting presumption); *see also* 11 U.S.C. § 707(b)(2)(B)(i) (stating special circumstances, such as serious medical condition or call to active duty may rebut presumption of abuse); *In re Louis*, 2008 WL 1777461, at *1 (stating, if case is presumed to be abuse of chapter 7, it must be dismissed unless debtor demonstrates special circumstances rebutting presumption or agrees to convert case to chapter 13).

(if they are eligible) and chapter 11,"[31] or addressing the situation outside of bankruptcy law.[32]

B. Medical Bankruptcy Reform

1. Political Environment

Currently, there are bills pending in both the House of Representatives and Senate, the Medical Bankruptcy Fairness Act ("MBFA"),[33] that create a special category of bankruptcy relief for medical debtors. Before discussing the specific proposed statutory reforms, recognizing the political environment and posture of such legislation is useful to appreciating the intent behind the MBFA. The proposition of providing special protections to such debtors is not new. Amendments attempting to provide some of these protections were proffered, but rejected, in the passage of BAPCPA.[34] In the political environment in which BAPCPA was passed, such an amendment could not win sufficient support; however, with the political landscape dramatically different, such legislative efforts will likely receive more support. This, coupled with the incremental nature of policymaking,[35] may make it a bit easier to move such legislation through.

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[31] Howard, *supra* note 21, at 217.

[32] There are a host of non-bankruptcy alternatives to deal with financial problems of an individual; however, the usefulness of each alternative may be very limited depending on the particular situation. For an overview of a wide range of alternatives, see 9 AM JUR. 2D *Bankruptcy* § 33 (2010).

[33] Medical Bankruptcy Fairness Act of 2009, S. 1624, 111th Cong. (2009) [hereinafter MBFA] (proposing title 11 amendment for protection of those whose debt arose from medical expenses).

[34] *See, e.g.*, 109 CONG. REC. S2324–25 (daily ed. Mar. 9, 2005) (statement of Sen. Clinton) (arguing in support of amendments for protection of families facing medical bankruptcy); Jensen, *supra* note 15, at 565–66 (discussing rejected amendments to expand means test safe harbor); Patricia A. Redmond & Jessica D. Gabel, *Summary of Certain Critical Consumer and Exemption Provisions*, *in* BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005, at 40 (A.L.I.-A.B.A. 2005), *available at* Westlaw, SL068 ALI-ABA 25 (noting introduction and rejection of medical bankruptcy exemption).

[35] Most policymaking and legislation is a result of "incrementalism," rather than a "rational comprehensive method." Therefore, creating a special category or rules for one type of debtor is likely more feasible in the context of limited reform effort, as opposed to widespread reform of the bankruptcy system. For a discussion of "incrementalism," a watershed theory in public policy, see Charles E. Lindblom, *The Science of "Muddling Through,"* 19 PUB. ADMIN. REV. 79, 81, 84–85 (1959); Charles E. Lindblom, *Still Muddling, Not Yet Through*, 39 PUB. ADMIN. REV. 517, 517–18 (1979). A commentator succinctly summarized Lindblom's theory as follows:

> In complex areas of policymaking, Lindblom argued, humans are incapable of designing perfect systems because human rationality is inherently limited. Instead of striving to apply a universal theory to the task and hope that first efforts will yield a fully-formed, all-inclusive scheme, Lindblom advises, policy-makers should accept that incremental alterations will be required as the policy is tested, with each test yielding useful information about its utility.

Sharon B. Jacobs, *Crises, Congress, and Cognitive Biases: A Critical Examination of Food and Drug Legislation in the United States*, 64 FOOD & DRUG L.J. 599, 626 (2009).

For further discussion of Lindblom's theory in different areas of the law, see Cary Coglianese & Jocelyn D'Ambrosio, *Policymaking Under Pressure: The Perils of Incremental Responses to Climate*

Even with the more favorable political environment, whether the MBFA will become law is still questionable. The key determinant will be politics. Policy decisions rely in large part, as identified by John W. Kingdon, on the convergence of three separate streams: problem, policy and political.[36] Whether there will be a convergence of the problem, policy and political streams for the MBFA is unknown at this juncture. The way a problem is defined is likely the determinative factor in "the likelihood of any eventual public policy formulation."[37] This is because the problem definition directly leads to the policy stream or solution.[38] The current problem stream, *i.e.*, the definition of the problem,[39] is not very convincing when it is closely scrutinized. The problem is defined by proponents of MBFA like most other problem streams—it is largely based on mainstream views or judgments in society.[40] This was the case with BAPCPA in which the problem was defined as too many consumer bankruptcies.[41] The problem is defined by proponents of MBFA as a high incidence of medical bankruptcy cases in which individuals are not afforded adequate bankruptcy relief.[42] The policy stream—the policy solution—offered by

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Change, 40 CONN. L. REV. 1411, 1411 (2008) (critiquing use of incrementalism in policies affecting climate change); Allen Rostron, *Incrementalism, Comprehensive Rationality, and the Future of Gun Control*, 67 MD. L. REV. 511, 513 (2008) (discussing incrementalism and gun control policies); J.B. Ruhl & James Salzman, *Climate Change, Dead Zones, and Massive Problems in the Adminsitrative State: A Guide for Whittling Away*, 98 CALIF. L. REV. 59, 72 (2010) (discussing role of incrementalism on how agencies address massive problems).

[36] *See, e.g.*, JOHN W. KINGDON, AGENDAS, ALTERNATIVES, AND PUBLIC POLICIES 16–20 (2d ed. 2003). For a concise overview of Kingdon's streams analogy, see Richard S. Whitt, *Adaptive Policymaking: Evolving and Applying Emergent Solutions for U.S. Communications Policy*, 61 FED. COMM. L.J. 483, 506 (2009) (explaining each element of streams analogy); see also William S. Blatt, *Interpretive Communities: The Missing Element in Statutory Interpretation*, 95 NW. U. L. REV. 629, 641 (2001) (discussing Kingdon's stream analogy in governmental decision making).

[37] Nan S. Ellis, *The Class Action Fairness Act of 2005: The Story Behind the Statute*, 35 J. LEGIS. 76, 80 (2009).

[38] This point was recognized by Kingdon, and reiterated recently: "The 'problems' stream includes certain societal conditions that are defined by some as problems in need of a policy solution." Whitt, *supra* note 36, at 506 (citation omitted).

[39] *See* Julie Davies, *Reforming the Tort Reform Agenda*, 25 WASH. U. J.L. & POL'Y 119, 147–58 (2007) (discussing importance of problem definition).

[40] *See, e.g.*, William S. Blatt, *Missing the Mark: An Overlooked Statute Redefines the Debate Over Statutory Construction*, 64 U. MIAMI L. REV. 641, 657 n.119 (2010) (commenting Kingdon's "problem stream" is mainly formed by societal judgments); Blatt, *supra* note 36, at 644 (noting role of general public opinion in problem stream); Robert J. Landry, III, *The Policy and Forces Behind Consumer Bankruptcy Reform: A Classic Battle Over Problem Definition*, 33 U. MEM. L. REV. 509, 526 (2003) [hereinafter Landry, *The Policy and Forces*] (indicating problem definition and solutions are defined to gain public support necessary to complete problem stream).

[41] *See* Landry, *The Policy and Forces*, *supra* note 40, at 518–19 (commenting rise in consumer bankruptcy characterized by credit and lending industry as harmful to all consumers); Porter, *supra* note 3, at 1377 (discussing decade-long effort by creditors to enact bankruptcy reform to respond to rising consumer bankruptcy rate); Press Release, Sen. Chuck Grassley, Opening Statement of Sen. Chuck Grassley at the Bankr. Reform Hearing (Feb. 10, 2005), *available at* http://grassley.senate.gov/news/Article.cfm?customel_dataPageID_1502=9716, (suggesting bankruptcy reform necessary because high level of consumer bankruptcies hurts businesses and society as whole).

[42] 155 CONG. REC. S9,022 (daily ed. Aug. 6, 2009) (statement of Sen. Whitehouse) (introducing legislation providing individuals greater protection from bankruptcy resulting from high medical bills); Press Release,

MBFA is to enhance bankruptcy protections for such debtors.[43] As discussed below, this policy solution is riddled with issues and may not even effectively address the problem definition,[44] assuming it is correct. And, even if the problem and policy streams coincide, there may be enough support—the political stream—to overcome opposition to the MBFA. Absent all three streams coinciding, there will not be a "policy window" for passing the MBFA.[45]

2. Summary of MBFA

The core of the MBFA is a newly defined class of chapter 7 debtor, the "medically distressed debtor."[46] First, an individual who has incurred or paid $10,000 or ten percent of his/her adjusted gross income in medical debt, which has not been paid by a third party, for the debtor or any immediate family member during any consecutive twelve-month period in the three years prior to filing bankruptcy qualifies as a medically distressed debtor.[47] Second, if an individual is a member of a household in which one of the household members lost his/her domestic support obligation income due to a medical problem of the person, and is obligated to pay the support for 4 or more weeks during any consecutive 12-month

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Senator Sheldon Whitehouse, New Legislation Would Help Families Struggling with Medical Debt (Aug. 6, 2009), *available at* http://whitehouse.senate.gov/newsroom/press/release/?id=3f03685e-913e-4c77-a395-e359466f2635 (indicating MBFA of 2009 would afford individuals more protection from bankruptcy resulting from high medical bills); John T. Orcutt, *Medical Bankruptcy Fairness Act of 2009*, N.C. BANKR. BLOG (Nov. 10, 2009, 11:16 AM), http://www.billsbills.com/bankruptcy-blog/medical-bankruptcy-fairness-act-of-2009/ (remarking MBFA would provide needed relief for individuals facing bankruptcy simply because of medical problems).

[43] 155 CONG. REC. S9,022 (daily ed. Aug. 6, 2009) (statement of Sen. Whitehouse) (stressing MBFA necessary to "help people who because of medical costs have no other choice but to file for bankruptcy" avoid complete poverty); Press Release, Senator Sheldon Whitehouse, New Legislation Would Help Families Struggling with Medical Debt (Aug. 6, 2009), *available at* http://whitehouse.senate.gov/newsroom/press/release/?id=3f03685e-913e-4c77-a395-e359466f2635 (stating MBFA would allow individuals with high medical debts they cannot pay to keep their homes and avoid poverty); Orcutt, *supra* note 42 (commenting MBFA common sense solution helps poor individuals keep their homes when faced with huge medical bills).

[44] *See infra* notes 116–80 and accompanying text.

[45] *See, e.g.*, Whitt, *supra* note 36, at 506 (citation omitted) (determining "policy window" works toward final legislation only when problem, policy, and political streams coincide); ANN M. GALLIGAN & CHRIS N. BURGESS, CULTURAL POLICY PROGRAM OCCASIONAL PAPER SERIES, MOVING RIVERS, SHIFTING STREAMS: PERSPECTIVES ON THE EXISTENCE OF A POLICY WINDOW 1 (2003), http://arted.osu.edu/publications/pdf_files/paper29.pdf (discussing combination and timing of streams necessary to change governmental policies); *Policy and Politics: Why do Windows of Opportunity Close*?, THE POLICY PRESS BLOG (Aug. 5, 2010), http://policypress.wordpress.com/2010/08/05/policy-politics-why-do-windows-of-opportunity-close/ ("The alignment of the problem, policy and politics streams opens a window of opportunity for change.").

[46] MBFA, § 2(a)(1) (2009).

[47] *See id.*; *see also Medical Debt: Can Bankruptcy Reform Facilitate a Fresh Start?: Hearing Before the Subcomm. on Administrative Oversight and the Courts of the Senate Judiciary Comm.*, 111th Cong. 4 (2009) (statement of Aparna Mathur, Research Fellow) [hereinafter Mathur Statement], *available at* http://www.aei.org/speech/100089 (criticizing proposed Act's definition of "medically distressed debtor" in relation to amount of yearly income used to pay medical bills not covered by medical insurance).

period in the last 3 years, s/he also qualifies.[48] Third, an individual can be a medically distressed debtor if s/he lost work due to a medical condition or for caring for a nondependent immediate family member for at least 30 days during any consecutive 12-month period in the last 3 years.[49]

If a debtor qualifies as a medically distressed debtor s/he is afforded three specific protections not afforded to other chapter 7 consumer debtors. First, the medically distressed debtor is allowed enhanced exemptions.[50] Rather than being afforded the real property exemption under the Code of $20,200[51] or applicable state law,[52] medically distressed debtors are afforded a homestead exemption of up to $250,000.[53] Second, the requirement of pre-petition credit counseling[54] would be waived for medically distressed debtors.[55] And third, the presumption of abuse

[48] *See* MBFA, § 2(a)(1) (protecting debtors from losing all or substantial amount of household income due to another household member's medical problems); *see also* Mathur Statement, *supra* note 47, at 4–5 (explaining inclusion of persons living in households with others who have lost week for four weeks in preceding twelve months for medical reasons into definition of "medically distressed debtors").

[49] *See* MBFA, § 2(a)(1) (including unemployed persons into "medically distressed debtor" definition if unemployment lasted 30 consecutive days and resulted from personal injury or providing care to immediate family member); *see also Medical Bankruptcy Fairness Act: Hearing on H.R. 901 Before the H. Subcomm. on Commercial and Admin. Law*, 111th Cong. 2 (2010) (statement of Peter Wright, Professor of Law, Franklin Pierce Law Center) [hereinafter Wright Statement] (reviewing MBFA definition of "medically distressed debtor" to include debtors who have lost or interrupted stream of income for medical reasons).

[50] *See* MBFA, § 3(a) (expanding upon exemptions listed in 11 U.S.C. § 522(b)(2)–(3) (2006) for medically distressed debtors); *see also* Mathur Statement, *supra* note 47, at 5 (arguing enhancement of exemptions for medically distressed debtors will change behavior of debtors allowing for abuse and harming bankruptcy system).

[51] *See* 11 U.S.C. § 522(d)(1) (exempting debtor real property interests not to exceed $21,625); Schwab v. Reilly, 130 S. Ct. 2652, 2661–62 (2010) (interpreting homestead exceptions to apply only to interests "up to a specified dollar amount" without distinguishing between different kinds of debtors such as medical debtors); *In re* Gebhart, 61 F.3d 1206, 1210 (9th Cir. 2010) (emphasizing exemption applies to debtor's interest in real property but only up to amount currently stated in 11 U.S.C. § 522(d)).

[52] States can opt out of the federal exemptions. *See* 11 U.S.C. § 522(b)(3) (allowing application of state law to exempt property of debtor if state law is applicable at time of petition); *In re* Schwartz, 362 B.R. 532, 535 (S.D. Fla. 2007) (exempting real property where state law recognized and exempted tenancy by entireties from bankruptcy creditors); *In re* Tevaga, 35 B.R. 157, 159–60 (Bankr. D. Haw. 1983) (prohibiting exemption of real property for failure to meet state statutory residence requirements).

[53] *See* Mathur Statement, *supra* note 47, at 4–5 (highlighting possible abuse of increased homestead exemption by illustrating how debtors may convert non-housing assets into housing to protect assets from bankruptcy creditors). *Compare* MBFA, § 3(a) (exempting medically distressed debtor homestead interests up to $250,000) *with* 11 U.S.C. § 522(d)(1) (limiting debtor homestead exemption to interests up to $21,625).

[54] *See* 11 U.S.C. § 109(h)(1) (stating debtor must receive credit counseling prior to filing bankruptcy petition); *see also In re* Ginsberg, 354 B.R. 644, 645–46 (Bankr. E.D.N.Y. 2006) (holding debtor's failure to comply with credit counseling requirements made debtor ineligible to be debtor under Code); *In re* Wallert, 332 B.R. 884, 891 (Bankr. D. Minn. 2005) (discussing section 109(h)(1) proscription against eligibility for relief under Coder if pre-petition credit counseling is not proven).

[55] *See* MBFA, § 5 (amending section 109(h)(4)). *Cf. In re* Winston, No. 07-20593-D-13L, 2007 WL 1650926, at *3–4 (Bankr. E.D. Cal. June 6, 2007) (finding disabled debtor failed to demonstrate (1) reasonable effort to participate in credit counseling and (2) disability rendered debtor incapable of participating in credit counseling, as required under current exemption provision); *In re* Hall, 347 B.R. 532, 536 (Bankr. N.D. W. Va. 2006) (finding debtor suffering from cancer, limited mobility, and severe hearing impairment sufficiently demonstrated inability to meaningfully participate in pre-petition credit counseling).

arising under the means test,[56] a cornerstone of BAPCPA,[57] would not be applicable to medically distressed debtors by eliminating statutory authority to bring dismissal motions for medically distressed debtors in which the presumption of abuse arises.[58] It is worth noting that the MBFA does not eliminate the need to comply with the means test if the debtor is required to; it simply eliminates the ability to rely on the means test to dismiss a case for abuse. Therefore, dismissal motions under the other tests for abuse would still be viable.[59]

II. FAULTY PREMISE: IS MEDICAL BANKRUPTCY REFORM REALLY NEEDED?

Medical bankruptcy reform is premised on two purported facts: (1) a clear connection between healthcare costs and most consumer bankruptcy filings, and (2) the assertion that the current consumer bankruptcy system is not providing adequate relief to debtors with medical debt. This section addresses each of these positions, as well as the impact of the recent healthcare reform on the strength of these arguments.

A. Medical Bankruptcy

It is clear that healthcare costs do contribute to filing consumer bankruptcy.[60] Disagreement lies in degree of influence that medical occurrences have on

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[56] *See* 11 U.S.C. § 707(b)(2) (delineating formula for determining if relief is presumptively abusive); *In re* Gilligan, No. 06-00885-5-ATS, 2007 WL 6370887, at *1 (Bankr. E.D.N.C. Jan. 24, 2007) (stating abuse is presumed if debtor's means test shows ability to repay portion of debts); *In re* Nockerts, 357 B.R. 497, 507 (Bankr. E.D. Wis. 2006) (requiring more than ability to pay be shown to demonstrate abuse).

[57] *See In re* Orawsky, 387 B.R. 128, 154 (Bankr. E.D. Pa. 2008) (noting statutory means test methodology viewed as cornerstone of BAPCPA reforms); *In re* Davis, 348 B.R. 449, 453 (Bankr. E.D. Mich. 2006) (stating BAPCPA's cornerstone is "formulaic Chapter 7 means test" redefining disposable income); Evan J. Zucker, Note, *The Applicable Commitment Period: A Debtor's Commitment to a Fixed Plan*, 15 AM. BANKR. INST. L. REV. 687, 711 (2007) ("The cornerstone of the BAPCPA reform was the creation of the chapter 7 means test.").

[58] *See* MBFA, § 4 (amending section 707(b) by disallowing dismissal of case for abuse based on means test where debtor is medically distressed).

[59] Such debtors would possibly be subject to motions for bad faith or under the totality of the debtor's financial circumstances tests. *See* 11 U.S.C. § 707(b)(1)–(3) (mandating court to consider whether debtor filed petition in bad faith and totality of circumstances in determining abuse as cause for dismissal); *In re* Hartwick, 359 B.R. 16, 20 (Bankr. D.N.H. 2007) (discussing section 707(b)(3) express requirement that, in determining abuse, court must consider bad faith and totality of circumstances); *In re* Polinghorn, 436 B.R. 484, 487 (Bankr. N.D. Ohio 2010) (characterizing section 707(b) bad faith inquiry as subjective test and totality of circumstances analysis as objective test); *see also infra* notes 170–76 and accompanying text.

[60] *See* Robert Landry, III & Amy K. Yarbrough, *Global Lessons from Consumer Bankruptcy and Healthcare Reforms in the United States: A Struggling Social Safety Net*, 16 MICH. ST. J. INT'L L. 343, 347 (2007) (citing empirical evidence demonstrating inability to pay heath care costs is leading cause of consumer bankruptcy); *see also* Robert M. Lawless, *The Paradox of Consumer Credit*, 2007 U. ILL. L. REV. 347, 350 (2007) (noting medical costs are generally accepted as major causes of consumer bankruptcy); David A. Skeel Jr., *Bankruptcy's Home Economics*, 12 AM. BANKR. INST. L. REV. 43, 53 (2004) (elaborating on connection between healthcare problems and bankruptcy).

consumer bankruptcy.[61] A 2005 study by Himmelstein and colleagues suggests that medical problems contribute to over half of all consumer bankruptcy filings.[62] This estimate is a bit extreme as it inflates the causal effect that medical issues actually have on bankruptcy filing rates. Critics assert that Himmselstein's definition of medical bankruptcy—any debtor with $1000 or more in medical debt during the last two years of filing bankruptcy—is overly broad in light of average annual private medical expenditures of nearly $2500.[63] The very low threshold, required to be classified as a medical bankruptcy, coupled without any distinction made for the magnitude of the medical debt in relation to other debts, lead to coding many filings as medical bankruptcies when in fact they may not really be medical bankruptcies.[64]

In 2006, Dranove and Millenson, in response to the Himmelstein study, suggested that medical related expenses more likely contribute to around 17% of consumer filings, and that the Himmelstein study neglected to incorporate the effects that job loss, existing debt, and housing costs have on filings.[65] The key concern that Dranove and Millenson proffer is simple: "All debt contributes to bankruptcy . . . [but] . . . Himmelstein and colleagues never establish the relative importance of medical bills in bankruptcy . . . ."[66]

Other studies and reports shed doubt on the prevalence of medical bankruptcies. The United States Trustee Program reported that 90% of consumers filing for bankruptcy have medical debt of less than $5000, accounting for only 13% of all

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[61] Himmelstein, *supra* note 5, at 742 (concluding through national random sample over sixty percent of all bankruptcies have medical cause); Jacoby et al., *supra* note 5, at 377–78 ("[M]ore than half a million middle-class families turned to the bankruptcy courts for help following a illness or injury in 1999."); Todd J. Zywicki, *An Economic Analysis of the Consumer Bankruptcy Crisis*, 99 NW. U. L. REV. 1463, 1517–18 (2005) [hereinafter Zywicki, *Economic Analysis*] (rejecting idea that rising healthcare costs have direct impact on increase in bankruptcy petitions).

[62] *See* David U. Himmelstein et al., *Marketwatch: Illness and Injury as Contributors to Bankruptcy*, HEALTH AFF., Feb. 2, 2005, http://content.healthaffairs.org/content/early/2005/02/02/hlthaff.w5.63.full.pdf. The authors provide that a range of between 46.2 to 54.5 percent of bankruptcies are medical. *Id.* at W5-66 (citing study finding 46.2 percent of surveyed debtors met criteria for "major medical bankruptcy" and 54.5 percent met criteria for "any medical bankruptcy").

[63] *See* David Dranove & Michael L. Millenson, *Medical Bankruptcy: Myth Versus Fact*, 25 HEALTH AFF. W74, W77 (2006) [hereinafter Dranove & Millenson, *Myth Versus Fact*], *available at* http://content.healthaffairs.org/content/25/2/w74.full.pdf (discussing argument filings classified as "medical bankruptcies" may not be caused by healthcare costs); Gail Heriot, *Misdiagnosed: A Medical-Bankruptcy Study Doesn't Live Up to its Billing*, NATIONAL REVIEW, Feb. 11, 2005, *available at* http://old.nationalreview.com/comment/heriot200502110735.asp (denouncing study's "misleading" characterization of any case where debtor had more than $1000 in medical expenses as insolvency with medical causes); Zywicki, *Economic Analysis*, *supra* note 61, at 1518–19 (highlighting flaws in researchers' methods of classifying "medical bankruptcy").

[64] *See, e.g.*, Dranove & Millenson, *Myth Versus Fact*, *supra* note 63, at W78 (presenting data supporting conclusion that healthcare costs statistically represent small portion of total financial burden on debtors); Heriot, *supra* note 63 ("[T]he authors present the data in ways that encourage the reader to misidentify medical expenses as the leading cause of bankruptcy."); Zywicki, *Economic Analysis*, *supra* note 61 (criticizing study's omission of total debt to medical debt ratio).

[65] Dranove & Millenson, *Myth Versus Fact*, *supra* note 63, at W75.

[66] David Dranove & Michael L. Millenson, *Medical Bankruptcy: Dranove and Millenson Respond*, 25 HEALTH AFF. W93, W93 (2006) [hereinafter Dranove & Millenson, *Respond*], *available at* http://content.healthaffairs.org/content/25/2/w93.full.pdf.

unsecured debt.[67] A 2000 report of the Congressional Budget Office cites medical bills, divorce, loss of income related to unemployment, and poor debt management as causal factors for bankruptcy filings.[68]

The root of the discrepancies in the degree of influence that medical expenses have on consumer bankruptcies might lie in the methods used to measure the level of medical debt among bankruptcy filers.[69] The study by Himmelstein and colleagues attributes the largest degree of influence to medical debt of those studies previously cited. Data from a survey of consumer bankruptcy filers were used to determine the role that medical debts played in influencing consumer bankruptcy.[70] As survey data are self-reported by debtors, the role that medical debts play in bankruptcy might be overemphasized due to social pressures. Simply put, debtors might feel that medical debt is less shameful and more of a justification for bankruptcy filing. Therefore, they might be overzealous in listing medical expenses as their major reason for bankruptcy filing.[71]

In contrast, the study conducted by the U.S. Trustee Program reports that medical debt has a very low level of influence on consumer bankruptcy filing.[72] This study used court records for data collection.[73] Using court records might under-represent the level of influence that medical expenses have on bankruptcy filings, because many of these expenses may have been paid by credit cards, equity mortgages, or other forms of consumer debt that will not show up on the schedules as medical debt. In effect, the medical debt might be invisible on the filings.[74]

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[67] *See* Dranove & Millenson, *Myth Versus Fact*, *supra* note 63, at W78 (discussing Department of Justice's examination of 5203 cases from U.S. Trustee's files).

[68] *See* CONGRESSIONAL BUDGET OFFICE, PERSONAL BANKRUPTCY: A LITERATURE REVIEW (2000), *available at* http://www.cbo.gov/ftpdocs/24xx/doc2421/Bankruptcy.pdf.

[69] Researchers have primarily used two approaches to extrapolate the role that medical debt plays in consumer bankruptcy filings: survey methodology and court record data collection. *See* Melissa B. Jacoby & Mirya Holman, *Managing Medical Bills on the Brink of Bankruptcy*, 10 YALE J. HEALTH POL'Y L. & ETHICS 239, 240–41 (2010) (acknowledging some scholars measure medically-related bankruptcy using survey techniques, and some analyze court records); *see also* Melissa B. Jacoby, *Ripple or Revolution: The Indeterminacy of Statutory Bankruptcy Reform*, 79 AM. BANKR. L.J. 169, 187–88 (2005) (explaining one study used post-bankruptcy interviews, while another analyzed court data); Zagorsky, *supra* note 9, at 290 (explaining study first analyzed court data, then expanded by sending questionnaire to filers). These two approaches often yield different results, and "skeptics of survey-based findings often cite studies of bankruptcy court records that yield more conservative estimates." Jacoby & Holman, *supra*, at 240–41.

[70] *See* Himmelstein, *supra* note 62, at W5-65.

[71] *See, e.g.*, Rafael Efrat, *Bankruptcy Stigma: Plausible Causes for Shifting Norms*, 22 EMORY BANKR. DEV. J. 481, 484–85 (2006) (discussing public's association of bankruptcy with "improvident, deceitful, or criminal behavior"); Jacoby & Holman, *supra* note 69, at 272 (asserting discrepancies in survey results can be attributed to social acceptance of medical debt as reason for bankruptcy); Jacoby et al., *supra* note 5, at 384–85 (arguing over time debtors have reported more acceptable reasons for bankruptcy, such as medical costs).

[72] *See* Dranove & Millenson, *Myth Versus Fact*, *supra* note 63, at W78 (asserting based on files of U.S. Trustee Program, data does not support claim that "almost 50 percent of consumer bankruptcies are 'medically related'").

[73] *See id.* (noting Department of Justice examined over 5203 cases from files of U.S. Trustee Program).

[74] *See* Jacoby & Holman, *supra* note 69, at 272 ("[S]ome existing medical bills might simply be missing from Schedule F . . . due to inadvertence, a mistaken belief that insurance would fully cover a pre-

The truth about the influence that medical debts have on consumer bankruptcy filings likely lies somewhere in the middle of the existent research. Judging from the evidence, the most likely case seems that individuals with existing debt are pushed over the financial edge when a medical problem occurs. Coupling the lost wages resulting from time away from work with the addition of medical debt, as well as other exogenous factors, certain individuals may not be able to meet their existing financial obligations and subsequently file for bankruptcy protection.[75] This suggests that a medical problem might exacerbate an individual's already tenuous financial picture to the point of bankruptcy, but does not suggest that medical problems are the primary cause of most bankruptcy filings.[76]

Even though there is not much agreement about the number of medical bankruptcies, it is crystal clear that the rhetoric that asserts that there is a medical bankruptcy every thirty seconds is simply not true. The math is simple: "this would mean more than 1 million [medical bankruptcies] per year when there were less than 825,000 actual American bankruptcies!"[77]

B. Adequacy of Current Bankruptcy System

The second basis for medical bankruptcy reform is that consumer bankruptcy is not providing adequate relief to medical debtors.[78] The validity of this proposition is not clear. Medical debtors, if a definition of such a debtor is accepted, are treated exactly like other individual debtors. The medical unsecured debts in chapter 7 and chapter 13 are treated the same. In the typical chapter 7 case, unsecured debts, including medical debts, are discharged.[79] In chapter 13, medical debt is treated the

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bankruptcy procedure [and other reasons]."); Zywicki, *Economic Analysis*, *supra* note 61, at 1492 (explaining medical debt may appear as credit card debt).

[75] The traditional model of consumer bankruptcy recognizes that consumer bankruptcy results from a convergence of facts. *See, e.g.*, Zywicki, *Economic Analysis*, *supra* note 61, at 1464 (discussing "factors such as heavy indebtedness or sudden and unexpected income or expense shocks, such as unemployment, medical problems, or divorce" that contribute to consumer bankruptcy); *see also* Efrat, *surpa* note 71, at 492 (discussing evolution of premise that "personal conditions beyond the debtor's control [precipitate] bankruptcy filings"); Todd J. Zywicki, *Institutions, Incentives, and Consumer Bankruptcy Reform*, 62 WASH. & LEE L. REV. 1071, 1074–75 (2005) [hereinafter Zywicki, *Institutions*] (noting traditional model "views consumer bankruptcies as arising from household financial distress"). The traditional model views consumer bankruptcy as an effort to "deal with insoluble financial problems brought on by exogenous factors such as heavy indebtedness or sudden and unexpected income or expense shocks, such as unemployment, medical problems, or divorce." Zywicki, *Economic Analysis*, *supra* note 61, at 1464.

[76] This calls into question whether a national health insurance solution to health reform would have any real influence on the country's consumer bankruptcy rate.

[77] David McKalip, *Rationed Care is Bad Care*, ST. PETERSBURG TIMES, Apr. 9, 2009, at 8A, *available at* http://www.tampabay.com/opinion/columns/article991071.ece.

[78] The assertion is that the means test and the current system is "drawing many needy Americans away from the financial relief in bankruptcy they require." Legislative Update, *Three ABI Members Testify During Busy Month for Congressional Hearings*, AM. BANKR. INST. J., Sept. 2009, at 71.

[79] *See* Mathur Statement, *surpa* note 47, at 7 (noting medical debts, including credit card debts incurred from medical costs are fully dischargeable under chapter 7); *see also In re* Carlisle, 205 B.R. 812, 820 (Bankr. W.D. La.1997) (discharging medical bills and consumer credit transactions); Zywicki, *Economic Analysis*, *supra* note 61, at 1473 (highlighting liberalization of discharge of debts).

same as other unsecured debts. Under a chapter 13 plan,[80] unsecured debts may be paid back in full, in part or not at all, depending on particular jurisdiction and treatment permitted under the Code.[81] The payments are based on an analysis of income and expenses, a liquidation analysis, and ultimately on what the debtor can afford.[82]

It has been argued that the means test does not distinguish medical debtors from other debtors, and medical debtors are not given any protection over and above other debtors.[83] That is true. All debtors with unsecured debt are treated the same under the means test.[84] The means test is designed to serve as a filter to detect abusive cases based on an ability to repay unsecured debts.[85] Only above-median debtors that are able to repay unsecured creditors would be subject to the

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[80] *See* 11 U.S.C. §§ 1321, 1322 (2006) (listing plan requirements).

[81] The exact return required to claimholders is not specified. The return to claimholders is governed by 11 U.S.C. § 1325(a)(4), which provides that a plan may be confirmed if "the value, as of the effective date of the plan, of property to be distributed under the plan on account of each unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 . . . ."

Some courts do not permit a zero percent plan or a minimal return to unsecured claimholders under the statutory good faith test under 11 U.S.C. § 1325(a)(3). *See In re* Rosencranz, 193 B.R. 629, 636 (Bankr. D. Mass. 1996) (denying chapter 13 plan because plan was not proposed in good faith after considering various facts including payment of only "10% to unsecured creditors"); *In re* Lattimore, 69 B.R. 622, 626 (Bankr. E.D. Tenn. 1987) ("Because the Debtors' Amended Plan proposes zero payment on unsecured claims, in abuse of the purpose and spirit of Chapter 13, the proposed plan fails to satisfy the good faith standard. Accordingly, pursuant to §1325(a)(1) and (3) confirmation must be denied."); *In re* Silva, 82 B.R. 845, 847 (Bankr. S.D. Ohio 1987) (denying confirmation of chapter 13 plan because it was not filed in good faith when debtors failed to make "a meaningful attempt to repay all creditors to the best of [their] abilities"). And other courts permit nominal or zero percent return to unsecured claimholders. *See, e.g., In re* Slade, 15 B.R. 910, 911–12 (B.A.P. 9th Cir. Cal. 1981) (holding unsecured creditors only receiving nominal amount should not bar to confirmation of chapter 13 plan and noting "[a]bsent any showing of a willful attempt to misuse Chapter 13 in defraud of creditors, best effort plans should normally satisfy the good faith requirements of 11 U.S.C. § 1325(a)(3)"); *In re* Greer, 60 B.R. 547, 554 (Bankr. C.D. Cal. 1986) (holding unsecured creditors might receive nothing in confirmation of chapter 13 plan); *In re* Matter of Esser, 22 B.R. 814, 816 (Bankr. E.D. Mich. 1982) (stating zero payment plans under chapter 13 should be confirmed if they meet "best interests" test of section 1325(a)(4)).

[82] *See* 11 U.S.C. § 1325(a)(4) (stating unsecured creditors must receive more than they would receive in chapter 7); 11 U.S.C. § 1325(b)(1)–(2) (providing if debtor cannot satisfy claims in five years then all disposable income during period must be used to partially satisfy claims; disposable income defined as "current monthly income received by the debtor . . . less amounts reasonably necessary to be expended"); Mathur Statement, *supra* note 47, at 3 ("In most cases, the payments will be based upon what the individuals can afford, rather than what they owe.").

[83] *See, e.g., Medical Debt: Is Our Healthcare System Bankrupting Americans? Hearing Before the Subcomm. on Commercial and Administrative Law*, 111th Cong. 58 (2009) (statement of John A. E. Pottow, Prof. of Law, Univ. of Mich. Law Sch.) ("What is important about the means test that is currently part of the Bankruptcy Code is that it does not distinguish 'medical debtors' or otherwise accord them any heightened protection that the average store charge-card junkie would enjoy.").

[84] *See* 11 U.S.C. § 707(b)(2) (making no classifications between types of unsecured creditors); Pottow, *supra* note 83, at 58 (noting "medical debtors" are treated same as every other debtor).

[85] *See* 11 U.S.C. § 707(b)(2) (blocking access to fresh start for consumers with above median gross income); *In re* Kibbe, 361 B.R. 302, 314 (B.A.P. 1st Cir. 2007) ("The heart of [BAPCPA's] consumer bankruptcy reforms consists of the implementation of an income/expense screening mechanism . . . *to ensure that debtors repay creditors the maximum they can afford*."); *In re* Crink, 402 B.R. 159, 168 (Bankr. M.D. N.C. 2009) ("Section 707(b)(2) functions as an initial filter, disqualifying some debtors from Chapter 7 because they have an ability to pay.").

presumption of abuse.[86] In that instance the case would be dismissed or converted to chapter 13 to repay some or possibly no unsecured debts under a plan[87] and receive a discharge[88] of the remaining unsecured debts, including medical debts. Debtors with medical debt that are below the median income are not be subject to the presumed abuse[89] and likely will receive a discharge[90] like most chapter 7 consumer debtors.[91] Above-median debtors that cannot repay would not be subject to the presumed abuse[92] and receive a discharge, like most chapter 7 consumer debtors.[93] It is only above-median debtors with the ability to repay debts who are unable to

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[86] *See* 11 U.S.C. § 707(b)(2) (providing debtors with below-median gross income automatically pass means test and are not subject to presumption of abuse); Pottow, *supra* note 83, at 58 (noting debtors with below-median gross income pass means test automatically); Eugene R. Wedoff, *Means Testing in the New § 707(b)*, 79 AM. BANKR. L.J. 231, 252 (2005) (stating if debtor is below state median income, debtor is not subject to means test presumption).

[87] *See supra* notes 80–81 and accompanying text; *see also In re* Gonzalez, 388 B.R. 292, 299 (Bankr. S.D. Tex. 2008) (stating section 707(b)(2)(A) test has practical effect of forcing debtors to file chapter 13 petitions); *In re* Knight, 370 B.R. 429, 434 (Bankr. N.D. Ga. 2007) (stating court may dismiss or convert case to chapter 13 if abuse is presumed); *In re* Pennington, 348 B.R. 647, 652 (Bankr. D. Del. 2006) (ruling abuse was presumed where debtor was able to repay partially).

[88] *See* 11 U.S.C. §§ 1321, 1322 (allowing debtor to file plan and contents therein); *In re Knight*, 370 B.R. at 434–35 (stating debtors are required to pay debt to extent they have ability to do so); *In re* Richie, 353 B.R. 569, 574 (Bankr. E.D. Wis. 2006) (acknowledging debtor may obtain immediate discharge of debt under chapter 7).

[89] *See* 11 U.S.C. § 707(b)(2)(A)(i) (listing income amounts giving rise to presumption of abuse); *see also In re Gonzalez*, 388 B.R. at 299 (noting presumption of abuse of relief under chapter 7 exists if debtor's section 707(b)(2) test exceeds statutorily provided amount); *In re Richie*, 353 B.R. at 571 (ruling presumption of abuse was not applicable because debtor's "current monthly income" was below applicable median income).

[90] *See* 11 U.S.C. § 727 (requiring court to grant debtor discharge with exceptions); *In re Knight*, 370 B.R. at 440 (stating presumption of abuse could preclude chapter 7 discharge); *In re* Singletary, 354 B.R. 455, 460 (Bankr. S.D. Tex. 2006) (stating below-median debtor could face section 707(b)(3) motion).

[91] Most typical chapter 7 debtors receive a discharge of most unsecured debts a few months after filing. *See* 6 COLLIER ON BANKRUPTCY, ¶ 700.05, at 700-6 (Alan N. Resnick et al. eds., 16th ed. 2010) (stating individual debtor receives court order of discharge shortly after passage of deadline for objections to discharge with exceptions); Scott F. Norberg, *Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13*, 7 AM. BANKR. INST. L. REV. 415, 437 (1999) (discussing most chapter 7 cases remain pending for four to six months); Katherine M. Porter, *Life After Debt: Understanding the Credit Restraint of Bankruptcy Debtors*, 18 AM. BANKR. INST. L. REV. 1, 6 (2010) (noting debtors receive discharge of most unsecured debt within few months after filing chapter 7).

[92] *See* 11 U.S.C. § 707(b)(2)(B)(i) (stating presumption of abuse may only be rebutted by showing special circumstances); *In re* Sorrell, 359 B.R. 167, 179 (Bankr. S.D. Ohio 2007) (positing above-median debtor can rebut presumption by showing special circumstances such as serious medical condition); *In re Singletary*, 354 B.R. at 462 (listing having sufficient expense deductions and rebutting with special circumstances as two ways for above-median debtor to avoid presumption of abuse).

[93] Most typical chapter 7 debtors receive a discharge of most unsecured debts a few months after filing. *See* Porter, *supra* note 91, at 6 (stating debtors receive discharge of most unsecured debt within few months after filing chapter 7); *see also* Melissa B. Jacoby, *Collecting Debts from the Ill and Injured: The Rhetorical Significance, but Practical Irrelevance, of Culpability and Ability to Pay*, 51 AM. U. L. REV. 229, 241 (2001) (noting debtors receive discharge in weeks or months for most chapter 7 cases); Jeffrey A. Logan, Comment, *The Troubled State of Chapter 13 Bankruptcy and Proposals for Reform*, 51 SMU L. REV. 1569, 1572 (1998) (stating chapter 7 debtor probably receives discharge within months of filing).

rebut the presumption,[94] which are subject to dismissal or conversion. These debtors are not refused relief under the Code as they can seek relief under chapter 13 or chapter 11,[95] if they are eligible.[96]

There is no logical basis to permit chapter 7 debtors with medical debt that can repay their debts to be exempt from the means test and receive a discharge. Whether the debt is medical or otherwise should not be the inquiry. Debtors that can repay some of their debts should be required to do so, and those that cannot—should be able to obtain a discharge. The current system is adequate and consistent with well-entrenched bankruptcy policy that balances a fresh start with the interest of creditors.[97] Consumer bankruptcy is designed to "serve the dual purposes of helping both debtors and creditors."[98] If the current system is in fact inadequate and the means test is not satisfactory,[99] reform should apply to all debtors. Otherwise, the reform will create more disparity in the treatment of debtors and creditors

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[94] *See* 11 U.S.C. § 707(b)(2)(B) (stating requirements to rebut presumption of abuse such as special circumstances for debtors who fail means test); *see also* Morse v. Rudler (*In re* Rudler), 576 F.3d 37, 40–41 (1st Cir. 2009) (reading dismissal under section 707(b)(2) as only applicable to above state median income debtors who fail means test); *In re* Siler, 426 B.R. 167, 171–72 (Bankr. W.D.N.C. 2010) (remarking above-median debtors who fail means test must have cases dismissed or converted).

[95] Section 707(b)(1) expressly provides for the conversion of a case to chapter 11 or chapter 13 with the debtor's consent. *See* 11 U.S.C. § 707(b)(1) ("[T]he court . . . may . . . convert such a case to a case under chapter 11 or 13 of this title."); *see also In re* Pageau, 383 B.R. 221, 231 (Bankr. D.N.H. 2008) (providing debtor with opportunity to convert case to chapter 13 after granting Trustee's motion to dismiss); *In re* Witek, 383 B.R. 323, 330 (Bankr. N.D. Ohio 2007) (granting Trustee's motion to dismiss chapter 7 for presumption of abuse subject to debtors' election to convert case to chapter 13).

[96] The Code sets forth the eligibility requirements for relief. *See* 11 U.S.C. § 109 (stating who may be debtor); *In re* Smith, 419 B.R. 826, 827–29 (Bankr. C.D. Cal. 2009) (discussing eligibility requirements of chapter 13); *see also In re* Rooney, 436 B.R. 454, 455 (Bankr. N.D. Ohio 2010) (allowing debtor to convert to chapter 11 if not eligible for chapter13 after granting motion to dismiss for abuse).

[97] There are two competing goals of consumer bankruptcy. First, consumer bankruptcy is designed to provide an equitable distribution of assets among creditors; and second, it is designed to provide debtors a fresh start via a discharge of their debts. *See, e.g., In re* Supplement Spot, 409 B.R. 187, 207 (Bankr. S.D. Tex. 2009) (noting two competing goals of bankruptcy are payment of creditor claims and debtor's "fresh start"); Adam D. Herring, *Fixing the Broken Machine: Means Testing and Secured Debt Payments under BAPCPA*, 18 NORTON J. BANKR. L. & PRACT. 1, 14 (2009) (citations omitted) ("The 'fresh start' concept in favor of debtors is not the sole interest reflected in U.S. bankruptcy law. A competing interest for years has been the recognition of debtors' debt-repayment obligations to their creditors."); Elizabeth Warren, *A Principled Approach to Consumer Bankruptcy*, 71 AM. BANKR. L.J. 483, 483 (1997) (describing concepts of "fresh start" for debtors and "equality of distribution" for creditors as "twin stars of consumer bankruptcy, reflecting the need for relief and the need for fairness, the balanced objectives of the system").

[98] Dalié Jiménez, *The Distribution of Assets in Consumer Chapter 7 Bankruptcy Cases*, 83 AM. BANKR. L.J. 795, 795 (2009).

[99] There are many different views of the effectiveness of the means test and its impact on consumer bankruptcy. *See, e.g.*, David Gray Carlson, *Means Testing: The Failed Bankruptcy Revolution of 2005*, 15 AM. BANKR. INST. L. REV. 223, 227 (2007) (concluding means test "either encourages bankruptcy abuse or has no effect"); Pardo, *Eliminating the Judicial Function*, *supra* note 16, at 472–73 (noting anti-debtor nature of "conventional story" of means-testing and problems of judicial discretion); Charles Jordan Tabb, *The Death of Consumer Bankruptcy in the United States?*, 18 BANKR. DEV. J. 1, 15–16 (2001) (criticizing assumptions underlying means-testing reforms); Jack F. Williams, *Distrust: The Rhetoric and Reality of Means-Testing*, 7 AM. BANKR. INST. L. REV. 105, 107–08 (1999) (discussing means-testing debate between those who argue it is unnecessary and burdensome and those who believe it is necessary to prevent abusive filings); Alper, *supra* note 10, at 1932 (detailing deterrence problems of means test).

without a strong justification. This will further the divide in similar treatment among similarly situated debtors and creditors and run counter to the core goals of consumer bankruptcy. Consumer bankruptcy attempts to balance the interests of debtors and creditors by providing a fresh start to debtors, coupled with an equitable distribution of assets to creditors.[100] Such reform will dilute the fundamental purpose of BAPCPA and means testing requirements—"to ensure that debtors repay creditors the maximum they can afford."[101]

C. Healthcare Reform

The connection between healthcare costs and consumer bankruptcies was used as a talking point surrounding the healthcare reform debate[102] that led to the passage of the Patient Protection and Affordable Care Act in March of 2010.[103] One of the main goals of the reform debate was to ensure that all citizens would have affordable access to healthcare via some form of health insurance coverage under the bill.[104] Theoretically, if all individuals have health insurance, their individual healthcare costs will be lower due to the coverage. However, the current healthcare financing system allows for cost sharing and direct liability even among insured patients.[105]

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[100] For a discussion of these basic goals, see generally Landry & Yarbrough, *supra* note 60, at 349–50 & n.32 (discussing policy orientation of bankruptcy legislation); see also Theresa M. Beiner & Robert B. Chapman, *Take What you Can, Give Nothing Back: Judicial Estoppel, Employment Discrimination, Bankruptcy, and Piracy in the Courts*, 60 U. MIAMI L. REV. 1, 37 (2005) ("Most contemporary conceptions of a just bankruptcy law address two goals: one, the payment of creditors through a common pool; and two, the provision to the debtor of some sort of fresh start." (citations omitted)); Lawrence Ponoroff, *Exemption Impairing Liens Under Bankruptcy Code Section 522(f): One Step Forward and One Step Back*, 70 U. COLO. L. REV. 1, 1 (1999) ("There has always been a fundamental tension between the frequently recited twin goals of the consumer bankruptcy system: a fresh start for financially beleaguered debtors and equality of distribution for creditors." (citations omitted)).

[101] *See In re* Kibbe, 361 B.R. 302, 314 (B.A.P. 1st Cir. 2007) (emphasis omitted) (citing H.R. REP. NO. 109-31, pt. 1, at 2 (2005)).

[102] *See supra* notes 4–5 and accompanying text.

[103] Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010).

[104] *See, e.g.*, David Deaton et al., *Distressed Healthcare: Significant Considerations for Buyers, Sellers and Lenders Arising from the Intersection of Healthcare and Bankruptcy Laws*, 3 J. HEALTH & LIFE SCI. L. 1, 4 (2010) ("The primary goal of healthcare reform is to increase affordable access to quality healthcare for all Americans, while reducing the growth in healthcare expenditures."); Wendy K. Mariner, *Health Reform: What's Insurance Got to Do With It? Recognizing Health Insurance as a Separate Species of Insurance*, 36 AM. J.L. & MED. 436, 439 (2010) (stating key goal of health reform is universal access to healthcare through health insurance for appropriate, affordable healthcare).

[105] *See* Jacoby & Holman, *supra* note 69, at 244 (positing current healthcare financing system imposes "cost-sharing and direct liability"); Dahlia K. Remler & Sherry A. Glied, *How Much More Cost Sharing Will Health Savings Accounts Bring?*, 25 HEALTH AFF. 1070, 1073 (2006), *available at* http://content.healthaffairs.org/content/25/4/1070.full.pdf ("[H]ealth care plans today already contain both substantial cost sharing and managed care measures that are likely to reduce spending."); Joseph White, *Gap and Parallel Insurance in Health Care Systems with Mandatory Contributions to a Single Funding Pool for Core Medical and Hospital Benefits for All Citizens in Any Geographic Area*, 34 J. HEALTH POL. POL'Y & L. 543, 549 (2009) (outlining current cost sharing policies).

Even given personal liability on behalf of insured individuals, the presence of individual insurance mandates should theoretically lower the total cost of healthcare in the country due to the elimination of artificially inflated charges by healthcare providers. The way the current system is structured, healthcare providers inflate charges to allow for the negotiation of favorable reimbursement rates with health insurance providers and federal payers.[106] This leaves uninsured individuals stuck with the full charges of healthcare services rendered, while an insurance company might reimburse a provider only 50% of charges incurred for the same services.[107]

Title I of the new health reform legislation mandates individuals have health insurance or pay a penalty.[108] Further, the legislation provides subsidies for individuals whose income does not allow them to afford health insurance.[109] The Congressional Budget Office estimates that, with implementation of this mandate, the number of uninsured Americans will be reduced from over fifty million to around twenty-three million by 2019.[110] While this will not totally eliminate the

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[106] *See* Landry & Yarbrough, *supra* note 60, at 361 (stating health insurance companies and health insurers negotiate favorable reimbursement rates with healthcare providers disadvantaging individuals); Abigail R. Moncrieff, *Federalization Snowballs: The Need For National Action In Medical Malpractice Reform*, 109 COLUM. L. REV. 844, 854–55 (2009) (listing policies behind healthcare industry's alarming inflation rate); Tamara R. Coley, Note, *Extreme Pricing of Hospital Care for the Uninsured: New Jersey's Response and the Likely Results*, 34 SETON HALL LEGIS. J. 275, 287 (2010) (describing system of negotiating reimbursement rates).

[107] *See* Beverly Cohen, *The Controversy Over Hospital Charges to the Uninsured – No Villains, No Heroes*, 51 VILL. L. REV. 95, 100 (2006) (noting private insurers negotiate discounts while self-insured and uninsured patients pay full price of services); Elizabeth A. Weeks, *Gauging the Cost of Loopholes: Health Care Pricing and Medicare Regulation in the Post-Enron Era*, 40 WAKE FOREST L. REV. 1215, 1275 (2005) (stating only uninsured patients exposed to non-discounted prices). *See generally* Christopher P. Tompkins, Stuart H. Altman & Efrat Eilat, *The Precarious Pricing System for Hospital Services*, 25 HEALTH AFF. 45, 52 (2006), *available at* http://content.healthaffairs.org/content/25/1/45.full.pdf (explaining consequence of pricing system is "patients who had the least ability to pay for their healthcare were charged higher prices").

[108] *See* The Patient Protection and Affordable Care Act, H.R. 3590, 111th Cong. § 1501 (2010) (proposing provision mandating every individual maintain minimum essential healthcare coverage); Kaiser Family Foundation, *Focus on Health Reform: Summary of New Health Reform Law*, at 1 (June 18, 2010), http://www.kff.org/healthreform/upload/8061.pdf (noting mandated minimum coverage provision); Jennifer Orr Mitchell & Matthew S. Arend, *Federal Court in Virginia Declares PPACA's "Minimum Essential Coverage" Provision Unconstitutional*, DINSMORE & SHOHL LLP (Dec. 15, 2010), http://www.jdsupra.com/post/documentViewer.aspx?fid=3816a351-2455-451a-85e7-fa87938c12d0 ("Under Section 1501 of PPACA, every U.S. citizen, other than those falling within certain exceptions, would be required to maintain a minimum level of health insurance beginning in 2014 or pay a fine included in the taxpayer's annual tax return.").

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> It is in Title I that the national reform most closely resembles Chapter 58 in Massachusetts. The core elements include, first, systemic insurance market reforms altering both the individual and small-employer markets; second, a mandate for residents to purchase health insurance if affordable coverage is available to them; and third, subsidies for lower- and moderate-income individuals and families to purchase coverage.

Kavita Patel & John McDonough, *From Massachusetts to 1600 Pennsylvania Avenue: Aboard the Health Reform Express*, 29 HEALTH AFF. 1106, 1106 (2010).

[110] *See* Letter from Douglas W. Elmendorf, Director, Cong. Budget Office, to Sen. Harry Reid, Majority Leader, U.S. Senate (Dec. 19, 2009), at 8, *available at* http://www.cbo.gov/ftpdocs/108xx/doc10868/12-19-Reid_Letter_Managers_Correction_Noted.pdf (noting expected decrease of uninsured by 2019); *see also*

problem of uninsurance, the increased number of insured Americans will help reduce the problem of the artificial inflation of charges for healthcare services[111] and decrease the cost of healthcare insurance premiums.[112]

Research demonstrates that state levels of uninsurance are significantly related to consumer bankruptcy filings.[113] Reducing the number of uninsured on a national level should also serve to reduce the number of consumer bankruptcies influenced by the lack of health insurance.

Based on the level of influence that medical debts have on consumer bankruptcy filings relative to other consumer debts[114] and the anticipated reduction in healthcare costs and uninsurance rates,[115] the necessity for a specific bill relevant to medical bankruptcy appears diminished. While all medical bankruptcies will certainly not be eliminated, they will no longer be a problem of the magnitude that requires legislative intervention that goes beyond the current system.

III. PROBLEMS WITH MEDICAL BANKRUPTCY REFORM

As outlined in Part II.B.2. above, the MBFA modifies the treatment of a debtor classified as a "medically distressed debtor."[116] Each area of reform will be addressed and the problems associated with each specific reform will be identified.

John Holahan & Bowen Garrett, *The Cost of Uncompensated Care with and without Health Reform*, THE URBAN INSTITUTE, Mar. 2010, *available at* http://www.urban.org/UploadedPDF/412045_cost_of_uncompensated.pdf?RSSFeed=UI_HealthPolicy.xml.

[111] *See generally supra* note 107.

[112] The individual mandate eliminates the issue of adverse selection, so that healthy individuals do not pass on health insurance leaving the insured risk pool to consist mainly of sick individuals who utilize greater amounts of health services. Diversifying the risk pool via an appropriate individual mandate will in essence cause premiums to decline because of the decrease in medical costs per insured individual.

[113] *See* Scott Fay et al., *The Household Bankruptcy Decision*, 92 AMER. ECON. REV. 706, 706–11 (2002) (discussing studies demonstrating link between rates of uninsured and bankruptcy rates); Himmelstein et al., *supra* note 62, at W5-66 (citing studies demonstrating link between consumer bankruptcy and healthcare costs); Amy K. Yarbrough & Robert J. Landry, III, *Navigating the Social Safety Net: A State-Level Analysis of the Relationships Between Medicaid, the Uninsured and Consumer Bankruptcy*, 35 POL'Y STUDIES J. 680, 683 (2007) (describing empirical evidence suggesting bankruptcy tied to rates of uninsured rates).

[114] *See* Dranove & Millenson, *Respond*, *supra* note 66, at W93 (acknowledging correlation between illness and financial hardship); David U. Himmelstein et al., *Discounting the Debtors Will Not Make Medical Bankruptcy Disappear*, 25 HEALTH AFF. W84, W85 (2006), *available at* http://content.healthaffairs.org/content/25/2/w84.full.pdf (asserting medical illnesses contribute to large number of bankruptcy filings). *See generally* Dranove & Millenson, *Myth Versus Fact*, *supra* note 63, at W75 (discussing causal connections between bankruptcy and healthcare costs).

[115] *See* Holahan & Garrett, *supra* note 110, at 1 (describing effect of anticipated decline in healthcare costs due to decreased numbers of uninsured individuals); *see also* Letter from Douglas W. Elmendorf, Director, Cong. Budget Office, to Rep. John D. Dingell, U.S. House of Representatives (Nov. 20, 2009), at 1, *available at* http://www.cbo.gov/ftpdocs/107xx/doc10741/hr3962Revised.pdf (estimating reduction in federal deficit due to legislation that will decrease number of uninsured individuals); Letter from Douglas W. Elmendorf, *supra* note 110, at 8 (predicting substantial decrease in number of uninsured individuals by 2019).

[116] MBFA, § 2(a)(1) (2009) (defining term "medical debt" and describing debtor who qualifies as "medically distressed debtor").

A. The Definition of a "Medically Distressed Debtor"

The MBFA definition of medically distressed debtor is overly broad and riddled with opportunities for manipulation by debtors. There are three ways for an individual debtor to fit into this classification.[117] The primary way is for an individual to have incurred or paid $10,000 or ten percent of his/her adjusted gross income in medical debt during any consecutive twelve-month period in the three years prior to filing bankruptcy for the debtor, a dependent or nondependent immediate family member, which has not been paid by a third party.[118] The reality is that many debtors will fit in this category, even if they have a relatively small portion of medical debt.

First, sixty percent of debtors have between $24,000 and $36,000 in income and had on average about $20,000 in credit card debt.[119] Therefore, if typical filers had medical debt of $2400 to $3600, they would fit into the category of medically distressed debtor even if their primary debts were consumer-oriented debts.[120]

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[117] The MBFA amends 11 U.S.C. § 101 by specifically adding a new subsection (39C) that contains the definition of a "medically distressed debtor." That new subsection provides three alternate ways to qualify for this classification. MBFA § 2(a)(1) provides in relevant part as follows:

> (39C) The term "medically distressed debtor" means a debtor who, in any consecutive 12-month period during the 3 years before the date of the filing of the petition—
> (A) incurred or paid medical debts for the debtor or a dependent of the debtor, or a nondependent member of the immediate family of the debtor (including any parent, grandparent, sibling, child, grandchild, or spouse of the debtor), that were not paid by any third party payor and were in excess of the lesser of—
> (i) 10 percent of the debtor's adjusted gross income (as such term is defined under section 62 of the Internal Revenue Code of 1986); or
> (ii) $10,000;
> (B) was a member of a household in which 1 or more members (including the debtor) lost all or substantially all of the member's domestic support obligation income, taking into consideration any disability insurance payments, for 4 or more weeks, due to a medical problem of a person obligated to pay such domestic support; or
> (C) experienced a downgrade in employment status that correlates to a reduction in wages or work hours or results in unemployment, to care for an ill, injured, or disabled dependent of the debtor, or an ill, injured, or disabled nondependent member of the immediate family of the debtor (including any parent, grandparent, sibling, child, grandchild, or spouse of the debtor), for not less than 30 days.

MBFA § 2(a)(1).

[118] *Id.* (defining criteria to classify debtor as medically distressed); *see also* Mathur Statement, *supra* note 47, at 9 (defining medically distressed debtor); Pottow, *supra* note 83, at 3 (demonstrating how MBFA's broad definition of "medically distressed" will unintentionally include large numbers of debtors).

[119] *See* Michelle J. White, *Abuse or Protection? Economics of Bankruptcy Reform Under BAPCPA*, 2007 U. ILL. L. REV. 275, 291 (2007) (displaying bankruptcy filing data and corresponding income in 2000–2002); *see also* Mathur Statement, *supra* note 47, at 9–10 (positing large number of debtors with proportionately small "actual" medical debt qualify as medically distressed).

[120] *See* MBFA, § 2(a)(1) (requiring only 10% of debtor's annual gross income have been used to pay medical debts).

Second, the timeframe in which to analyze the medical debt is very broad. The legislation looks back three years.[121] Most typical debtors will be able to fit within the definition with such a broad window in which to fit. Third, the definition applies not only to the debtor and dependents of the debtor, but even a nondependent immediate family member.[122] Pulling nondependent immediate family members into the definition will bring questions about who exactly fits into that category, and may result in manipulation of the broad category. Fourth, the medical debt must not have been paid by a third party.[123] This will be very difficult to show, particularly if a creditor, trustee, or other party is attempting to verify what medical debts have been paid by insurance or other government programs. It makes the enforcement and verification of the qualification very difficult and likely cost-prohibitive.

The second way to fit into the classification of a medically distressed debtor is if, within any consecutive twelve-month period in the three years prior to filing bankruptcy, the debtor was in a household in which all or substantially all of a domestic support obligation income was lost for four or more weeks because of a medical problem of the person obligated to pay the domestic support.[124] This is riddled with several significant problems. First, this qualification relies on a determination that a person outside the household who is responsible for a domestic support obligation experienced a medical problem for at least four weeks causing a loss of income. Second, this qualification looks back a full three years, and, the way the legislation is written, the lost income for 4 weeks or more may not have to be consecutive. Third, the qualification is based on loss of "all or substantially all" of the domestic support obligation income. Questions will certainly arise about what is substantial. Further, the qualification does not examine if the debtor seeking the qualification had other sources of income or employment during the timeframe. The temporary loss of a domestic support obligation may have very different impacts on different debtors depending on other aspects of their financial situation.

The final way to be classified as a medically distressed debtor is if the debtor in any consecutive twelve-month period in the three years prior to filing had a downgrade in employment with a reduction in wages, work hours, or unemployment due to care for a dependent or nondependent member of the immediate family who was ill, injured or disabled, for at least thirty days.[125] Again the broad time period and definition of "nondependent" is subject to abuse. More importantly, the qualification does not look to see if the time off of work was actually paid, as some employers permit the use of paid leave for care of sick family

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[121] *See id.* (looking to "any consecutive 12-month period during the 3 years before the date of the filing of the petition"); *see also* Wright Statement, *supra* note 49 (discussing provisions of MBFA).

[122] *See* MBFA, § 2(a)(1) (defining "immediate family member" as "including any parent, grandparent, sibling, child, grandchild, or spouse of the debtor").

[123] *See id.* (mandating debts "were not paid by any third party payor").

[124] *See id.* (considering any disability insurance payments in addition to other factors).

[125] *See id.* (requiring correlation between reduction of wages and illness or injury).

members. The qualification provides for reduction in "wages or work hours." Simply reducing work hours does not mean the person was not paid. And, as with the second qualification, it is unclear if the thirty days must be consecutive.

B. Enhanced Exemptions

The MBFA enhances the exemption rights for medically distressed debtors.[126] Rather than being afforded the real property exemption under the Code of $15,000[127] or applicable state law,[128] medically distressed debtors will have a homestead exemption of up to $250,000.[129] The legislative history and record do not specifically explain why enhancing exemptions is part of the MBFA and what the intended purpose is. It appears that the purpose is to protect the equity that medically distressed debtors have in their homes and other property. Otherwise, if there is equity over and above the applicable exemption level, the home and personal property are subject to liquidation in a chapter 7 case,[130] or the debtor may be required to pay the value of that equity position in a chapter 13 plan.[131]

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[126] MBFA § 3(a) provides:

> (a) Exempt Property.–Section 522 of title 11, the United States Code, is amended by adding at the end the following:
> "(r) For a debtor who is a medically distressed debtor, if the debtor elects to exempt property–
> "(1) listed in subsection (b)(2), then in lieu of the exemption provided under subsection (d)(1), the debtor may elect to exempt the debtor's aggregate interest, not to exceed $250,000 in value, in real property or personal property that the debtor or a dependent of the debtor uses as a residence, in a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence, or in a burial plot for the debtor or a dependent of the debtor; or
> "(2) listed in subsection (b)(3), then if the exemption provided under applicable law specifically for property of the kind described in paragraph (1) is for less than $250,000 in value, the debtor may elect in lieu of such exemption to exempt the debtor's aggregate interest, not to exceed $250,000 in value, in any such real or personal property, cooperative, or burial plot."

Id. § 3(a).

[127] *See* 11 U.S.C. § 522(d) (2006).

[128] States can opt out of the federal exemptions. *See* 11 U.S.C. § 522(b)(3) (permitting application of state law to exempt property of debtor if state law is applicable at time of petition); Storer v. French (*In re* Storer), 58 F.3d 1125, 1127 (6th Cir. 1995) (finding Congress vested states with authority to deny citizens ability to use federal exemption scheme); *In re* Tevaga, 35 B.R. 157, 159–60 (Bankr. D. Haw. 1983) (prohibiting exemption of real property for failure to meet state statutory residence requirements).

[129] MBFA, § 3(a).

[130] Under chapter 7, the trustee will liquidate non-exempt assets, if there are any, and distribute the proceeds to creditors pursuant to the priorities established in the Code. *See* 11 U.S.C. §§ 507, 704; *see also* Charles M. Foster & Stephen L. Poe, *Consumer Bankruptcy: A Proposal to Reform Chapters 7 and 13 of the U.S. Bankruptcy Code*, 104 DICK. L. REV. 579, 581 (2000) (stating chapter 7 debtor surrenders non-exempt assets to trustee, who liquidates property and distributes proceeds to creditors); John T. Brooks, Note,

The problem with this reform is that it ignores the effect that raising exemptions will really have. First, simply increasing exemption levels for the sake of raising them ignores the purpose of exemption laws in the first place. Exemptions are designed to provide basic necessities of life so the debtors are not destitute.[132] In light of this purpose of providing for "the essential needs of the debtor and his family, some statutes, both state and federal, limit the exemptions 'to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.'"[133] The MBFA raises the exemption level without considering this well-rooted purpose of exemptions. It seems that in many cases, this exemption may provide something more than the basic necessities of life to some debtors.

Second, this will shield assets that would otherwise be available to creditors in a bankruptcy case. Shielding these assets, if they are not needed to sustain basic necessities, runs counter to the goals of bankruptcy law.[134] It will in effect give some debtors not only a fresh start, but a head start. Simultaneously, it will violate the goal of an equitable distribution of assets among creditors.

Third, raising the exemption levels, without considering how this impacts human behavior, may lead to unintended results. The empirical research on the impact of homestead exemption levels and consumer filing is mixed.[135] Some research has shown that higher exemption levels actually lead to lower chapter 13 rates and higher chapter 7 rates.[136] These results are logical because higher

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Shopping Center Tenants in Bankruptcy: The Effect of the 1984 Code Amendments, 1988 U. ILL. L. REV. 725, 729 (1988) ("In a typical Chapter 7 liquidation, the court appoints a trustee to collect all of the debtor's non-exempt property, to convert that property into cash, and to distribute the cash to the creditors.").

[131] The Code requires that the plan provide a value of "not less than the amount that would be paid . . . under chapter 7." 11 U.S.C. § 1325(a)(4).

[132] Uriel Rabinovitz, Note, *Toward Effective Implementation of 11 U.S.C. § 522(d)(11)(E): Invigorating a Powerful Bankruptcy Exemption*, 78 FORDHAM L. REV. 1521, 1540 (2009) (discussing legislative purpose of bankruptcy exemptions); *see also* Laurencic v. Jones, 180 So. 2d 803, 805 (La. App. 4th Cir. 1965) (acknowledging exemptions are intended to protect debtor and family from becoming public charges); Amanda K. Bloch, Comment, *Approaching the Limits of the Bankruptcy Code: Does Surcharging a Debtor's Exempt Assets Go Too Far?*, 76 U. CHI. L. REV. 1747, 1753 (2009) (stating Congress intended exemption statutes as protective measures both for individual debtor's benefit and for public good).

[133] Rabinovitz, *supra* note 132, at 1541–42 (citation omitted).

[134] *See supra* note 100 and accompanying text.

[135] *See* Robert J. Landry, III, *An Empirical Analysis of the Causes of Consumer Bankruptcy: Will Bankruptcy Reform Really Change Anything?*, 3 RUTGERS BUS. L.J. 2, 18, 25 (2006) [hereinafter Landry, *An Empirical Analysis*] (arguing higher homestead exemption levels may incentivize debtors to file chapter 7); Teresa A. Sullivan, Elizabeth Warren & Jay Lawrence Westbrook, *Consumer Debtors Ten Years Later: A Financial Comparison of Consumer Bankrupts 1981- 1991*, 68 AM. BANKR. L.J. 121, 123 (1994) (finding no correlation between level of exemptions and chapter of bankruptcy filed by debtors); Lawrence A. Weiss, Jagdeep S. Bhandari & Russell Robins, *An Analysis of State-Wide Variation in Bankruptcy Rate in the United States*, 17 BANKR. DEV. J. 407, 417–18 (2001) (asserting home exemption levels are not statistically significant to predict chapter 7 or 13 filings).

[136] *See* Landry, *An Empirical Analysis*, *supra* note 135, at 40–41 (claiming negative correlation between level of homestead exemption and number of chapter 13 filings); *see also* Michelle J. White, *Personal Bankruptcy Under the 1978 Bankruptcy Code: An Economic Analysis*, 63 IND. L.J. 1, 45–47 (1987) (citing empirical data showing increase in chapter 7 filings associated with increase in exemption levels). *But see* Chrystin Ondersma, *Are Debtors Rational Actors? An Experiment*, 13 LEWIS & CLARK L. REV. 279, 304 (2009) (finding no correlation between chapter 13 filings and low exemption levels).

exemption levels protect the homestead from creditors so there is less of a need to seek relief under chapter 13 to keep a home if the equity is protected under the exemption.[137] Other research has shown that higher exemption levels lead to higher consumer filings overall.[138] These findings indicate that the MBFA may encourage more chapter 7 filings. If more equity in a home is protected by filing bankruptcy than the typical state-level exemption, then individuals will have an economic incentive to file for chapter 7. What may very well occur is that higher income debtors, with greater equity positions in their homes, who can afford good legal counsel, will be able to plan and strategically position themselves to be able to qualify as medically distressed debtors and retain assets, over and above what is necessary for support and maintenance, that could be used to repay creditors.

C. Waiver of Pre-Petition Credit Counseling

The MBFA exempts medically distressed debtors from pre-petition credit counseling[139] that is required for most consumer debtors.[140] Procedurally, a debtor

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[137] Saving a home is the primary reason that individuals choose to file chapter 13. *See* Jean Braucher, *Counseling Consumer Debtors to Make Their Own Informed Choices – A Question of Professional Responsibility*, 5 AM. BANKR. INST. L. REV. 165, 186–87 (1997) (arguing chapter 13 gives debtors better chance of saving their home than chapter 7); Cheri L. Cohen, *Chapter 11 For Individual Consumer Debtors: Fresh Start or False Start?*, 13 N. ILL. U. L. REV. 401, 422–23 (1993) (commenting "chapter 13 was the chapter to choose when a debtor's primary reason for filing the petition was to save a home"); Michelle J. White & Ning Zhu, *Saving Your Home in Chapter 13 Bankruptcy*, 39 J. LEGAL STUD. 33, 56–57 (2010) (asserting nearly all chapter 13 filers do so to save their home from foreclosure, but most fail to save their homes when they otherwise would have defaulted). Therefore, if state law exemptions provide protection, chapter 13 may not be necessary. And, if the enhanced exemptions provide greater protection in chapter 7, this may increase the incentive to file under chapter 7.

[138] *See* Mathur Statement, *supra* note 47, at 12 (discussing relationship between high exemption levels, increased rates of bankruptcy filings, and adverse effect high exemption levels can have on credit markets); Zywicki, *Institutions*, *supra* note 75, at 1086 (explaining empirical evidence has shown correlation between increases in exemption levels and overall bankruptcy filings). *But see* David A. Moss & Gibbs A. Johnson, *The Rise of Consumer Bankruptcy: Evolution, Revolution, or Both?*, 73 AM. BANKR. L.J. 311, 343 (1999) (asserting low exemption levels lead to less stringent lending, increased amounts of credit available to debtors, and increased bankruptcy filings).

[139] MBFA § 5 (2009) provides: "Section 109(h)(4) of title 11 United States Code, is amended by inserting 'a medically distressed debtor or' after 'with respect to'." This will add the medically distressed debtor to the existing applicable debtors whom are exempt from the credit counseling requirement.

[140] *See* 11 U.S.C. §§ 109(h), 521(b) (2006) (requiring credit counseling course). Section 109(h)(1) provides as follows:

> [A]n individual may not be a debtor under this title unless such individual has, during the 180-day period preceding the date of filing of the petition by such individual, received from an approved nonprofit budget and credit counseling agency described in section 111(a) an individual or group briefing (including a briefing conducted by telephone or on the Internet) that outlined the opportunities for available credit counseling and assisted such individual in performing a related budget analysis.

See also In re Hedquist, 342 B.R. 295, 297–98 (B.A.P. 8th Cir. 2006) (explaining mandatory requirements of credit counseling); *In re* Allen, 378 B.R. 151, 153 (N.D. Tex. 2007) (stating individual debtors who file bankruptcy petitions are required to have credit counseling).

must obtain a certificate that evidences pre-petition credit counseling was obtained prior to filing, or the debtor must fit within a statutory exemption and fulfill the requirement within thirty days of filing.[141] The Code provides an exemption of this requirement in very limited circumstances, such as active military duty in combat zone, incapacity, or disability.[142] The MBFA adds the medically distressed debtor to the list of individuals subject to the exemption.[143]

Part of the rationale for expanding the exemption to a medically distressed debtor is based on the ramifications of failing to obtain a certificate as required by the Code. The ramifications can be quite extreme, including dismissal[144]or striking a petition.[145] Examining one particularly thorny issue that courts have had to address highlights the problem. Section 109(h) requires that the credit counseling be obtained "during the 180-day period preceding the date of filing."[146] Many debtors obtain the counseling on the same day as the filing and not "preceding the date of filing" as the Code provides. Debtors in this position are subject to having their case dismissed for not meeting the eligibility requirements of section 109(h).[147] Courts, when faced with this issue, have adopted two approaches. Some courts adhere to the plain reading of the statute and require the credit counseling to precede the date of filing,[148] and other courts find that as long as the credit

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[141] *See* 11 U.S.C. § 109(h)(1) (explaining requirements); *In re* Seaman, 340 B.R. 698, 700 (Bankr. E.D.N.Y. 2006) (disallowing debtor's case for not filing credit counseling certificate); *In re* Hubbard, 333 B.R. 377, 382 (Bankr. S.D. Tex. 2005) (describing credit counseling requirement and exemption).

[142] *See* 11 U.S.C. § 109(h)(4) (listing exemptions); *see also In re* Denger, 417 B.R. 485, 487 (Bankr. N.D. Ohio 2009) (setting forth exclusive grounds for waiver of credit counseling course); *In re* Tulper, 345 B.R. 322, 326–27 (Bankr. D. Colo. 2006) (waiving credit counseling due to physical impairment).

[143] *See* MBFA, § 5.

[144] *See, e.g., In re* Giles, 361 B.R. 212, 215 (Bankr. D. Utah 2007) (granting motion to dismiss debtor's chapter 13 case for failure to complete credit counseling within 180 days of filing); *In re* McBride, 354 B.R. 95, 97 (D.S.C. 2006) (denying debtor's request for waiver of credit counseling due to incarceration); *In re* Ross, 338 B.R. 134, 141 (Bankr. N.D. Ga. 2005) (finding debtor ineligible when failing to obtain credit counseling briefing).

[145] *See, e.g., In re* Cannon, 376 B.R. 847, 849 (Bankr. M.D. Tenn. 2006) (indicating striking petitions creates new burdens and uncertainties for case administration); *In re* Rios, 336 B.R. 177, 179 (Bankr. S.D.N.Y. 2005) (striking petition rather than dismissing when debtor neither sought pre-petition credit conseling nor asked for exemption); *In re Hubbard*, 333 B.R. at 388 (noting courts must consider whether to strike or dismiss a case filed by ineligible debtors).

[146] 11 U.S.C. § 109(h)(1) ("[A]n individual may not be a debtor . . . unless such individual has, during the 180-day period preceding the date of filing of the petition . . . received . . . credit counseling . . . .").

[147] *See id.* (stating individual may not be considered debtor without receiving credit counseling preceding date of filing); *In re* Ross, 338 B.R. at 136 (concluding upon determining ineligibility to be debtor, proper remedy is dismissal); *cf. In re* Pagaduan, 429 B.R. 752, 757 n.2 (Bankr. D. Nev. 2010) (noting court does not have authority to excuse debtor from complying with credit counseling requirement).

[148] *See, e.g., In re* Hammonds, No. 08-40928-JJR-13, 2008 WL 4830071, *4–5 (Bankr. N.D. Ala. Sept. 22, 2008) (stating plain language of Code is starting point, unless it would lead to absurd result and denying confirmation when debtor obtained credit counseling on same day as filing bankruptcy petition); *cf.* United States v. Ballinger, 395 F.3d 1218, 1237 (11th Cir. 2005) (presuming legislature acts with sensible, reasonable purpose, so statute should be read to avoid unjust conclusion).

counseling was obtained prior to filing, even if on the same day, the requirement is satisfied.[149] Exempting the medically distressed debtor avoids this issue.

The other argument for waiving this requirement for the medically distressed debtor is that it is not effective and serves no valid purpose.[150] Credit counseling of consumers was intended by Congress to provide an opportunity to learn of the consequences of filing for bankruptcy prior to deciding to actually file.[151] Indeed, the effectiveness of credit counseling has been called into question,[152] even before the legislation was passed.[153] Early "anecdotal evidence suggests that by the time most consumers receive the counseling, their financial problems are dire and they have few viable alternatives to bankruptcy."[154] If most consumers are in such a position at the time of required credit counseling, the effectiveness of this

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[149] *See, e.g., In re* Francisco, 390 B.R. 700, 705 (B.A.P. 10th Cir. 2008) (concluding debtor satisfies section 109(h) if "he or she completes the required credit counseling at any time between 180 days before, and the moment of, filing the petition"); *In re* Barbaran, 365 B.R. 333, 336 n.4 (Bankr. D.C. 2007) (denying trustee's motion to dismiss case because "in § 109(h), Congress failed to accord the term 'date' its usual meaning of calendar day, and instead intended 'date' to mean the moment of the filing of the petition"); *In re* Moore, 359 B.R. 665, 675 (Bankr. E.D. Tenn. 2006) (recognizing "§ 109(h)(1) governs not the period of time for doing an act after a bankruptcy case is commenced but rather describes the requisite time for taking a step to establish eligibility to file a case" and denying dismissal when debtor completed credit counseling on same day as filing petition).

[150] Representative John Conyers characterized credit counseling meaningless. *See Medical Debt: Is Our Health Care System Bankrupting Americans? Before the Subcomm. on Commercial and Admin. Law of the Comm. on the Judiciary H.R.*, 111th Cong. 111-56 (July 28, 2009) (statement of Rep. John Conyers), *available at* http://judiciary.house.gov/hearings/pdf/Conyers090728.pdf.

[151] The legislative history clearly states the intended purpose of the pre-petition credit counseling:

> The legislation's credit counseling provisions are intended to give consumers in financial distress an opportunity to learn about the consequences of bankruptcy – such as the potentially devastating effect it can have on their credit rating (citation omitted) before they decide to file for bankruptcy relief.

H.R. REP. NO. 109-31, pt. 1, at 18 (2005), *reprinted in* 2005 U.S.C.C.A.N. 104, 104.

[152] For a discussion of some of the problems with the requirement and ramifications of not meeting this requirement, see Jean Braucher, *A Guide to Interpretation of the 2005 Bankruptcy Law*, 16 AM. BANKR. INST. L. REV 349, 367–69 (2008).

[153] *See, e.g.*, Richard L. Stehl, *The Failings of the Credit Counseling and Debtor Education Requirements of the Proposed Consumer Bankruptcy Reform Legislation of 1998*, 7 AM. BANKR. INST. L. REV. 133, 148–50 (1999) (discussing several practical difficulties with enforcing mandatory credit counseling); Winton E. Williams, *Resolving the Creditor's Dilemma: An Elementary Game - Theoretic Analysis of the Causes and Cures of Counterproductive Practices in the Collection of Consumer Debt*, 48 FLA. L. REV. 607, 642–44 (1996) (describing burdens of credit counseling process). For an analysis of the effectiveness of credit counseling generally, see Michael E. Staten & John M. Barron, *Evaluating the Effectiveness of Credit Counseling* 25 (May 31, 2006), http://www.consumerfed.org/elements/www.consumerfed.org/file/finance/Credit_Counseling_Report061206.pdf ("[E]ven after controlling for risk scores at the outset, the regression model estimates . . . indicate that those who visited a counseling agency had an increased likelihood of a subsequent bankruptcy or derogatory public record.").

[154] U.S. GOV'T ACCOUNTABILITY OFFICE, GAO-07-203, VALUE OF CREDIT COUNSELING REQUIREMENT IS NOT CLEAR 19 (2007); *see also* U.S. GOV'T ACCOUNTING OFFICE, GAO/T-GGD-99-58, PERSONAL BANKRUPTCY: METHODOLOGICAL SIMILARITIES AND DIFFERENCES IN THREE REPORTS ON DEBTORS' ABILITY TO PAY 4 (1999) (discussing background of personal bankruptcy); Dickerson, *supra* note 9, at 148–49 (criticizing credit counseling measures for placing obstacles before debtors in dire need of relief).

requirement is assuredly very small.[155] The mode of the credit counseling for debtors in this position is often a phone call or internet session, which raises serious questions about its usefulness and effectiveness.[156]

One court has equated the requirement for debtors in this position as akin to requiring spouses in a bitter divorce to attend counseling as a condition of obtaining a decree for divorce.[157] It is likely too little, too late. And when the explicit and implicit costs imposed on consumer debtors are considered, regardless of having medical or non-medical debt, with no strong empirical evidence showing its effectiveness,[158] the requirement certainly appears to be a waste of resources. As such, the requirements should be eliminated for all debtors, not just the medically distressed debtor.[159]

D. Waiver of Means Test

The fundamental purpose behind BAPCPA was to reduce the number of chapter 7 consumer-bankruptcy filings, which have continued to grow at dramatic rates

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[155] There is other anecdotal evidence, albeit very thin, that suggests credit counseling may be steering some consumers away from bankruptcy. *See* Dickerson, *supra* note 9, at 147 (noting significant decrease in bankruptcy filings in response to legislation); Clifford J. White, III, *Making Bankruptcy Reform Work: A Progress Report in Year 2*, AM. BANKR. INST. J., June 2007, at 51 ("While available USTP data show that there are 10 percent more certificates than bankruptcy filings, which may suggest that some debtors find nonbankruptcy alternatives, further research is necessary to determine the overall effectiveness of credit counseling.").

[156] *See* Susan Block-Lieb & Edward J. Janger, *The Myth of the Rational Borrower: Rationality, Behavioralism, and the Misguided "Reform" of Bankruptcy Law*, 84 TEX. L. REV. 1481, 1561 (2006) (questioning manner and late stage at which credit counseling occurs); MacArthur, *supra* note 19, at 427–28 (doubting usefulness of counseling conducted over telephone or through internet); Joseph Satorius, Note, *Strike or Dismiss: Interpretation of the BAPCPA 109(h) Credit Counseling Requirement*, 75 FORDHAM L. REV. 2231, 2238 (2007) ("The fact that the counseling requirement can be satisfied with a phone call or Interenet session in the final days of a petitioner's financial distress has caused many scholars to question the usefulness of the counseling.").

[157] *See In re* Wilson, 346 B.R. 59, 62 (Bankr. N.D.N.Y. 2006) ("[C]ompelling an individual already buried in a financial morass to undergo credit counseling . . . as a condition precedent to . . . filing a petition, makes about as much sense as requiring spouses locked in a bitter divorce proceeding to attend a marriage counseling . . . before . . . dissolving their marriage.").

[158] *See, e.g.*, Braucher, *supra* note 152, at 365–66 (stating General Accounting Office's 2007 study suggests late timing of credit counseling requirement provides little assistance to consumers); Dickerson, *supra* note 9, at 148 (noting commentators' conclusions credit counseling has little value for most consumers); Robert J. Landry, III & Amy K. Yarbrough, *An Empirical Examination of the Direct Access Costs to Chapter 7 Consumer Bankruptcy: A Pilot Study in the Northern District of Alabama*, 82 AM. BANKR. L.J. 331, 337 (2008) (examining evidence suggesting additional cost of credit counseling does not render any tangible benefit to consumers).

[159] Congress has considered eliminating this requirement for other specific debtors, such as homeowners facing foreclosure. *See* Home Owners Mortgage and Equity Savings Act, H.R. 3778, 110th Cong. § 4 (2007) (permitting delay of credit counseling requirement until post-filing for debtors in foreclosure); Emergency Home Ownership and Mortgage Equity Protection Act of 2007, H.R. 3609, 110th Cong. § 5 (2007) (proposing elimination of credit counseling requirement for Ch. 13 debtors in foreclosure); A. Mechele Dickerson, *The Myth of Home Ownership and Why Home Ownership is not Always a Good Thing*, 84 IND. L.J. 189, 223 (2009) (citing legislation waiving or delaying requirement for homeowners in bankruptcy). The burden of this requirement should not be linked to special cases, but eliminated for all consumer debtors.

each year over the last decade.[160] The means test was designed to hold people more accountable for their debts and give creditors more of what they are owed.[161] The basic goal was to shut the door on chapter 7 for consumer debtors who can afford to repay all or some of their debts.[162] Creating a special category for medical debtors, so they are exempt from the requirements of the means test, without any regard to whether the debtors can actually repay some of their debts or considering the magnitude of the medical vs. consumer debt, is inconsistent with the policy behind the implementation of the means test in 2005.

Consideration of how the means test works is needed to appreciate the potential for abuse if the MBFA becomes law. A presumption of abuse in chapter 7 cases is determined by the debtor's ability to repay a portion of general unsecured debts.[163] This computation is based on the debtor's current monthly income, less allowed deductions, utilizing an IRS standard for expenses.[164] If the debtor's current monthly income is at or below the median family income in the debtor's state, there is no presumption that the debtor is abusing the system.[165] If the debtor's current monthly income is above the median family income in the debtor's state, then a presumption of abuse can arise in two ways. First, if the debtor's monthly disposable income, based on the debtor's current monthly income less statutorily prescribed expenses is greater than $182.50, then the case is presumed abusive.[166] Second, if the debtor's

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[160] *See* Top Rank, Inc. v. Ortiz (*In re* Ortiz), 400 B.R. 755, 770 (C.D. Cal. 2009) ("The purpose of the BAPCPA was to reduce the number of consumer bankruptcy filings and ensure that debtors repay their creditors as much money as possible."); Warren v. Wirum, 378 B.R. 640, 644 (N.D. Cal. 2007) (noting BAPCPA's avowed purpose was to reduce excessive amount of bankruptcy filings); *see also* Michelle J. White, *Bankruptcy and Small Business*, 24 REG. 18, 18 (2001) (positing purpose of BAPCPA was to reduce consumer bankruptcy filings by making these filings less appealing to consumers above median income level).

[161] *See* Landry & Yarbrough, *supra* note 60, at 356 (noting use of means test as accountability mechanism); Ronald J. Mann, *Bankruptcy Reform and the "Sweat Box" of Credit Card Debt*, 2007 U. ILL. L. REV. 375, 377 (2007) (stating means test was designed to limit ability of consumers to discharge debts); Shaun Mulreed, Note, *In re Blair Misses the Mark: An Alternative Interpretation of the BAPCPA's Homestead Exemption*, 43 SAN DIEGO L. REV. 1071, 1079 n.54 (2006) (positing goal of means test to ensure debtors pay creditors maximum amount they can afford).

[162] *See supra* note 85 and accompanying text.

[163] *See, e.g.*, *In re* Champagne, 389 B.R. 191, 200 (Bankr. D. Kan. 2008) (suggesting, if debtor's expenses exceed those permitted by means test, presumption of abuse may be rebutted); *In re* Patterson, 392 B.R. 497, 502 (Bankr. S.D. Fla. 2008) (noting courts can dismiss chapter 7 cases when presumption of abuse is rebutted or does not arise); Landry & Yarbrough, *supra* note 60, at 357 (indicating special circumstances are required for debtor to obtain chapter 7 relief when presumption of abuse exists).

[164] *See* 11 U.S.C. § 707(b)(2)(A)(ii)(I) (2006) (stating how debtor's monthly expenses are to be calculated with IRS Standards); *In re* Wisham, 416 B.R. 790, 798–99 (Bankr. M.D. Fla. 2009) (applying IRS Local Standards for vehicle operation expense to determine disposable income).

[165] *See In re* Hageney, 422 B.R. 254, 257 (Bankr. E.D. Wash. 2009) (recognizing below median income debtors are not subject to presumption of abuse.); *In re* Justice, 404 B.R. 506, 512, 517 (Bankr. W.D. Ark. 2009) (applying statutory means test to debtor and his family and finding no presumption of abuse); *In re* Mestemaker, 359 B.R. 849, 852 (Bankr. N.D. Ohio 2007) (stating presumption of abuse arises if monthly income is greater than median family income).

[166] *See* 11 U.S.C. § 707(b)(2)(A)(i) (providing for when court shall presume abuse based on disposable monthly income); *In re* James, 414 B.R. 901, 907 & n.1 (Bankr. S.D. Ga. 2009); *see also In re* Burggraf, 436 B.R. 466, 470 (Bankr. N.D. Ohio 2010) (outlining means test for presumption of abuse under chapter 7). The

current monthly net income lies between \$100 and \$166.67, and the product after multiplying by 60 results in at least 25% of the debtor's general unsecured claims, then it is presumed to be an abuse.[167] The presumption of abuse can be rebutted by showing special circumstances.[168]

Medically distressed debtors would not be subject to this test at all,[169] regardless of their income or the magnitude of the other debts a debtor may have. The filter of the means test would not be available to detest abusive filings. The MBFA would create a free-pass for such debtors, at least as far as the means test. Higher income debtors, those that are currently subject to the requirements of the means test, would arguably be able to "walk away from not only their medical debts, but also other debts such as credit card debts."[170]

An issue, not addressed by the MBFA, is that although the bill would create a waiver from the presumption of abuse of the means test by not permitting motions to be filed as to medically distressed debtors, that waiver and limitation applies only to presumed abuse cases under section 707(b)(2). MBFA section 4 expressly limits the standing or ability to bring a motion to dismiss for abuse of medically distressed debtors under section 707(b)(2).[171] Section 707(b)(2) is limited to cases of presumed abuse resulting from the means test.[172] However, there are two statutory methods for determining abuse under section 707(b)(1). The means test of section 707(b)(2) is one way to find abuse. Section 707(b)(3) is applicable to cases in which the presumption of abuse under section 707(b)(2) does not arise or is

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dollar amounts in the Bankruptcy Code are adjusted periodically and reflect the change in the Consumer Price Index for all Urban Consumers. For more information see *Adjustments to Certain Dollar Amounts in the Bankruptcy Code and Official Forms*, U.S. BANKR. CT. DIST. WYO., http://www.wyb.uscourts.gov/court-information/court-news/adjustments-to-certain-dollar-amounts-in-the-bankruptcy-code-and-official-forms (last visited Feb. 15, 2011); Revision of Certain Dollar Amounts in the Bankruptcy Code Prescribed Under Section 104(A) of the Code, 75 Fed. Reg. 8747, 8747–49 (Feb. 25, 2010), *available at* http://www.thefederalregister.com/d.p/2010-02-25-2010-3807.

[167] *See* 11 U.S.C. § 707(b)(2)(A)(i) (stating means test); *In re* Fonash, 401 B.R. 143, 146 (Bankr. M.D. Pa. 2008) (explaining means test); Wedoff, *supra* note 86, 241–42 (containing table explaining means test).

[168] *See* 11 U.S.C. § 707(b)(2)(B)(i) ("In any proceeding brought under this subsection, the presumption of abuse may only be rebutted by demonstrating special circumstances . . . ."); Morse v. Rudler (*In re* Rudler), 576 F.3d 37, 41 n.3 (1st Cir. 2009) (offering examples of "serious medical condition or active duty military service" as rebutting presumption of abuse).

[169] *See* MBFA, § 4 (2009) (indicating trustees and others may not claim chapter 7 abuse against "medically distressed debtors"); *Medical Bankruptcy Fairness Act: Hearing on S. 111-114 Before the Subcomm. on Commercial and Administrative Law of the H. Comm. on the Judiciary*, 111th Cong. 2 (2010) (statement of Rep. Steve Cohen, Chairman, S. Comm. on Commercial and Admin. Law) (stating bill would exempt medically distressed debtors from chapter 7 means test); *see also Medical Bankruptcy Fairness Act: Hearing Before the Subcomm. on Commercial and Amdmin. Law*, H.R. 901 No. 111-141, at 97-98 (2d Sess. 2010) (statement of Aparna Mathur, Resident Scholar, Amer. Enterprise Inst.) (testifying bill's exemption of medically distressed debtors from means test can lead to abuse by debtors).

[170] Mathur Statement, *supra* note 47, at 11.

[171] *See* MBFA § 4 (adding no judge, United States trustee, trustee, or other party in interest may move to dismiss case under section 707(b)(2)).

[172] *See* 11 U.S.C. § 707(b)(2)(A)(i) (describing only means test as creating abuse presumption); *In re* Haman, 366 B.R. 307, 317 (Bankr. D. Del. 2007) (describing Congressional intent to create mechanical means test for presumptive abuse); *In re* Singletary, 354 B.R. 455, 465 (Bankr. S.D. Tex. 2006) (requiring totality of circumstances motion before considering facts external to means test).

rebutted.[173] The MBFA will prevent the presumption of abuse under the means test as serving as a basis for dismissal for abuse for medically distressed debtors; however, the bill does nothing to limit motions for abuse under section 707(b)(3). It is well settled that, even when the presumption of abuse does not arise, section 707(b)(3) is applicable.[174] And, even in cases where the Code expressly exempts a debtor from application of the means test and the presumption of abuse as a basis for dismissal,[175] such debtors are still subject to motions under section 707(b)(3).[176] The result is that medically distressed debtors will still be subject to motions to dismiss based on abuse under section 707(b)(3) for bad faith or the totality of financial circumstances test. And, in fact, probably more so in light of the opportunity for manipulation and abuse that MBFA will present. The bill may actually cause more problems and hurdles by increased litigation by the United

[173] *See In re* Reed, 422 B.R. 214, 230 (C.D. Cal. 2009) (noting section 707(b)(3) applies when presumption of abuse does not arise or is rebutted); *In re* Henebury, 361 B.R. 595, 601 (Bankr. S.D. Fla. 2007) (reciting section 707(b)(3) applies when means test fails or is rebutted); *In re* Nockerts, 357 B.R. 497, 507 (Bankr. E.D. Wis. 2006) (describing application of totality of circumstances test when means test passed or proper excuse given). Section 707(b)(3) provides:

> In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter in a case in which the presumption . . . does not arise or is rebutted, the court shall consider —
> (A) whether the debtor filed the petition in bad faith; or
> (B) the totality of the circumstances . . . .

11 U.S.C. § 707(b)(3).

[174] *See In re Reed*, 422 B.R. at 230 (stating case may still be dismissed even without abusive presumption); *In re Henebury*, 361 B.R. at 604 (indicating when no presumptive abuse, then either bad faith or totality of circumstances tests apply); *In re Singletary*, 354 B.R. at 461 (recognizing if debtor passes means test or rebuts presumption, debtor could still face motion to dismiss under section 707(b)(3)); *In re Nockerts*, 357 B.R. at 507 (warning of potential manipulation of means test as safeguarded by totality of circumstances test). The Ninth Circuit Court of Appeals stated that "[e]ven if a debtor's financial situation does not create a presumption of abuse (or if the presumption is rebutted), the bankruptcy court may still dismiss the petition if the debtor filed the petition in bad faith or if the 'totality of the circumstances' demonstrates 'abuse' of Chapter 7." Egebjerg v. Anderson (*In re* Egebjerg), 574 F.3d 1045, 1048 (9th Cir. 2009); *see also* Blausey v. U.S. Trustee, 552 F.3d 1124, 1127 n.1 (9th Cir. 2009) ("If the presumption does not arise, the bankruptcy court may still find abuse under § 707(b)(3) based on the totality of the circumstances."). Likewise, the Seventh Circuit has interpreted the statutory framework of section 707(b) in this same way. *See* Ross-Tousey v. Neary (*In re* Ross-Tousey), 549 F.3d 1148, 1161–62 (7th Cir. 2008) (stating when there is no presumption of abuse, "dismissal [can still be requested] . . . either for bad faith or based on the totality of circumstances").

[175] *See* 11 U.S.C. § 707(b)(2)(D) (stating debtor is exempt from means test and presumption of abuse and court may not dismiss case); *cf. In re* Fox, 370 B.R. 639, 642 (Bankr. D.N.J. 2007) (listing disabled veterans exception to means test); *In re* Batzkiel, 349 B.R. 581, 584 (Bankr. N.D. Iowa 2006) (describing exception from means test for disabled veterans).

[176] *See In re* Green, 431 B.R. 187, 193 (Bankr. S.D. Ohio 2010) (holding veterans exception to means test inapplicable to totality of circumstances test); Craig D. Robbins, *Disabled Veterans Exempted from Bankruptcy Means Test*, LONG ISLAND BANKR. BLOG (Apr. 3, 2009, 11:37 AM), http://longislandbankruptcyblog.com/disabled-veterans-exempted-bankruptcy-means-test (noting veterans exemption but also need for lack of income to qualify for bankruptcy).

States Trustees,[177] Bankruptcy Administrators,[178] and other parties[179] in cases of medically distressed debtors to ferret out abuse under the tests employed in section 707(b)(3). As it is now, the tests employed under section 707(b)(3) are an area of significant litigation,[180] even without creating the additional potential loopholes for medically distressed debtors.

CONCLUSION

We can all agree that healthcare costs are a causal factor of consumer bankruptcy. Regardless of the disagreement on to what extent healthcare costs actually cause bankruptcy, if we step back from the rhetoric and assume that half of bankruptcies are caused by illness or medical bills, bankruptcy law is not the problem. Professor Warren, a co-researcher on some of the most persuasive empirical studies showing a causal connection between healthcare costs and bankruptcy, wrote prior to the passage of BAPCPA in 2005: "The problem is not in the bankruptcy laws. The problem is in the healthcare finance system and in

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[177] The United States Trustee ("UST") program operates in all judicial districts other than those in Alabama and North Carolina. *See* 28 U.S.C. §§ 581–589b (2006). It has standing to bring motions for abuse. *See* 11 U.S.C. § 707(b)(1). Most motions are brought by the UST, as opposed to other parties, in their districts in light of the costs associated with private parties prosecuting such motions. *See, e.g., In re* Passis, 235 B.R. 562, 567 (Bankr. D.N.J. 1999) (explaining how trustees are in best position to bring abuse motions).

[178] The Bankruptcy Administrator Program ("BA") operates in North Carolina and Alabama. *See In re* Miles, 330 B.R. 861, 865 (Bankr. D. Ga. 2005) (discussing how North Carolina and Alabama use BA program). The BA program is part of the Judicial Branch, whereas the UST program is part of the Executive branch. *See generally* 10 COLLIER ON BANKRUPTCY ¶ 9035.01 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2010). The BA program performs many of the same functions as the UST program, including prosecuting motions for abuse as the BA. *See* 11 U.S.C. § 707(b)(1); Schultz v. United States, 529 F.3d 343, 348 (6th Cir. 2008) (stating trustee or bankruptcy administrator can take action and file statements); Mann v. Am. Federated Life Ins. Co., 215 B.R. 822, 822 (S.D. Miss. 1997) (indicating BA or trustee may move for dismissal under certain circumstances). Most motions in BA districts are brought by the BA rather than other parties in light of the costs associated with prosecuting such motions.

[179] Other parties, including case trustees, have standing to bring abuse motions. *See* 11 U.S.C. § 707(b)(1) ("[A]ny party in interest [] may dismiss a case filed by an individual debtor under this chapter . . . ."). However, standing is limited in cases involving below median debtors. *See* 11 U.S.C. § 707(b)(6).

[180] Scores and scores of published opinions exist on how to interpret and apply the two enumerated grounds a court must consider under section 707(b)(3): bad faith and totality of the debtor's financial circumstances. For example, see *In re* Cardona-Pereira, No. 08-18337, 2010 WL 500404, at *3–6 (Bankr. D.N.J. Feb. 4, 2010) (considering both faith and totality tests and factors to employ under each); *In re* Mestemaker, 359 B.R. 849, 855–58 (Bankr. N.D. Ohio 2007) (applying totality test and relevant factors); *In re* Henebury, 361 B.R. 595, 597–99 (Bankr. S.D. Fla. 2007) (providing extensive review of statutory framework and application of totality test). And hundreds of pages have been written in dozens of law review articles on this same issue. For example, see Robert J. Landry, III, *The Means Test: Finding a Safe Harbor, Passing the Means Test, or Rebutting the Presumption of Abuse May Not Be Enough*, 29 N. ILL. U. L. REV. 245, 256, 262–63 (2009) (reviewing statutory framework and application of two tests in practice); Adam J. Ruttenberg, *The Totality of What Circumstances? How Courts Determine Whether Granting Bankruptcy Relief Would Be an Abu*se, 2009 NORTON ANN. SURV. OF BANKR. LAW PART II § 4 (June 2009) (discussing various approaches courts employ); Ned W. Waxman & Justin H. Rucki, *Chapter 7 Bankruptcy Abuse: Means Testing is Presumptive, But "Totality" is Determinative*, 45 HOUS. L. REV. 901, 922–23 (2008) (discussing approaches courts employ in applying two tests).

chronic debates about reforming it."[181] This statement is as true today as it was then. Rather than continually tinkering with the bankruptcy system, policymakers need to confront, in a meaningful way, the other policy domains that are connected to bankruptcy. Similarly, scholars need to focus on those policy connections in their research.[182] As Professor Warren recognizes, healthcare reform should be a priority, but so should reforms that increase financial literacy and access to high quality education or minimum wage laws.[183] The medical bankruptcy reform is just another incremental reform to consumer bankruptcy that fails to address the root causes of consumer bankruptcy. It is a reform that is based on a fallacy of composition. Such a reform is misguided and leaves the social safety net in the same tattered state as that in which it was found.

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[181] Elizabeth Warren, *Sick and Broke*, WASH. POST, Feb. 9, 2005, at A23.

[182] *See, e.g.*, Katherine Porter, *The Potential and Peril of BAPCPA for Empirical Research*, 71 MO. L. REV. 963, 1078 (2006) (recognizing whole host of policy areas intersecting with bankruptcy system and importance of empirical research on relationship between those areas and consumer bankruptcy).

[183] *See* Warren, *supra* note 181, at A23 (mentioning difficulties with healthcare reform).

In the matter of: HENRY E. THORNE, Debtor

Chapter 13, Case Number 05-41544

UNITED STATES BANKRUPTCY COURT FOR THE SOUTHERN DISTRICT OF GEORGIA, SAVANNAH DIVISION

2008 Bankr. LEXIS 4379

March 12, 2008, Decided
March 13, 2008, Filed

CASE SUMMARY:

PROCEDURAL POSTURE: On November 26, 2007, debtor filed a Motion to Incur Debt for a Reverse Mortgage in order to pay his Chapter 13 in full. After notice and a hearing, the court entered an order granting the motion to incur a reverse mortgage but reserved its ruling on using the proceeds to pay off the mortgages and reduce/pay-off the Chapter 13 plan for a future order.

OVERVIEW: The issue raised by the parties was the interpretation of *11 U.S.C.S. § 1325(b) (2005)* and whether it required debtor to fund a plan for at least a full term of 36 months unless he paid all the allowed claims in full, or whether debtor could pay off his plan early by paying the projected cash dividend proposed in the original plan. Debtor contended that since there was no bad faith on his part, no prejudice to the creditors, no harm to the Trustee, and the creditors would receive the dividend now rather than having to wait, the court should allow him to make a lump sum payment to the Trustee earlier than the installments otherwise would have come due. The court stated that, in order to pay off his plan early, debtor had to modify his current plan under *11 U.S.C.S. § 1329 (2005)*. Citing *§ 1325(b)(1)(B)*, the court held that debtor had to continue his monthly payments for a minimum of 36 months, after the first payment was due, subject to modification of any provision other than the plan duration. After that minimum 36-month threshold, debtor could then propose a modified plan to pay a lump-sum to conclude his Chapter 13 plan.

OUTCOME: Debtor's Motion to pay off the case early was denied. Debtor was previously authorized to close a reverse mortgage. It was further ordered that debtor was to report on the status of his reverse mortgage transaction and an accounting of funds received and disbursed by March 24, 2008.

LexisNexis(R) Headnotes

Bankruptcy Law > Individuals With Regular Income >

Plans > Modification
[HN1] See *11 U.S.C.S. § 1329 (2005)*.

Bankruptcy Law > Individuals With Regular Income > Plans > Confirmation > General Overview
Bankruptcy Law > Individuals With Regular Income > Plans > Modification
[HN2] Once a debtor meets the subsection (a) criteria, he must still deal with the additional prerequisite to confirmation in *11 U.S.C.S. § 1325(b)(1)(B)*: (b)(1) If the trustee of 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, (B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan. *11 U.S.C.S. § 1325(b)(l)(B) (2005)*.

Bankruptcy Law > Individuals With Regular Income > Plans > Confirmation > General Overview
[HN3] The issue whether a debtor must fund a plan for a minimum of 36 months unless he pays all unsecured claims in full, or whether a debtor may pay his projected monthly disposable income multiplied by 36 at any time during the plan is answered by *11 U.S.C.S. § 1325(b)(1)(B) (2005)*. It plainly requires a debtor to make plan payments for a period of at least 36 months.

Bankruptcy Law > Individuals With Regular Income > Plans > Confirmation > General Overview
[HN4] Prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act, the U.S. Bankruptcy Court for the Southern District of Georgia has found that *11 U.S.C.S. § 1325(b) (2005)* requires a standard minimum length of thirty-six months for any plan objected to by the trustee or an unsecured creditor, unless the plan provides for payment of all allowed unsecured claims.

Bankruptcy Law > Individuals With Regular Income > Plans > Confirmation > General Overview
Governments > Legislation > Interpretation
[HN5] The express words of *11 U.S.C.S. § 1325(b)(1)(B) (2005)* require a minimum three-year period unless all allowed creditors are paid in full. The starting point in any case involving the meaning of a statute is the language of the statute itself. In construing a federal statute it is appropriate to assume that the ordinary meaning of the language that Congress employed accurately expresses its legislative purpose. For where the statute's language is plain, the sole function of the courts is to enforce it according to its terms.

Bankruptcy Law > Individuals With Regular Income > Plans > Confirmation > General Overview
Bankruptcy Law > Individuals With Regular Income > Plans > Modification
[HN6] If a trustee or allowed unsecured creditor objects to the confirmation of the modified plan, then this court may not approve the modified plan unless (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 three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan. *11 U.S.C.S. § 1325(b)(l) (2005)*. The express words of the statute give a debtor two options if the Trustee objects to a plan: (1) pay all of the creditors in full; or (2) provide his projected disposable income over a three-year period. The term "three-year period" "uses a word with temporal meaning: "period" means "chronological division," "length of time," "portion of time," or a "length of existence." If Congress wanted the three-year period to function as a multiplier, it could have stated so in the statute. Once a debtor reaches this minimum 36-month threshold, he may propose a modified plan that would allow him to make a lump-sum payment to conclude a Chapter 13 plan which extends beyond 36 months.

COUNSEL: [*1] For Henry E. Thorne, Debtor: Charles W. Bell, Charles W. Bell & Associates, Savannah, GA.

Trustee: O. Byron Meredith, III, Savannah, GA.

JUDGES: Lamar W. Davis, Jr., United States Bankruptcy Judge.

OPINION BY: Lamar W. Davis, Jr.

OPINION

FINAL MEMORANDUM AND ORDER ON

DEBTOR'S MOTION TO INCUR DEBT

FINDINGS OF FACT

Debtor filed Chapter 13 on June 17, 2005. On November 1, 2005, this Court confirmed Debtor's plan of $ 303.00 per month for 60 months. The plan proposed to pay a dividend to unsecured creditors of no less than 10%. Trustee's Report of Confirmation, Dckt.No. 18 (March 8, 2006). On November 26, 2007, Debtor filed a Motion to Incur Debt for a Reverse Mortgage in order to pay his Chapter 13 in full. Motion, Dckt No. 21. After notice and a hearing, this Court entered an order granting the motion to incur a reverse mortgage but reserved its ruling on using the proceeds to pay off the mortgages and reduce/pay-off the Chapter 13 plan for a future order. Order Granting Motion to Incur Debt, Dckt.No. 28 (December 17, 2007). As of February 22, 2007, Debtor's case had been pending for 27 months, he has paid $ 12,423.23, and still has a "balance" of $ 8,699.00.

The issue raised by the parties is the interpretation of *§ 1325(b)* [*2] and whether it requires Debtor to fund a plan for at least a full term of 36 months unless he pays all the allowed claims in full, or whether Debtor can pay off his plan early by paying the projected cash dividend proposed in the original plan. The Trustee objects to Debtor's proposed early payment by arguing that Debtor must either fund his plan for a minimum of 36 months or, if he wants to pay his plan off early, must pay the creditors 100% of their allowed claims. Debtor, on the other hand, argues that since there is no bad faith on his part, no prejudice to the creditors, no harm to the Trustee, and the creditors would receive the dividend now rather than having to wait, this Court should allow Debtor to make a lump sum payment to the Trustee earlier than the installments otherwise would have come due.

CONCLUSIONS OF LAW

Since Debtor filed his petition before October 17, 2005, this issue is governed by the law prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA"). In order to pay off his plan early, Debtor must modify his current plan under *11 U.S.C. § 1329*:

> [HN1] (a) At any time after confirmation of the plan but before the completion of payments [*3] under such plan, the plan may be modified, upon request of the debtor, the trustee, or the holder of an allowed unsecured claim, to ...
>
> (2) extend or reduce the time for such payments ...
>
> (b)(1) *Section 1322(a), 1322(b),* and *1323(c)* of this title and *the requirements of section 1325(a) of this title apply* to any modification under subsection (a) of this title.
>
> *11. U.S.C. § 1329 (2005)*(emphasis added).

a plan. [HN2] Once Debtor meets the *subsection (a)* criteria, he must still deal with the additional prerequisite to confirmation in *§ 1325(b)(1)(B)*:

> (b)(1) If the trustee of 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...
>
> (B) the plan provides that all of the debtor's projected disposable income to be received in the *three-year period* beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.
>
> *11 U.S.C. § 1325(b)(1)(B)(2005)*(emphasis added).

[HN3] The issue whether a Debtor must fund a plan for a minimum of 36 months unless he pays all unsecured claims in full, or whether Debtor may pay his projected monthly disposable income multiplied [*4] by 36 at any time during the plan is answered by *§ 1325(b)(1)(B)*. It plainly requires Debtor to make plan payments for a period of at least 36 months.

This holding is consistent with this Court's previous practice. [HN4] Prior to the enactment of BAPCPA, I have found that *§ 1325(b)* requires a standard minimum length of thirty-six months for any plan objected to by the trustee or an unsecured creditor, unless the plan provides for payment of all allowed unsecured claims. *See also In re Weaver, 2006 U.S. Dist. LEXIS 4758, 2006 WL 305437, at *2 (E.D.Pa. 2006)*; *In re Martin, 189 B.R.*

619, 625 (Bankr.E.D.Va. 1995)("[T]he Bankruptcy Code mandates a minimum of 36 months duration for any plan objected to unless that plan pays 100% of allowed unsecured claims."); *In re Evans, 183 B.R. 331, 333 (Bankr.S.D.Ga.l995)*(J.Dalis)(refers to the "minimum three-year period of *§ 1325(b)(1)(B)*.").

Second,[HN5] the express words of *§ 1325(b)(1)(B)* require a minimum three-year period unless all allowed creditors are paid in full. "The starting point in any case involving the meaning of a statute [] is the language of the statute itself." *Group Life & Health Ins. Co, v. Royal Drug Co., 440 U.S. 205, 210, 99 S.Ct. 1067, 1073, 59 L.Ed.2d 261 (1979)*. [*5] "In construing a federal statute it is appropriate to assume that the ordinary meaning of the language that Congress employed 'accurately expresses its legislative purpose.'" *Mills Music, Inc. v. Snyder, 469 U.S. 153, 164, 105 S.Ct. 638, 645, 83 L.Ed.2d. 556 (1985)*(*quoting Park 'N Fly Inc. v. Dollar Park and Fly, Inc., 469 U.S. 189, 194, 105 S.Ct. 658, 83 L. Ed. 2d 582)*. "[F]or where, as here, the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.'" *United States v. Ron Pair Enterprises, Inc., 489 U.S. 235, 241, 109 S.Ct. 1026, 1030, 103 L.Ed.2d 290 (1989)*(*quoting Caminetti v. United States, 242 U.S. 470, 485, 37 S.Ct. 192, 194, 61 L.Ed. 442 (1917))*.

[HN6] If a trustee or allowed unsecured creditor objects to the confirmation of the modified plan, then this court may not approve the modified plan unless

> (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 three-year period beginning on the date that the first payment is due under the plan will be applied to make payments [*6] under the plan.
>
> *11 U.S.C. § 1325(b)(1)(2005)*.

The express words of the statute give Debtor two options if the Trustee objects to a plan: (1) pay all of the creditors in full; or (2) provide his projected disposable income over a three-year period. Since Debtor is not paying all allowed claims in full, he must pay all his projected disposable income for a three year period. The term "three-year period" "uses a word with temporal meaning: 'period' means 'chronological division,'" "length of time, "portion of time," or a "length of existence." *In re Schanuth, 342 B.R. 601, 607 (Bankr.W.D.Mo. 2006)*; *In re Slusher, 359 B.R. 290, 301 (Bankr.D.Nev. 2007)*; *In re Davis, 348 B.R. 449, 456 (Bankr.E.D.Mich. 2006)*. "If Congress wanted the [three-year] period to function as a multiplier, it could have stated so in the statute." *In re Alexander, 344 B.R. 742, 751 (Bankr.E.D.N.C. 2006)*; *see e.g., 11 U.S.C. §§ 507(a)(4)(B)(i)(2005)* ("the number of employees covered by each such plan multiplied by $ 4,925").

Once Debtor reaches this minimum 36-month threshold, he may propose a modified plan that would allow him to make a lump-sum payment to conclude a Chapter 13 plan which extends beyond 36 months. Although [*7] some courts pre-BAPCPA permitted a Chapter 13 debtor to pay off a 36 month plan on an accelerated basis without first confirming a modified plan shortening the length of the plan, [1] I disagree with that holding for the reasons stated by the Bankruptcy Court of the Eastern District of California in *In re Keller, 329 B.R. 697, 699-701 (Bankr.E.D.Cal. 2005)*:

> [1] . . . if a court is prepared to permit a debtor to accelerate payments, the same logic would permit the deferral or reduction of monthly plan payments as long as, by the last month of the plan, the payments have been caught up. After all, if the length of the plan and the amount of the monthly plan payment are nothing more than the two components of a formula determining the total amount due creditors, why not permit the debtor to make a lump sum payment in the last month of the plan?
>
> This is not permitted because a debtor, like a creditor, is bound by all plan provisions, including those requiring regular monthly payments. *See 11 U.S.C. § 1327(a)*.
>
> [2] ... a chapter 13 plan is required to provide for the means of its execution... It makes little sense to require that a plan

specify how it will be funded, and to require regular monthly [*8] payments that continue for at least 3 years, then verify that the debtor has the ability to make such payments only to permit the debtor to perform differently than required by the plan. *See 11 U.S.C. §§ 1322(a)(1), 1325(a)(6)* & *(b)*.

[3]... There may be a good reason to question the source of an accelerated lump sum payment. If a debtor has a sudden ability to make a large lump sum payment, this may indicate that the debtor's income has increased significantly or that the debtor has received a windfall. In either case, the debtor's new financial ability might warrant confirming a modified plan in order to pay more to creditors rather than just paying off the dividends promised in the original plan.

[4] . . . when a debtor makes an accelerated lump sum payment rather than the regular monthly payments required by the plan, the debtor is preempting the right of the trustee and the unsecured creditors to propose a modified plan should circumstances (such as an increase in the debtor's income) warrant a modification. *See 11 U.S.C. § 1329(a)*.

For the foregoing reasons, I hold that Debtor must continue his monthly payments for a minimum of 36 months, after the first payment was due, subject to [*9] modification of any provision other than the Plan duration. After that minimum 36-month threshold, Debtor may then propose a modified plan to pay a lump-sum to conclude his Chapter 13 plan.

1 *See e.g.*, *In re McCollum, 363 B.R. 789, 797 (E.D.La. 2007)*; *In re Golek, 308 B.R. 332, 337 (Bankr.N.D.Ill. 2004)*; *In re Sounakhene, 249 B.R. 801, 805 (Bankr.S.D.Cal. 2000)*.

ORDER

Pursuant to the foregoing Findings of Fact and Conclusions of Law, IT IS THE ORDER OF THIS COURT THAT THE Debtor's Motion to pay off the case early is denied.

Debtor was previously authorized to close a reverse mortgage. IT IS FURTHER ORDERED that Debtor is to report on the status of his reverse mortgage transaction and an accounting of funds received and disbursed by March 24, 2008.

/s/ Lamar W. Davis, Jr.

Lamar W. Davis, Jr.

United States Bankruptcy Judge

Dated at Savannah, Georgia

This 12th day of March, 2008.

Analysis
As of: Feb 20, 2012

In re JAMES F. JACONO, Debtor.

Chapter 13, Bankruptcy No. 06-13912DWS

UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

360 B.R. 84*; *2006 Bankr. LEXIS 3743

November 30, 2006, Decided

CASE SUMMARY:

PROCEDURAL POSTURE: Creditor, the United States of America through the Department of Housing and Urban Development (HUD), filed a motion to dismiss Chapter 13 debtor's case with prejudice pursuant to *11 U.S.C.S. § 1307(c)(1)*.

OVERVIEW: HUD granted debtor's father a reverse mortgage. HUD sought to foreclose on the mortgage after it became due when the father died. Debtor filed a Chapter 13 petition. His plan was not confirmed because it was too speculative, and the case was dismissed. HUD then obtained a court order, foreclosing the mortgage lien and allowing the sale of the property and payment to HUD from its proceeds, and declaring that the father and any heirs, executors, and assigns of the father, including debtor, were forever barred and foreclosed of all rights in the mortgaged property. Less than 12 months after the dismissal of his first petition, debtor filed a second petition. Debtor proposed to pay HUD in full from the proceeds of a reverse mortgage and a personal injury claim arising from an accident with a city truck. In granting HUD's motion to dismiss the case, the court held that HUD was no closer to realizing on its secured claim through a reorganization in the case than it was in the first one. The court held that HUD should not have to indefinitely await the speculative fulfillment of debtor's conditions precedent to funding his plan while HUD's secured position continued to erode.

OUTCOME: The court granted the motion to dismiss, barring debtor from filing a further bankruptcy petition for 180 days without leave of the court.

LexisNexis(R) Headnotes

Bankruptcy Law > Conversion & Dismissal > Individuals With Regular Income

[HN1] The court may dismiss a case under *11 U.S.C.S. § 1307(c)(1)* for unreasonable delay that is prejudicial to creditors. *Section 1307(c)* allows a court to dismiss or convert for cause, whichever is in the best interests of creditors. Whether to dismiss or convert is left to the discretion of the bankruptcy judge.

COUNSEL: [**1] For James F. Jacono, Debtor: DAVID A. SCHOLL, Regional Bankruptcy Center of SE PA, Newtown Square, PA.

WILLIAM C. MILLER, Trustee, Philadelphia, PA.

JUDGES: DIANE WEISS SIGMUND, Chief U.S. Bankruptcy Judge.

OPINION BY: DIANE WEISS SIGMUND

OPINION

[*84] ***MEMORANDUM OPINION***

BY: DIANE WEISS SIGMUND, Chief Bankruptcy Judge

Before the Court is the Motion to Dismiss With Prejudice the above captioned Chapter 13 case ("Dismissal Motion") filed by the United States of America through the Department of Housing and Urban Development ("HUD"). The Dismissal Motion is the latest of a series of legal actions in this and the United States District Court for the Eastern District of Pennsylvania (the "District Court") by HUD to secure relief to foreclose on a mortgage delivered by William Jacono ("William"), the deceased father of Debtor, on residential property at 4178 Oliver Street, Boothwyn, Pennsylvania (the "Property"). The mortgage loan, commonly referred to as a reverse mortgage, was granted to William on or about June 11, 1993 through HUD's Home Equity Conversion Mortgage Program ("HECM") and was secured by the Property where Debtor now resides. For the reasons that follow, the Dismissal [**2] Motion shall be granted.

[*85] **BACKGROUND**

Most of the facts relevant to this contested matter were set forth in (1) my Memorandum Opinion, *In re Jacono, 2005 Bankr. LEXIS 1594, 2005 WL 2077045 (Bankr. E.D. Pa. August 16, 2005)* (the "2005 Opinion"), granting HUD relief from the automatic stay imposed in Debtor's prior and unsuccessful Chapter 13 case ("*Jacono I*") and (2) my Order in this case, dated October 10, 2006, Doc. No. 22, ("No Stay Order") denying Debtor's motion to extend the automatic stay beyond the 30-day period provided in *§ 362(c)(3)* to a debtor who has had a prior bankruptcy case dismissed within twelve months and Rather than reiterate the facts found in both of those adjudicatory documents, I will incorporate them as though set forth herein, supplementing only as to the new facts elicited at the hearing held on November 7, 2006 and as necessary to put those facts in proper context.

In the 2005 Opinion, I concluded that Debtor's proposed Chapter 13 plan (the "2005 Plan") was far too speculative to compel HUD to forbear until 2007 with no payment while its collateral diminished by reason of the growing tax liens arising because Debtor does not have the financial resources [**3] to pay real estate taxes. I was not convinced that the two essential components of the 2005 Plan necessary to pay HUD's secured claim in full (a new reverse mortgage and the proceeds of an eminent domain claim) would be accomplished by March 31, 2006, the date promised in the 2005 Plan, if at all. As the updated facts demonstrate, that conclusion was not misplaced since as of the November 2006 hearing date Debtor had still not secured the reverse mortgage and the eminent domain claim was no longer even mentioned as a potential source of funding of a Chapter 13 plan. With relief from stay granted in *Jacono I*, HUD returned to the District Court to complete its foreclosure action, and Debtor did not resist the Chapter 13 trustee's motion to dismiss the bankruptcy case which had lost its utility with the lifting of the stay.

On March 3, 2006, the Honorable John Padova issued a sixteen-page Opinion and Order in favor of HUD, liquidating its claim at $ 189,754.44 plus $ 13.00 per day from the date of the order, foreclosing the mortgage lien on and allowing the sale of the Property and payment to HUD from its proceeds, and declaring that William and any heirs, executors and assigns of [**4] William (to wit, Debtor) as well as Robert Miller, Trustee Under Irrevocable Living Trust (the "William Trust") are "forever barred and foreclosed of all rights, claims, liens and equity of redemption in the mortgaged premises." *United States v. Jacono, 2006 U.S. Dist. LEXIS 8623, 2006 WL 560142, at * 7 (E.D. Pa. March 3, 2006)*. [1] Undeterred by this setback, Debtor filed another petition under Chapter 13 on September 8, 2006 ("*Jacono II*") before HUD could complete the permitted foreclosure.

1 Defendants were represented by Dennis

Dunne, Esquire ("Dunne") who testified that he continues to represent the William Trust in an appeal of the District Court judgment to the Third Circuit Court of Appeals. In the District Court litigation, the William Trust unsuccessfully argued that HUD's lien rights were subordinate to an unrecorded deed transferring the Property from William to the William Trust.

As noted above, because Debtor had a case dismissed within twelve months of the filing of the new petition, the provisions of [**5] *§ 362(c)(3)* attached. Debtor thus filed a motion to extend the stay ("Extension Motion") which was opposed by HUD. [2] In the [*86] No Stay Order, I concluded that the new case was presumptively filed not in good faith as to HUD as it had been granted relief from stay in the prior case, *11 U.S.C. § 362(c)(3)(C)(ii)*, and as to all creditors because there had not been a substantial change in the financial or personal affairs of Debtor since the dismissal of *Jacono I*. I found that Debtor had not taken any meaningful step toward pursing the reverse mortgage which continues to be the basis for addressing HUD's debt in a Chapter 13 plan and that by his own admission, the potential proceeds of a reverse mortgage would be insufficient to pay HUD in full. I found the newly discovered asset proferred to make up the shortfall, proceeds of a personal injury claim arising from an accident with a municipal truck in June 2006 (the "PI Claim"), too speculative to rebut the presumption that *Jacono II* was not filed in good faith.

2 Whether the stay expires after 30 days as to property of the estate (thus requiring the extension) is an issue of some debate in the bankruptcy courts. *Compare In re Clifton Williams, Jr., 346 B.R. 361 (Bkrtcy E.D. Pa. 2006) with In re Jupiter*, *344 B.R. 754 (Bankr. D.S.C. 2006)*. There has been no appellate decision notwithstanding the divergence of the decisional law. Perhaps for that reason, Debtor sought an extension of the stay where its only efficacy of the stay applied to HUD. Both parties proceeded with an evidentiary hearing without raising the issue of whether the relief was necessary at all.

[**6] Presumably uncertain whether it had relief from stay to proceed with its foreclosure as ordered by Judge Padova, *see* note 2 *supra*, HUD now files a motion to dismiss *Jacono II* with prejudice in order to bar Debtor's access to bankruptcy protection for 180 days so that it can complete its foreclosure unimpeded by the bankruptcy stay of yet another case. HUD argues that the extraordinary relief is warranted given the repeat bankruptcy filings without payment and the failure to propose any confirmable Chapter 13 plan. In response, Debtor urges the Court to find that a confirmable plan is in progress for the same reasons he asked the Court to extend the stay one month ago. Thus, the evidentiary hearing on the Dismissal Motion became the third opportunity for Debtor to attempt to convince me that he could propose a confirmable plan that would treat HUD's liquidated claim as required by the Bankruptcy Code.

At the Dismissal Motion hearing I witnessed the return of Dunne, the attorney for the William Trust, who had just been retained at the time of the Extension Hearing to represent Debtor in connection with the PI Claim. At that time Dunne was fairly confident that liability [**7] would be established but had not developed his case on damages as Debtor was still undergoing medical evaluation. While Dunne, who had not yet filed the complaint on Debtor's behalf, could offer no estimate as to when a recovery could be expected, he speculated that he believed that an award of $ 100,000 would be possible. I found this testimony to be too speculative to serve as the foundation for a Chapter 13 plan that would require HUD to await payment until the proceeds of the litigation were received. [3] With the No Stay Order in mind, Dunne testified one month later that he now had a police report that established liability and had received some notes from Dr. Robert L. Knobler, [4] Ex. D-4, that showed a serious and permanent plexus injury. [5] He reiterated that it was too early [*87] to ask for a report from Dr. Knobler but nonetheless stated his belief that a settlement could be achieved in the $ 100,000 range in twelve to eighteen months. He did not state when the case would come to trial if a settlement in that range could not be negotiated.

3 I cannot help but note that I reached the same conclusion in the 2005 Opinion about the eminent domain claim which Dunne also was prosecuting and which he testified in *Jacono I* would be the source of funding for that plan.

[**8]

4 Dr. Knobler is a neurologist that Dunne states is highly regarded in his field.

5 The notes, which were admitted without

opposition, are unintelligible. Dunne provided little else to support the number he has affixed to the claim.

Debtor also testified again in support of his Chapter 13 plan which proposes to pay HUD in full from the proceeds of a reverse mortgage and the PI Claim. Notably Debtor proffers no date by which the foregoing will occur while he continues to pay $ 10 per month to the Chapter 13 trustee and nothing to HUD. While the Plan states that "if he cannot accomplish these ends, he will proceed to sell the Home," notably he made the same commitment in *Jacono I* and to date has not engaged a realtor. On the subject of the reverse mortgage, he claims to have moved the process along by completing the required counseling and applying for the reverse mortgage. Exhibit D-1 is a letter from Carmine Raspucci, Corp. Sec. ("Raspucci"), of Mortgage Network Solutions, [6] so stating and listing the other conditions that are "in the process of being completed." Although an appraisal [**9] was obtained on October 31, 2006, Exhibit D-2, Debtor has not addressed title, liens and taxes, the other conditions which must be reviewed and found to meet the "Guidelines for Reverse Mortgage Loan," to secure the HECM. To my inquiry, Debtor stated that Raspucci was not provided title information (which would have revealed that title was not in Debtor's name), but knew about the HUD mortgage (although with a payoff as of six months ago) and the real estate taxes. Presumably Raspucci must believe that the purpose of his letter is to show that an application has been made, since the other conditions cannot be met given that the available proceeds of the reverse mortgage will not satisfy liens and title is not in Debtor's name. [7] It is clear that Debtor has hardly advanced the ball with this element of his Chapter 13 plan. Nor am I impressed with Debtor's generalized contention that his advancing age improves his prospects for a larger reverse mortgage. Accepting that proposition would reward Debtor for obstructing HUD whose claim continues to increase with the passage of time through non-payment, interest accrual and the advancement of taxes and insurance. In short, the updated picture [**10] is no more impressive that the record made twice before.

6 While originally described by Debtor as a lender, it is clear that Raspucci is a mortgage broker.

7 When asked whether Raspucci had a solution to these problems, Debtor acknowledged that Raspucci had never done a reverse mortgage and indeed had asked Debtor why he did not seek conventional financing, obviously knowing little about Debtor's financial circumstances.

DISCUSSION

In this case HUD filed an action in the District Court in 2004 to foreclose its reverse mortgage on the Property. As a reverse mortgage, it had become due when William died in October 2003. Exhibit B to Dismissal Motion. On April 18, 2005 William's son James, Debtor herein, filed a petition under Chapter 13 to stay the consequences of the District Court foreclosure litigation which appeared imminent. In that case, *Jacono I*, no payment was made to HUD, and HUD was compelled to pay real estate taxes on the Property which would prime its lien since Debtor did not [**11] pay them either. On August 16, 2005 I issued a comprehensive opinion rejecting Debtor's proposed plan as speculative and allowed HUD to continue with the stayed District Court litigation. HUD sought to do so. However, because Debtor did not [*88] resist the dismissal of *Jacono I*, he was in a position to file another petition as HUD neared the exercise of its foreclosure remedy. The second petition filed by Debtor on September 9, 2006, accomplished its intended purpose to halt the District Court action. The two back to back bankruptcy cases have stayed HUD for over 1/1/2 years, and the record made in this case convinces me that it is no closer to realizing on its secured claim through a reorganization in this case than it was in the last one. The bottom line of Debtor's position is that HUD should indefinitely await the speculative fulfillment of Debtor's conditions precedent to funding his Plan while HUD's secured position continues to erode. This premise is antithetical to bankruptcy policy which entails a careful balancing of the debtor's right to a fresh start and the creditor's right to adequate protection of its interest in property. *In re Wile, 310 B.R. 514, 517 (Bankr. E.D. Pa. 2004).* [**12]

[HN1] The court may dismiss a case under *§ 1307(c)(1)* for unreasonable delay that is prejudicial to creditors. [8] Courts have not hesitated to dismiss on this ground when the sole object of the bankruptcy is to obstruct a foreclosing creditor without any real prospect of reorganization. *See, e.g., In re Spear, 203 B.R. 349 (D. Mass 1996)*; *Wile, supra; In re Rusher, 283 B.R. 544 (Bankr. W.D. Mo. 2000)*; *In re Fricker, 116 B.R. 431 (Bankr. E.D. Pa. 1990)*; *In re Clark, 86 B.R. 593 (Bankr.*

E.D. Ark. 1988). Moreover, as it appears clear that Debtor has utilized the bankruptcy stay twice to impede HUD's legitimate remedies without the ability to propose a confirmable plan, something more than dismissal is required to preclude a repetition as HUD moves once again to exercise its rights.

8 *Section 1307(c)* allows a court to dismiss or convert for cause, whichever is in the best interests of creditors. Whether to dismiss or convert is left to the discretion of the bankruptcy judge. *Sievers v. Green (In re Green), 64 B.R. 530, 530-31 (BAP 9th Cir. 1986)*; *In re Smith, 85 B.R. 729, 730-31 (E.D. Va. 1988)*; *In re White, 126 B.R. 542, 546-47 (Bankr. E.D. Ill. 1991)*. Since the only other real creditors are taxing authorities with obligations arising from the Property, the dismissal and liquidation of the Property, as requested by HUD, would be in the best interest of creditors here. A review of the Schedules does not support conversion since there would be no asset for a Chapter 7 trustee to administer other than the recently identified tort claim which would be eroded by attorney's fees and Debtor's exemption. HUD, which seeks dismissal, would be entitled to the overwhelming portion of the remaining distribution.

[**13] HUD has asked for a bar on refiling for 180 days, a remedy that I have granted when I have found serial petitions filed for the sole purpose of invoking the automatic stay of *§ 362(a)*. *In re Dami, 172 B.R. 6, 11 (Bankr. E.D. Pa. 1994)*. The authority to grant such relief has been found in *Bankruptcy Rule 9011*, incorporating *Fed.R.Civ.P.11*. *In re Narod, 138 B.R. 478, 482 (E.D. Pa. 1992)* (sanctions imposed under *Rule 9011* are not limited to expenses or fees); *In re Jones, 117 B.R. 415, 420 (Bankr. N.D. Ind. 1990)* ([W]here a debtor files a petition in bankruptcy with no intention of obtaining the benefits or the goals for which the proceeding was designed, the Bankruptcy Code is being abused and bankruptcy *rule 9011* is implicated). Other courts have relied on their discretionary power under *§ 349*, *see, e.g.*, *Spear, 203 B.R. at 353-54*; *In re McKissie, 103 B.R. 189, 193 (Bankr. N.D. Ill. 1989)*; or *§ 105*, *see, e.g.*, *Spear, 203 B.R. at 354*; *In re Earl, 140 B.R. 728, 741 (Bankr. N.D. Ind. 1992)*; *Clark, 86 B.R. at 595*, [**14] to enjoin future filings to prevent abuse of the bankruptcy process. While this case does not have the indicia of bad faith present in some other cases where the repeat [*89] filings have been more numerous before the creditor seeks to stop the bankruptcy cycle, it nonetheless evidences a determination by this Debtor to reside under the protection of the bankruptcy stay until every hope of raising funds to pay HUD has been dashed. If HUD's secured position was not eroding during the stay, more time might be an appropriate balance of the parties' respective interests. However, Debtor continues to reside in the Property without payment to HUD or the taxing authorities after the District Court has held that he has no interest to protect. Notably the bar order I will enter will allow Debtor to make application to this Court to refile should there be a change in circumstances that would suggest a reorganization is feasible. This relief merely shifts the burden to Debtor to earn his injunction, obviating the opportunity to halt the foreclosure again by simply filing another petition.

An Order consistent with the foregoing Memorandum Opinion shall issue.

DIANE WEISS SIGMUND

Chief U.S. Bankruptcy [**15] Judge

Dated: November 30, 2006

ORDER

AND NOW, this 30th day of November 2006, upon consideration of the (1) confirmation of Debtor's amended Chapter 13 plan and (2) the Motion to Dismiss the Chapter 13 Case with Prejudice ("Dismissal Motion") filed by the United States of America through the Department of Housing and Urban Development ("HUD"), after notice and hearing and for the reasons stated in the accompanying Memorandum Opinion;

It is hereby **ORDERED and DECREED** that:

1. Confirmation of the Plan is **DENIED.**

2. The Dismissal Motion is **GRANTED**, and the Chapter 13 case is **DISMISSED.**

3. Debtor is barred from filing a further bankruptcy petition for 180 days without leave of this Court.

DIANE WEISS SIGMUND

Chief U.S. Bankruptcy Judge

In re: Joseph Cortez Evans and Marsha Ann Evan, Debtors.

Case No. 11-80123

UNITED STATES BANKRUPTCY COURT FOR THE MIDDLE DISTRICT OF NORTH CAROLINA, DURHAM DIVISION

2011 Bankr. LEXIS 1425

April 11, 2011, Decided
April 11, 2011, Filed

COUNSEL: [*1] For Joseph Cortez Evans, Durham, NC, Richard M. Hutson, II, Durham, NC, Debtor: Terry D. Fisher, Durham, NC.

For Marsha Ann Evans, Durham, NC, Joint Debtor: Terry D. Fisher, Durham, NC.

Trustee: Richard M. Hutson, II, Chapter 13 Office, Durham, NC.

JUDGES: Catharine R. Aron, UNITED STATES BANKRUPTCY JUDGE.

OPINION BY: Catharine R. Aron

OPINION

ORDER AND OPINION DENYING MOTION FOR RELIEF FROM STAY

THIS MATTER came on for hearing before the undersigned bankruptcy judge upon Financial Freedom Acquisition LLC's Motion for Relief from Stay. Appearing at the hearing was Terry D. Fisher, attorney for the Debtors, Kimberly A. Sheek, attorney for Financial Freedom Acquisition LLC (the "Creditor"), and Benjamin Lovell, attorney for the Chapter 13 Trustee. After consideration of the Creditor's motion, the arguments of counsel, and other matters of record, the Court finds as follows:

FACTS

The Debtors are the owners of real property located at 207 Apex Street in Durham, North Carolina (the "Property"), which serves as their principal residence. The Property is subject to a reverse mortgage in favor of the Creditor by virtue of a note and deed of trust executed by Ola May Evans Bynum on September 7, 2007 in the original principal [*2] amount of $70,000.00. The reverse mortgage includes a provision requiring immediate payment in full upon the death of the borrower. Mrs. Bynum passed away and the Debtors inherited the Property prepetition. Pursuant to the terms of the reverse mortgage, the debt became due in full upon Mrs. Bynum's death, and the Creditor instituted foreclosure proceedings.

The Debtors filed a petition for relief under Chapter 13 of the Bankruptcy Code on January 24, 2011 (the "Petition Date"). The Debtors listed the Property on Schedule A of their petition with a value of $70,000.00 and listed the Creditor as the holder of a reverse mortgage on Schedule D. The Debtors propose to pay the Creditor in full through their Chapter 13 plan. In its motion seeking relief from the automatic stay, the Creditor contends that the total payoff due on the loan is $33,688.35, and that pursuant to a "drive by" appraisal, the value of the Property is $28,500.00.

ANALYSIS

The Creditor contends the Debtors' proposal to pay the reverse mortgage through the Chapter 13 plan impermissibly modifies the Creditor's rights in violation of *§ 1322(b)(2)*. The Court disagrees. On the Petition Date, the Property became property of the [*3] estate pursuant to *§ 541 of the Bankruptcy Code*. *11 U.S.C. § 541*. As such, the Property falls under the scope of *§ 362*, which operates to stay the enforcement against property of the estate of a judgment obtained prepetition and any act to obtain possession of property of the estate. *11 U.S.C. § 362(a)*. Despite the fact that the Debtors did not execute the note and deed of trust for the reverse mortgage and, as a result, are not personally liable for the debt, the Creditor has a claim in this proceeding, as it holds a claim enforceable against property of the estate. *Johnson v. Home State Bank, 501 U.S. 78, 85, 111 S. Ct. 2150, 115 L. Ed. 2d 66 (1991)*. S*ee also In re Cady, 440 B.R. 16, 23 (Bankr. N.D.N.Y. 2010)* (holding that lender with mortgage on property transferred without lender's consent to debtor, who was not obligated on the note, was nonetheless a "creditor" with "claim" that could be dealt with in debtor's plan); *In re Curinton, 300 B.R. 78, 84 (Bankr. M.D. Fla. 2003)* (interpreting the term "claim" to include a defaulted mortgage on property owned by the debtor when no privity of contract exists between the debtor and creditor).

Section 1322(b)(2) prohibits the modification of a claim that is secured only by [*4] a security interest in real property that is the debtor's principal residence. *11 U.S.C. § 1322(c)*. *Section 1322(c)(2)* provides an important exception to *§ 1322(b)(2)*, providing debtors with the opportunity to pay a mortgage indebtedness that has matured or ballooned prepetition over the term of a Chapter 13 plan. *Section 1322(c)(2)* states:

> (c) Notwithstanding subsection (b)(2) and applicable nonbankruptcy law--
>
> ...
>
> (2) in a case in which the last payment on the original payment schedule for a claim secured only by a security interest in real property that is the debtor's principal residence is due before the date on which the final payment under the plan is due, the plan may provide for the payment of the claim as modified pursuant to section 1325(a)(5) of this title.

11 U.S.C. § 1322(c). The facts of this case fall squarely under this provision as the property securing the reverse mortgage is the Debtors' principal residence and the last payment on the original payment schedule became due upon Mrs. Bynum's death, prepetition. *E.g. In re Newcomer, 438 B.R. 527, 542 n.14 (Bankr. D. Md. 2010)* (stating that the majority view since the Supreme Court's decision in *Johnson* is that it is appropriate [*5] to permit a Chapter 13 debtor who is the owner of real property to cure a prepetition default under a mortgage, even if the debtor lacks privity with the mortgagee); *In re Brown, 428 B.R. 672, 677 (Bankr. D.S.C. 2010)* (holding that *§ 1322(c)(2)* permits debtor to pay full amount of reverse mortgage on inherited property which became due in full prepetition in Chapter 13 plan); *In re Wilcox, 209 B.R. 181, 182 (Bankr. E.D.N.Y. 1996)* (holding that debtor could pay reverse mortgage on inherited property through Chapter 13 plan).

Based upon the foregoing, and as the Debtors have proposed to pay the Creditor's claim in full inside their Chapter 13 plan and are currently current with their plan payments, the Creditor's Motion for Relief from Stay is DENIED.

April 11, 2011

/s/ Catharine R. Aron

UNITED STATES BANKRUPTCY JUDGE

In re WILLIAM EARLY, Debtor. KEVIN R. McCARTHY, Trustee, Plaintiff, v. FINANCIAL FREEDOM SENIOR FUNDING CORPORATION, Defendant.

Case No. 05-01354, (Chapter 7), Adversary Proceeding No. 05-10079

UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF COLUMBIA

2008 Bankr. LEXIS 1605

May 12, 2008, Decided

NOTICE: NOT FOR PUBLICATION

SUBSEQUENT HISTORY: Supplemented by, Adversary proceeding at, Amended by *McCarthy v. Fin. Freedom Senior Funding Corp. (In re Early), 2008 Bankr. LEXIS 4930 (Bankr. D.D.C., June 23, 2008)*

CASE SUMMARY:

PROCEDURAL POSTURE: The plaintiff, the chapter 7 trustee, brought an adversary proceeding seeking, pursuant to *11 U.S.C.S. §§ 544*, *550*, and *551*, to avoid the lien of the defendant, the creditor on a reverse mortgage against the debtor's interest in a parcel of real property that the debtor and his non-debtor wife owned as tenants by the entirety. The creditor conceded that, pursuant to D.C. law, it failed to timely record its lien against the property.

OVERVIEW: In his complaint, the trustee requested that, upon avoidance of the lien, he either recover the avoided lien or its value. The balance due on the loan was apparently $ 203,940.13. The trustee was entitled to a summary judgment adjudicating that the lien granted to the creditor on the debtor's one-half interest in the property was avoided as against the estate. He was entitled to summary judgment pursuant to *11 U.S.C.S. § 551* decreeing that the lien was automatically preserved for the benefit of the estate. The question was, assuming a lien based on a reverse mortgage against one-half of the tenancy by the entirety was not readily marketable, what the value of the lien was for purposes of a money judgment. A reverse mortgage was a relatively novel creature for purposes of valuation. The trustee did not have the right under *11 U.S.C.S. § 363* to attempt to sell the property. It was possible, if the creditor consented, for the trustee to sell the entire lien, as opposed to just the trustee's half. The court did allow the trustee to seek an expert opinion as to the value of the lien as of the petition date.

OUTCOME: The trustee's motion for summary judgment was granted in part, and he was allowed to avoid the lien for the reverse mortgage as to the debtor's one-half interest in the property, for the benefit of the estate. Summary judgment for a monetary amount as to the lien was denied, but the court reopened discovery for a period of time to permit the trustee to obtain an expert opinion as to the value of the lien. The creditor's motion was denied.

LexisNexis(R) Headnotes

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Voidable Transfers > Lien Creditor & Purchaser
[HN1] Where the holder of a security interest in the debtor's property fails to perfect that interest prior to the filing of the bankruptcy, the trustee can avoid that interest, reducing the holder to the status of an unsecured creditor.

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Voidable Transfers > Lien Creditor & Purchaser
[HN2] When exercising strong-arm powers under *11 U.S.C.S. § 544*, a trustee enjoys the status of a bona fide purchaser for value and the trustee is thus insulated from certain defenses that might be available to the creditor were the trustee to proceed under *11 U.S.C.S. § 547*.

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Voidable Transfers > Lien Creditor & Purchaser
[HN3] Under *11 U.S.C.S. § 544*, a trustee in bankruptcy shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by a bona fide purchaser of real property from the debtor, against whom applicable law permits such transfer to be perfected. Although a trustee's strong-arm powers arise under federal law, her rights as a bona fide purchaser are governed by state law.

Real Property Law > Deeds > Delivery
[HN4] In the District of Columbia, a deed conveying an interest in real property is not effective against a subsequent bona fide purchaser or creditor without notice unless it is recorded. *D.C. Code § 42-401*.

Real Property Law > Deeds > Delivery
[HN5] See *D.C. Code § 42-401* (2001).

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Voidable Transfers > Lien Creditor & Purchaser
[HN6] Once a trustee has avoided the fixing of a lien under *11 U.S.C.S. § 544*, the lien is automatically preserved for the benefit of the estate under *11 U.S.C.S. § 551* and becomes property of the estate under *11 U.S.C.S. § 541(a)(4)*.

Bankruptcy Law > Exemptions > Bankruptcy Code
[HN7] A debtor's equity in property, as opposed to the lien on the property, becomes exempt when no one timely objects under *Fed. R. Bankr. P. 4003(b)* to the claim of exemption. *11 U.S.C.S. § 522(1)*.

Bankruptcy Law > Exemptions > Bankruptcy Code
[HN8] Under *11 U.S.C.S. § 522(c)(2)*, if a lien on the property is avoided and, as a consequence, automatically preserved for the benefit of the estate under *11 U.S.C.S. § 551*, the property will remain subject to the lien pursuant to *11 U.S.C.S. § 522(c)(2)*, despite the claim of exemption regarding the property. The lien on the debtor's interest in the property, because preserved for the benefit of the estate, becomes property of the estate pursuant to *11 U.S.C.S. § 541(a)(4)*.

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Transferee Liability
[HN9] *11 U.S.C.S. § 550(a)* may allow an alternative remedy of recovering a monetary judgment for an avoided lien if the trustee does not assert the automatic preservation of the avoided lien under *11 U.S.C.S. § 551*. But the remedies are mutually exclusive: a trustee may not both recover the lien via automatic preservation under *§ 551* and recover a monetary judgment for the value of the lien. If a trustee proceeds under *§ 551*, or the court holds that the trustee must proceed under *§ 551*, no other provision of the Bankruptcy Code gives the trustee the right to obtain a monetary judgment against the previous holder of the lien.

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Voidable Transfers > Lien Creditor & Purchaser

[HN10] By reason of *11 U.S.C.S. § 551*, a trustee steps by way of subrogation into the shoes of the lienor whose lien is avoided.

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Voidable Transfers > Lien Creditor & Purchaser

[HN11] In the shoes of the former holder of the lien by reason of *11 U.S.C.S. § 551*, a bankruptcy trustee's rights to enforce the avoided lien are governed by nonbankruptcy law. A trustee's rights pursuant to the lien to which she is subrogated pursuant to *§ 551* are no greater than those of the creditor who held the avoided lien. *Section 551* does not expand or otherwise enhance the status of the avoided lien.

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Voidable Transfers > Lien Creditor & Purchaser

[HN12] Under *11 U.S.C.S. § 551*, once a transfer is avoided, it is automatically preserved for the benefit of the estate. That "stick" is returned to the "bundle" that makes up estate property. *11 U.S.C.S. § 541(a)(4)* makes explicit that any interest that is preserved for the benefit of the estate under *11 U.S.C.S. § 551* is part of the bankruptcy estate.

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Transferee Liability

[HN13] Resort to *11 U.S.C.S. § 550(a)* to recover a lien is almost never, if ever, necessary. When a lien is preserved under *11 U.S.C.S. § 551* in an intact state (that is, without having been diminished since the transfer date), resort instead to *11 U.S.C.S. § 550* to make a monetary recovery is generally inappropriate.

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Transferee Liability

[HN14] Resort to *11 U.S.C.S. § 550* may be unnecessary if the proceeds of collateral can be traced. A lien follows the proceeds of the collateral. But if the proceeds of the collateral could no longer be traced to a specific fund, the lien would be avoidable but worthless as such (because no collateral could be identified). However, the value of a lien as it existed at the time of the transfer could be recovered by the trustee by virtue of the ability of the court to order under *11 U.S.C.S. § 550(a)* that the trustee recover the value of the property transferred.

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Transferee Liability

[HN15] *11 U.S.C.S. § 550(a)* permits a bankruptcy trustee to recover the transferred property or, upon court order, the transferred property's value, yet neither the statute nor the legislative history gives any guidance as to when the court should order a transferee or a beneficiary of a transfer to pay over the value of the property transferred. Although it is within a court's discretion to award the trustee the value of the lien, it is a remedy to only be employed in limited circumstances, and only where the voiding of the lien is inadequate or unavailable as a remedy.

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Transferee Liability

[HN16] Among the relevant factors that a court may consider in deciding whether to permit a trustee to recover the value of an avoided transfer rather than the transferred property itself, are: (1) the presence of conflicting evidence with respect to the value of the transferred property; (2) whether the property has been converted and is thus no longer recoverable; (3) whether the property has depreciated in value subsequent to the transfer; and (4) whether the value is readily determinable and awarding the value would realize a savings for the estate.

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Transferee Liability

[HN17] The costs a bankruptcy trustee would face in selling a reverse mortgage, for which there is a limited market, is not reason to award the trustee a monetary judgment when he or she is allowed to dispose of the entire conveyed interest as an avoidable lien.

Bankruptcy Law > Estate Property > General Overview

[HN18] A debtor's schedules are admissible evidence as to the value of a residential property as a homeowner can testify as to the value of his home.

Bankruptcy Law > Case Administration > Examiners,

Officers & Trustees > Transferee Liability
[HN19] The Bankruptcy Code does not define the term "value" for purposes of *11 U.S.C.S. § 550(a)*.

Bankruptcy Law > Case Administration > Examiners, Officers & Trustees > Transferee Liability
[HN20] There is no prescribed valuation formula under *11 U.S.C.S. § 550(a)* and the value indicator relied upon by a court in any given case depends upon the circumstances of the case and the nature and relative weight of the available evidence.

Bankruptcy Law > Estate Property > General Overview
[HN21] If a property is not transferred pursuant to a sale, other circumstances surrounding the transfer of the property may provide insight into the fair market value of the property.

Bankruptcy Law > Case Administration > Administrative Powers > Estate Property Lease, Sale & Use > Sales Free of Interests & Liens
[HN22] *11 U.S.C.S. § 363(f)(3)* permits the trustee to sell estate property if such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property.

COUNSEL: [*1] For Kevin R. McCarthy (05-10079), Plaintiff: Kevin R. McCarthy, Kevin R. McCarthy, LEAD ATTORNEY, McCarthy & White, PLLC, McLean, VA.

For Financial Freedom Senior Funding Corporation (05-10079), Defendant: Brian F. Kenney, Miles & Stockbridge, McLean, VA.

For William Early (05-01354), Debtor: Michael R. Murphey, Washington, DC usa.

For Kevin R. McCarthy (05-01354), Trustee: McCarthy & White, PLLC, McCarthy & White, PLLC, McLean, VA.

JUDGES: S. Martin Teel, Jr., United States Bankruptcy Judge.

OPINION BY: S. Martin Teel, Jr.

OPINION

MEMORANDUM DECISION AND ORDER RE CROSS-MOTIONS FOR SUMMARY JUDGMENT

The plaintiff McCarthy in this adversary proceeding is the trustee in the case under chapter 7 of the Bankruptcy Code (11 U.S.C.) of the debtor, William Early. Pursuant to *11 U.S.C. §§ 544*, *547*, *550*, and *551*, McCarthy's complaint seeks to avoid the lien of the defendant, Financial Freedom Senior Funding Corporation, on the debtor's interest in a parcel of real property (the "Property") that he and his wife own as tenants by the entirety. Although the complaint requests that upon avoidance of the lien, McCarthy either recover the avoided lien or its value, McCarthy has filed a motion for summary judgment in which he seeks [*2] both avoidance of the lien, and upon avoidance of the lien, a monetary judgment against Financial Freedom for one-half of the balance due under the avoided deed of trust and related loan agreement.

Although Financial Freedom concedes McCarthy's right to avoid the lien as to the debtor's interest in the Property, it has filed a motion for partial summary judgment, contending that even if McCarthy were entitled to recover the value of the lien under *§ 550*, McCarthy has failed to submit expert testimony as to the value of the avoided lien, as required. Financial Freedom contends that because McCarthy was required to submit expert valuation testimony, and because the deadline for disclosing experts has expired, McCarthy will be unable to demonstrate the value of the avoided lien at trial. Accordingly, it argues, the court should grant partial summary judgment in favor of Financial Freedom and deny McCarthy's request for a monetary judgment for the value of the avoided lien.

For reasons stated in more detail below, the court will grant McCarthy's motion in part to allow him to avoid and preserve the lien as to the debtor's one-half interest in the property for the benefit of the estate. The [*3] court will deny McCarthy's motion as to his request for entry of a monetary judgment, and deny Financial Freedom's motion for partial summary judgment.

I

FACTS

Other than the value of the lien sought to be avoided, the relevant facts are not in dispute.

As tenants by the entirety, the debtor and his wife Annell Wilson Early own the Property, real estate located at 209 Florida Avenue, N.W., Washington, D.C. On February 28, 2005, the debtor and his wife executed an Adjustable Rate Home Equity Conversion Deed of Trust ("Deed of Trust") in favor of Financial Freedom on the Property to secure a Home Equity Conversion Loan Agreement ("Loan Agreement") dated February 28, 2005, in the maximum principal amount of $ 469,342.40 executed by them. [1] Financial Freedom initially loaned the debtor and his wife a total of $ 188,099.78, including a payoff of $ 138,198.63 to the prior recorded deed of trust, which was released of record on May 17, 2005. As of May 31, 2006, the balance due on the loan was $ 203,940.13, consisting of $ 183,199.78 in the initial advance, $ 5,075 in credit line advances, $ 1,274.33 in MIP interest, $ 13,911.02 in contractual interest, and $ 480 in service fees.

1 Although the [*4] instrument granting a security interest in favor of Financial Freedom is a deed of trust, both parties have described the instrument as a reverse mortgage or a reverse mortgage deed of trust. Indeed, the Deed of Trust bears the hallmark features of a reverse mortgage, which Black's Law Dictionary describes as "[a] mortgage in which the lender disburses money over a long period to provide regular income to the (usu. elderly) borrower, and in which the loan is repaid in a lump sum when the borrower dies or when the property is sold." BLACK'S LAW DICTIONARY 1028 (7th Ed. 1999). Although the Deed of Trust together with the Loan Agreement calls for Financial Freedom to make monthly advances to the debtor and his spouse, Financial Freedom's obligation to make such advances terminated as of the petition date pursuant to paragraph 4.4 of the Loan Agreement.

On September 10, 2005, the debtor filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code. Although executed on February 28, 2005, and the disbursement date shown on the HUD-1 for the subject transaction was March 4, 2005, and the prior recorded deed of trust was released of record on May 17, 2005, after being paid off [*5] by proceeds from the Deed of Trust loan, the Deed of Trust was not recorded until September 26, 2005, almost seven months after the Deed of Trust was executed and sixteen days after the petition was filed.

II

McCARTHY IS ENTITLED TO AVOID AND PRESERVE THE LIEN FOR THE BENEFIT OF THE ESTATE

Financial Freedom does not dispute that McCarthy is entitled to avoid Financial Freedom's lien as to the debtor's one-half interest in the property under *§ 547* or *§ 544 of the Bankruptcy Code*, and that the avoided lien is preserved for the benefit of the estate under *11 U.S.C. § 551*.

McCarthy can seek to avoid as a transfer the fixing of its lien as to the debtor's one-half interest in the Property either as a preference under *section 547* or pursuant to a trustee's *§ 544* strong-arm powers. See *Walker v. Elm (In re Fowler), 201 B.R. 771, 779 (Bankr. E.D. Tenn. 1996)* ("If [HN1] the holder of a security interest in the debtor's property fails to perfect that interest prior to the filing of the bankruptcy, the trustee can avoid that interest, reducing the holder to the status of an unsecured creditor."); *Farmer v. Green Tree Servicing LLC (In re Snelson), 330 B.R. 643, 648 (Bankr. E.D. Tenn. 2005)* (creation of [*6] lien constitutes transfer within the meaning of the Bankruptcy Code).[HN2] When exercising his strong-arm powers under *§ 544*, a trustee enjoys the status of a bona fide purchaser for value and McCarthy is thus insulated from certain defenses that might be available to Financial Freedom were he to proceed under *section 547*. [2] The court will thus examine only McCarthy's power to avoid the lien under *§ 544*.

2 For example, some courts require that a trustee seeking to avoid and recover a transfer under *§§ 547* and *550* first demonstrate that the transfer caused a diminution to the estate. Creditors often raise this defense, and the related common-law earmarking doctrine, when a lien sought to be avoided was acquired through the refinancing of real property and there was a corresponding (if not contemporaneous) release of a pre-existing and valid security interest that would have been enforceable against the trustee had it not been released. See, e.g., *Collins v. Greater Atlantic Mortgage Co. (In re Lazarus), 334 B.R. 542 (Bankr. D. Mass. 2005)*. The court expresses no view as to the applicability of the earmarking doctrine were McCarthy's avoidance action being pursued exclusively under *§ 547*, and [*7]

observes merely that the defense is unavailable to defendants when the trustee's avoidance action arises under *§ 544*.

[HN3] Under *§ 544*, a trustee in bankruptcy "shall have, as of the commencement of the case, and without regard to any knowledge of the trustee or of any creditor, the rights and powers of, or may avoid any transfer of property of the debtor or any obligation incurred by the debtor that is voidable by . . . a bona fide purchaser of real property . . . from the debtor, against whom applicable law permits such transfer to be perfected . . . ." Although a trustee's strong-arm powers arise under federal law, her rights as a "bona fide purchaser" are governed by state law. *Sovran Bank/DC National v. United States (In re Aumiller), 168 B.R. 811, 817 (Bankr. D.D.C. 1994)*. [HN4] In the District of Columbia, "a deed conveying an interest in real property is not effective against a subsequent bona fide purchaser or creditor without notice unless it is recorded." Id.; *D.C. Code § 42-401*. [3] The parties agree that, pursuant to D.C. law, Financial Freedom's failure to timely record the Deed of Trust entitles McCarthy to avoid the recording of the deed under *§ 544*.

3 *D.C. Code § 42-401* (2001) provides [*8] that [HN5] "Any deed conveying real property in the District, or interest therein, or declaring or limiting any use or trust thereof, executed and acknowledged and certified as provided in [other sections of the D.C. Code] and delivered to the person in whose favor the same is executed, shall be held to take effect from the date of the delivery thereof, except that as to creditors and subsequent bona fide purchasers and mortgagees without notice of said deed, and others interested in said property, it shall only take effect from the time of its delivery to the Recorder of Deeds for record."

[HN6] Once a trustee has avoided the fixing of a lien under *§ 544*, the lien is automatically preserved for the benefit of the estate under *§ 551* and becomes property of the estate under *§ 541(a)(4)*. *Hendon v. G.E. Capital Mortg. Servs., Inc. (In re Carpenter), 266 B.R. 671 (Bankr. E.D. Tenn. 2001)*, citing *Walker v. Elan (In re Fowler), 201 B.R. 771, 781 (Bankr. E.D. Tenn. 1996)*.

The debtor listed the Property as exempt on Schedule C of his Schedules pursuant to *D.C. Code § 15-501(a)(14)*. [HN7] The debtor's equity in the Property (as opposed to the lien on the Property) became exempt when no one timely objected under [*9] *F.R. Bankr. P. 4003(b)* to the claim of exemption. *11 U.S.C. § 522(1)*. [HN8] Under *11 U.S.C. § 522(c)(2)*, if the lien on the Property is avoided and, as a consequence, automatically preserved for the benefit of the estate under *11 U.S.C. § 551*, the Property will remain subject to the lien pursuant to *11 U.S.C. § 522(c)(2)*, despite the claim of exemption regarding the Property. See *In re Bethea, 275 B.R. 127, 134 (Bankr. D.D.C. 2002)*. See also *In re Guido, 344 B.R. 193 (Bankr. D. Mass. 2006)*; *Styler v. Local Loan Fin. Servs. (In re Lanctot), 6 B.R. 576 (Bankr. D. Utah 1980)*. The lien on the debtor's interest in the Property, because preserved for the benefit of the estate, becomes property of the estate pursuant to *11 U.S.C. § 541(a)(4)*.

McCarthy is thus entitled to summary judgment adjudicating that the lien granted to the defendant on the debtor's one-half interest in the Property is avoided as against the estate. Furthermore, he is entitled to summary judgment pursuant to *11 U.S.C. § 551* decreeing that the lien is automatically preserved for the benefit of the estate (unless he were held to be entitled to a monetary judgment against Financial Freedom in lieu of asserting his rights under [*10] *§ 551*).

III

IF A TRUSTEE ELECTS TO PROCEED UNDER *§ 551* TO RECOVER AN AVOIDED LIEN, THAT PRECLUDES RESORT TO THE TRUSTEE'S RIGHT UNDER *§ 550(a)* TO RECOVER A MONETARY JUDGMENT, AND THE TRUSTEE'S RIGHTS AS THE NEW HOLDER OF THE AVOIDED LIEN RISE NO HIGHER THAN THE RIGHTS THAT WERE HELD BY THE PREVIOUS HOLDER OF THE LIEN

[HN9] *Section 550(a)* may allow an alternative remedy of recovering a monetary judgment for an avoided lien if the trustee does not assert the automatic preservation of the avoided lien under *§ 551*. But the remedies are mutually exclusive: a trustee may not both recover the lien via automatic preservation under *§ 551* and recover a monetary judgment for the value of the lien. *Lindquist v. Household Indust. Fin. Co. (In re Vondall), 352 B.R. 193, 200 (Bankr. D. Minn. 2006)*, aff'd, *364 B.R. 668 (B.A.P. 8th Cir. 2007)*. If a trustee proceeds under *§ 551*, or the court holds that the trustee must proceed under *§ 551*, no other provision of the Bankruptcy Code gives her the right to obtain a monetary judgment against the previous holder of the lien.

If a trustee announces that she is willing to forego proceeding under *§ 551*, and seeks a judgment under *§ 550(a)*, the trustee's contentions in [*11] attempting to invoke *§ 550(a)* regarding what difficulties she would face if she only proceeded under *§ 551* must accurately take account of the rights conferred on her by reason of *§ 551*. McCarthy contends that he would have difficulty proceeding under *§ 551*, for one reason, because he would likely not be able to sell the entire Property under *§ 363(b)* because he would not likely be able to show under *11 U.S.C. § 363(h)(3)* that "the benefit to the estate of a sale of such property free of the interests of [the debtor's wife] outweighs the detriment . . . to [the debtor's] wife." However, the avoided and preserved lien would not give McCarthy the right to attempt to sell even the debtor's interest in the Property under *§ 363(b)*. The lien would not confer title to the Property on the estate, and thus McCarthy is not entitled to sell title to the Property under *§ 363(b)*. Were the law otherwise, a debtor who files a bankruptcy case could see his home sold under *§ 363(b)* by the trustee who avoids an unperfected lien on the home even though the debtor is current on the mortgage and was looking to live there indefinitely by continuing to make mortgage payments. Congress surely did not intend [*12] that result.

[HN10] By reason of *§ 551*, a trustee steps by way of subrogation into the shoes of the lienor whose lien is avoided. See *Taubel-Scott-Kitzmiller Co., Inc. v. Fox, 264 U.S. 426, 436-37, 44 S. Ct. 396, 68 L. Ed. 770 (1924)* (subrogation is the process by which the preservation of the lien was made available under a similar provision under the Bankruptcy Act providing for preservation of an avoided lien for the benefit of the estate). [HN11] In the shoes of the former holder of the lien by reason of *§ 551*, a trustee's rights to enforce the avoided lien are governed by nonbankruptcy law. See *In re John I. Paulding, Inc., 76 B.R. 7, 8 (Bankr. D. Mass. 1987)*. A trustee's rights pursuant to the lien to which she is subrogated pursuant to *§ 551* are no greater than those of the creditor who held the avoided lien. See *In re Haberman, 347 B.R. 411, 414-15 (B.A.P. 10th Cir. 2006)* ("*§ 551* . . . does not expand or otherwise enhance the status of the avoided lien."). [4] Accordingly, except as provided by nonbankruptcy law, the avoided lien here does not give the trustee a right to sell the debtor's interest in the Property itself. Under nonbankruptcy law, the avoided lien does not give McCarthy an ownership interest in the Property, [*13] it only gives him the enforcement rights available to a lienor.

4 See also *Baker v. CIT Group/Consumer Fin. Inc. (In re Hastings), 353 B.R. 513, 520 (Bankr. E.D. Ky. 2006)*; *In re Seibold, 351 B.R. 741, 746 (Bankr. D. Idaho 2006)*; *Carvell v. Bank One, Lafayette, N.A. (In re Carvell), 222 B.R. 178, 180 (B.A.P. 1st Cir. 1998)*.

IV

THE AVAILABILITY OF AUTOMATIC PRESERVATION UNDER *§ 551* OF A LIEN FULLY INTACT SINCE THE DATE OF ITS TRANSFER GENERALLY RENDERS RELIEF UNDER *§ 550* INAPPROPRIATE

As explained in *In re Schmiel, 319 B.R. 520, 529 (Bankr. E.D. Mich. 2005)*:

> [HN12] [U]nder *§ 551*, once the transfer to Interstate is avoided, it is automatically preserved for the benefit of the estate. That "stick" is returned to the "bundle" that makes up estate property. "*Section 541(a)(4)* [ ] makes explicit that any interest that is 'preserved for the benefit of . . . the estate under *section* . . . *551*' is part of the bankruptcy estate." *Suhar v. Burns (In re Burns), 322 F.3d 421, 428 (6th Cir. 2003)* (quoting *11 U.S.C. § 541(a)(4)*).

Accordingly, [HN13] resort to *§ 550(a)* to recover a lien is almost never, if ever, necessary. [5] When a lien is preserved under *§ 551* in an intact state (that is, without having been [*14] diminished since the transfer date), resort instead to *§ 550* to make a monetary recovery is generally inappropriate. See *Gold v. New Century Mortg. Corp. (In re Salinitro), 355 B.R. 15 (Bankr. E.D. Mich. 2006)*; *Lindquist v. Household Indust. Fin. Co. (In re Vondall), 352 B.R. 193, 200 (Bankr. D. Minn. 2006)*, aff'd, *364 B.R. 668 (B.A.P. 8th Cir. 2007)*; *Kelley v. Chevy Chase Bank (In re Smith), 236 B.R. 91, 100 (Bankr. M.D. Ga. 1999)*; *Kelley v. GMAC (In re Farmer), 209 B.R. 1022, 1024-25 (Bankr. M.D. Ga. 1997)*. In In re Salinitro, the court held that once a lien is avoided on a car that is property of the estate and automatically preserved for the benefit of the estate under *§ 551*, the trustee may not recover a monetary judgment against the entity to whom the lien had been transferred. The court reasoned that once a lien is preserved for the benefit of the estate upon avoidance, "there is nothing for the trustee to recover under *§ 550(a)*." *In re Salinitro, 355 B.R. at 20*. The theory is that if the estate already owns the collateral itself, the estate makes a full recovery by virtue of avoidance of the lien. See *In re Farmer, 209 B.R. at 1025*.

5 In *In re Greater Southeast Community Hosp. Found., Inc., 237 B.R. 518 (Bankr. D.D.C. 1999)*, [*15] the debtor had granted a prepetition lien on accounts receivable that were no longer property of the debtor when the case commenced. The accounts receivable were thus not property of the estate when the case commenced. When the lien was avoided under *§ 544*, the new owner of the accounts receivable argued that the lien was not automatically preserved for the benefit of the estate because *§ 551* provides for such preservation "only with respect to property of the estate." However, it was evident that even if that were true, resort to *§ 550(a)* could recover the avoided lien and bring it back into the estate. Instead of resorting to *§ 550* in Greater Southeast, the court, as in In re Schmiel, could have viewed the avoidance of the transfer of the lien, and its automatic preservation for the benefit of the estate, as *implicitly* placing the transferred property represented by the lien back into the estate (except to the extent that the lien had reached property that was not a transfer of property subject to avoidance, and that thus would not be hauled into the estate). The lien itself would *explicitly* become property of the estate under the somewhat redundant provision in *11 U.S.C. § 541(a)(4)*. [*16] The restriction in *§ 551* of automatic preservation of the avoided transfer for the benefit of the estate "only with respect to property of the estate" would still serve a purpose. For example, as discussed in the legislative history, an avoided federal tax lien for nondischargeable claims against an individual debtor would be preserved for the estate with respect to property of the estate but not with respect to the debtor's postpetition salary. See *Greater Southeast, 237 B.R. at 522-23* and *527*.

The holding in In re Salinitro ought not apply when the avoided lien is not preserved intact without having been diminished via enforcement or other events, then a monetary recovery under *§ 550* may be necessary and appropriate. That a trustee may invoke *§ 550* if *§ 551* alone would not make the trustee whole is illustrated by *Seaver v. Mortgage Elec. Registr. Sys., Inc. (In re Schwartz), 383 B.R. 119 (B.A.P. 8th Cir. 2008)*. There the debtor refinanced a prepetition mortgage postpetition through a loan from postpetition lenders. In the postpetition refinance, the holders of the prepetition mortgage received full payment of the obligation secured by that mortgage, and released the lien. The trustee [*17] avoided the prepetition mortgage as a preference under *§ 547*. Because the postpetition lenders' mortgages still encumbered the property, the estate would not have been made whole by the mere avoidance of the prepetition lenders' mortgage. Accordingly, it was appropriate to grant the trustee a monetary recovery under *§ 550(a)* against the entities that had held the prepetition mortgage. *Id. at 126-27*. "A money judgment under *Section 550(a)* was the only remedy available to restore the bankruptcy estate to the pre-preference position of the Debtor because the Lenders no longer held the mortgages and thus could not return them to the bankruptcy estate." *Id. at 128*.

[HN14] Resort to *§ 550* may also be unnecessary if the proceeds of collateral can be traced. A lien follows the proceeds of the collateral. *Phelps v. United States, 421 U.S. 330, 334-35, 95 S. Ct. 1728, 44 L. Ed. 2d 201 (1975)*, citing *Sheppard v. Taylor, 30 U.S. 675, 5 Pet. 675, 710, 8 L.Ed. 269 (1831)*; and *Loeber v. Leininger, 175 Ill. 484, 51 N.E. 703 (1898)*. [6] But if the proceeds of the collateral could no longer be traced to a specific fund, the lien would be avoidable but worthless as such (because no collateral could be identified). However, the value of the lien as it existed [*18] at the time of the transfer could be recovered by the trustee by virtue of the ability of the court to order under *§ 550(a)* that the trustee recover the value of the property transferred. See also *Halverson v. Le Sueur State Bank (In re Willaert), 944 F.2d 463, 464 (8th Cir. 1991)* (payment of a bank's preferential mortgage from sale of real estate prepetition was nothing more than the proceeds of the preferential transfer, and the trustee was thus entitled to recover from the bank pursuant to *§ 550(a)* the amount of the payment it had received); *In re Schwartz, 383 B.R. at 125* ("Any preferential cash payments received by the Lenders from the Debtors are proceeds of the mortgages and their recovery is included in the judgment amounts.")

6 In Sheppard v. Taylor, seamen held a lien on a ship for unpaid wages, but the ship had been condemned by Spain as engaging in illicit trade.

The owners assigned their rights to assignees (who, as against the seamen, did not enjoy the status of bona fide purchasers). Those assignees later made a recovery from Spain in compensation for the ship pursuant to a treaty between the United States and Spain. The seamen sought to enforce their lien on those proceeds [*19] of the ship. The Court observed:

> [T]here is no difference between the case of a restitution in specie of the ship itself, and a restitution in value. The lien reattaches to the thing and to whatever is substituted for it. This is no peculiar principle of the admiralty. It is found incorporated into the doctrines of courts of common law and equity. The owner and the lien holder, whose claims have been wrongfully displaced, may follow the proceeds wherever they can distinctly trace them.

Sheppard v. Taylor, 5 Pet. at 710.

McCarthy cannot contend that his one-half of the lien has been diminished in value through acts of Financial Freedom, and there are not yet any proceeds of the lien. Financial Freedom has left the lien undisturbed, and the lien is not yet even ripe to be enforced. Nevertheless, this case is distinguishable from the cases in which the courts ruled that the availability of *§ 551* makes resort to *§ 550* unnecessary, as discussed below.

V

THE TRUSTEE HAS SHOWN SPECIAL CIRCUMSTANCES THAT MAY MERIT THE IMPOSITION OF A MONETARY JUDGMENT AGAINST FINANCIAL FREEDOM

[HN15] *Section 550(a)* permits the trustee to recover the transferred property or, upon court order, the transferred property's [*20] value, yet "[n]either the statute nor the legislative history gives any guidance as to when the court should order a transferee or a beneficiary of a transfer to pay over the value of the property transferred." *Gennrich v. Mont. Sport U.S.A. (In re Int'l Ski Serv., Inc.), 119 B.R. 654 (Bankr. W.D. Wis. 1990),* quoting The Trustee's Recovery in Preference Actions, *3 Bankr. Dev. J. 449, 467 (1986)*. Although it is within this court's discretion to award the trustee the value of the lien, it is a remedy to only "be employed in limited circumstances, and only where the voiding of the lien is inadequate or unavailable as a remedy." [7] *Kelley v. Chevy Chase Bank (In re Smith), 236 B.R. 91, 100 (Bankr. M.D. Ga. 1999)*; *Cooper v. Ashley Communications, Inc. (In re Morris Communications NC, Inc.), 75 B.R. 619 (Bankr. W.D.N.C. 1987),* rev'd on other grounds, *In re Morris Communications NC, Inc., 914 F.2d 458 (4th Cir. 1990)* (finding under *§ 550* "a congressional intent to return the property transferred unless to do so would be inequitable . . . . [because] [t]his approach avoids unnecessary contests over the meaning of the term "value," and thereby promotes judicial economy.").

7 The trustee cites [*21] to Bank of America (In re Howell), A.P. No. 02-10017 (Bankr. D.D.C. January 27, 2003), as an example of this court's recognition of its right to "award the value of the lien rather than [limit the trustee's recovery to] recovery of the lien itself for the benefit of the estate." In that case, however, the issue was not whether it would be appropriate for the court to award the trustee the value of the avoided lien, but rather whether the trustee, as opposed to the bank, was entitled to post-petition payments from the debtor under the promissory note. The holding in Howell was limited to a decree that future payments to the bank would not diminish the trustee's lien. See also, *Morris v. Vulcan Chemical Credit Union (In re Rubia), 257 B.R. 324 (B.A.P. 10th Cir. 2001)* (dissenting opinion discussing the valuation of an avoided lien and why postpetition payments reduce the value of the lien by reducing the underlying obligation and should be deemed proceeds of the loan). Although Howell remains good law, it is of little relevance to this dispute.

The trustee cites to several cases in which courts have addressed the question of when it is appropriate to award a trustee the value of an avoided [*22] transfer under *§ 550(a)* rather than limit the trustee's recovery to the transferred property itself; however, none of the cases cited by the trustee address the avoidance of a one-half interest in a lien on real property. *In re Int'l Ski Service, Inc., 119 B.R. 654 (Bankr. W.D. Wis. 1990)* (within discretion of court to award trustee value of avoided transfer of machinery and equipment); *Morris v. Kansas Drywall Supply Co., (In re Classic Drywall, Inc.), 127*

B.R. 874 (D. Kan. 1991) (within discretion of court to require supplier to pay trustee value of avoided transfer of merchandise removed from the debtor's warehouse); *First Software Corp. V. Computer Associates International, Inc. (In re First Software Corp.), 107 B.R. 417 (D. Mass. 1989)* (not abuse of discretion for bankruptcy court to award trustee value of preferential transfer of computer software that had depreciated in value after the transfer); *Pritchard v. Brown (In re Brown), 118 B.R. 57 (Bankr. N.D. Tex. 1990)* (trustee awarded value of transferred oil and gas lease where the value of such lease was now more speculative than it had been at time the preferential transfer was made).

[HN16] Among the relevant factors that a court may [*23] consider in deciding whether to permit a trustee to recover the value of an avoided transfer rather than the transferred property itself include: (1) the presence of conflicting evidence with respect to the value of the transferred property; (2) whether the property has been converted and is thus no longer recoverable; (3) whether the property has depreciated in value subsequent to the transfer; and (4) whether the value is readily determinable and awarding the value would realize a savings for the estate. See *In re Int'l Ski Service, 119 B.R. at 657-58* (citing cases); *In re Classic Drywall, 127 B.R. at 877*.

McCarthy has shown special circumstances that may make resort to a monetary judgment under *§ 550(a)* appropriate. First, McCarthy does not have the right under *§ 363(b)* to attempt to sell the Property, and thus would not be able to collect an amount equal to one-half of the value of the lien via a *§ 363(b)* sale of the Property. Second, McCarthy would be left under *§ 551* with only one-half of a lien. Although McCarthy could attempt to sell his one-half of the lien, any sale of that one-half interest would present marketing problems because the purchaser would have to deal with Financial [*24] Freedom as the owner of the other half of the lien. The trustee would thus not be able to realize one half of the value of the entire lien.

Unless *11 U.S.C. § 363(h)* applies, the trustee would be authorized to sell under *§ 363(b)(1)* only the estate's share of the lien on the Property. The only co-owner of that lien is Financial Freedom, not the debtor's wife. It is not clear that *§ 363(h)* would apply to permit a sale of the entire lien as property, that by reason of the avoidance of the debtor's transfer of the lien, would be treated as property in which "the debtor had, at the time of the commencement of the case, an undivided interest." However, Financial Freedom is in a position to consent to the trustee's selling the entire lien, with the proceeds to be divided between the estate and Financial Freedom. If Financial Freedom refuses such consent, and *§ 363(h)* were held to be inapplicable, that would put the trustee in the position of attempting to sell only the estate's one-half interest in the lien.

Financial Freedom has not yet addressed whether it is willing to permit the trustee to sell the entire lien. If it expresses such willingness, that might alter the court's conclusion that [*25] a monetary judgment may be appropriate under *§ 550(a)*. [HN17] The costs the trustee would face in selling a reverse mortgage for which there is a limited market would not be reason to award him a monetary judgment when he is allowed to dispose of the entire conveyed interest. See *In re Farmer, 209 B.R. at 1025*. [8] The trustee has not shown that this case is similar to a conveyance of a special type of equipment for which only the transferee would have a use, and as to which it might be appropriate to award a judgment for the amount that was paid for the equipment as a measure of its value to the transferee. There is no evidence in the record that only Financial Freedom would have reason to want to hold the lien. Moreover, Financial Freedom has taken no steps to impair the value of the lien. Unlike a lien on a car where the collateral's value clearly depreciates, with the lienor receiving periodic payments to guard against such depreciation, the lien here was on a home and Financial Freedom did not insist on any periodic payments to protect it against any decline in the value of the Property. Any decline in value of the Property (and thus of the lien) is a function of market forces. If Financial [*26] Freedom is willing to permit the trustee to sell the entire lien, it would be inequitable to hold Financial Freedom liable for such a decline in value, and to permit McCarthy to resort to a monetary judgment based on the value at the time of transfer. Correspondingly, if the Property has increased in value, Financial Freedom's willingness to permit the entire lien to be sold would assure that the estate realized its share of any increase in the value of the lien (if it did not originally equal the debt).

8 In *In re Farmer*, a case in which the trustee successfully avoided a car lien and sought recovery of the value of the lien under *§ 550* because it would work a savings for the estate, the court made the astute observation that although "awarding a monetary recovery to the Trustee

> would save the estate the costs which it would otherwise incur in trying to sell the vehicle. . . . this fact does not justify such an award. If it did, the value of the property would always be awarded, and the *section 550* provision allowing the trustee to recover the property transferred would be rendered meaningless, a result which Congress could not have intended. While there are circumstances in which an [*27] award of the value of the property transferred is appropriate, no such circumstances exist in the instant case. The vehicle subject to the avoided lien, rather than being in the hands of a bona fide purchaser, is in the Debtors' possession, available to be administered by the Trustee as an asset of the estate." *In re Farmer, 209 B.R. at 1025*.

Absent special circumstances, this case does not present any need for the trustee to resort to *§ 550(a)* if he is permitted to sell the entire lien. The lien has been avoided with the collateral still in place and with the amount secured by the lien at the petition date still owed. The lien as it existed on the petition date thus remains fully intact. [9]

> 9 This case does not present the issue of payments made by the debtor to the lienor on the debt secured by the lien (and by virtue of there being a lien because the debt itself would be discharged if unsecured), and made prior to the lien being avoided.

If Financial Freedom will not consent to a sale by McCarthy of the entire lien, then a monetary judgment may be appropriate. When the lien that a lender received extended to both the debtor's and another party's interest in real property, the difficulties [*28] that a trustee would face in realizing the value of the lien may warrant resort to a monetary judgment under *§ 550(a)*. Although the court's research did not find any cases dealing with a lien that extended to property jointly owned by the debtor and someone else, the point is illustrated by *Bohm v. Dolata (In re Dolata), 306 B.R. 97 (Bankr. W.D. Pa. 2004)*. There the debtors owned real property adjoining real property owned by relatives. In building their own residence (the Personal Residence), the relatives encroached onto part of the real property owned by the debtors. The debtors then transferred that part of their real property (the Corrective Deed Property) to the relatives in an avoidable transfer. Even though the trustee's avoidance of the transfer of the Corrective Deed Property nullified the transfer and restored title in the debtors, the court decided that a monetary judgment under *§ 550(a)* was the appropriate remedy "because, in order to effect a recovery of the Corrective Deed Property itself, such property, which now constitutes but a small portion of the Personal Residence, would have to be partitioned from such latter property, which partitioning the Court suspects would [*29] be very difficult, if not impossible." *Id. at 138*.

Here, as in *Bohm*, the trustee in effect is invoking avoidance only as a vehicle to entitle him to proceed to invoke *§ 550(a)* to obtain a monetary judgment because a sale of only one-half of the lien would likely not yield one-half of the value of the entire lien (as one would hesitate to buy only half of a lien) and because he believes there is little market for selling even the entire lien. Upon recovery of that judgment he would waive the nullification results of the avoidance of the lien, leaving Financial Freedom free to enforce the entire lien on the Property. The court, however, does not believe that the trustee has established that for summary judgment purposes he is entitled to proceed by way of obtaining a monetary judgment in lieu of simply recovering the avoidable lien. That is a discretionary decision upon which different factfinders could reasonably rule differently, and it will depend in part on whether Financial Freedom is willing to let McCarthy sell the entire lien, not just the one-half of the lien that McCarthy has avoided. The court thus holds that summary judgment in favor of the trustee is precluded at this juncture [*30] regarding his entitlement to proceed under *§ 550(a)*.

VI

THE TRUSTEE HAS NOT SHOWN THE VALUE OF THE LIEN IF HE IS ENTITLED TO RECOVER A JUDGMENT FOR THE VALUE OF THE LIEN

Even if the court were inclined to award the trustee a monetary judgment for the value of the lien under *§ 550*, the trustee must first demonstrate the value of the lien in question. The trustee contends that the value of the lien is at least equal to the balance due under the Loan Agreement because, according to the trustee, the Property must have a fair market value in excess of the balance due under the Loan Agreement given that it anticipates future advances and Financial Freedom presumably believed its loan to be fully secured. Thus, submits the trustee, the one-half of the lien that he has avoided has a value of one-half the balance due under the Loan Agreement. Financial Freedom, by contrast, contends that the unique features of a reverse mortgage in the debtor's one-half interest in the Property preclude the trustee from establishing the value of the avoided lien by mere reference to the value of the property securing the debt or by reference to the balance due under the Loan Agreement. Rather, Financial Freedom [*31] urges that the trustee must present expert testimony to establish the value of the avoided lien, an option that is no longer available to the trustee given that the deadline for disclosing experts has expired.

The trustee urges that the court need only look to the balance due under the Loan Agreement and the fact that the loan is fully secured to conclude that the value of the lien is one-half the balance due under the Loan Agreement. In support of this theory, the trustee has submitted an unsworn declaration to which he has attached the debtor's schedule A listing the property as having a market value of $ 158,620, a District of Columbia Property Detail showing an assessed value of $ 158,620 for the tax year 2006 and a proposed new assessed value of $ 220,860 for the tax year 2007, a copy of Financial Freedom's proof of claim for $ 199,231.13, and data relating to sales in the debtor's neighborhood since January 1, 2005. Financial Freedom complains that this evidence is both inadmissible and insufficient. [HN18] The debtor's schedules are admissible evidence as to the value of the Property as a homeowner can testify as to the value of his home. Although the debtor's statement of the value [*32] of the Property matches the tax assessed value, there is no evidentiary restriction on how the homeowner is entitled to form his view of the value of the Property. Moreover, as McCarthy contends, he would be entitled to call the debtor as a witness at trial to establish that the value of the Property has increased.

[HN19] The Bankruptcy Code does not define "value" for purposes of *§ 550(a)*, and it has been observed that "[t]here is no word used in the bankruptcy court which is more elusive than the word value." *Crampton v. Dominion Bark of Bristol (In re H.P. King Co.), 64 B.R. 487, 489 n.1 (Bankr. E.D.N.C. 1986)*, quoting *In re Rehbein, 49 B.R. 250, 252 (Bankr. D. Mass. 1985)*. [10] Although there is ample authority for the proposition that "value" as that term is used in *§ 550(a)* refers to market value, *Widemire v. Siddiki Bros., Inc. (In re King Arthur Clock Co.), 105 B.R. 669 (Bankr. S.D. Ala. 1989)* ("The term value connotes market value."), [HN20] there is no prescribed valuation formula under *§ 550(a)* and the value indicator relied upon by a court in any given case depends upon the circumstances of the case and the nature and relative weight of the available evidence. See *Am. Furniture Outlet USA, Inc. V. Woodmark Originals, Inc., 209 B.R. 49, 52 (Bankr. M.D.N.C. 1997)* [*33] (sales price more reliable indicator of market value than letter of credit). For example, determining the market value of transferred property is simplified if that property was transferred by way of a sale, because "what a willing buyer will pay a willing seller is the absolute best indication of fair market value." *In re First Software Corp., 84 B.R. at 284*. [HN21] If the property was not transferred pursuant to a sale, however, other circumstances surrounding the transfer of the property may provide insight into the fair market value of the property. *Derryberry v. Albers (In re Albers), 67 B.R. 530, 534 (Bankr. N.D. Ohio 1986)* (best indicator of value of transferred trailer was the amount credited to debtor's account in exchange for trailer).

10 *Section 550(a)* is one of several Code provisions giving rise to litigation over the meaning of the term "value." For example, *§ 550(b)(1)* provides that the trustee may not recover from a "transferee that takes for value . . . in good faith, and without knowledge of the voidability of the transfer avoided." Courts, however, are divided on whether value as that term is used in *§ 550(b)(1)* signifies fair market value, or if the proper measure is reasonably [*34] equivalent value. *Rodgers v. Monaghan (In re Laguna Beach Motors, Inc.), 159 B.R. 562 (Bankr. C.D. Cal. 1993)* (further explaining that the meaning of value under *§ 550(b)(1)* differs from the meaning of value under *§ 550(a)* because "[t]he two sections use value for different purposes. *Section 550(a)* seeks to recover property from a person who has wrongfully taken funds from an estate, while *§ 550(b)(1)* is meant to protect an innocent third party transferee from liability on avoidable transfers.").

A similar dispute arises under [HN22] *§ 363(f)(3)*, which permits the trustee to sell estate property if "such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property." Courts disagree as to whether the term value as it is used in that section refers to the "face amount

> of the claim secured by the lien, i.e. the amount owed to the lienholder . . . . [or whether value should be] interpreted . . to mean the economic value of the lien as determined by the fair market value of the property." *Criimi Mae Services Limited Partnerhip v. WDH Howell, LLC (In re WDH Howell, LLC), 298 B.R. 527, 531 (D.N.J. 2003)* (referring to the different [*35] views as the "face value approach" and the "economic value approach.").
>
> Assuming the trustee could prove that the value of the Property exceeds the balance due under the Loan Agreement, the trustee's proffered valuation would survive scrutiny under either the economic value or face value approach. The trustee has not, however, explained why the court should accept the valuation methods applicable to a *§ 363(f)(3)* analysis as indicative of the market value of the avoided lien under *§ 550*.

The first issue to address is whether the value is to be based on one-half of the value of the entire lien, or instead the value of the one-half of the lien held by the trustee. The value should be the former. The debtor and his wife both had to agree to make the transfer to Financial Freedom because the Property was held by them as tenants by the entirety. Accordingly, Financial Freedom would not have been able to obtain a lien by virtue of only the debtor conveying a lien on the debtor's interest in the Property. The debtor's conveyance was thus part of a conveyance of the entire Property. Had he and his wife sold the Property, the value of the conveyance would be attributable equally to both of them. [*36] Moreover, in Financial Freedom's hands as transferee, the one-half of the lien avoided here had one-half of the value of the entire lien. It is thus appropriate to use one-half of the value of the entire lien as the measure of the value of what the debtor transferred to Financial Freedom.

McCarthy has satisfactorily shown the value of the Property as of the petition date, which is close enough in time to use as the value of the Property at the time of the prepetition transfers (consisting of the initial conveyance of the deed of trust, as well as the lending of additional amounts before the filing of the petition which became additional amounts secured by the deed of trust). McCarthy also points out that he would be entitled to call the debtor as a witness at trial to establish the current value of the Property (which McCarthy believes has increased in value).

The issue, however, is whether the value of the Property may be used to measure the value of the lien. Were this a case of a lien on a car, a depreciating asset, with the lien enforceable in the event of default in monthly payments, it might make sense to rule that McCarthy is entitled to recover one-half of the value of the Property [*37] on the petition date, limited by the amount of the debt secured by the Property. In *Morris v. St. John Nat. Bank (In re Haberman), 347 B.R. 411, 417 (B.A.P. 10th Cir. 2006)*, aff'd, *516 F.3d 1207, 1209 (10th Cir. 2008)*, the court ruled that for purpose of awarding a monetary judgment to a trustee with respect to an avoided lien that had been held by a Bank, the trustee's "rights in the collateral were to be valued at the amount of the Bank's debt [sic: should be claim] on the petition date, limited by the value of the collateral on that date." McCarthy understandably viewed this case as similar. There is no evidence in this case that Financial Freedom looked to anything other than the Property to assure that its claim would be paid. From this it may be inferred that Financial Freedom viewed the Property as fully securing its loan, whenever it might come due. If the lien had become enforceable shortly after the petition date, that is, if both the debtor and his wife died, then a sale of the Property in enforcement of the lien should have fetched the value ascribed to it by the debtor on his schedules. The lien protected Financial Freedom to that extent, and that, McCarthy would argue, [*38] is a fair measure of the value of the lien.

Although the trustee proposes that the value of the lien be established by reference to the balance due under the loan, capped by the value of the Property, McCarthy himself asserts that there is an "obviously limited market for an avoided reverse mortgage lien on the Debtor's interest in the Property." When a trustee asserts a right to recover the value of an avoided lien due to the general unmarketability of the avoided lien, Financial Freedom contends that it stands to reason that the holder of the lien against whom the trustee seeks to recover the lien's value should be entitled to rely on that same limited market to establish that the market value of the lien is less than the lien's face value. When looking at the market value of the lien, it may be appropriate to consider, for example, the secondary market for reverse mortgages as compared with conventional mortgages, and the effect of changing interest rates on the value of the debt.

But when a monetary judgment is granted under *§ 550(a)*, McCarthy can respond, the value is not necessarily what the lien would have fetched if sold on the open market, but, as in Haberman, the value of the [*39] lien in the hands of the entity whose lien was avoided, measured by the amount it could realize via enforcement of the lien. Nevertheless, that value turns on the prospect of when the lien would be enforceable, and that distinguishes this case from *Haberman*. The lien's enforceability depends on the life expectancies of the debtor and his wife, and measuring the value of the lien today depends on a prediction of the present value of the lien today based on the amount of debt that will be owed and what the Property will be worth at the time it becomes enforceable.

Financial Freedom urges that because expert testimony is required to establish the value of the avoided lien, and because the deadline for disclosing experts has expired, the trustee is unable meet his burden of proving the value of the avoided transfer. In response, the trustee, assuming that the only issue pertinent to valuation is the fair market value of the house, suggests several options that would allow him to demonstrate the fair market value of the lien without running afoul of the scheduling order. As discussed at length above, valuation evidence is required not simply to demonstrate the value of the house, but to [*40] further establish the market value of the avoided lien. It may be that the value of the house and the face value of the lien are reflective, at least in part, of the fair market value of the avoided lien as to the debtor's one-half interest in the Property, but such evidence is merely a starting point for such an analysis.

The deadline for disclosing experts has expired, and it is thus evident that the trustee will not be able to demonstrate the value of the lien on only the debtor's interest in the Property. Nevertheless, it is understandable that McCarthy might have viewed Financial Freedom as itself viewing its claim as fully secured. Moreover, the case law has not discussed how to value a reverse mortgage lien under *§ 550(a)*, and it was not clear that the value of the Property and the amount of the debt would not establish the value of the lien. Finally, a court's scheduling order is not carved in stone, and may be modified in the interest of justice. The court will reopen discovery for a period of time to permit McCarthy to obtain the opinion of an expert as to the value of the lien.

VII

In light of the foregoing, it is

ORDERED that Financial Freedom's motion for partial summary judgment [*41] is denied without prejudice. It is further

ORDERED that the trustee's motion for summary judgment is granted in part to allow the trustee to avoid the fixing of one-half of the lien granted to Financial Freedom on the Property owned by the debtor and his wife, and pursuant to *11 U.S.C. § 551* that lien is preserved for the benefit of the estate (unless the trustee recovers a monetary judgment against Financial Freedom for the value of the one-half of the lien). It is further

ORDERED that the trustee's motion for summary judgment is otherwise denied. It is further

ORDERED that the parties appear before the court on the date that was set for argument on the motions for summary judgment to address modifications of the scheduling order.

The Memorandum Decision and Order re Cross-Motions for Summary Judgment below is hereby signed.

Dated: May 12, 2008.

/s/ S. Martin Teel, Jr.

S. Martin Teel, Jr.

United States Bankruptcy Judge

IN RE: Patricia Ann Brown, Debtor(s).

C/A No. 09-09068-JW, Chapter 13

UNITED STATES BANKRUPTCY COURT FOR THE DISTRICT OF SOUTH CAROLINA

428 B.R. 672*; *2010 Bankr. LEXIS 2094

March 2, 2010, Decided
March 2, 2010, Filed

CASE SUMMARY:

PROCEDURAL POSTURE: A creditor filed an objection to confirmation of a Chapter 13 debtor's plan and a motion to modify the stay for cause under *11 U.S.C.S. § 362(d)(1)*. The debtor filed an objection to the stay motion on the basis that the creditor was adequately protected and also asserted that the plan should be confirmed. A Chapter 13 trustee recommended confirmation of the plan, dependent upon resolution of the objection in the debtor's favor.

OVERVIEW: The creditor was the holder of a note executed by the debtor's mother that was secured by a reverse mortgage on property that was owned by the debtor's mother. The debtor inherited the property. Under the terms of the note and mortgage, the full and final payment of the debt was accelerated and became immediately due upon her mother's death. The debtor proposed to pay the creditor the total outstanding indebtedness plus interest over the term of her plan. The creditor argued that this would constitute an impermissible modification of its rights under *11 U.S.C.S. § 1322(b)(2),* as the plan proposed to extend the repayment term of a fully accelerated debt that was secured only by the debtor's principal residence. The court held that under *§ 1322(c)(2),* the debtor could pay over the term of her plan the total outstanding indebtedness on the reverse mortgage that accelerated prior to the petition date as a result of her mother's death. The court also overruled the creditor's objection that the plan lacked feasibility or was proposed in bad faith. Stay relief was not warranted, as the creditor's interest was adequately protected by the equity in the property and the proposed payments.

OUTCOME: The court overruled the creditor's objection to confirmation and denied its motion to modify stay.

LexisNexis(R) Headnotes

Bankruptcy Law > Claims > Types > Secured Claims & Liens > General Overview
Bankruptcy Law > Individuals With Regular Income > Plans > Contents
[HN1] *11 U.S.C.S. § 1322(b)(2)* provides, in part, that a Chapter 13 plan may modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is a debtor's principal residence.

Bankruptcy Law > Claims > General Overview
Bankruptcy Law > Estate Property > Content

[HN2] Even where there is no privity of contract between a mortgage creditor and a debtor, the mortgage creditor holds a claim against the debtor's estate where the debtor owns property as to which the mortgage creditor holds a lien and that property is property of the estate.

Bankruptcy Law > Claims > Types > Secured Claims & Liens > General Overview
Bankruptcy Law > Individuals With Regular Income > Plans > Contents
[HN3] *11 U.S.C.S. § 1322(b)(5)* provides that notwithstanding *§ 1322(b)(2)*, a plan may provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any secured claim on which the last payment is due after the date on which the final payment under the plan is due.

Bankruptcy Law > Claims > Types > Secured Claims & Liens > General Overview
Bankruptcy Law > Individuals With Regular Income > Plans > Contents
[HN4] *11 U.S.C.S. § 1322(c)(2)* provides that notwithstanding *§ 1322(b)(2)* and applicable nonbankruptcy law, in a case in which the last payment on the original payment schedule for a claim secured only by a security interest in real property that is a debtor's principal residence is due before the date on which the final payment under the plan is due, the plan may provide for the payment of the claim as modified pursuant to *11 U.S.C.S. § 1325(a)(5)*. In other words, with respect to mortgages on which the last payment on the original payment schedule is due before the date on which the final payment under the Chapter 13 plan is due, debtors are permitted under *11 U.S.C.S. § 1322(c)(2)* to modify a mortgage creditor's rights by proposing in their plan to pay the mortgage creditor in full over the course of the bankruptcy.

Contracts Law > Negotiable Instruments > Discharge & Payment > Payment > Time for Payment
Real Property Law > Financing > Mortgages & Other Security Instruments > Transfers > Due-on-Sale Clauses
[HN5] The term "acceleration" is defined as the advancing of a loan agreement's maturity date so that payment of the entire debt is due immediately.

Bankruptcy Law > Individuals With Regular Income > Plans > Contents
Real Property Law > Financing > Mortgages & Other Security Instruments > Transfers > Due-on-Sale Clauses
[HN6] *11 U.S.C.S. § 1322(c)(2)* permits a debtor to pay over the term of his plan the total outstanding indebtedness on a reverse mortgage that matured or accelerated prior to the petition date.

COUNSEL: [**1] For Patricia Ann Brown, Columbia, SC, Debtor: J. Steven Huggins, Columbia, SC.

JUDGES: John E. Waites, UNITED STATES BANKRUPTCY JUDGE.

OPINION BY: John E. Waites

OPINION

[*673] **ORDER**

This matter comes before the Court on the Objection to Confirmation of Debtor's Chapter 13 Plan ("Objection") and Motion [*674] to Modify Stay ("Stay Motion") filed by Financial Freedom Senior Funding ("Financial Freedom"). Patricia Ann Brown ("Debtor") filed an objection to the Stay Motion on the basis that Financial Freedom is adequately protected. Debtor also asserts that the plan should be confirmed. The Chapter 13 Trustee recommended confirmation of Debtor's plan dependent upon resolution of the Objection in Debtor's favor. After considering the pleadings in this matter and the arguments and evidence presented at the hearing, the Court makes the following findings of fact and conclusions of law pursuant to *Federal Rule of Civil Procedure 52*, which is made applicable to this contested matter by *Federal Rules of Bankruptcy Procedure 7052* and *9014(c)*.[1]

1 To the extent any of the following findings of fact constitute conclusions of law, they are adopted as such; and to the extent any of the following conclusions of law constitute findings of fact, [**2] they are so adopted.

FINDINGS OF FACT

1. Financial Freedom is the holder of an adjustable rate home equity conversion note ("Note") executed by

Debtor's mother, Doris Jean Zeigler.[2] The Note in an amount of up to $90,000.00 is secured by a reverse mortgage ("Mortgage") on real property located at 726 Dixie Avenue, Columbia, South Carolina ("Property"). The Property was owned by Debtor's mother at the time of the execution of the Note and Mortgage.

2 The Note was signed by Debtor as attorney-in-fact on behalf of Doris Jean Zeigler.

2. According to the Mortgage, the maturity date of the debt is February 14, 2078.

3. Debtor's mother died on October 10, 2007, and Debtor inherited title to the Property. Under the terms of the Note and Mortgage, the full and final payment of the debt owed to Financial Freedom was accelerated and became immediately due upon the death of Debtor's mother. The loan was called and foreclosure proceedings were commenced prior to the filing of this case, as indicated by Debtor's Statement of Financial Affairs.

4. On December 4, 2009, Debtor filed a voluntary petition for relief under chapter 13 of the Bankruptcy Code. In her schedules, Debtor lists the Property as her [**3] principle residence and lists Financial Freedom as a creditor holding a secured claim in the amount of $29,524.44. The Property is listed as having a current value of $70,000.00.[3]

3 In its Certification of Facts for its Stay Motion, Financial Freedom agreed that the fair market value of the property is $70,000.00.

5. On December 17, 2009, Debtor filed her chapter 13 plan, wherein she proposes to pay Financial Freedom the total outstanding indebtedness of $29,524.44, plus 5.25% interest, over a period of 60 months at a rate of $561.00 per month.

6. Financial Freedom objects to confirmation of the plan, asserting that (1) its treatment under the plan is impermissible because Debtor is unable to cure the default under *11 U.S.C. § 1322(b)(5)*, (2) the plan has been proposed in bad faith and (3) the plan is not feasible. Additionally, Financial Freedom has moved for relief from the automatic stay for cause under *11 U.S.C. § 362(d)(1)*.

7. Debtor has been employed with the same company for the past 11 years and has resided in the Property for the past 40 years. Debtor receives financial assistance from her daughter and son, who also reside at the Property. Debtor's daughter has also resided in [**4] the Property for the past 40 years. Debtor's son has resided in [*675] the Property intermittently during the past 40 years.

<u>CONCLUSIONS OF LAW</u>

Financial Freedom objects to its treatment under Debtor's chapter 13 plan and asserts that Debtor should be required to amend her plan to reflect that she will surrender her interest in the Property. Financial Freedom argues that allowing Debtor to cure over the term of the plan would constitute an impermissible modification of its rights under *11 U.S.C. § 1322(b)(2)*,[4] because the plan proposes to extend the term of repayment of a fully accelerated debt that is secured only by Debtor's principal residence.[5] Financial Freedom asserts that Debtor is unable to cure the acceleration of the debt under *11 U.S.C. § 1322(b)(5)*,[6] because the cause of the acceleration was the death of Debtor's mother. In support of this argument, Financial Freedom cites *In re Trapp, 260 B.R. 267 (Bankr. D.S.C. 2001)*, in which this Court quoted the holding in *In re Taddeo, 685 F.2d 24 (2d. Cir. 1982)* that "the power to cure must comprehend the power to 'de-accelerate'." Financial Freedom also cites *In re Henry, 153 Fed. Appx. 146 (4th Cir. 2005)*, an unpublished Fourth Circuit [**5] opinion in which the Fourth Circuit found that debtor could not cure a claim that fully matured prior to the bankruptcy filing within the meaning of *§ 1322(b)(5)*.

4 [HN1] *Section 1322(b)(2)* provides, in relevant part, that a chapter 13 plan may "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence..."

5 The parties do not appear to dispute that the Property is property of the estate or that the mortgage debt is a claim within the meaning of *11 U.S.C. §§ 1322(b)(2), (b)(5), (c)(2)*, or *101(5)*. This Court has previously held that [HN2] even where there is no privity of contract between mortgage creditor and the debtor, the mortgage creditor holds a claim against debtor's estate where the debtor owns property as to which the mortgage creditor holds a lien and that property is property of the estate. See *In re Trapp, 260 B.R. 267, 271 (Bankr. D.S.C. 2001)*.

> 6 [HN3] *Section 1322(b)(5)* provides that "notwithstanding *[§ 1322(b)(2)]*, [the plan may] provide for the curing of any default within a reasonable time and maintenance of payments while the case is pending on any ... secured claim on which the last payment [**6] is due after the date on which the final payment under the plan is due."

In response, Debtor argues that *§ 1322(c)(2)* contains an exception that allows her to modify Financial Freedom's Mortgage and pay its claim in full over the term of her chapter 13 plan. [HN4] *Section 1322(c)(2)* provides that "[n]otwithstanding *[§ 1322(b)(2)* and applicable nonbankruptcy law ... in a case in which the last payment on the original payment schedule for a claim secured only by a security interest in real property that is the debtor's principal residence is due before the date on which the final payment under the plan is due, the plan may provide for the payment of the claim as modified pursuant to *section 1325(a)(5)* of this title." In other words, with respect to mortgages on which the last payment on the original payment schedule is due before the date on which the final payment under the chapter 13 plan is due, debtors are permitted under *§1322(c)(2)* to modify a mortgage creditor's rights by proposing in their plan to pay the mortgage creditor in full over the course of the bankruptcy. Under the terms of Debtor's Note and Mortgage, no payment schedule is provided. By its terms, the Note provides that the [**7] debt becomes immediately payable in full upon the occurrence of one of the following conditions: (1) death of the borrower, (2) the transfer of all of borrower's title in the Property, (3) the Property ceases to be the [*676] principal residence of the borrower, (4) the borrower fails to physically occupy the Property for a period of more than twelve months, or (5) the borrower fails to perform an obligation under the Mortgage. Debtor argues that *§ 1322(c)(2)* applies to Financial Freedom's debt in this case because the death of Debtor's mother caused the debt to become immediately payable in full and this payment was due prior to the due date of the final payment under Debtor's plan.

Financial Freedom argues that *§ 1322(c)(2)* does not apply because the debt in this case has not yet matured, noting the maturity date set forth in the note is beyond the term of Debtor's chapter 13 plan. This argument is not persuasive. Financial Freedom contends that acceleration of the Note has occurred in this case according to its terms. [HN5] The term "acceleration" is defined as "the advancing of a loan agreement's maturity date so that payment of the entire debt is due immediately." Black's Law Dictionary 11 [**8] (7th ed. 1999). Thus, the acceleration of the Note in this case caused the last payment of the debt to be moved to a date that was prior to the date of the final payment on Debtor's chapter 13 plan. Furthermore, the authority cited by Financial Freedom does not appear to address *§ 1322(c)(2)*. The Court's opinion in *Trapp* addressed the issue of whether a debtor could cure a default under *§ 1322(b)(5)* where the debt had been accelerated under the terms of the note due to the debtor's default in making payments. The Court concluded that the fact that the debt was accelerated due to the debtor's default did not prohibit the curing of such default through the chapter 13 plan. The applicability of *§ 1322(c)(2)* was not raised. The debt in this case became payable in full due to the occurrence of an acceleration event under the terms of the Note and not due to default in payment. In the *Henry* case, an unpublished opinion that is not binding precedent, the Fourth Circuit only addressed the issue of whether a debtor could cure a fully matured debt under *§ 1322(b)(5)*. These cases do not preclude a finding that *§ 1322(c)(2)* would allow the treatment proposed by Debtor in her chapter 13 plan.

The [**9] Fourth Circuit stated in Witt v. United Companies Lending Corp. that *§ 1322(c)(2)* serves primarily to permit debtors to cure maturing obligations by paying the remaining part of the debt over the life of a chapter 13 plan and that this repayment flexibility is an important tool for debtors in restructuring the payment of home mortgage debt in chapter 13 plans. *113 F.3d 508, 512 (4th Cir. 1997)*. [HN6] This subsection has been applied by bankruptcy courts in other jurisdictions to permit a debtor to pay over the term of his plan the total outstanding indebtedness on a reverse mortgage that matured or accelerated prior to the petition date. See *In re Carter, No. 09-35587, 2009 Bankr. LEXIS 4201, 2009 WL 5215399, at *3 (Bankr. S.D. Tex. Dec. 28, 2009)* (holding that the debtor may pay the full outstanding indebtedness of a reverse mortgage that matured pre-petition as a result of the death of the mortgagor over the course of his bankruptcy plan); see also *In re Wilcox., 209 B.R. 181, 183 (Bankr. E.D.N.Y. 1996)* (same). Furthermore, legislative history indicates that Congress added this subsection for the purpose of overruling *First National Fidelity Corp. v. Perry (In re Perry), 945 F.2d 61 (3d Cir. 1991)*, which held [**10] that under *§ 1322 (b)(2)*, a debtor could not utilize *§ 1325(a)(5)* to provide for a mortgage debt that was due in full prior to the due date of the final payment of the plan by paying the full amount of the secured claim though the chapter 13 plan. See *Witt, 113 F.3d at 512* (finding that the changes made to *§ 1322(c)* were intended to overrule the [*677] result in *Perry*); see also *In re Escue, 184 B.R. 287 (Bankr. M.D. Tenn. 1995)* ("*[Section 1322](c)(2)* appears to contemplate mortgages which mature post-petition, but the Congressional intent of this statute when considered in light of the other provisions of Chapter 13, and the overall objectives of bankruptcy, suggest that Congress also intended for debtors to be able to cure defaults on short-term mortgages which mature or balloon prior to the petition date.")

Based on its examination of the language of *§ 1322(c)(2)*, the legislative history and case law interpreting this section,[7] the Court finds *§ 1322(c)(2)* applies to permit Debtor to pay the full amount of Financial Freedom's claim over the course of her bankruptcy plan. Separately, even if *§ 1322(c)(2)* did not apply, the substantial equity in the Property could allow Debtor, who is financially [**11] able to retire the debt in a short period, to retain the collateral for a substantial period even without a confirmed plan in order to seek to pay or refinance the debt. Accordingly, First Financial's objection on the basis that its treatment under the plan is impermissible is overruled.

7 This Court agrees with the reasoning in the *Carter* and *Wilcox* opinions and notes that these cases were decided on nearly identical facts as the case at bar.

Financial Freedom also objects to confirmation on the basis that the plan lacks feasibility because Debtor is relying on assistance from family members and on the basis that the plan has been proposed in bad faith because Debtor knew the Note was due upon her mother's death. It asserts that the plan is not feasible because Debtor is relying on assistance from family members. However, Debtor presented testimony that she has been regularly employed with the same employer for eleven years and is receiving contributions from her daughter, who is employed and has lived with Debtor for over forty years. She also testified that her son had recently moved into the family home and was contributing to the household expenses. The chapter 13 trustee did not [**12] raise concerns regarding the feasibility of the plan and recommended confirmation in the event Financial Freedom's objection was overruled. No persuasive evidence was presented indicating bad faith. Accordingly, the Court finds that Financial Freedom's objection to confirmation on these grounds should be overruled.

Finally, Financial Freedom seeks relief from the automatic stay pursuant to *11 U.S.C. § 362(d)(1)* on the grounds that Debtor cannot cure the default and its interest is not adequately protected. Debtor's plan proposes to pay the full outstanding indebtedness of the mortgage, plus interest, over the course of her bankruptcy plan. As previously discussed, it appears that the proposed treatment of Financial Freedom's claim in the plan is permitted under *§ 1322(c)(2)* and provides assurance of periodic payments to Financial Freedom.[8] The parties do not dispute that there is significant equity in the Property and that the Property, as Debtor's residence, is necessary for reorganization. It appears that Financial Freedom's interest is adequately protected by the equity in the Property and the proposed payments. Accordingly, the Court finds no cause for relief from the automatic [**13] stay.

8 The Court observes that Financial Freedom has not yet filed a proof of claim. The deadline for filing a proof of claim has not yet expired. Without an allowed claim, Financial Freedom will not receive distributions under the plan.

For the foregoing reasons, the Financial Freedom's Objection to Confirmation is [*678] overruled and its Motion to Modify Stay is denied.

AND IT IS SO ORDERED.

/s/ John E. Waites

UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina
March 2, 2010

IN RE: LENA L. BOUDREAUX, DEBTOR

CASE NO. 09-12724 SECTION A, CHAPTER 13

UNITED STATES BANKRUPTCY COURT FOR THE EASTERN DISTRICT OF LOUISIANA

2010 Bankr. LEXIS 777

February 24, 2010, Decided

CASE SUMMARY:

PROCEDURAL POSTURE: As of the date that a debtor filed her petition for relief under Chapter 13, her home loan was fully accelerated because she failed to maintain the required insurance on the property. The creditor, who held a reverse mortgage executed by the debtor, filed a motion to lift the stay, and the debtor opposed the motion.

OVERVIEW: The debtor had executed a reverse mortgage on her residential property in favor of the creditor. She proposed to pay the past due amounts through her Chapter 13 plan, but the creditor contended that the debtor could not "de-accelerate" the debt and modify the secured loan by curing the defaults over the length of the plan and reinstating the contract. The court concluded that the debtor's monetary obligations were secured by a security interest on her primary residence and that the reverse mortgage did not change that fact. The fact that the debtor's monetary obligations were not specifically delineated under the note was of no effect. Her obligation to pay property taxes when due in full and to insure the property obligated the debtor to monetary satisfaction of her obligations on a timely basis. The monthly installments paid by the creditor to the debtor were nothing other than advances on a loan subject to repayment with interest. The debtor proposed a plan that fully satisfied all amounts due prepetition and placed the loan contractually current on its completion. Thus, the creditor's rights were not modified and the provisions of *11 U.S.C.S. § 1322(c)(2)* were honored.

OUTCOME: The court denied the creditor's motion to lift the stay.

LexisNexis(R) Headnotes

Bankruptcy Law > Individuals With Regular Income > Plans > Contents

[HN1] A plan may not modify the rights of a secured creditor if the claim is secured by the debtor's principal residence. However, there are exceptions. A prepetition default that results in the acceleration of the debt may be cured in one of two ways. The entire debt may be repaid within the plan term under repayment terms approved by a court. Alternatively, the past due prepetition amounts may be satisfied over the term of the plan such that on the plan's completion, the loan will be current and its remaining balance satisfied as originally contracted.

Bankruptcy Law > Individuals With Regular Income > Plans > Contents

[HN2] *11 U.S.C.S. § 1322(b),* construed in light of its legislative history and of its context within Chapter 13 as a whole, evinces no legislative intent that a home-mortgagor debtor is barred either (a) from curing a pre-petition acceleration into maturity of the unpaid installments due upon his home mortgage, or (b) from proposing (in his Chapter 13) plan for consideration by the bankruptcy court) that all past due or matured amounts secured by his home mortgage be paid during the term of his plan, if approved by the court - so that, thereby, proceedings upon foreclosure of his home mortgage may be properly stayed, while permitting the debtor to pay off his arrearages in accordance with the terms of the plan confirmed by the court.

Bankruptcy Law > Individuals With Regular Income > Plans > Contents
[HN3] *11 U.S.C.S. § 1322* governs all loans created by agreement that are secured by the debtor's primary residence.

Real Property Law > Financing > Mortgages & Other Security Instruments > Definitions & Interpretation
Real Property Law > Financing > Mortgages & Other Security Instruments > Nonconventional Mortgages
[HN4] A reverse mortgage is nothing more than a contractual obligation between the parties.

COUNSEL: [*1] For Lena L. Boudreaux, Debtor: Edwin M. Shorty, Jr., Shorty, Dooley & Hall, LLC, New Orleans, LA.

Trustee: S. J. Beaulieu, Jr., Metairie, LA.

JUDGES: Hon. Elizabeth W. Magner, U.S. Bankruptcy Judge.

OPINION BY: Elizabeth W. Magner

OPINION

REASONS FOR DECISION

This matter came before the Court on October 27, 2009, on the Motion to Lift Stay filed by Reverse Mortgage Solutions, Inc., as assignee of Standard Mortgage Corp., ("RMS") [1] and the Opposition filed by Lena L. Boudreaux ("Debtor"). [2] The Court ordered post-hearing briefs, which were filed on November 30, 2009. [3] After the filing of the briefs, the Court took the matter under advisement.

1 Pl. 12.
2 Pl. 18.
3 Pl. 28 and 29.

I. Facts

Debtor filed for relief under Chapter 13 of the Bankruptcy Code on August 27, 2009 ("Petition Date").

On May 10, 2004, Debtor executed a reverse mortgage on her property at 4231-33 S. Street, New Orleans, in favor of RMS. The mortgage required Debtor to maintain insurance and satisfy all property taxes accruing on the property in exchange for monthly payments through August 29, 2071. At the end of the term, the property is subject to sale to satisfy the amounts advanced with interest.

Prior to filing, Debtor failed to maintain insurance on [*2] the property. As a result, RMS declared the contract immediately payable in full. [4] Both Debtor and RMS agree that the loan was fully accelerated on the Petition Date. [5]

4 Pl. 12, Exh. B, P 9.
5 Pl. 28, p. 2; Pl. 29, p. 1.

Debtor proposes to pay the past due insurance premiums, taxes, and attorneys' fees, to RMS through her Chapter 13 plan ("the Plan"). [6] RMS contends that Debtor cannot "de-accelerate" the debt and modify the secured loan by curing the defaults over the length of the Plan and reinstating the contract.

6 Pl. 20.

II. Law and Analysis

[HN1] A plan may not modify the rights of a secured creditor if the claim is secured by the debtor's principal residence. [7] However, there are exceptions. A prepetition default that results in the acceleration of the debt may be cured in one of two ways. The entire debt may be repaid within the plan term under repayment terms approved by the Court. [8] Alternatively, the past due prepetition amounts may be satisfied over the term of the plan such that on the plan's completion, the loan will be current and its remaining balance satisfied as originally contracted. In *Grubbs v. Houston First American Savings Association,* [9] an *en banc* [*3] Fifth Circuit explained:

> [HN2] *Section 1322(b)* of the Code, construed in light of its legislative history and of its context within Chapter 13 as a whole, evinces no legislative intent that a home-mortgagor debtor is barred either (a) from curing a pre-petition acceleration into maturity of the unpaid installments due upon his home mortgage, or (b) from proposing (in his Chapter 13)plan for consideration by the bankruptcy court) that all past due or matured amounts secured by his home mortgage be paid during the term of his plan, if approved by the court - so that, thereby, proceedings upon foreclosure of his home mortgage may be properly stayed, while permitting the debtor to pay off his arrearages in accordance with the terms of the plan confirmed by the court. [10]

7 *11 U.S.C. § 1322(b)(2)*.
8 *11 U.S.C. § 1322(c)(2)*.
9 *Grubbs v. Houston First American Savings Association, 730 F.2d 236 (5th Cir. 1984)*; *see also In re Taddeo, 685 F.2d 24 (2nd Cir. 1982)* and *Matter of Clark, 738 F.2d 869 (7th Cir. 1984)*.
10 *Id. at 237*.

RMS argues that *Grubbs* is distinguishable because a reverse mortgage is not a "conventional loan," does not have regular installment payments, and is subject to acceleration under Housing [*4] and Urban Development ("HUD") regulations which do not provide for cure. RMS does not cite a single case in support of its position.

[HN3] *Section 1322* governs all loans created by agreement that are secured by the debtor's primary residence. [11] Contrary to RMS' assertion, [HN4] a reverse mortgage is nothing more than a contractual obligation between the parties. Debtor's monetary obligations are secured by a security interest over his primary residence. As such, a reverse mortgage falls squarely within the holding of *Grubbs*. The fact that Debtor's monetary obligations are not specifically delineated under the note by amount or time is of no effect. Debtor's obligation to pay property taxes when due in full, as well as to insure the property against all risks, obligates Debtor to monetary satisfaction of her obligations on a timely basis. In addition, the monthly installments paid by RMS to Debtor are nothing other than advances on a loan subject to repayment with interest upon maturity or Debtor's death.

11 *11 U.S.C. §§ 1322(b)(2)* and *101(51)*.

RMS' argument that HUD regulations do not provide for the de-acceleration of the debt is also without support. The terms of RMS' mortgage are directly contrary [*5] to its position. Paragraph 11 of the mortgage provides:

> 11. **Reinstatement**. Borrower has a right to be reinstated if Lender has required immediate payment in full. This right applies after foreclosure proceedings are instituted. To reinstate this Security Instrument, Borrower shall correct the condition which resulted in the requirement for immediate payment in full. Foreclosure costs and reasonable and customary attorneys' fees and expenses properly associated with a foreclosure proceeding shall be added to the principal balance. Upon reinstatement by Borrower, this Security Instrument and the obligations that it secures shall remain in effect as if Lender had not required immediate payment in full. [12]

12 Pl. 12, Exh. B.

Debtor's case is comparable to *In re Carter*. [13] In *Carter*, the debtor's mother executed a reverse mortgage in favor of a creditor also subject to HUD regulations. The loan matured when the debtor's mother died, and the debtor inherited a 20% interest in the home. The *Carter* Court ruled that the creditor had an *in rem* claim against the debtor's property that could be included in the debtor's Chapter 13 plan. [14] The Court also ruled that the debtor could pay the full debt [*6] through the plan.

13 *In re Carter, 2009 Bankr. LEXIS 4201, 2009 WL 5215399 (Bankr.S.D.Tex. 2009)*.
14 *Id*. citing *Johnson v. Home State Bank, 501 U.S. 78, 111 S.Ct. 2150, 115 L.Ed.2d 66 (1991)*.

Similarly in *In re Wilcox,* [15] the debtor's father executed a reverse mortgage in favor of the creditor. The debtor's father died prepetition, leaving the debtor a 50% interest in the home. The debt was accelerated upon the death of the debtor's father, so the full balance was owed prepetition. The debtor proposed to pay the full balance through his Chapter 13 plan. The Court found:

> [*11 U.S.C. § 1322(c)(2)*] appears to contemplate mortgages which mature post-petition, but the Congressional intent of this statute when considered in light of the other provisions of Chapter 13, and the overall objections of bankruptcy, suggest that Congress also intended for debtors to be able to cure defaults on short-term mortgages which mature or balloon prior to the petition date. . . . [B]ased upon the legislative history, the stated objectives of Chapter 13, and Congress' preference for a Chapter 13 filing rather than [] Chapter 7, that Congress intended to allow debtors to cure a mortgage indebtedness which mature[d] or ballooned prepetition [*7] by providing for full payment [] to the mortgagee over the life of the Chapter 13 Plan. [16]

15 *In re Wilcox, 209 B.R. 181 (Bankr.E.D.N.Y. 1996)*.
16 *Id. at 183* (quoting *In re Escue, 184 B.R. 287 (Bankr.M.D.Tenn. 1995))*.

Unlike *Carter* or *Wilcox,* the obligations owed in this case were contracted by Debtor and are fully executable against her. The contract provides that upon default, RMS may declare the contract fully accelerated. Acceleration is a remedy on default which RMS argues cannot be unwound under HUD regulations. RMS offers no legal support for its position, and its own contract and the jurisprudence are squarely at odds with its assertions.

The *Grubbs* Court provides an exhaustive legislative history of *section 1322(b)*. The *en banc* Fifth Circuit determined Congress' intent was to allow the cure of accelerated debt upon the filing, distinguishing between the power to "cure" and "de-accelerate" and *section 1322(b)*'s prohibition against modification of a mortgagee's rights. [17] In its opinion, the Fifth Circuit explained:

> [W]e should note that the clause, "on which the last payment is due," can be interpreted, as a matter of preempting federal bankruptcy law, to mean "on which the last payment [*8] before acceleration is due." [18]

17 *730 F.2d at 242-246*.
18 *Id. at 241 n.7*.

Grubbs specifically rejected the notion that state laws, or in this case federal regulations, would determine the effect of the creditor's acceleration and the debtor's ability to cure his default. [19]

> To permit, for chapter 13 purposes, the variations of the laws of the different states to govern the effect of an acceleration and its curability, would be to defeat one of Congress' important purposes, in exercising its preemptive bankruptcy powers under the federal constitution, to provide by chapter 13 a uniform national remedy . . . by which to adjust the debts of individuals with regular incomes as an alternative to them being forced to undergo liquidating bankruptcy. H. Rep. No. 595, 95th Cong., 1st Sess. 4-5, 116-21 (1977); 5 *Collier on Bankruptcy, P 1300.01* (5th ed. 1983). Along with the *Taddeo* panel, "[w]e do not believe that Congress labored for five years over this controversial question only to remit consumer debtors-intended to be primary beneficiaries of the new Code-to the harsher mercies of state law." *685 F.2d at 25*. [20]

19 *Id. at. 240-241*.
20 *Id. at 241 n.9*.

Debtor has proposed a plan which fully satisfies [*9] all amounts due prepetition and places the loan contractually current on its completion. As a result, RMS' rights are not modified and the provisions of *11 U.S.C. §*

1322(c)(2) are honored. For these reasons and in accordance with the cases cited above, the Motion to Lift Stay filed by RMS is denied. An Order in accord with these Reasons will be separately rendered.

New Orleans, Louisiana, February 24, 2010.

/s/ Hon. Elizabeth W. Magner

Hon. Elizabeth W. Magner

U.S. Bankruptcy Judge

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For Consumers

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Federal Trade Commission
For The Consumer

ftc.gov ■ 1-877-ftc-help

March 2011

Reverse Mortgages:
Get the Facts Before Cashing in on Your Home's Equity

If you're 62 or older – and looking for money to finance a home improvement, pay off your current mortgage, supplement your retirement income, or pay for healthcare expenses – you may be considering a reverse mortgage. It's a product that allows you to convert part of the equity in your home into cash without having to sell your home or pay additional monthly bills.

The Federal Trade Commission (FTC), the nation's consumer protection agency, wants you to understand how reverse mortgages work, the types of reverse mortgages available, and how to get the best deal.

In a "regular" mortgage, you make monthly payments to the lender. In a "reverse" mortgage, you receive money from the lender, and generally don't have to pay it back for as long as you live in your home. The loan is repaid when you die, sell your home, or when your home is no longer your primary residence. The proceeds of a reverse mortgage generally are tax-free, and many reverse mortgages have no income restrictions.

In a reverse mortgage, you receive money from the lender, and generally don't have to pay it back for as long as you live in your home.

Types of Reverse Mortgages

There are three types of reverse mortgages:

- *single-purpose reverse mortgages*, offered by some state and local government agencies and nonprofit organizations
- *federally-insured reverse mortgages*, known as Home Equity Conversion Mortgages (HECMs) and backed by the U. S. Department of Housing and Urban Development (HUD)
- *proprietary reverse mortgages*, private loans that are backed by the companies that develop them.

■ Single-purpose reverse mortgages are the least expensive option. They are not available everywhere and can be used for only one purpose, which is specified by the government or nonprofit lender. For example, the lender might say the loan may be used only to pay for home repairs, improvements, or property taxes. Most homeowners with low or moderate income can qualify for these loans.

- HECMs and proprietary reverse mortgages may be more expensive than traditional home loans, and the upfront costs can be high. That's important to consider, especially if you plan to stay in your home for just a short time or borrow a small amount. HECM loans are widely available, have no income or medical requirements, and can be used for any purpose.

Before applying for a HECM, you must meet with a counselor from an independent government-approved housing counseling agency. Some lenders offering proprietary reverse mortgages also require counseling. The counselor is required to explain the loan's costs and financial implications, and possible alternatives to a HECM, like government and nonprofit programs or a single-purpose or proprietary reverse mortgage. The counselor also should be able to help you compare the costs of different types of reverse mortgages and tell you how different payment options, fees, and other costs affect the total cost of the loan over time. To find a counselor, visit **www.hud.gov/offices/hsg/sfh/hecm/hecmlist.cfm** or call 1-800-569-4287. Most counseling agencies charge around $125 for their services. The fee can be paid from the loan proceeds, but you cannot be turned away if you can't afford the fee.

HECM loans are widely available, have no income or medical requirements, and can be used for any purpose.

How much you can borrow with a HECM or proprietary reverse mortgage depends on several factors, including your age, the type of reverse mortgage you select, the appraised value of your home, and current interest rates. In general, the older you are, the more equity you have in your home, and the less you owe on it, the more money you can get.

The HECM lets you choose among several payment options. You can select:

- a "term" option – fixed monthly cash advances for a specific time.
- a "tenure" option – fixed monthly cash advances for as long as you live in your home.
- a line of credit that lets you draw down the loan proceeds at any time in amounts you choose until you have used up the line of credit.
- a combination of monthly payments and a line of credit.

You can change your payment option any time for about $20.

HECMs generally provide bigger loan advances at a lower total cost compared with proprietary loans. But if you own a higher-valued home, you may get a bigger loan advance from a proprietary reverse mortgage. So if your home has a higher appraised value and you have a small mortgage, you may qualify for more funds.

Loan Features

Reverse mortgage loan advances are not taxable, and generally don't affect your Social Security or Medicare benefits. You retain the title to your home, and you don't have to make monthly repayments. The loan must be repaid when the last surviving borrower dies, sells the home, or no longer lives in the home as a principal residence.

In the HECM program, a borrower can live in a nursing home or other medical facility for up to 12 consecutive months before the loan must be repaid.

If you're considering a reverse mortgage, be aware that:

- Lenders generally charge an origination fee, a mortgage insurance premium (for federally-insured HECMs), and other closing costs for a reverse mortgage. Lenders also may charge servicing fees during the term of the mortgage. The lender sometimes sets these fees and costs, although origination fees for HECM reverse mortgages currently are dictated by law. Your upfront costs can be lowered if you borrow a smaller amount through a reverse mortgage product called a "HECM Saver."

- The amount you owe on a reverse mortgage grows over time. Interest is charged on the outstanding balance and added to the amount you owe each month. That means your total debt increases as the loan funds are advanced to you and interest on the loan accrues.

- Although some reverse mortgages have fixed rates, most have variable rates that are tied to a financial index: they are likely to change with market conditions.

- Reverse mortgages can use up all or some of the equity in your home, and leave fewer assets for you and your heirs. Most reverse mortgages have a "nonrecourse" clause, which prevents you or your estate from owing more than the value of your home when the loan becomes due and the home is sold. However, if you or your heirs want to retain ownership of the home, you usually must repay the loan in full – even if the loan balance is greater than the value of the home.

Reverse mortgage loan advances are not taxable, and generally don't affect your Social Security or Medicare benefits.

- Because you retain title to your home, you are responsible for property taxes, insurance, utilities, fuel, maintenance, and other expenses. If you don't pay property taxes, carry homeowner's insurance, or maintain the condition of your home, your loan may become due and payable.

- Interest on reverse mortgages is not deductible on income tax returns until the loan is paid off in part or whole.

Getting a Good Deal

If you're considering a reverse mortgage, shop around. Compare your options and the terms various lenders offer. Learn as much as you can about reverse mortgages before you talk to a counselor or lender. That can help inform the questions you ask that could lead to a better deal.

- If you want to make a home repair or improvement – or you need help paying your property taxes – find out if you qualify for any low-cost single-purpose loans in your area. Area Agencies on Aging (AAAs) generally know about these programs. To find the nearest agency, visit

www.eldercare.gov or call 1-800-677-1116. Ask about "loan or grant programs for home repairs or improvements," or "property tax deferral" or "property tax postponement" programs, and how to apply.

- All HECM lenders must follow HUD rules. And while the mortgage insurance premium is the same from lender to lender, most loan costs, including the origination fee, interest rate, closing costs, and servicing fees vary among lenders.
- If you live in a higher-valued home, you may be able to borrow more with a proprietary reverse mortgage, but the more you borrow, the higher your costs. The best way to see key differences between a HECM and a proprietary loan is to do a side-by-side comparison of costs and benefits. Many HECM counselors and lenders can give you this important information.
- No matter what type of reverse mortgage you're considering, understand all the conditions that could make the loan due and payable. Ask a counselor or lender to explain the Total Annual Loan Cost (TALC) rates: they show the projected annual average cost of a reverse mortgage, including all the itemized costs.

Be Wary of Sales Pitches

Some sellers may offer you goods or services, like home improvement services, and then suggest that a reverse mortgage would be an easy way to pay for them. If you decide you need what's being offered, shop around before deciding on any particular seller. Keep in mind that the total cost of the product or service is the price the seller quotes plus the costs – and fees – tied to getting the reverse mortgage.

Some who offer reverse mortgages may pressure you to buy other financial products, like an annuity or long term care insurance. Resist that pressure. You don't have to buy any products or services to get a reverse mortgage (except to maintain the adequate homeowners or hazard insurance that HUD and other lenders require). In fact, in some situations, it's illegal to require you to buy other products to get a reverse mortgage.

You don't have to buy any products or services to get a reverse mortgage.

The bottom line: If you don't understand the cost or features of a reverse mortgage or any other product offered to you – or if there is pressure or urgency to complete the deal – walk away and take your business elsewhere. Consider seeking the advice of a family member, friend, or someone else you trust.

Your Right to Cancel

With most reverse mortgages, you have at least three business days after closing to cancel the deal for any reason, without penalty. To cancel, you must notify the lender in writing. Send your letter by certified mail, and ask for a return receipt. That will allow you to document what the lender received and when. Keep copies of your correspondence and any enclosures. After you cancel, the lender has 20 days to return any money you've paid up to then for the financing.

Reporting Possible Fraud

If you suspect that someone involved in the transaction may be violating the law, let the counselor, lender, or loan servicer know. Then, file a complaint with:

- the Federal Trade Commission (FTC). You can do that online at **www.ftccomplaintassistant.gov** or by phone at 1-877-FTC-HELP (1-877-382-4357).
- your state Attorney General's office at **naag.org** or state banking regulatory agency at **www.csbs.org/Pages/default.aspx**.

Whether a reverse mortgage is right for you is a big question. Consider all your options. You may qualify for less costly alternatives. The following organizations have more information:

Reverse Mortgage Education Project
AARP Foundation
601 E Street, NW
Washington, DC 20049
www.aarp.org/revmort
1-800-209-8085

U. S. Department of Housing and Urban Development (HUD)
451 7th Street, SW
Washington, DC 20410
www.hud.gov/offices/hsg/sfh/hecm/rmtopten.cfm
1-800-CALL-FHA (1-800-225-5342)

Federal Trade Commission
Consumer Response Center
600 Pennsylvania Avenue, NW
Washington, DC 20580
www.ftc.gov/yourhome
1-877-FTC-HELP (1-877-382-4357)

The FTC works to prevent fraudulent, deceptive and unfair business practices in the marketplace and to provide information to help consumers spot, stop and avoid them. To file a complaint or get free information on consumer issues, visit **ftc.gov** or call toll-free, 1-877-FTC-HELP (1-877-382-4357); TTY: 1-866-653-4261. Watch a video, *How to File a Complaint,* at **ftc.gov/video** to learn more. The FTC enters consumer complaints into the Consumer Sentinel Network, a secure online database and investigative tool used by hundreds of civil and criminal law enforcement agencies in the U.S. and abroad.

If there is pressure or urgency to complete the deal, walk away and take your business elsewhere.

The Federal Trade Commission (FTC) is the nation's consumer protection agency. Here are some tips from the FTC to help you be a more savvy consumer.

1. **Know who you're dealing with.** Do business only with companies that clearly provide their name, street address, and phone number.
2. **Protect your personal information.** Share credit card or other personal information only when buying from a company you know and trust.
3. **Take your time. Resist the urge to "act now."** Most any offer that's good today will be good tomorrow, too.
4. **Rate the risks.** Every potentially high-profit investment is a high-risk investment. That means you could lose your investment — all of it.
5. **Read the small print.** Get all promises in writing and read all paperwork before making any payments or signing any contracts. Pay special attention to the small print.
6. **"Free" means free.** Throw out any offer that says you have to pay to get a gift or a "free" gift. If something is free or a gift, you don't have to pay for it. Period.
7. **Report fraud.** If you think you've been a victim of fraud, report it. It's one way to get even with a scam artist who cheated you. By reporting your complaint to 1-877-FTC-HELP or ftc.gov, you are providing important information to help law enforcement officials track down scam artists and stop them!

Attorney General of Texas
Greg Abbott

REVERSE MORTGAGE OFFERS

SENIOR CITIZENS over the age of 62 whose homes carry little or no mortgage debt may receive offers for a specialized loan called a reverse mortgage. Under these arrangements, eligible homeowners are promised an upfront cash payout with no obligation to repay the loan. Even better, the sales pitch goes, seniors can live out the rest of their lives in their own homes – with no monthly mortgage – and have extra money to spend enjoying their retirement years.

So what's the catch? Although seniors are generally not required to repay these loans, once they pass away or permanently leave their homes, that property essentially belongs to the lender. Under a typical arrangement, the lender places a lien on the property in exchange for the cash it provides to the borrower. This allows the lender to recoup the loan, fees and interest, by selling the home after it is vacated.

Reverse mortgages are attractive to many seniors, particularly those who are not concerned with leaving behind property for their relatives or friends to inherit. But homeowners who are considering a reverse mortgage need to know that these agreements significantly reduce or eliminate the inheritance that would have otherwise gone to their surviving loved ones. As with all matters involving their homes, seniors should carefully consider the fine print before accepting the terms of a reverse mortgage.

Seniors who are interested in a reverse mortgage should contact the U. S. Department of Housing and Urban Development (HUD) at (800) 569-4287 for a list of local lenders that are approved by the Federal Housing Administration. HUD can also supply the name of a government-approved debt counseling agency, which can provide useful information to homeowners considering a reverse mortgage.

Senior citizens may consider hiring an attorney to help them review reverse mortgage documents. Seniors can contact the Office of the Attorney General at (800) 252-8011 or visit our Web site at www.oag.state.tx.us to find out about legal clinics and other free legal help.

Even when dealing with legitimate lenders, seniors should carefully consider more than one reverse mortgage offer, because terms of varying offers can differ significantly. Homeowners should NEVER sign any paperwork that affects their home unless they clearly understand the impact of what they are signing. Seniors should walk away from any lender who tries to pressure them into making a quick, spur-of-the-moment decision.

Finally, seniors interested in a reverse mortgage should be very skeptical of "mortgage consultants." Some unscrupulous operators will insist that a home needs costly renovations in order for the homeowner to qualify for a loan. Seniors should be particularly wary of consultants who insist on using a specific contractor. If the consultant is unable to help the homeowner obtain a loan, then the homeowner could be left with a sizeable remodeling bill. Refusal to pay the bill could cost the homeowner his or her home. If repairs or renovations are necessary, consumers should deal directly with lenders and registered builders or contractors to compare their offers and recommendations. Consumers who believe they have encountered a reverse mortgage scam should immediately contact the Office of the Attorney General.

Sincerely,

Greg Abbott
Attorney General of Texas

WRITE TO: Greg Abbott, Office of the Attorney General
PO Box 12548, Austin, TX 78711-2548
800-252-8011 • www.oag.state.tx.us

Reverse Mortgage Loans

Borrowing Against Your Home

AARP®

AARP does not endorse any reverse mortgage lender or product, but wants you to have the information you need to make an informed decision about these loans and other, less costly, alternatives.

AARP prohibits any company or individual from inserting a name or attaching any materials to this publication.

If your copy of this booklet includes any attachment or contact information for a lender or any other company, please notify AARP by calling 1-888-687-2277 toll free.

Reverse Mortgage Loans: *Borrowing Against Your Home*

*An online version of this booklet is available at www.aarp.org/revmort.

Reverse Mortgage Loans: Borrowing Against Your Home

October 2010 Update

Since the publication of this booklet in 2008, there have been a number of important changes in the reverse mortgage world. The following is a summary of these issues, as they affect the content of this book as of October 2010. Page numbers are provided to help you find the areas of the book that are affected by these changes.

Property eligibility: Though legislation to allow HECM loans on cooperatives was passed, the enabling regulations have not been finalized, so as of this time (October 2010), cooperatives are still not eligible. (page 8)

Home value limits: The nationwide home value limit of $417,000 on HECM loans was raised to $625,500 and will continue at that level until at least December 2011. This increase made HECMs more attractive for borrowers with higher value homes, and is one reason for the disappearance of proprietary loans. (pages 9, 26, 32)

Loan amounts: HUD reduced the percentages of home value that can be borrowed, as of October 1, 2009. For example, prior to October 2009, a 62-year-old homeowner could borrow about 62% of their home value in a HECM loan. After the 2009 change, they could get about 56%. Similar changes were put in place at all age levels. On October 4, 2010, another set of changes went into effect, with more complicated results. In general, loan limits were reduced by another 1-5 percent. However, for some borrowers with low interest rates, loan amounts increased compared to 2009. These changes affect estimated loan amounts throughout this book, such as the tables on page 10 and 11, and examples on pages 9 and 15.

Origination fee: Limits on origination fees have not changed, but the willingness of lenders to reduce or even eliminate origination fees has changed dramatically. Since April 2010, some lenders are waiving or reducing origination fees on many of their loans. Be aware that some lenders offer the lower origination fee in exchange for a higher interest rate, and some offer lower origination fees only on lump-sum loans, so make sure you get the details. (page 13)

Servicing fees: As with origination fees, lenders have recently begun reducing or eliminating monthly servicing fees on many loans. When comparison shopping for a lender, it pays to ask about a $0 service fee, as this can increase available loan proceeds by several thousand dollars. As with origination fees, lower service fees may be offset by higher interest rates in some cases. (page 14)

Mortgage insurance premiums: Beginning October 4, 2010, the annual mortgage insurance premium on all HECM loans increased from 0.5% per year to 1.25% per year. (pages 13, 14, 15, 16)

Creditline growth rate: Because of the increase in the annual mortgage insurance premium, the creditline growth rate will now be the interest rate + 1.25%. (page 10)

Fixed interest rates: Fixed rates became much more widely available beginning in early 2009, and many lenders are offering moderately low fixed rates at this time. It is still the case that lenders typically require a 100% lump sum draw as a condition of offering the fixed rate option —that is, the borrower must take all available loan funds at closing. (page 27)

Adjustable interest rates: Rates that adjust only once a year stopped being widely available in September 2009. At the present time, adjustable-rate HECMs are all monthly adjustable, and nearly all are based on the LIBOR index, which is more volatile than the 10-year Treasury rate that has been historically used as the basis for HECM loans. (page 27)

HECM for Purchase: A new variation on the HECM program that began in 2009, the HECM for Purchase allows a borrower to use a HECM to purchase a new home, rather than borrowing against a home they already own. Loan-to-value percentages are the same as for regular HECMs. The borrower can use the HECM to pay for part of the purchase, and then would have to bring a downpayment equal to the remaining cost of the home. For example, a 62-year-old borrower who wanted to buy a $200,000 home could get about $112,000 from a HECM, and then would have to pay about $88,000 plus closing costs using their own funds. Borrowers must make their new homes their principal residence within 60 days of closing the loan.

HECM Saver: Another variation on the HECM went into effect on October 4, 2010. The HECM Saver product has a much lower upfront mortgage insurance premium (0.01% compared to 2%), but offers loan amounts that are 10-18% lower than the traditional HECM, which is now called the HECM Standard. This product is designed for people who want to borrow a smaller amount of money. Also, since the upfront costs are lower, it can be more appropriate for those who expect to move or sell the home within a few years.

Non-HECM reverse mortgages: Proprietary, or privately insured, reverse mortgages (those that are not FHA-insured HECM loans) nearly vanished from the marketplace during the recession. At this time, only a few products are available, mostly for very high-value homes. (pages 8, 20, 26)

Reverse mortgage counseling: All HECM counselors are now required to pass an exam and receive specialized education in order to be HUD-approved. A searchable list of agencies with approved HECM counselors can be found at: **https://entp.hud.gov/idapp/html/hecm_agency_look.cfm**. (page 25)

Preparing for counseling: As of September 2010, all HECM counselors are required to send a packet of information to each client, and allow time for the client to review it, before the counseling session can take place. This packet will include individualized loan estimates and other materials. "Emergency" or same-day counseling is only available in cases of financial or medical emergency. (page 25)

Selecting a lender: As noted above, there is now more variation among lenders with respect to loan costs. Be sure to ask about servicing fees, origination fees, and 3rd party costs. Some lenders are even offering to pay the initial mortgage insurance premium on the client's behalf. If you are considering an adjustable rate HECM, be sure to ask about the "margin"—this is the part of the rate that the lender actually controls.

Note that some lenders will offer reduced fees only on the fixed-rate products with the lump-sum draw requirement. Others will offer reduced fees on both fixed and adjustable-rate products. Don't let yourself be talked into borrowing more money than you need, just to get lower upfront fees—a lump-sum draw can cost you a lot more money in the long run! (page 28)

Reverse Mortgage Loans: Borrowing Against Your Home

Some of the material in this booklet was adapted with permission from publications previously developed by Ken Scholen and published by the National Center for Home Equity Conversion.

Part 1: Basic Questions

Here are five important questions to keep in mind when reading this booklet:

1) Do you really need a reverse mortgage?
2) Can you afford a reverse mortgage?
3) Can you afford to start using up your home equity now?
4) Do you have less costly options?
5) Do you fully understand how these loans work?

1) Do you really need a reverse mortgage? Why are you interested in these loans? What would you do with the money you would get from one? Are the needs you intend to meet really worth the high cost of these loans?

If you want to take that dream vacation, a reverse mortgage is a very expensive way to pay for it. Investing the money from these loans is an especially bad idea because the loan is highly likely to cost more than you could safely earn.

If anyone is trying to sell you something and recommending you use a reverse mortgage to pay for it, that's generally a good sign that you don't need it and shouldn't be buying it. Be especially wary if you don't fully understand what they are selling or aren't certain that you need it.

2) Can you afford a reverse mortgage? These loans are very expensive, and the amount you owe grows larger every month. The younger you are when you take out a reverse mortgage, the longer compound interest will grow and the more you will owe. On the other hand, due to high upfront costs, reverse mortgages can be especially costly if you sell and move just a few years after taking one out.

3) Can you afford to start using up your home equity now? The more you use now, the less you will have later when you may need it more, for example, to pay for future emergencies, health care needs, or everyday living expenses—especially if your current needs grow or your income does not keep pace with inflation. You may also need your equity to pay for future home repairs or a move to assisted living.

If you are not facing a financial emergency now, then consider postponing a reverse mortgage. Homeowners who decide to wait have "a reasonable expectation of securing a better product at a lower cost in the not-too-distant future," according to a report by the Fidelity Research Institute.

4) Do you have less costly options? Do you have other financial resources that you could use instead of taking out a loan? If you don't, and if you could easily make the monthly repayments on a home equity loan or home equity line-of-credit, these alternatives are much less costly than a reverse mortgage.

Many state and local governments offer very low-cost loans for paying your property taxes or making home repairs. Have you checked at **www.aarp.org/quicklink** to see if you are eligible for federal, state, local and private programs that help pay for prescription drugs, utility bills, meals, health care and other needs?

Have you seriously looked into the costs and benefits of selling your home and moving to a less expensive one? You just might find that you may prefer living somewhere else with lower costs or more services.

5) Do you fully understand how these loans work? Reverse mortgages are quite different from any other loan, and the risks to borrowers are unique. Before considering one, you need to do your homework carefully and thoroughly. A reverse mortgage is a major financial decision, and you can't afford to find out too late that you misunderstood or were not aware of any important facts about these loans.

Read this entire booklet. Then, for more information and answers to your questions, request a reverse mortgage counseling session as described in Part 5 of this booklet. If the counselor doesn't know the answers to all of your specific questions, request counseling from a different counselor or agency.

Part 2: Introducing Reverse Mortgages

Until recently, there were two main ways to get cash from your home: you could sell your home, but then you would have to move; or you could borrow against your home, but then you would have to make monthly loan repayments.

Now there is a third way of getting money from your home that does not require you to leave it or to make regular loan repayments.

"Reverse" Mortgages

A "reverse" mortgage is a loan against your home that you do not have to pay back for as long as you live there. With a reverse mortgage, you can turn the value of your home into cash without having to move or to repay a loan each month.

The cash you get from a reverse mortgage can be paid to you as:

- a single lump sum of cash;
- a regular monthly cash advance;
- a "creditline" account that lets you decide when and how much of your available cash is paid to you; or
- a combination of these payment methods.

No matter how this loan is paid out to you, you typically don't have to pay anything back until you die, sell your home, or permanently move out of your home. To be eligible for most reverse mortgages, you must own your home and be 62 years of age or older.

Other Home Loans

To qualify for most home loans, the lender checks your income to see how much you can afford to pay back each month. But with a reverse mortgage, you don't have to make monthly repayments. So you don't need a minimum amount of income to qualify for a reverse mortgage. You could have no income, and still be able to get a reverse mortgage.

With most home loans, if you fail to make your monthly repayments, you could lose your home. But with a reverse mortgage, you don't have any monthly repayments to make, so you can't lose your home by failing to make them.

Reverse mortgages typically require no repayment for as long as you—or any co-owner(s) of yours—live in your home. So they differ from other home loans in these important ways:

- you don't need an income to qualify for a reverse mortgage; and
- you don't have to make monthly repayments on a reverse mortgage.

"Forward" Mortgages

You can see how a reverse mortgage works by comparing it to a "forward" mortgage—the kind you use to buy a home. Both types of mortgages create debt against your home and affect how much equity or ownership value you have in your home. But they do so in opposite ways.

"Debt" is the amount of money you owe a lender. It includes cash advances made to you or for your benefit, plus interest. "Home equity" means the value of your home (what it would sell for) minus any debt against it. For example, if your home is worth $150,000 and you still owe $30,000 on your mortgage, your home equity is $120,000.

Falling Debt, Rising Equity

When you purchased your home, you probably made a small down payment and borrowed the rest of the money you needed to buy it. Then you paid back your "forward" mortgage loan every month over many years. During that time:

- your debt decreased; and
- your home equity increased.

As you made each repayment, the amount you owed (your debt or "loan balance") grew smaller. But your ownership value (your "equity") grew larger. If you eventually made a final mortgage payment, you then owed nothing, and your home equity equaled the value of your home. In short, your forward mortgage was a "falling debt, rising equity" type of deal.

Rising Debt, Falling Equity

Reverse mortgages have a different purpose than forward mortgages do. With a forward mortgage, you use your income to repay debt, and this builds up equity in your home. But with a reverse mortgage, you are taking the equity out in cash. So with a reverse mortgage:

- your debt increases; and
- your home equity decreases.

It's just the opposite, or reverse, of a forward mortgage. During a reverse mortgage, the lender sends you cash, and you make no repayments. So the amount you owe (your debt) gets larger as you get more cash, and more interest is added to your loan balance. As your debt grows, your equity shrinks, unless your home's value is growing at a high rate.

When a reverse mortgage becomes due and payable, you may owe a lot of money and your equity may be very small. If you have the loan for a long time, or if your home's value decreases, there may not be any equity left at the end of the loan.

In short, a reverse mortgage is a "rising debt, falling equity" type of deal. But that is exactly what informed reverse mortgage borrowers want: to "spend down" their home equity while they live in their homes, without having to make monthly loan repayments.

(To make certain you understand what "rising debt" and "falling equity" mean, read the Appendix at the end of this booklet.)

Exceptions

Reverse mortgages don't always have rising debt and falling equity. For example, if a home's value grows rapidly, your equity could increase over time. But most home values don't grow at consistently high rates, so the majority of reverse mortgages end up being "rising debt, falling equity" loans.

Common Features

Although there are different types of reverse mortgages, all of them are similar in certain ways. Here are the features that most have in common.

Homeownership

With a reverse mortgage, you remain the owner of your home just like when you had a forward mortgage. So you are still responsible for paying your property taxes and homeowner insurance and for making property repairs.

When the loan is over, you or your heirs must repay all of your cash advances plus interest (see "Debt Limit" below for more on repayment). Reputable lenders don't want your house; they want repayment.

Financing Fees

You can use the money you get from a reverse mortgage to pay the various fees that are charged on the loan. This is called "financing" the loan costs. The costs are added to your loan balance, and you pay them back plus interest when the loan is over.

Loan Amounts

The amount of money you can get depends most on the specific reverse mortgage plan or program you select. It also depends on the kind of cash advances you choose. Some reverse mortgages cost a lot more than others, and this reduces the amount of cash you can get from them. Within each loan program, the cash amounts you can get generally depend on your age and your home's value:

- the older you are, the more cash you can get; and
- the more your home is worth, the more cash you can get.

The specific dollar amount available to you may also depend on interest rates and closing costs on home loans in your area.

Debt Payoff

Reverse mortgages generally must be "first" mortgages; that is, they must be the primary debt against your home. So if you now owe any money on your property, you generally must do one of two things:

- pay off the old debt before you get a reverse mortgage; or
- pay off the old debt with the money you get from a reverse mortgage.

Most reverse mortgage borrowers pay off any prior debt with an initial lump sum advance from their reverse mortgage. In some cases, you may not have to pay off other debt against your home. This can occur if the prior lender agrees to be repaid after the reverse mortgage is repaid. Generally, the only lenders willing to consider "subordinating" their loans in this way are state or local government agencies.

Debt Limit

The debt you owe on a reverse mortgage equals all the loan advances you receive (including any used to finance loan costs or to pay off prior debt), plus all the interest that is added to your loan balance. If that amount is less than your home is worth when you pay back the loan, then you (or your estate) keep whatever amount is left over.

But if your rising loan balance ever grows to equal the value of your home, then your total debt is generally limited by the value of your home. Put another way, you generally cannot owe more than what your home is worth at the time you repay the loan.

This overall cap on your loan balance is called a "non-recourse" limit. It means that the lender, when seeking repayment of your loan, generally does not have legal recourse to anything other than your home's value and cannot seek repayment from your heirs. (See Part 3 for an exception to this limit on federally insured reverse mortgages.)

Repayment

All reverse mortgages become due and payable when the last surviving borrower dies, sells the home, or permanently moves out of the home. (Typically, a "permanent move" means that neither you nor any other co-borrower has lived in your home for one continuous year.) Reverse mortgage lenders can also require repayment at any time if you fail to:

- pay your property taxes or special assessments;
- maintain and repair your home; or
- keep your home insured.

These are fairly standard "conditions of default" on any mortgage. On a reverse mortgage, however, lenders generally have the option to pay for these expenses by reducing your loan advances, and using the difference to pay these obligations. This is only an option, however, if you have not already used up all of your available loan funds.

Other default conditions could include:

- your declaration of bankruptcy;
- your donation or abandonment of your home;
- your perpetration of fraud or misrepresentation; or
- eminent domain or condemnation proceedings involving your home.

A reverse mortgage may also include "acceleration" clauses that make it due and payable. Generally, these relate to changes that could affect the security of the loan for the lender. For example:

- renting out part or all of your home;
- adding a new owner to your home's title;
- changing your home's zoning classification; or
- taking out new debt against your home.

You must read the loan documents carefully to make certain you understand all the conditions that can cause your loan to become due and payable.

Canceling the Deal

After closing a reverse mortgage, you have three extra days to reconsider your decision. If for any reason you decide you do not want the loan, you can cancel it. But you must do this within three business days after closing. "Business day" includes Saturdays, but not Sundays or legal public holidays.

If you decide to use this "right of rescission," you must do so in writing, using the form provided by the lender at closing, or by letter, fax, or telegram. It must be hand delivered, mailed, faxed, or filed with a telegraph company before midnight of the third business day. You cannot rescind orally by telephone or in person. It must be written.

Loan Types & Costs

The most well-known and widely available reverse mortgage is the Home Equity Conversion Mortgage (HECM). This loan is discussed in detail in Part 3. Other types of reverse mortgages and alternatives to these loans are discussed in Part 4.

Loan costs can vary by a lot from one type of reverse mortgage to another. Not all reverse mortgages include the same types of loan costs. As a result, the true, total cost of reverse mortgages can be difficult to understand and compare. That is why federal Truth-in-Lending law requires lenders to disclose a "Total Annual Loan Cost" for these loans.

Total Annual Loan Cost

The Total Annual Loan Cost (TALC) combines all of a reverse mortgage's costs into a single annual average rate. TALC disclosures can be useful when comparing one type of reverse mortgage to another. But they also show that the true, total cost of an individual reverse mortgage loan can vary by a lot and can end up being much more—or less—expensive than you might imagine.

TALC disclosures reveal that reverse mortgages generally are most costly when you live in your home only a few years after closing the loan.

Short-term TALC rates are very high because the start-up costs are usually a very large part of the total amount that you owe in the early years of the loan.

However, as your loan balance grows larger over time, the start-up costs become a smaller part of your debt. As these costs are spread out over more and more years, the TALC rate declines.

If the loan's growing balance catches up to the home's value, your debt is then generally limited by that value. This makes the true cost of the loan decrease at a faster rate. So the longer you live in your home, or the less its value grows, the less expensive your loan is likely to be.

Some shortcomings of the TALC disclosure and a more complete way to measure reverse mortgage costs and benefits are discussed in Part 3.

Part 3: The Home Equity Conversion Mortgage (HECM)

The HECM is the only reverse mortgage insured by the federal government. HECM loans are insured by the Federal Housing Administration (FHA), which is part of the U.S. Department of Housing and Urban Development (HUD). The FHA tells HECM lenders how much they can lend you, based on your age and home value. The HECM program limits your loan costs, and the FHA guarantees that lenders will meet their obligations.

HECMs Versus Other Reverses

HECM loans generally provide the largest loan advances of any reverse mortgage. HECMs also give you the most choices in how the loan is paid to you, and you can use the money for any purpose.

Although they can be costly, HECMs are generally less expensive than privately insured reverse mortgages. These other reverse mortgages may have smaller fees, but they generally have higher interest rates. On the whole, HECMs are likely to cost less in most cases. A notable exception may be the reverse mortgages now being developed by some credit unions.

The only reverse mortgages that always cost the least are the ones offered by state or local governments. These loans typically must be used for one specific purpose only; for example, to repair your home or to pay your property taxes. They also generally are available only to homeowners with low to moderate incomes. Part 4 of this booklet discusses reverse mortgages other than HECMs.

HECM Eligibility

HECM loans are available in all 50 states, the District of Columbia, and Puerto Rico. To be eligible for a HECM loan:

- You, and any other owners of your home, must be aged 62 or over, live in your home as a principal residence, and not be delinquent on any federal debt.
- Your home must be a single-family residence in a 1- to 4-unit dwelling, or part of a planned unit development (PUD) or a HUD-approved condominium. Some manufactured homes are eligible, but most mobile homes are not. Cooperatives are expected to become eligible by the end of 2008.
- Your home must meet HUD's minimum property standards, but you can use the HECM to pay for repairs that may be required.
- You must discuss the program with a counselor from a HUD-approved counseling agency; information on

HECM counseling appears in Part 5 of this booklet.

HECM Benefits

The HECM program provides the widest array of cash advance choices. You can take your entire loan as a:

- single lump sum of cash; or
- "creditline" account of a specific dollar amount that you control, that is, you decide when to make a cash withdrawal from this account, and how much cash to withdraw; or as a
- monthly cash advance for a specific period of time, or for as long as you live in your home.

In addition, you can choose any combination of these options, and change your cash advance choices at any future time.

Loan Amounts

The amount of cash you can get depends on your age, current interest rates, and your home's value. The older you are, the more cash you can get. If there is more than one owner, the age of the youngest is the one that counts. The lower the interest rate, the greater your loan amount will be.

In general, the greater your home's appraised value, the more money you can get. However, the value is subject to a limit of $417,000 in November of 2008, and this limit is subject to change every January. If your home is worth more than $417,000, you are still eligible for an HECM loan, but the amount of money you can get is based on $417,000, not on your home's actual value. For example, if your home is valued at $500,000, then the amount you can borrow is the same as it would be if your home were valued at $417,000.

(The $417,000 limit does not apply to parts of Hawaii, which have higher limits. But it does apply to the other 49 states plus the District of Columbia and Puerto Rico.)

Lump Sums & Creditlines

Table 1 shows how much you could get from a HECM if you take it all as a single lump sum of cash or as a creditline, if:

- the value of your home is $150,000, $250,000, or $350,000;
- the expected interest rate on the loan is 6%, 7%, or 8%;
- the age of the youngest borrower at closing is 65, 70, 75, 80, 85, or 90; and
- the servicing fee is $35, closing costs are $2,500, and the origination fee is the maximum allowed by HUD (see p. 13).

You can divide the amounts in Table 1 between a lump sum and a creditline. For example, a 75-year-old borrower living in a $250,000 home getting a HECM loan at 7% expected interest could select:

- a lump sum or creditline of $135,484; or
- any combination of lump sum and creditline that totals $135,484, for example, a lump sum of $30,000 and a creditline of $105,484.

For an estimate of HECM cash benefits based on your age, home value, and current interest rates, go to the online calculator at **www.aarp.org/revmort** (click on "Reverse Mortgage Calculator").

Creditline Growth

Perhaps the most attractive HECM feature is that its creditline grows larger over time. This means that the amount of cash available to you increases until you withdraw all of it.

For example, if the creditline equals $100,000 and you withdraw $20,000, you would have $80,000 left. But if your next withdrawal is one year later, you would then have more than $80,000 left because the $80,000 grows larger by the same total rate being charged on your loan balance. If that rate were to equal 6% per year, for example, your available creditline one year later would be $84,800 (6% x $80,000 = $4,800).

So a growing HECM creditline can give you a lot more total cash than a creditline that does not grow. The HECM creditline keeps growing larger every month for as long as you have any credit left; that is, until you withdraw all your remaining cash.* The calculator at

Table 1: HECM Lump Sum or Creditline

		Lump sum or creditline when expected rate is		
Home Value	Age	6%	7%	8%
$150,000	65	$74,325	$59,626	$47,530
	70	81,782	68,513	56,965
	75	89,638	78,084	67,672
	80	97,930	88,228	79,088
	85	106,260	98,400	90,820
	90	114,250	108,233	102,207
$250,000	65	$129,925	$105,026	$84,530
	70	142,182	119,713	100,165
	75	155,038	135,484	117,872
	80	168,530	152,128	136,688
	85	181,960	168,700	155,920
	90	194,650	184,533	174,407
$350,000	65	$186,025	$150,926	$122,030
	70	203,082	171,413	143,865
	75	220,938	193,384	168,572
	80	239,630	216,528	194,788
	85	258,160	239,500	221,520
	90	275,550	261,333	247,107

* The rate at which your creditline grows each month equals the current interest rate being charged on your loan plus one-half of one percentage point, divided by 12. So if the interest rate this month is 5.5%, your creditline would grow by 0.5% (5.5% + 0.5% = 6%/12 = 0.5%). If you had a creditline of $80,000 at the start of the month, it would equal $80,400 at the end (0.5% X $80,000 = $400).

www.aarp.org/revmort (click on "Reverse Mortgage Calculator") estimates how much cash would remain in a HECM versus a non-growing creditline.

HECM creditline growth means you should not even think about taking a large lump sum of cash from a HECM and putting it into savings or an investment. If you did that, you would be charged interest on the full amount of the HECM lump sum.

But if you leave the money in the creditline, not only would you avoid substantial interest charges. You would also end up with more available cash, as your creditline increases at a greater rate than a savings account or safe investments are likely to increase.

Plus a Monthly Advance

The HECM program lets you combine a lump sum, a creditline, or both with a monthly advance. A monthly loan advance does not increase or decrease in dollar amount over time. So it will buy less in the future as prices increase with inflation.

You can choose to have monthly HECM advances paid to you for:

- a specific number of years that you select (a "term" plan); or
- as long as you live in your home (a "tenure" plan).

A term plan gives you larger monthly advances than a tenure plan does. The shorter the term, the greater the advances can be. But the advances only run for a specific period of time. You do not have to repay the loan when the term ends, but you no longer receive monthly advances past the end of the term you select.

Table 2 shows some of the combinations that could be selected by a 75-year-old female borrower living in a $250,000 home with a loan at 7% expected interest

Table 2: HECM Monthly Advance Plus Lump Sums or Creditlines for a 75-Year-Old Borrower Living in a $250,000 Home*

Any combination of a lump sum and a creditline totaling...

	plus a monthly advance for...			
	tenure	15 years	10 years	5 years
0	$995	$1,248	$1,598	$2,697
$ 25,000	811	1,017	1,303	2,200
$ 50,000	627	787	1,008	1,702
$ 75,000	444	557	713	1,204
$100,000	260	326	418	706
$125,000	77	96	123	208
$135,484	0	0	0	0

*Based on a 7% expected interest rate and the loan costs used in Table 1.

and the same loan costs as assumed in Table 1.

For example, if this borrower selects a $25,000 lump sum and a $50,000 creditline, she also could get any one of the following: a monthly advance of $444 for as long as she lives in her home, $557 each month for 15 years, $713 each month for 10 years, or $1,204 monthly for 5 years. Table 2 makes two things clear:

- if you take more money as a lump sum or creditline, the monthly advances are smaller; and
- if you select a shorter term of monthly advances, the amount of each advance is greater.

Monthly Advances Only

Table 2 also shows that you get the largest possible monthly advance if you do not take a lump sum or a creditline. But putting all of your loan funds into a monthly advance reduces your financial flexibility, especially if you have little in savings. Remember, monthly advances are fixed, so their purchasing power decreases with inflation.

Adding a growing creditline to a monthly advance not only gives you a hedge against rising prices. It also provides readily available cash for unexpected expenses. So if you are interested in a monthly advance, it's a good idea to consider adding a creditline as well.

On the other hand, for a $20 fee, you could change your payment plan at any time. For example, you could add a creditline to a monthly advance, although this would reduce the amount of the monthly advance. You could also convert part or all of a creditline into a monthly advance.

HECM Repayment

As with most reverse mortgages, you must repay a HECM loan in full when the last surviving borrower dies or sells the home. It also may become due and payable if:

- you allow the property to deteriorate, except for reasonable wear and tear, and you fail to correct the problem; or
- all borrowers permanently move to a new principal residence; or
- due to physical or mental illness, the last surviving borrower fails to live in the home for 12 months in a row; or
- you fail to pay property taxes or hazard insurance, or violate any other borrower obligation.

Debt Limit

If your rising HECM loan balance ever grows to equal the value of your home, then your total debt is limited by the value of your home if the home is sold to repay the loan. But if the home is not sold and the loan is repaid with other funds, then you or your estate would owe the full loan balance—even if it is greater than your home's value. Your heirs would not have any personal liability for repaying the loan.

HECM Costs

Almost all the costs of a HECM can be "financed," that is, they can be paid from the proceeds of the loan. Financing the costs reduces the net loan amount available to you, but it also reduces your cash, out-of-pocket cost. The itemized costs of a HECM loan include an origination fee, third-party closing costs, a mortgage insurance premium, a servicing fee, and interest.

Origination Fee

An origination fee pays a lender for preparing your paperwork and processing your loan, also known as "originating" a loan. If your home is worth less than $125,000, a lender can charge up to $2,500 for this fee. If it is worth more than $125,000, the fee is limited to 2% of the first $200,000 of your home's value plus 1% of any amount over $200,000, up to an absolute limit of $6,000. On a $250,000 home, for example, the origination fee limit would be $4,500 (2% x $200,000 = $4,000 plus 1% of $50,000 = $500). Origination fees vary from one lender to another, so it can pay to shop around. The amount of this fee may also be negotiable with a lender.

Third-Party Closing Costs

A "closing" is a meeting at which legal documents are signed to "close the deal" on setting up a mortgage. The date of closing is the day on which a mortgage begins. Closing a mortgage requires a variety of services by third parties other than the originating lender. These services include an appraisal, title search and insurance, surveys, inspections, recording fees, mortgage taxes, credit checks, and others.

Third-party closing costs on a HECM loan vary with the value of the home and from one state or area to another. However, all the HECM lenders in a given area are likely to charge about the same closing costs on any specific loan. The total of all these costs generally ranges from about $2,000 to $3,000, although they are substantially higher in some areas.

A lender may require a cash application fee to pay for an appraisal and minimal credit check. Some will refund this fee to you. Others will apply it to your origination fee or third-party closing costs.

Mortgage Insurance Premium (MIP)

HECM insurance is financed by an MIP charged on all HECM loans. The cost, which may be financed with the loan, is charged in two parts:

- 2% of your home's value (or 2% of HUD's home value limit, whichever is less) is charged "upfront" at closing; and
- 0.5% is added to the interest rate charged on your rising loan balance.

HECM insurance guarantees that you will receive your promised loan advances, and not have to repay the loan for as long as you live in your home, no matter:

- how long you live there;
- what happens to your home's value; and
- what happens to the lender from whom you got your loan.

The MIP also guarantees that your total debt can never be greater than the value of your home if it is sold to repay the loan. It makes it possible for you to keep getting your monthly loan advances or growing creditline as promised even if:

- you live much longer than others your age;

- your home's value grows very little, not at all, or declines; or
- your loan balance catches up to and then is limited by the value of your home.

As a government program, HECM insurance does not generate a profit. The premiums paid by all borrowers are used to continue making loan advances to and limit the amount owed by the borrowers who live the longest and whose home values grow the least or decline.

The MIP is a substantial cost. The upfront portion on a $250,000 home, for example, would be $5,000. The cost of the 0.5% added to the interest rate depends on how much money you borrow, when you borrow it, and the interest rate on the loan. For a 75-year-old borrower living in a $250,000 home, who borrows one-half of the maximum loan amount at closing at an expected rate of 7%, the cost during her remaining life expectancy (12 years) would be about $7,900.

Servicing Fee

"Servicing" a loan means everything lenders or their agents do after closing it, including making or changing loan advances at your request, transferring insurance premiums to FHA, sending account statements, paying property taxes and insurance from the loan at your request, and monitoring your compliance with your obligations under the loan agreement.

FHA limits the servicing fee to $30 per month if the loan has an annually adjustable interest rate, and to $35 if the rate is monthly adjustable (see below). But the amount of this fee can vary from lender to lender within these limits. So it can pay to shop around.

To finance this fee with the loan, a lender is required to "set aside" a prescribed dollar amount* and deduct it from your available loan funds. But this total amount is not added to your loan balance. Instead, the monthly fee is added to your loan balance each month.

The total amount actually paid in servicing costs depends on the amount of the monthly charge plus how long it is paid. For a 75-year-old borrower who pays $35 per month for her remaining life expectancy (12 years), that cost would be $5,040.

On traditional "forward" mortgages, the cost of servicing is added to the interest rate. So you may not have seen this fee before—but you've paid it.

Total Non-Interest Costs

If you've been keeping track of all the upfront and ongoing costs described for a 75-year-old borrower in a $250,000 home, you know that the total (not including interest) could be about $25,000. For the youngest borrowers (aged 62) in higher-valued homes ($417,000 or more) in the areas with higher third-party closing costs ($4,000), the total of all non-interest costs could be over $45,000.

*The amount "set aside" for servicing is the "present value" of the monthly fee from closing until the borrower would reach age 100. Since few borrowers live to age 100, the total amount set aside overstates the actual amount likely to be charged on most loans over the life of the loan.

Interest Charges and Total Costs

The largest single cost of any reverse mortgage is generally the interest that is charged on these loans. For example, a 75-year-old borrower living in a $250,000 home qualifies for a HECM creditline of about $135,484 at 7% expected interest. If this homeowner takes one-half of that amount ($67,742) as a lump sum at closing, she would immediately owe that $67,742 plus about $12,000 in upfront costs, for a total of $89,742.

The remaining life expectancy of a 75-year-old borrower assumed in the HECM program is 12 years. If this borrower lives in her home that long, the total amount of interest added to her loan balance at 7% interest would be $111,056 if the interest rate does not change over the life of the loan. So after 12 years, at age 87, she would owe the initial $67,742 she borrowed plus $12,000 in upfront costs, $7,933 in monthly mortgage insurance premiums (MIPs), $5,040 in servicing fees, and $111,056 in interest charges for a total of $203,771 (see Table 3).

Table 3: HECM Loan Costs at Life Expectancy for a 75-Year-Old Borrower in a $250,000 Home

Total Amount Borrowed	**$67,742**
Loan Costs	
Upfront Costs	$12,000
Total Monthly MIPs	$7,933
Total Monthly Servicing Fees	$5,040
Total Monthly Interest Charges	$111,056
Total Loan Costs	$136,029
Total Amount Owed (Loan Balance)	**$203,771**

Table 4 (see page 16) shows how the costs summarized in Table 3 would be added to the loan balance year by year, making the total amount owed increase over time. The figures in both tables assume that the loan's 7% interest rate would not change. But any increases or decreases in that rate would increase or decrease the amount of interest and MIP owed on the loan. Information on interest rate choices is discussed in Part 5 of this booklet.

Tables 3 and 4 also assume that the borrower makes no creditline withdrawals after taking a $67,742 lump sum advance at closing. If she does take creditline draws after closing, the total amount of interest charges and MIPs would be greater than the amounts shown in these tables.

Total Cost Disclosures

As discussed in Part 2, the true, total cost of a reverse mortgage depends on factors in addition to its various costs. The Total Annual Loan Cost (TALC) of a reverse mortgage also depends upon:

- how long you live in your home; and
- what happens to its value during that time.

In general, the TALC rate is greatest when the loan is repaid within a few years after closing when the upfront costs are still a large part of the total amount owed. On the other hand, TALC rates are lowest when you live longer than others your age, or when your home's value grows little, or declines. But TALC disclosures also do not address two key considerations for reverse mortgage borrowers:

- the total amount of cash you get from the loan; and
- the amount of equity you get to keep at the end of the loan.

Model Specifications

In 2000, under a grant from the U.S. Department of Housing and Urban Development, the AARP Foundation's Reverse Mortgage Education Project invited reverse mortgage counselors and lenders to develop a more complete and individually customized standard for measuring reverse mortgage costs and benefits. The result of this joint effort was a set of model specifications for analyzing and comparing reverse mortgages. The specifications are based on a simple way of looking at these loans. All reverse mortgages turn your home equity into three things:

- loan advances paid to you;
- loan costs paid to the lender and others; and
- leftover equity, if any, paid to you or your heirs at the end of the loan.

Because reverse mortgages turn home equity into only these three things, you

Table 4: Rising Loan Costs for a 75-Year-Old HECM Borrower Living in a $250,000 Home

At end of year	Upfront Fees	Servicing Fees	Monthly MIPs	Interest Charges	Total Costs
0	$12,000				$ 12,000
1	$12,000	$ 420	$ 414	$ 5,794	$ 18,628
2	$12,000	840	862	12,068	25,770
3	$12,000	1,260	1,347	18,860	33,467
4	$12,000	1,680	1,872	26,210	41,762
5	$12,000	2,100	2,440	34,161	50,701
6	$12,000	2,520	3,054	42,759	60,333
7	$12,000	2,940	3,718	52,055	70,713
8	$12,000	3,360	4,436	62,103	81,899
9	$12,000	3,780	5,212	72,962	93,954
10	$12,000	4,200	6,050	84,694	106,944
11	$12,000	4,620	6,955	97,368	120,943
12	$12,000	5,040	7,933	111,056	136,029

can analyze any reverse mortgage by asking three simple questions:

- How much would I get?
- How much would I pay?
- How much would be left at the end of the loan?

At the end of a reverse mortgage, all of your home's value will have been turned into one of these three things: loan advances, loan costs, or leftover equity.

AARP's model specifications provide a set of rules for estimating how much of your home's value will have been turned into each of these three things at various future times. They also estimate a total annual average loan cost for each of these future times.

The specifications permit all of these estimates to be based on the creditline advances and a future interest rate that you select. You can also choose the rate at which you expect your home's value will grow. By varying these factors, you can see how much effect each can have on a loan's total cash advances, total cost, and leftover equity. You need to keep in mind, however, that all of these figures are estimates. The actual figures will depend on:

- the actual creditline advances you select during the loan;
- the actual interest rates charged on the loan; and
- the actual changes in your home's value during the loan.

Information on obtaining loan analyses and comparisons produced by the model specifications is discussed in Part 5 of this booklet. For a copy of the model specifications, go to **www.aarp.org/revmort**, click on "Basics," and then on "Total Costs and Model Specifications." Scroll down to "AARP Resources" for a link to the specifications.

Other Choices

TALC disclosures and other measures estimate the total cost of a HECM. But only you can determine how much it would be worth to you. And that might depend on other choices that may be available to you.

Part 4 of this booklet discusses other reverse mortgages that may be available to you. It also explores various alternatives to reverse mortgages for you to consider.

Part 4: Other Choices

A Home Equity Conversion Mortgage (HECM) may be a reasonable choice for you, either now, or at some future time. But until you compare it to your other options, you cannot make an informed decision about it. This section discusses other types of reverse mortgages, and alternatives to reverse mortgages. Seriously considering all your options will help you see more clearly why you prefer some to others. It is also likely to lead you to the decision that best serves your needs.

Other Reverse Mortgages

Deferred Payment Loans (DPLs)

Many local and some state government agencies offer DPLs for repairing or improving your home. This type of public sector reverse mortgage provides a one-time, lump sum advance. No repayment is required for as long as you live in your home.

DPLs aren't available everywhere, and they can be difficult to find, in part because they go by a variety of names and descriptions. Contact your city or county housing department, area agency or county office on aging, or the nearest community action or community development agency. Also contact your state housing finance agency. If these agencies don't offer DPLs, they may know where to find them, or they may offer other low-cost home repair loans with easily affordable monthly payments.

Eligibility criteria vary from program to program. Most are limited to homeowners with low or moderate incomes. Many place a limit on a home's value, or lend only in defined areas. Some have a minimum borrower age or a disability requirement.

DPLs can be used only for the specific types of repairs or improvements that each program allows. This may limit you to projects that replace or repair basic items such as your roof, wiring, heating, plumbing, floors, stairs, or porches. Many programs will cover improvements in accessibility or energy efficiency. Such modifications may include the installation of ramps, rails, grab bars, storm windows, insulation, or weather-stripping. (Search for "fixing homes" at **www.aarp.org**.)

You may be able to combine a DPL with a HECM loan. To do this, the DPL lender must agree to be repaid after the HECM is repaid. The best thing about DPLs is their very low cost. Generally they have no origination fee, no insurance premium, minimal (if any) closing costs, and very low (or no) interest. If interest is charged, it is often done on a "fixed" basis, that is, the rate never changes. Many DPL programs also charge “simple” rather than “compound” interest. This means that interest is not charged on any of the interest that has been previously added to the loan balance.

Some DPL programs even forgive part or all of the loan if you live in your home for a certain period of time. In other words, you may end up paying nothing back ever. If you can find and qualify for a “forgivable” DPL, you would most likely have more equity left at the end of the loan than you had at the beginning. In any case, a DPL is one of the best bargains you will find.

Even so, you still must be careful dealing with home improvement contractors. Ask the DPL program for help in finding a reliable contractor and developing a sound contract.

Property Tax Deferral (PTD)

Some state and local government agencies offer “property tax deferral” (PTD) loans. This type of public sector reverse mortgage generally provides annual loan advances that can be used only to pay your property taxes. No repayment is required for as long as you live in your home.

According to a 2007 AARP study, some type of PTD program is available in parts or all of the following states: Arizona, California, Colorado, Florida, Georgia, Idaho, Illinois, Iowa, Maine, Maryland, Massachusetts, Michigan, Minnesota, New Hampshire, North Dakota, Oregon, Pennsylvania, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, Wisconsin, Wyoming, and the District of Columbia.

In some states, PTD is available on a uniform, statewide basis. In many others, it is not available in all areas, or is not the same in all the areas where it is available. Eligibility criteria vary considerably. Most programs have a minimum age of 65 and are limited to homeowners with low or moderate incomes.

If you live in a state listed above, contact the local government agency to which you pay your property taxes. This agency can tell you if the program is available in your area, and what you must do to qualify. It also can give you details on how the program works.

The amount of the annual PTD loan advance is generally limited by the amount of your property tax bill for that year. Some programs limit the annual advance to some part of the tax bill, or to a specific amount.

In the most restrictive programs, the loan can only be used to pay for special assessments.

The total amount you can borrow over the life of a PTD loan is limited in most programs. In other words, you may become ineligible for additional annual loan advances at some point in the future.

PTD programs generally do not permit these loans to be “subordinate” to other loans. So you cannot have a PTD loan and another reverse mortgage at the same time.

Like deferred payment loans, PTD loans

generally charge no origination fee, no insurance premium, and minimal, if any, closing costs. The interest rate is usually fixed, but it varies from program to program. In some cases, interest is charged on a simple basis, that is, no "interest on interest."

Other Public Loans

State housing finance agencies in Connecticut and Montana offer specialized reverse mortgage loans. The Connecticut plan is limited to persons who are no longer able to function on their own.

These plans provide limited lump sum advances, plus monthly advances that stop after a fixed period of time. But the loan does not have to be repaid for as long as you live in your home. The cost of these plans is very low, but the benefits are limited as well.

For more information on the Connecticut plan, call 1-860-571-3502. For information on the Montana program call 1-800-761-6264 or 1-406-841-2840.

Proprietary Reverse Mortgages

"Proprietary" reverse mortgages can provide larger loan amounts than the HECM program, but they are generally the most expensive type of reverse mortgage. Private companies develop and back these loans, and decide which lenders may offer them. By contrast, HECMs are backed by the U. S. Government and may be offered by any lender approved by the Federal Housing Administration.

If you live in a home worth a lot more than HUD's home value limit for the HECM program (currently $417,000), you may qualify for a larger loan amount from a proprietary plan than from a HECM. For example, in order to get a greater loan amount from a leading proprietary plan than from a HECM, a 75-year-old consumer would need to own a home worth more than about $850,000. A 62-year-couple, on the other hand, would need to own a home worth more than about $1.1 million to get a larger loan amount from the proprietary plan.

But even if you could get a larger loan amount from a proprietary plan, it might not actually provide you with more in total loan advances than a HECM would provide. As explained earlier, the amount of funds remaining available in a HECM creditline grows larger every month, and may do so at a rate that is greater than the one at which proprietary creditlines grow.

Proprietary creditline funds generally do not grow at all or do so at a fixed rate. But that fixed rate may be less than the rate at which HECM creditlines grow. So an initially smaller HECM creditline may provide more total cash over time than an initially larger creditline that grows at a lower rate.

Compared with HECMs, proprietary reverse mortgages typically offer lower upfront and monthly fees but charge much greater interest rates—as much as three percentage points (3%) greater. So the lower fees on a proprietary plan can be offset by its much higher interest rate, resulting in greater total costs for the proprietary plan.

A new type of proprietary reverse mortgage now being developed by some credit unions, however, may provide a clearly lower-cost alternative to HECMs. These plans would provide smaller loan amounts than a HECM, but would charge much smaller fees.

The best way to compare a proprietary plan with a HECM is to use a side-by-side comparison produced by software that meets the model specifications for analyzing reverse mortgages discussed in Part 3 of this booklet. Information on obtaining these revealing comparisons is presented in Part 5.

Alternatives to Reverse Mortgages

Selling and Moving

Many homeowners become interested in reverse mortgages as a way to remain living in their present homes. Selling the home and moving elsewhere are generally not very appealing to most reverse mortgage shoppers.

The single best way to evaluate a reverse mortgage, however, is to compare it to what may be your only other viable option: selling your home and using the proceeds to buy or rent a new home. Do you know:

- How much cash you could get by selling your home?
- What it would cost you to buy (and maintain) or rent a new home?
- How much money you could safely earn on any money left over after you buy a new home?

Have you recently looked into buying a less costly home, renting an apartment, or moving into assisted living or other alternative housing?

Until you have seen and considered other housing options, how do you know that none could be preferable to your current home? Or preferable to a reverse mortgage? For your own peace of mind, you should seriously look into what else might be available. (Search for "housing options" at **www.aarp.org**.)

Most likely you will come to one of two conclusions:

- you may find another housing option that is a lot more attractive than you thought; or
- you may confirm what you were fairly certain of all along: that where you live now is the best place for you to be.

No matter what you conclude, you will have a much better idea of the overall costs and benefits of staying versus moving. That will give you a better sense of what is important to you. And it will then be easier for you to evaluate the comparative costs and benefits of a reverse mortgage.

Public Benefits

Your home is probably the most important investment you have ever made. You've probably spent much of your adult life making monthly payments on a traditional "forward" mortgage. So cashing in on that long-term investment while continuing to live in your home can be an appealing idea.

But most people have also made another kind of long-term investment. They've paid taxes all of their adult lives, and this has supported a variety of public programs. From time to time, most of us have benefited from some of these programs.

But you can't benefit from a program if you don't know it exists. That's why you should be aware of the major programs for which you may be eligible.

Supplemental Income

A substantial portion of all Americans aged 65 and over who are eligible for monthly cash benefits from SSI (Supplemental Security Income) are not getting them.

To qualify for this program, your liquid resources (cash and savings) must be less than $2,000 ($3,000 for a couple). Certain resources, such as home equity up to $500,000 ($750,000 in some states), a small burial fund, or one car usually do not count. Your monthly unearned income in 2008 could not exceed $657 ($976 for a couple). But the income limits are greater if you have earned income from a job, or if you live in one of the states providing a supplement to SSI.

If you qualify for SSI, you may be automatically eligible for other public benefits as well. For the latest information, call 1-800-772-1213. On the Internet, go to **www.ssa.gov** and search for "SSI."

Health Care Costs

Public benefit programs can also help pay for medical expenses. For the latest information, search for "Medicaid" and "Medicare prescripton drug coverage" at **www.aarp.org**. You can also call the Medicare Hotline at 1-800-633-4227. When you call, say "Medicaid" or "drug coverage" to get information about these programs.

Property Tax Relief

Most states have one or more property tax relief programs. For information on property tax relief in your state, contact the local agency to which you pay your property taxes, your state department of revenue or taxation, or your nearest area agency on aging.

Agencies on Aging

Your single best source for a wide variety of public benefit programs is your AAA (area agency on aging). Find your AAA by calling 1-800-677-1116 or search online at **www.eldercare.gov**.

This agency can help you find programs such as

- energy assistance
- household chore services
- home health care
- prescription drugs
- meal programs
- housing
- transportation, and many others.

Benefits QuickLINK

This one-stop online public benefits source helps you find low and no-cost programs that can pay for basic expenses, help you stay healthy, and assist older relatives. You fill out a questionnaire to find programs for which you may be eligible. You get the contact information you need to learn more about—and apply for—these programs. To use this resource, go to **www.aarp.org/quicklink**.

Postpone or Combine

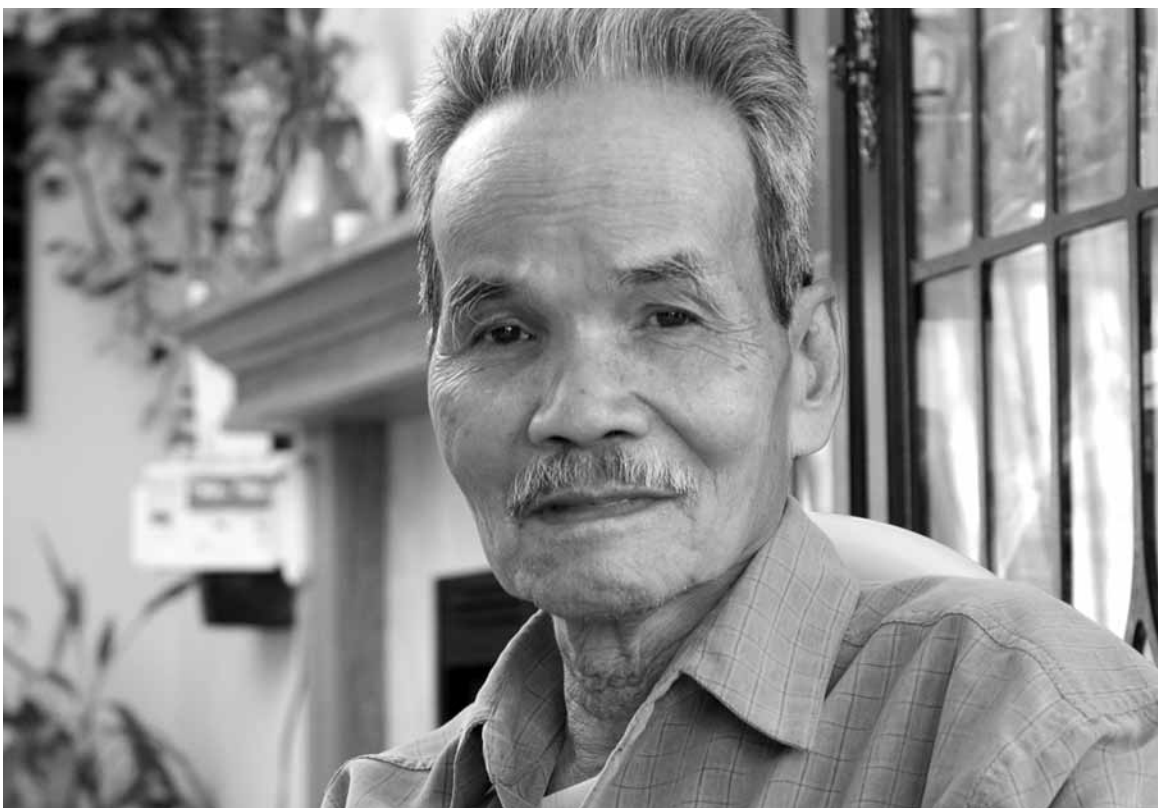
Public benefits can make it possible for you to postpone getting a reverse mortgage until a future time. In many cases, that may allow you to get larger future loan dvances because you will be older and your home's value is likely to be greater at that time. And the longer you wait, the less your equity will have been consumed by interest charges.

On the other hand, you can sign up for public benefits and take out a reverse mortgage. If you do, your need for loan advaces will be less than if you were not receiving public benefits. By taking smaller loan advances, you will have smaller interest charges and preserve more equity for future use.

Cautions

Just make certain you don't jeopardize any public benefits by getting more cash than you need from a reverse mortgage.

For example, loan proceeds remaining in a checking or savings account at the end of a calendar month are counted as liquid assets by SSI and similar programs. If your total liquid assets exceed SSI limits (currently $2,000 for a single person, $3,000 for a couple), you can lose your eligibility. So limit your loan proceeds to what you expect to spend in a given month (*Source: Reverse Mortgages: A Lawyer's Guide*, American Bar Association, 1997, pp. 35-36).



Part 5: Key Decisions

Homeowners seriously considering a reverse mortgage should ask themselves these key questions:

- **Who else should I involve in considering this loan?**
- **Which counselor should I choose?**
- **Have I given due consideration to all my choices?**
- **When would be the best time to take out a reverse mortgage?**
- **What interest rate should I select?**
- **Which lender should I choose?**
- **How should I use this loan?**

No one can answer these questions for you. Only you can decide what's right for you and your situation. But you need to consider these decisions carefully, because you will make them one way or another. And it's better to do so by thinking them through.

Sharing the Decisions

Who else should you involve in making your decisions about a reverse mortgage? You may have a trusted friend or advisor who knows your circumstances—or someone who is generally good at figuring things out or discussing them with you. You may even want to invite such people to your discussion with a HUD-approved counseling agency.

On the other hand, you should be cautious of anyone who seems eager for you to get a reverse mortgage. Be especially alert if that person just happens to have ideas about what you might do with your loan proceeds. Watch out in particular for anyone trying to sell you something, or to get your signature on an agreement to pay them for any purpose.

Remember, we call such people "con men" because they are very good at gaining our confidence and trust. It's sad but true that the stranger being so nice to you may be more interested in your equity than your well-being.

Your Heirs

You also need to think about the impact of a reverse mortgage on your heirs. A loan with "rising debt and falling equity" means there will be less equity left for your heirs. If you get a lot of cash over many years from the loan, there may be little if any left for them.

Many children of reverse mortgage borrowers are pleased that their parents are able to use their equity and remain living in their homes. Often it is a great relief to these children that their parents are able to take care of their own needs; many even encourage their parents to do so.

Whether or not you decide to discuss this matter with your children or other heirs depends on a variety of personal and family factors. You may value their advice or want to know what they think. Or you may think it best not to discuss it before making a decision, or not to tell them after you have closed a loan.

On the other hand, to avoid future misunderstanding, you may want to make a note of your decision in your will. Whatever you decide, the important thing is to give some thought to your heirs. A reverse mortgage can have a substantial impact on your estate. So you need to think through how you want this to become known to your heirs.

Selecting a Counselor

To be eligible for a federally insured HECM (Home Equity Conversion Mortgage), you must discuss the loan with a counselor employed by a nonprofit or public agency approved by HUD (the U. S. Department of Housing and Urban Development). This counseling can be very helpful. So it can be a good idea even if you are thinking about applying for some other type of reverse mortgage.

HECM counselors provide in-person counseling in their local areas, and counseling by telephone in other areas nationwide. For current information on requesting HECM counseling, go to **https://entp.hud.gov/idapp/html/hecm_agency_look.cfm**. This counseling generally takes at least one hour. When provided by telephone, it typically requires two or more calls.

Counseling agencies may charge a fee for HECM counseling, but they must tell you about it before the counseling occurs, and the fee amount must be based on your ability to pay. Agencies cannot turn you away because of your inability to pay, and they cannot refuse to counsel you if you fail to pay. The maximum allowable fee in 2008 is $125 or the actual cost of providing the counseling, whichever is less. If your counseling agency charges a fee, you can have it paid out of your loan proceeds just like other HECM fees, or you can pay it directly to the counseling agency.

Be Prepared

However you request counseling, prepare for it carefully. If you are interested in a HECM, make certain you are eligible by re-checking the eligibility criteria in Part 3. Use the calculator at **www.aarp.org/revmort** (click on “Reverse Mortgage Calculator”) to see if you can get the amount of cash you need to pay off any current debt on your home, and for other purposes.

Before requesting counseling, thoroughly consider the questions in Part 1 of this booklet and the key decisions discussed in this section. Make a written list of your questions, concerns, and the additional information you need. Include questions about the alternatives discussed in Part 4.

HUD’s HECM network counselors use loan analysis and comparison software that meets the model specifications discussed in Part 3. Ask your counselor to send you loan printouts in advance so you can review them before your counseling session, and have them in hand when your counselor explains them.

Considering Alternatives

Have you carefully considered the main alternatives to a HECM? Have you seriously looked into the other options discussed in Part 4? If not, you should do so before applying for a HECM. Even if you end up getting a HECM, combining it with another option may make more sense than not.

If you can qualify for a home equity loan and easily make the required monthly repayments, this option is generally less costly than a HECM or a proprietary reverse mortgage. But before applying for one of these loans, learn about the potential pitfalls in this market. Search for "home equity loans" and "predatory lenders" at **www.aarp.org**.

If you are considering a proprietary reverse mortgage, you must proceed with caution. Unlike HECMs, these loans are not insured by the federal government.If your home is worth more than $850,000 ($1.1 million for couples), you may be able to get larger loan advances than you could get from a HECM. But you may also pay more, and you need to understand how much more these loans may cost.

The best way to compare the costs and benefits of a proprietary plan versus a HECM is to get the side-by-side loan comparisons produced by software that meets AARP's model specifications discussed in Part 3. You can get these comparisons from counselors who belong to HUD's national HECM counseling network, who can be found at **www.hecmresources.org/hecmresources/requests.cfm**.

You can also get these comparisons from some lenders. For the latest information on lenders who can provide these comparisons, go to **www.aarp.org/revmort** and click on "Key Decisions," and then on "Selecting a Lender."

Selecting a Time

When would be the best time to take out a reverse mortgage: now or later? In the future, you may be eligible for larger cash advances because you will be older and your home is likely to be worth more. If your home's value is greater than HUD's home value limit (currently $417,000), that limit is subject to change each January. On the other hand, if interest rates rise, you may not be able get greater loan advances in the future.

Look at Table 1 in Part 3 or use the calculator at **www.aarp.org/revmort** (click on "Reverse Mortgage Calculator") to see how much difference an older age or greater home value could make. The table also shows you how much difference a higher interest rate could make.

Remember, one month after you take out a reverse mortgage your debt will begin growing. Look at Table 4 in Part 3 to see how fast that debt can grow. The longer you postpone taking out a reverse mortgage, the more interest charges you will avoid and the more equity you will most likely have if and when you do decide to become a reverse mortgage borrower.

Selecting an Interest Rate

If you are considering a HECM, you can select an interest rate that is subject to change once a month or once a year, or one that remains the same (a "fixed" rate) for the life of the loan.

Fixed Interest Rates

Fixed rate loans are attractive to most consumers, but fixed rate HECMs may be no bargain for most borrowers, as the interest rate on some of these loans has exceeded 15%.

The only way homeowners could get a realistic fixed rate from these lenders was if they agreed to take 100% of their available loan amount in a single lump sum at closing. But this meant they would be charged interest on the full amount of the largest possible loan advance, and most HECM borrowers have no need for such a large advance. So if they were to agree to a 100% lump sum, they would be paying substantial unnecessary interest charges and—by completely exhausting their loan amounts—losing the creditline growth to which they would otherwise be entitled.

On the other hand, if a borrower needs such a large loan amount, for example, to pay off the current mortgage on a home, a fixed rate HECM of this type would be worth considering.

Adjustable Interest Rates

HECM lenders must offer an interest rate that is subject to change once a year. These "annually-adjustable" HECMs can increase or decrease by the same amount as any increase or decrease in a HUD-approved interest rate index identified in the loan documents. But this rate cannot change by more than 2 percentage points up or down per year, nor by more than 5 total points over the life of the loan,

HECM lenders may also offer a "monthly-adjustable" rate that may increase or decrease each month by the same rate as any increase or decrease in a HUD-approved interest rate index identified in the loan documents. Although HUD does not require any interest rate caps on these rates, some lenders may provide them.

The index rate indices approved by HUD are the 1-month and 1-year U. S. Constant Maturity Treasury (CMT) rate and the 1-month and 1-year London Interbank Offered Rate (LIBOR), an international index widely used for adjustable rate mortgages in the U. S.

Monthly Versus Annually Adjustable

Monthly adjustable rates are generally lower than annually adjustable rates when based on the same rate index. Lower rates mean larger HECM loan amounts, less growth in the amount you owe, and less growth in your available creditline funds. When interest rates fall, monthly adjustable rates drop sooner and more often than annually adjustable rates. They can also decrease by more than 2 percentage points per year and by more than 5 percentage points over the life of the loan.

The main advantage of annually adjustable HECMs are that when interest rates rise, they increase later and less frequently than monthly adjustable rates. In addition, they cannot increase by more than 2 percentage points in any year, and by no more than 5 percentage points over the life of the loan.

To date, most HECM borrowers have selected monthly adjustable rates, no doubt because they prefer the greater loan amounts and the lower initial rate charged on the loan. Some may also believe that rates are unlikely to increase by more than the caps on annually adjustable rates.

Borrowers selecting an annually adjustable rate are generally concerned that rising rates might exceed the annual rate's caps for extended periods. Without the protection of these caps, they fear, their loans balances will grow faster, so there will be a lot less equity for them or their heirs when the loan is over.

Selecting a Lender

The most complete lists of HECM lenders can be found online at **www.hud.gov/ll/code/llslcrit.cfm**. Enter your city or select your state, place a checkmark in the "HECM" box, and click the "SUBMIT" button.

But which lender should you use to get a HECM loan? You need to consider cost, origination services, loan servicing, and a lender's professional commitment to meeting consumer needs.

Cost

HECM loan costs can vary by a lot from lender to lender, so it pays to shop around before deciding on a lender. Letting lenders know that you are shopping around may also help you get a better deal.

The only HECM costs that lenders do not control are the upfront and monthly mortgage insurance premiums. So you need to find out how much each lender you are considering would charge you for the origination fee, all third-party closing costs, the monthly servicing fee, and—most importantly—the interest rate. Some lenders may say that their interest rate is based on a specific rate index plus a "margin." If they do, ask what the actual interest rate would currently be.

When comparing the cost of loan fees versus interest, keep in mind that the interest rate will apply to your total and growing loan balance for as long as the loan lasts. Ask lenders and your HECM counselor to show you what the impact of different available combinations of loan fees and interest rates would be on the amount you would owe in the future. If you are concerned about rising interest rates on an adjustable rate loan, ask them to show you how much more you would owe if the average rate on your loan would be higher than the rate initially charged on the loan.

Origination Services

The level of service a lender provides may be more difficult to assess than cost is, but service can be important. You will want your loan officer to be knowledgeable, experienced, and respectful.

After reading this booklet, you will be better able to gauge how well a lender knows reverse mortgages. How long a lender has been offering HECMs and in how many places may be particularly important if your loan runs into any unexpected snags. An experienced lender has already encountered most of the issues that can cause problems, and is most likely to have a good working relationship with the nearest HUD office.

You will also want a loan officer who respects your knowledge and preferences and helps you reach your own decisions. Pressure sales tactics are a sure sign that a lender is more concerned about selling you a loan than meeting your needs.

Loan Servicing

At loan closing, most lenders transfer their loans to another office or company specializing in servicing the loan from that point forward. Ask each lender you are considering: "Who will service my loan after it closes?"

Request a sample of the account statements the servicer would send you. Make certain you fully understand all the information on these statements. In particular, if you are considering a HECM creditline, find out how the servicer would keep you informed about the growing amount of credit a HECM provides (see Part 3).

Professional Commitment

A commitment to meeting consumer needs can be seen in a lender's professional relationships and consumer information.

For example, members of the National Reverse Mortgage Lenders Association (NRMLA) have developed "best practices" for their industry. For more information, go to **www.reversemortgage.org**. If you don't want to be contacted by a NRMLA lender, however, be sure to state that preference if you request any NRMLA publications.

Lenders committed to the highest standard of consumer information can provide loan analyses and comparisons that meet AARP's model specifications as discussed in Part 3. For the latest information on lenders who can provide this type of consumer information, go to **www.aarp.org/revmort**. But please note that AARP does not endorse any reverse mortgage product or lender.

Spending Your Equity

How much of your available loan amount would you take as a lump sum, as a creditline, or as a monthly advance? For what reasons would you take withdrawals from a HECM creditline?

You need to consider these questions carefully, especially if your home equity is one of your few financial assets. Very simply, the more equity you use now, the less will be left in the future. If you spend all your equity too soon, it may become financially difficult for you to remain living in your home.

For example, if you have to move due to disability or failing health, you would need to pay for the cost of moving, future living expenses, and possibly assisted living or other types of care. So the amount of equity remaining at the end of your loan could be vitally important to you.

Leftover Estimates

HECM counselors and lenders can estimate how much equity would be left at various future times based on assumptions about future interest rates, your loan advances, and about changes in your home's value.

These estimates generally assume that your home would be sold to repay the loan. So they deduct the estimated cost of selling your home from your remaining equity.

Then it's a simple calculation: If the estimated net sale proceeds are greater than your estimated debt, you (or your heirs) would get the difference in a lump sum of cash. If at any point your rising debt catches up to your home's value, then there would be no equity left.

Realistic Estimates

Unless your counselor or lender uses computer software based on AARP's model specifications discussed in Part 3, the leftover estimates they provide may have serious shortcomings.

Most reverse mortgage borrowers select a creditline. The amount of leftover equity at the end of a creditline loan depends primarily on the size and timing of the cash advances a borrower requests during the loan.

Computer software based on the model specifications lets you enter the creditline draws that you expect to make. This gives you a more accurate estimate of the equity that would remain if your loan were to end at various points in the future. Other loan software may not permit you to see how your expected creditline draws would affect your remaining equity.

Other loan software may also assume that the initial interest rate charged on your loan will never change. But that may be unlikely after a time of relatively low interest rates over the past several years. So this assumption may overestimate your future leftover equity.

Software based on the model specifications lets you select the interest rate used to estimate your leftover equity. So you can choose a higher rate than the one that is initially charged on your loan.

By varying these factors, you can see how much effect each can have on your leftover equity. You should remember, however, that all of these figures are estimates. The actual figures will depend on:

- the actual creditline advances you select during the loan;
- the actual interest rates charged on the loan; and
- the actual changes in your home's value during the loan.

Creditline Growth

Most HECM borrowers put all of their available cash into a creditline. So it's important to be able to see how creditline withdrawals affect the growing amount of credit available from a HECM.

The calculator at **www.aarp.org/revmort** (click on "Reverse Mortgage Calculator") can show you the effect of various creditline withdrawal patterns on a year-by-year basis. To see them, run the calculator and then on the "Loan Calculator Estimates" page click on the "Creditline" button toward the bottom of the page, and follow the instructions.

Computer software based on AARP's model specifications discussed in Part 3 can also show the effect of different creditline withdrawals on your future loan balance, total amount owed, and total annual average loan cost.

If you take a HECM creditline, keep an eye on its growth. Being aware of how much cash remains in your creditline and the rate at which it is growing will help you make decisions about making cash withdrawals.

Remember, you can control the amount of credit that remains in your account. The less cash you take out now, the more will remain for later. It doesn't make much sense to set up a creditline and then not use it. But you should also avoid using too much too soon if you can.

For example, if you spend all the cash in your creditline, will you still be able to pay your property taxes and homeowner's insurance? If you fail to make these payments, and there is no cash left in your creditline, a HECM lender can foreclose on your loan. Just like with a forward mortgage, if you do not pay your property taxes and insurance, you could lose your home.

So be certain to leave enough cash in your creditline to pay your taxes and insurance if you do not have other funds available for this purpose.

Investing

Investing the money you get from a reverse mortgage is not wise. It is extremely unlikely that you could safely earn more from an investment than the loan would cost. Besides, the funds you do not spend from a HECM creditline grow larger at a greater rate than you could safely earn.

Careful Spending

Be wary of anyone who wants to sell you something, and suggests a reverse mortgage as a way to pay for it. Be especially wary if

- you do not fully understand what they are selling; or
- you are not certain that you need what they are selling.

Remember that the total cost to you equals the cost of what they are selling plus the cost of the reverse mortgage. If you conclude that you do need what they are selling, be sure to shop around before making a decision. You are under no obligation to buy goods or services from the party that suggested you borrow against your home to pay for them.

For example, if an insurance agent tries to sell you an annuity by way of reverse mortgage financing, be sure to check out all the cautions about these types of arrangements on the "Spending Your Equity" page at **www.aarp.org/revmort**.

Refinancing

After you get a reverse mortgage, sometime in the future you may be able to increase the loan funds available to you by refinancing the loan. Large increases in your home's value, increases in HUD's home value limit (currently $417,000), or lower interest rates could make this possible.

When you refinance a HECM, lenders are required to show you the total cost of refinancing, and compare it to the increase in available loan funds that a refinance would provide.

This comparison makes it easy for you to see the total costs that would be added to the amount you owe versus the additional loan funds that would become available to you. If you need help understanding the comparison, HECM counselors can explain it to you.

Glossary

acceleration clause
the part of a contract that defines when a loan may be declared due and payable

adjustable rate
an interest rate that changes, based on changes in a published market-rate index

appraisal
an estimate of a home's market value

appreciation
an increase in a home's value

Area Agency on Aging (AAA)
a local or regional nonprofit organization providing information on services and programs for older adults

cap
a limitation on the amount by which an adjustable interest rate may change during a specified time period

closing
a meeting at which legal documents are signed to "close the deal" on a mortgage; the time at which a mortgage begins

CMT rate
the Constant Maturity Treasury rate, used as an interest rate index in the HECM program

condemnation
a court action adjudging a property to be unfit for use, or converting a private property to public use under the right of eminent domain

creditline
a credit account that permits a borrower to control the timing and amount of the loan advances; also known as a "line-of-credit"

current interest rate
the interest rate currently being charged on a loan

deferred payment loans (DPLs)
reverse mortgages providing lump sums for repairing or improving homes, usually offered by state or local governments

depreciation
a decrease in the value of a home

eminent domain
the right of a government to take private property for public use, for example, to build a highway

expected interest rate
in the HECM program, the interest rate used to determine a borrower's loan advances

Fannie Mae
a private company that buys and sells mortgages; a government-sponsored entity that operates under the general oversight of the federal government

Federal Housing Administration (FHA)
the part of HUD (the U.S. Department of Housing and Urban Development) that insures HECM loans

federally insured reverse mortgage
a Home Equity Conversion Mortgage (HECM) (see below)

home equity
the value of a home, minus any debt against it

home equity conversion
turning home equity into cash without having to leave your home or make regular loan repayments

Home Equity Conversion Mortgage (HECM)
the only reverse mortgage program insured by the Federal Housing Administration (see Part 3)

home value limit
in the HECM program, the largest home value that can be used to determine a borrower's loan advance amounts

initial interest rate
the interest rate that is first charged on a loan beginning at closing

leftover equity
the net proceeds from selling a home, minus the total amount of debt owed against it

LIBOR
the London Interbank Offered Rate, used as an interest rate index in the HECM program

loan advances
payments made to a borrower, or to another party on behalf of a borrower

loan balance
the amount owed, including principal and interest; generally capped (limited) in a reverse mortgage by a non-recourse limit

lump sum
a single loan advance at closing

margin
in the HECM program, the amount added to an interest rate index to determine the initial, current, and expected interest rates

maturity
when a loan becomes due and payable

model specifications
a detailed set of rules for analyzing and comparing reverse mortgages (see Part 3)

mortgage
a legal document making a home available to a lender to satisfy a debt

non-recourse mortgage
a home loan in which a lender generally may look only to the value of the home for repayment

origination
the overall administrative process of setting up a mortgage, including the preparation of documents

property tax deferral (PTD)
reverse mortgages providing annual loan advances for paying property taxes, usually offered by state or local governments

proprietary reverse mortgage
a reverse mortgage product owned by a private company

reverse mortgage
a non-recourse loan against home equity providing cash advances to a borrower and requiring no repayment until a future time

right of rescission
a borrower's right to cancel a home loan within three business days of closing

servicing
performing administrative functions on a loan after closing

Supplemental Security Income (SSI)
a federal program providing monthly cash benefits to low-income persons aged 65+, blind, or disabled

tenure advances
fixed monthly loan advances for as long as a borrower lives in a home

term advances
fixed monthly loan advances for a specific period of time

Total Annual Loan Cost (TALC) rate
the projected annual average cost of a reverse mortgage including all itemized costs

More Information Online

To get the latest information on reverse mortgages, visit AARP's website at **www.aarp.org/revmort**. There you will find more details and more up-to-date coverage of the topics presented in this booklet.

Appendix: Rising Debt and Falling Equity

The purpose and operation of a reverse mortgage are different from those of a standard "forward" mortgage. The purpose of a forward mortgage is to purchase a home; the purpose of a reverse mortgage is to generate cash.

In a forward mortgage, your home equity increases over time. Your loan balance (the amount you owe) decreases as you make monthly repayments to the lender. Meanwhile the value of your home is usually increasing. Forward mortgages are "falling debt, rising equity" transactions (see Table A-1).

In a reverse mortgage, your home equity generally decreases over time. Your loan balance rises as loan advances are made to you by the lender, interest is added to the outstanding loan balance, and you make no repayments to the lender. Unless the home appreciates (grows in value) at more than a moderate rate, the loan balance starts "catching up" to the home. Reverse mortgages are typically "rising debt, falling equity" transactions (see Table A-1).

A simplified example of a reverse mortgage is presented in Table A-2. The purpose of this table is to show the "rising debt, falling equity" characteristics of reverse mortgages in general. To simplify the example, the table does not include all the closing costs and fees that are generally charged by a mortgage company or bank. It also does not include the costs of selling a home, which typically reduce the amount of equity remaining at the end of the loan.

In the example, you can see that the $1,000 monthly loan advances in column A are added to the monthly interest at 0.5% in column B to equal the loan balance (amount owed) in column C. Over time, the loan balance grows larger. You can also see that the loan balance is subtracted from the home's value (assumed to be growing at 4% per year) in column D to produce the amount of remaining home equity in column D-C.

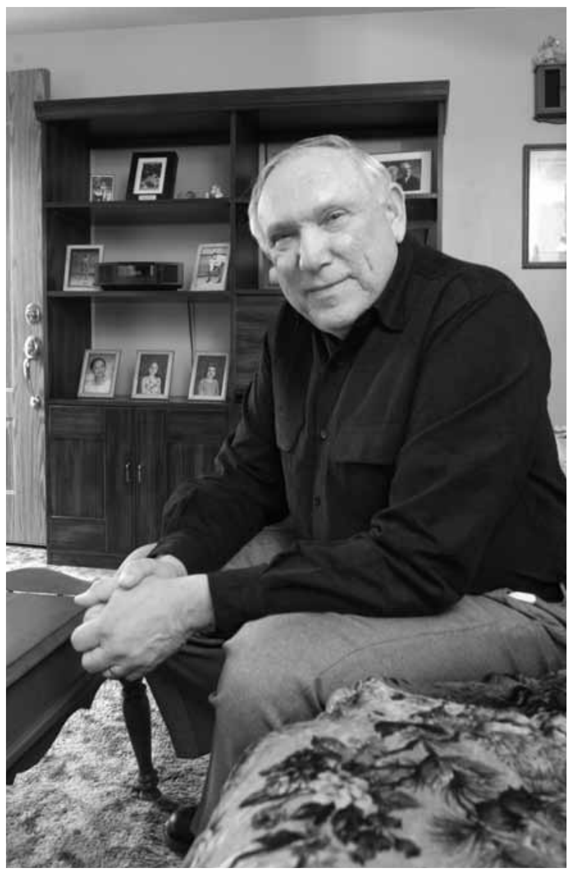


Table A-1:
Comparison of Typical "Forward" and Reverse Mortgages

Item	"Forward" Mortgage	Reverse Mortgage
Purpose of loan	to purchase a home	to generate income
Before closing, borrower has...	no equity in the home	a lot of equity in the home
At closing, borrower	owes a lot, and has little equity	owes very little, and has a lot of equity
During the loan, borrower...	makes monthly payments to the lender loan balance goes down equity grows	receives payments from the lender loan balance rises equity declines
At end of loan, borrower...	owes nothing has substantial equity	owes substantial amount has much less, little, or no equity
Type of Transaction	Falling Debt- Rising Equity	Rising Debt- Falling Equity

Table A-2: Simplified* Reverse Mortgage Example

Assumptions:

Monthly Loan Advance	$1,000
Monthly Interest Rate	0.5%
Original Home Value	$200,000
Appreciation Rate	4% per year

	A	B	C	D	(D-C)
End of Year	Principal Advances	Interest@ 0.5%/mo.	Loan Balance	Home Value	Home Equity
1	$12,000	$397	$12,397	$208,000	$195,602
2	24,000	1,559	25,559	216,320	190,760
3	36,000	3,532	39,532	224,872	185,339
4	48,000	6,368	54,368	233,971	179,602
5	60,000	10,118	70,118	243,330	173,211
6	72,000	14,840	86,840	253,063	166,222
7	84,000	20,594	104,594	263,186	158,591
8	96,000	27,442	123,442	273,713	150,270
9	108,000	35,453	143,453	284,662	141,208
10	120,000	44,698	164,698	296,048	131,349

*Illustrative example only; does not include loan closing costs and fees, or home selling costs. For complete cost example, see Part 3, Tables 3 and 4.

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For more information, go to AARP.org **Reverse Mortgage section** at **www.aarp.org/revmort**.

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D12894 (1110)

Moving Forward With A Reverse Mortgage?

No one *plans* to go broke during retirement. Most seniors fill up their retirement's gas tank and get ready to cruise. But with today's longer life spans, seniors often need more cash to help them motor through their golden years. No one can predict the financial roadblocks that may arise, such as the need for expensive prescriptions or medical procedures. Just one major setback could drain more of those hard-earned retirement dollars than anyone expects.

Fortunately, seniors have some options to keep the financial engine running during retirement. One option is the reverse mortgage. This loan allows senior Texans to liquidate the equity in their homes for cash without selling the home or incurring a monthly loan payment. The money can be used to supplement an income, make a purchase, or cover upcoming expenses.

How does a reverse mortgage work?

The borrower typically chooses from three payment options: 1) one lump sum in cash, 2) equal monthly payments for as long as both borrowers live in the home, or 3) equal monthly payments over time. Repayment is not required until both borrowers move, sell their home, or are deceased. At that time, the lender may exercise its security interest and foreclose on the property, or the owner or the heirs of the owner may pay off the lien. Naturally, heirs may object to a reverse mortgage for that reason.

Like any other loan, a reverse mortgage accrues interest charges, beginning when the first payment is made to the borrower. Usually a reverse mortgage is an Adjustable Rate Mortgage (ARM), with interest compounded monthly.

Are you eligible?

To be eligible for a reverse mortgage, a borrower must be 62 or older, own the home outright (or have a low loan balance), and have no other liens against the home. A borrower continues to be responsible for property taxes, homeowners insurance, and upkeep of the home; failure to do so can result in foreclosure.

Borrowers are also required to attend financial counseling before closing—a crucial step that helps a borrower learn more about the loan. You can view a list of HUD-approved local credit counseling agencies at www.hud.gov/groups/seniors.cfm.

Using the equity a homeowner has built up over the years can help a borrower detour away from public assistance programs. Seniors who rely on public assistance need to research the impact reverse mortgage payouts may have on their benefits.

What about your heirs?

Certainly a borrower should discuss the reverse mortgage loan option with family or other heirs before closing on the loan. An heir will need to be prepared to pay off the loan balance if the heir would like to keep the home. An open line of communication, along with strong monthly financial planning, is necessary to keep family affairs running smoothly. One possible financial plan is for the family or heirs to obtain and maintain life insurance on the borrower, with proceeds designated for paying off the loan balance.

Consider Your Alternatives

A reverse mortgage is not an answer to every senior's situation; these loans can be complicated and expensive. Consider other strategies before fully committing to a reverse mortgage:

- Take out a home equity loan
- Decrease expenses by moving into a smaller home or an apartment
- Seek property tax credit or abatement based on your senior status

A reverse mortgage is not for everyone

If you are running low on cash, put on the brakes and carefully analyze cash flow before obtaining a reverse mortgage. Because of the high closing costs, a reverse mortgage is a bad idea if you plan to move in a couple years, or if you have a temporary financial emergency that might be better resolved with a home equity loan. Carefully weigh the pros and cons of all cash flow options. Folks in early retirement should remember that the younger they are, the less money they are eligible to receive because of the life expectancy factor in the loan payment formula.

If you would like to learn more about reverse mortgage lending in Texas, contact the Office of Consumer Credit Commissioner:

- ☞ 2601 North Lamar Boulevard, Austin TX 78705
- ☞ Consumer Helpline (800) 538-1579
- ☞ E-mail info@occc.state.tx.us
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