2011
DISTRICT OF ARIZONA
ANNUAL CONFERENCE

BANKRUPTCY LAW –
THE BUMPY ROAD TO RELIEF:
PRE-BANKRUPTCY PLANNING

- *Arizona Exemptions and Pre-Bankruptcy Planning*
- *Ways & Means? Pre-Bankruptcy Planning for Individuals*
- *Pre-Planning for the Corporate or Single Asset Filing*

Presented by

THE ARIZONA LAWYER REPRESENTATIVES
TO THE NINTH CIRCUIT

Friday, March 11, 2011

WESTWARD LOOK RESORT
245 East Ina Road, Tucson, Arizona 85704

DISTRICT OF ARIZONA ANNUAL CONFERENCE

MARCH 11, 2011

Panel 1

Arizona Exemptions and Pre-Bankruptcy Planning

Honorable Randolph J. Haines, Lawrence Hirsch, Wayne Mortenson, Richard Lorenzen

1. **Hypothetical**
2. **Chart of Arizona Exemptions**
3. **Case Abstracts**
4. **Cases:**
   - **In re Thiem**
   - **In re Crater**
   - **In re Bowyer**
   - **In re Swift**
   - **In re Vangen**
   - **In re Hanson**
   - **In re Hummel**

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MARCH 11, 2011

Panel 2

Ways & Means? Pre-Bankruptcy Planning for Individuals Chapter 7, 11, or 13

Honorable Charles G. Case, Edward Bernativicius, Warren Stapleton, Steven Jerome

1. **"Issues in Individual Chapter 11 Cases" – Honorable Charles G. Case, II**
2. **Individual Chapter 11s – The Case of Dr. Gupta – Warren Stapleton**
3. **Analysis of Consumer vs. Non-Consumer Debts in Chapter 7 (with associated cases) - Ed Bernativicius**

Panel 3

Pre-Planning for the Corporate or Single Asset Filing

Honorable Redfield T. Baum, Lori Winkelman, Fred Petersen, Janet Chubb (Reno, NV)

1. **Pre-Filing Considerations in Corporate Chapter 11 Cases – Lori Winkelman**
2. **Debtor's Corporate Bankruptcy Planning Checklist – Fred Petersen**
3. **Creditor's Bankruptcy Planning Considerations – Janet Chubb**

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ARIZONA EXEMPTIONS - District Court Conference Hypothetical

MARCH 11, 2011

A Lawrence D. Hirsch Production

NOTES FROM AN INITIAL PARALEGAL INTERVIEW

Steve and Cindy have been married for twenty years. Steve is a general contractor/real estate developer and Cindy is a real estate sales agent. During their marriage they have accumulated assets and bought and sold real estate. Steve and Cindy have personally guaranteed most of the major debts for Steve's company, **OUT OF TRUST CONSTRUCTION, LLC.** (OOTC). Like most people in the real estate industry, they started to fall behind on their debts in late 2007.

ASSETS?

Pension Plan. By the spring of 2011, Steve and Cindy were mired in debt. Steve had created a pension plan for himself through **OOTC**. He is the sole employee of the company. The plan was prepared by Steve's accountant and is based upon a form that the accountant uses for his own practice, Taxes R Us. Steve has **borrowed heavily from the pension plan and insurance policies** in order to meet his personal and business obligations. As of the spring of 2010, there remains $500,000 in the plan and there are several loans outstanding totaling $75,000.

Personal Property. Steve and Cindy have acquired a number of items of personal property through the years, when things were going well for them.:

- **2.5 carat diamond ring**, which was appraised for insurance for $25,000.
- She also has numerous items of **jewelry,** including diamond earrings, necklaces and bracelets.
- Steve has two **Rolex watches**.
- They have some Kachina **dolls, some Navajo rugs, a baseball card collection, sterling silver service for 12 and a few pieces of antique furniture** which Steve inherited from his parents.
- Steve has a few **guns and some ATV's**.
- The **jewelry and art** are insured for a total of $100,000.
- A free and clear **annuity** purchased in 2005 – lump sum invested was $100,000.
- **Whole Life Insurance Policies** – each own a policy insuring the other's life for $1 Million. Each policy has $200,000 cash value but $150,000 in policy loans.
- **Bank account – Qualified Tuition Savings Account** for their 10 year old prodigal son Lawrence with $22,000 in it, over the last 5 years.
- **Bank Account - $20,000 received from a life insurance policy distribution** from Cindy's mom's death earlier this year. They hadn't talked or had any financial doings with one another for 10 years.

Everything else they own is either fully encumbered or is undeniably exempt.

DEBTS:

Steve was in the middle of a construction project in Prescott Valley when the real estate market began to collapse. He lost a subdivision that he was developing and he and Cindy have personally guaranteed a construction loan of $3.5 million. The property has been foreclosed upon and there is **a deficiency claim of $1,000,000** due and owing to a junior lien holder, who did not conduct the sale. In addition, there is about **$500,000 of business debt** that has been guaranteed, some by both Steve and Cindy and some just by Steve.

Steve and Cindy have been unable to service their personal debt, due to the drop in income which they both suffered after the real estate collapse. Their debts include:

- four months arrears in their house payments (no equity in the house above the $1.5MM 1st trust deed)
- $75,000 to the pension fund on several loans (accountant says pay these back immediately!)
- are having trouble making their car payments
- $250,000 in credit card debt.
- IRS 100% penalty for missed payroll taxes - $50,000.

Potential Loan?

Cindy's sister, Roseanne, is a successful doctor and is willing to help. She will lend Steve and Cindy the funds necessary to pay back their pension loans, catch up the house payments and let them get a little ahead on living expenses. Steve and Cindy would like to keep the personal property they have accumulated and also want to protect Eileen in the event that they die or are completely unable to financially recover from the disasters they have faced.

They have an appraisal from the jewelry and the art, which is worth $88,000.

Eileen is ready to loan them $100,000 and in fact wants to fund our retainer.

Q FOR ATTORNEY:

HOW DO WE PLAN FOR A SUCCESSFUL

CHAPTER 7 OR CHAPTER 11?

Arizona Exemption chart was created by Jamie McDonald, McDonald Law Offices PLLC Reprinted with express permission.

Property Exempt in Arizona

The use of Federal bankruptcy exemptions is prohibited in Arizona. ARS § 33-1133
Federal non-bankruptcy exemptions are available.

Type of Property & Description	Amount Exempt	Statute Creating Exemption
Homestead. Equity in a home, townhouse, condominium, mobile home, or mobile home and lot in which the debtor resides. A married couple may have only one homestead, and if the couple is then divorced the total exemption allowed for that residence to either or both persons is $150,000. The homestead exemption in identifiable cash proceeds continues for eighteen months after the date of the sale of the property or until the person establishes a new homestead. ARS § 33-1101 [Prior to August 25, 2004 the homestead exemption was $100,000.] The homestead exemption is automatic and no written claim is required, but the exemption must be claimed in bankruptcy schedules. ARS § 33-1102 The homestead is abandoned by written declaration, transfer of the property, or moving from the homestead for more than two years. ARS § 33-1104	$150,000	ARS § 33-1101 Amended effective 8-25-04
Availability of exemptions to married persons. In the case of married persons, each spouse is entitled to the personal property exemptions listed below [ARS § 33-1120 to 1149], which may be combined with the other spouse's exemption in the same property or taken in different exempt property.		ARS § 33-1121.01
Prepaid rent & security deposit. *If a homestead exemption is not claimed,*	Lesser of $1,000 or one and one-half month's rent	ARS § 33-1126.C

prepaid rent, including security deposits.		
Household goods. The following household items: • One kitchen and one dining room table with four chairs each, plus one additional chair for each dependent of the debtor who resides in the household if the debtor and dependents exceed four in number. • One living room couch. • One living room chair, plus one additional chair for each dependent of the debtor who resides in the household. • Three living room coffee or end tables. • Three living room lamps. • One living room carpet or rug. • Two beds, plus one additional bed for each dependent of the debtor who resides in the household. • One bed-table, dresser and lamp for each exempt bed. • Bedding for each exempt bed. • Pictures, oil paintings and drawings, drawn or painted by debtor and family portraits in their necessary frames. • One television set or radio or stereo. • One radio alarm clock. • One stove. • One refrigerator. • One washing machine. • One clothes dryer. • One vacuum cleaner.	$4,000	ARS § 33-1123
Food, fuel & provisions. All food, fuel and provisions actually provided for the debtor's individual or family use for six months.	100%	ARS § 33-1124
Wearing apparel.	$500	ARS § 33-1125.1
Music instruments. All musical instruments provided for the debtor's individual or family use.	$250	ARS § 33-1125.2

Pets & animals. Domestic pets, horses, milk cows and poultry.	$500	ARS § 33-1125.3
Rings. All engagement and wedding rings.	$1,000	ARS § 33-1125.4
Library. The library of a debtor, including books, manuals, published materials and personal documents.	$250	ARS § 33-1125.5
Watch. One watch.	$100	ARS § 33-1125.6
Other personal property. One typewriter, one bicycle, one sewing machine, a family bible, a lot in any burial ground, one shotgun or one rifle or one pistol.	$500	ARS § 33-1125.7
Motor vehicle. One motor vehicle. [Prior to August 8, 2001, the motor vehicle exemption was $1,500; $4,000 if debtor was maimed or crippled.]	$5,000; ($10,000 if debtor is physically disabled)	ARS § 33-1125.8 Amended effective 8-9-01
Prostheses. Professionally prescribed prostheses for the debtor or a dependent of the debtor, including a wheelchair.	100%	ARS § 33-1125.9
Life insurance proceeds. Money received by or payable to a surviving spouse or child upon the life of a deceased spouse, parent or legal guardian. Exclusion applies.	$20,000	ARS § 33-1126.A.1
Earnings of a minor child. The earnings of the minor child of a debtor or the proceeds thereof by reason of any liability of such debtor not contracted for the special benefit of such minor child. Exclusion applies.	100%	ARS § 33-1126.A.2
Child support & spousal maintenance. All monies received by or payable to a person entitled to receive child support or spousal maintenance pursuant to a court order. Exclusion applies.	100%	ARS § 33-1126.A.3
Health, accident, or disability benefits. All money, proceeds or benefits of any kind to be paid in a lump sum or to be rendered on a periodic or installment basis to the insured or any beneficiary under any policy of health, accident or disability insurance or any similar plan or program of benefits in use by any	100%	ARS § 33-1126.A.4

employer, except for premiums payable on such policy or debt of the insured secured by a pledge, and except for collection of any debt or obligation for which the insured or beneficiary has been paid under the plan or policy and except for payment of amounts ordered for support of a person from proceeds and benefits furnished in lieu of earnings which would have been subject to such order and subject to any exemption applicable to earnings so replaced. Exclusion applies.		
Damage to exempt property. Money from any claim for the destruction of, or damage to, exempt property, including fire or other insurance. Exclusion applies.	100%	ARS § 33-1126.A.5
Life insurance policies. The cash surrender value of life insurance policies where for a continuous unexpired period of two years such policies have been owned by a debtor and have named as beneficiary the debtor's surviving spouse, child, parent, brother or sister, or any other dependent family member, in the proportion that the policy names any such beneficiary, except that, subject to the statute of limitations, the amount of any premium which is recoverable or avoidable by a creditor pursuant to title 44, chapter 8, article 1, with interest thereon, shall not be exempt. The exemption provided by this paragraph does not apply to a claim for the payment of a debt of the insured or beneficiary that is secured by a pledge or assignment of the cash value of the insurance policy or the proceeds of the policy. For the purposes of this paragraph "dependent" means a family member who is dependent on the insured debtor for not less than half support. Exclusion applies.	100%	ARS § 33-1126.A.6 ARS § 20-1131(D)
Annuity Contract. An annuity contract where for a continuous unexpired period of two years such contract has been owned by a debtor and has named as beneficiary the debtor, debtor's surviving spouse,	100%	ARS § 33-1126.A.7

child, parent, brother or sister, or any other dependent family member, except that, subjecThe cash surrender value of life insurance policies where for a continuous unexpired period of two years such policies have been owned by a debtor and have named as beneficiary the debtor's surviving spouse, child, parent, brother or sister, or any other dependent family member, in the proportion that the policy names any such beneficiary, except that, subject to the statute of limitations, the amount of any premium which is recoverable or avoidable by a creditor pursuant to title 44, chapter 8, article 1, with interest thereon, shall not be exempt. The exemption provided by this paragraph does not apply to a claim for the payment of a debt of the insured or beneficiary that is secured by a pledge or assignment of the cash value of the insurance policy or the proceeds of the policy. For the purposes of this paragraph "dependent" means a family member who is dependent on the insured debtor for not less than half support.t to the statute of limitations, the amount of any premium, payment or deposit with respect to such contract is recoverable or avoidable by a creditor pursuant to title 44, chapter 8, article 1 shall not be exempt. The exemption provided by this paragraph does not apply to a claim for a payment of a debt of the annuitant or beneficiary that is secured by a pledge or assignment of the contract or its proceeds. For the purposes of this paragraph, "dependent" means a family member who is dependent on the debtor for not less than half support. Exclusion applies.		
Wrongful taking of exempt property. Any claim for damages recoverable by any person by reason of any levy upon or sale under execution of his exempt personal property or by reason of the wrongful taking or detention of such property by any person, and the judgment recovered for such damages. Exclusion applies.	100%	ARS § 33-1126.A.8

Bank account. Money held in a single account in any one financial institution as defined by ARS § 6-101 [banks, trust companies, savings and loan associations, credit unions, consumer lenders, international banking facilities and financial institution holding companies under the jurisdiction of the state banking department]. The exemption does not apply against normal service charges assessed against the account by the financial institution at which the account is carried. Exclusion applies.	$150	ARS § 33-1126.A.9
Exclusion. Exemptions of ARS § 33-1126.A do not apply to annuities, or to cash surrender values increased by premium payments within two years in excess of the average annual premium paid during the previous three years. Exemptions of ARS § 33-1126 do not apply to orders which are the result of a judgment for arrearages of child support or for a child support debt.		ARS § 33-1126.B ARS § 20-1126.E
IRAs. Money in qualifying Individual Retirement Accounts, except amounts contributed within one hundred twenty days before bankruptcy or amounts to an alternate payee under a qualified domestic relations order.	100%	ARS § 33-1126.C
Tools of trade. The tools, equipment, instrument and books of a debtor or the spouse of a debtor primarily used in, and necessary to carry on, the commercial activity, trade, business or profession of the debtor or the debtor's spouse. This does not include a motor vehicle primarily used by a debtor for personal, family or household purposes such as transportation to and from the debtor's place of employment.	$2,500	ARS § 33-1130.1
Farming implements. Farm machinery, utensils, implements of husbandry, feed, seed, grain and animals belonging to a debtor whose primary income is derived from farming.	$2,500	ARS § 33-1130.2
Arms, uniforms and accoutrements. All arms, uniforms	100%	ARS § 33-1130.3

and accoutrements required by law to be kept by a debtor.		
Disposable earnings. That remaining portion of a debtor's wages, salary or compensation for his personal services, including bonuses and commissions, or otherwise, and includes payments pursuant to a pension or retirement program or deferred compensation plan, after deducting from such earnings those amounts required by law to be withheld. Exemption does not apply a Bankruptcy Court order under Chapter 13, or to any debt due for any state or federal tax.	Greater of 75% or 30 times Federal hourly minimum wage; 50% for support orders	ARS § 33-1131
Fraternal Benefit Society benefits.	100%	ARS § 20-877
Unemployment compensation benefits. Exemption does not apply to actions to recover support under the child support enforcement act, or to recover over issuances of food stamp coupons	100%	ARS § 23-783
Workmen's compensation benefits.	100%	ARS § 23-1068
Welfare assistance.	100%	ARS § 46-208
Firemen's relief and pension benefits. Exemption does not apply to child support.	100%	ARS § 9-968
Police pension benefits. Exemption does not apply to child support.	100%	ARS § 9-931
Arizona Rangers' pensions.	100%	ARS § 41-955
Arizona State Retirement Benefits. Benefits and annuities, member and employer contributions and the securities in Arizona State Retirement System [ASRS] accounts.	100%	ARS § 38-792
Long-Term Disability [LTD] Program benefits. Employer and member contributions and the securities in the LTD trust fund established by section 38-797.02 are not subject to execution or attachment and are nonassignable except as specifically provided in this article.	100%	ARS § 38-797.11
Corrections Officer Retirement Plan	100%	ARS § 38-897

benefits. The right of an individual to a pension, to a refund of accumulated member contributions, to the pension itself or to any other right accrued or accruing to any individual, and the monies and assets of the retirement plan, are not subject to execution, garnishment, attachment, the operation of bankruptcy or insolvency law or other process of law except a qualified domestic relations order and are unassignable except as may be otherwise specifically provided. Exemption does not apply to a qualified domestic relations order or a judgment for child support.		
Public Safety Personnel Retirement System. Benefits, employee contributions or employer contributions, including interest, earnings and all other credits, payable under this system shall not be subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, charge, garnishment, execution or levy of any kind, either voluntary or involuntary, prior to actually being received by the person entitled to the benefit, contribution, earning or credit, under the terms of the system, and any attempt to anticipate, alienate, sell, transfer, assign, pledge, encumber, charge or otherwise dispose of any such right hereunder shall be void.	100%	ARS § 38-850.C
Specific partnership property. Repealed effective 1/1/2000.	N/A	ARS § 29-225

Exemptions listed are based upon information compiled April 2004 and may not be exhaustive. Before relying upon any exemption, its current availability should be verified by checking with the applicable Arizona Revised Statute (ARS) which establish the exemption. The code may be reviewed and searched at the web site of Arizona Legislative Computer Service of the Arizona State Legislature, ALIS Online.

CASE ABSTRACTS
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In re Beverly, —- F.3d —— (9th Cir. Dec 24, 2008)

Marital settlement agreement may be set aside as fraudulent transfer:

Affirming *In re Beverly*, 374 B.R. 221 (9th Cir. B.A.P., July 24, 2007) on this issue, and adopting that "well-reasoned" opinion as its own, the Ninth Circuit Court of Appeals (Circuit Judges Melvin Brunetti and Barry G. Silverman and District Judge Suzanne B. Conlon) held that, under Code § 544(b), the trustee may set aside a martial settlement agreement as actually fraudulent, even where the parties receive reasonably equivalent value. The BAP found that the MSA was actually fraudulent because the debtor (an attorney) and his wife's divorce attorney purposefully structured the MSA so as to assign a $425,000 community debt to the debtor, while exchanging assets with his wife so that he received approximately $1 million in exempt assets, while she received nonexempt assets of about the same value.

Case number 07-56133; BAP case numbers CC-06-01250-KBN, CC-06-01273-KBN, CC-06-01284-KBN, CC-06-01449-KBN [C.D. Cal.]

In re Gebhart, 621 F.3d 1206 (9th Cir., Sept. 14, 2010), page 250

(case nos. 07-16769, 07-35704)

In a case that poses a real threat to Chapter 7 debtors who hope to retain their homes, the Ninth Circuit Court of Appeals, affirming *In re Chappell*, 373 B.R. 73 (9th Cir. B.A.P. 2007), held that, even though a Chapter 7 debtor has validity exempted all of the equity the debtor has in the home on the petition date, the Chapter 7 trustee may hold the case open for years, wait for the property to appreciate, and then sell it and pay the debtor the amount exempted. The court reasoned that, under *Schwab v. Reilly*, 130 S.Ct. 2652, 177 L.Ed.2d 234 (2010), the debtor's exemption removed only an "interest" in the property equal to the amount exempted from the debtor's bankruptcy estate; the property itself, subject to the debtor's exemption, remained property of the estate. The value of the property was not fixed on the petition date; only the amount of the debtor's exemption was. Therefore, appreciation in the value of the property belonged to the estate. The trustee was not estopped, by his long delay in selling the house (three years after discharge in one case, 22 months in the other), from proceeding with the sale, as the debtor made no showing that the trustee intended for the debtor to act as if he would be able to retain the homestead property permanently. Abandonment of an estate asset is not a remedy for a trustee's misconduct; if there were any misconduct by the trustee, the duty to police it fell on the U.S. Trustee in the debtor's district, who could suspend or expel a trustee for failure to perform his or her duties or comply with the Bankruptcy Code.

In re JTS Corporation, 617 F.3d 1102 (9th Cir., August 10, 2010), page 219

(case nos. 07-15970, 07-16004)

Under Code § 544(b) and § 550(a), a trustee may avoid a fraudulent transfer of property if that transfer is voidable under applicable state law. Here, where the Chapter 7 trustee sought to set aside a prepetition transfer as constructively fraudulent, relying on Code § 544(b) and proceeding under Cal. Civ. Code § 3439.04, which renders a transfer avoidable if the debtor made the transfer without receiving a reasonably equivalent value in exchange

for the transfer and the debtor intended to incur, or believed or reasonably should have believed that it would incur debts beyond its ability to pay as they became due, the adversary defendant was entitled to limit the recovery by invoking Cal. Civ. Code § 3439.08(d), which applies in the case of a good-faith transferee. Code § 550 specifies the conditions under which, once a transfer is avoided under § 544 or other provisions, a trustee can recover from various transferees. There are, in effect, three conceptual steps to the trustee's case; the trustee must establish (1) fraud or illegality under the applicable substantive law; (2) resulting voidness or voidability of the transfer under the applicable law so as to allow avoidance pursuant to Code § 544(b); and (3) liability of the particular transferee pursuant to the provisions of section 550. *Lippi v. City Bank*, 955 F.2d 599 (9th Cir. 1992). Once fraud and voidness are shown, a trustee may recover under § 550 to the extent it "benefits the estate," *i.e.,* even if there is a right to avoid a transfer, it does not mean that a right to recover on every transfer is automatic. *In re Acequia, Inc.*, 34 F.3d 800 (9th Cir. 1994).

In re Costas, 555 F.3d 790, 61 Collier Bankr. Cas. 2d 52, Bankr. L. Rep. ¶ 81,413 (9th Cir., Feb. 6, 2009), *March 2009, page 126*

- The debtor's prepetition disclaimer, executed in accordance with Arizona law, relinquishing her claim to certain trust property was not as a "transfer ... of an interest of the debtor in property" subject to avoidance under Code § 548(a).

In re Rosson, 545 F.3d 764, 60 Collier Bankr. Cas. 2d 587, Bankr. L. Rep. ¶ 81,326 (9th Cir., Sept. 24, 2008), *October 2008, part 2, pages 112-113*

- A bankruptcy court order converting a case from one under another chapter of the Bankruptcy Code to one under Chapter 7 is a final and appealable order.

- After *Marrama v. Citizens Bank of Massachusetts*, 549 U.S. 365, 127 S. Ct. 1105, 166 L. Ed. 2d 956, there is no absolute right to voluntarily dismiss a Chapter 13 case.

- A court's involuntary conversion of a case from Chapter 13 to Chapter 7, whether under Code § 1307(c) or the court's general powers under Code § 105(a), requires notice to, and a hearing provided, the debtor.

- When the bankruptcy court learned that the Chapter 13 debtor intended to retain estate assets rather than turn them over the trustee as he had promised, the court's order immediately converting the case to Chapter 7 was consistent with Code § 102(1), which provides that "after notice and a hearing," or a similar phrase "authorizes an act without an actual hearing" if "there is insufficient time for a hearing to be commenced before such act must be done."

In re Beckx, Case No. 08-1193 (9th Cir. B.A.P., March 18, 2009), *March 2009, page 68*

- Even though the debtor's and his wife's stipulated judgment of marital dissolution included explicit waivers of support by both parties and stated that a $50,000 payment from the debtor to the wife was intended "to equalize the division of the community property as set forth herein," the bankruptcy court did not err in (1) considering parol evidence as to the parties' intention with regard to the payment, and (2) determining that it was in the nature of support, rather than a property settlement agreement.
-

In re Cook, Case No. CC-08-1091-HMoD (9th Cir. BAP, Nov. 3, 2008), *January 2009, page 147*

- Property received by the Chapter 7 debtor in the 180 days postpetition was not property of the estate, where (1) the debtor's parents established a revocable, inter vivos trust during their lifetimes; (2) under a pour-over provision in the debtor's mother's will, upon her death her assets were transferred to the trust; and (3) at that point, the trust corpus was distributed to the trust beneficiaries, one of whom was the debtor. Property rights are determined by state law, and, under California law, distributions from an inter vivos trust do not constitute testamentary dispositions.

In re Patrick, 2008 WL 5521181 (Bankr. C.D. Cal., Oct. 31, 2008), *January 2009, page 158*

- Under Code § 522(b)(4)(D)(ii), which applies to both § 522(b)(3)(C) and § 522(d)(12), retirement accounts and/or distributions are exempt from the bankruptcy estate only to the extent that the accounts and/or distributions are exempt from taxation under the applicable sections of the Internal Revenue Code. Thus, because IRC § 408(d)(3)(B) permits only one rollover of an IRA in a one-year period, and the debtor rolled over the funds in his IRA three times in a year, he was not permitted to claim an exemption in the IRA under Code § 522(b)(3)(C).

In re Latone, 2008 WL 5049460, Bankr. L. Rep. ¶ 81,346 (Bankr. D. Ariz., Oct. 23, 2008), *November 2008, page 129*

- The below-median debtor's monthly payments of $1,483 in repayment of various loans from his 401(k) account did not demonstrate, in itself, that granting the debtor a Chapter 7 discharge would be an abuse under the totality of the circumstances.

In re Wallace, 2008 WL 5025003 (Bankr. D. Ariz., Sept. 15, 2008), *January 2009, page 92*

- Where the parties' divorce decree included an attachment listing, and equitably dividing, the parties' property, and a separate section of the decree, entitled "Spousal Maintenance/Support," awarded the wife a $100,000 lump-sum payment, the parties' intention—to provide a one-time payment to the wife in lieu of the husband's future spousal maintenance obligations—was clear, and the debt was a domestic support obligation nondischargeable under Code § 523(a)(5).

- Under Code § 550(a), the Chapter 7 trustee was entitled to recover the transferred property for the benefit of the bankruptcy estate. While the lender asserted that it would not have released its previous liens if it had not received the new lien, and some courts had looked to Code § 105(a) as authority to place parties in the same position they would have been in in the absence of the avoided transfer, the court would not do so, given the lender's knowledge of the debtors' bankruptcy filing.

Schwab v. Reilly, —- U.S. —-, 130 S.Ct. 2652, 177 L.Ed.2d 234 (June 17, 2010)

Property of the estate—Exemptions—Procedure:

Reversing *In re Reilly*, 534 F.3d 173 (3rd Cir. 2008) in a 6-3 decision, the Supreme Court held that the trustee is under no duty to object if the debtor's claimed exemption is facially lawful. Thus, here, where the debtor, the owner of a catering business, listed as an asset her "business equipment," valued it at $10,718, and claimed two facially-valid exemptions totaling that amount (an $1,850 tools of the trade exemption under Code § 522(d)(6) and an $8,868 wildcard exemption under § 522(d)(5)), the Chapter 7 trustee was under no duty to object, even though he knew within the 30-day period that the property was worth some $17,000. Thus, the debtor's claim of exemption did not have the effect of exempting the full value of the equipment.

Marrama v. Citizens Bank of Massachusetts, 549 U.S. 365, 127 S.Ct. 1105, 166 L.Ed.2d 956 (2007)

Chapter 7—Conversion of case by debtor:

In a 5-4 decision along ideological lines, the Supreme Court held that a Chapter 7 debtor's right to convert to Chapter 13 under Code §706(a), where the debtor has not previously converted his or her case, is not absolute. Conversion may be denied in "extraordinary cases" in which the debtor has engaged in bad faith. This follows from Code § 706(d), which provides that "a case may not be converted to a case under another chapter of this title unless the debtor may be a debtor under such chapter," as, under Code § 1307(c), a debtor guilty of bad faith may not be a Chapter 13 debtor. Indeed, the broad authority granted to bankruptcy judges in Code § 105(a) to take any action that is necessary or appropriate "to prevent an abuse of process" may provide a basis for denying a motion to convert under these circumstances, as may the inherent power of every federal court to sanction abusive litigation practices. Accordingly, the bankruptcy court did not err in denying a Chapter 7 debtor's motion to convert to Chapter 13 after the debtor had failed to disclose certain property in his schedules. The dissent, rejecting the majority's "strained reading of the Code," contended that § 706(d) refers only to eligibility requirements found in Code § 109.

The Court said that a debtor may express an intent to claim an exemption in the full value of listed property by claiming an exemption in the "full fair market value (FMV)" or "100% of FMV." The Court also noted that, in *Taylor* v. *Freeland & Kronz*, 503 U.S. 638 (1992), the trustee was held to a duty to object where the debtor had claimed an exemption in the full value of an asset whose value was described as "unknown." In either case, the Court reasoned, the debtor was giving explicit notice that he/she was, or might be, claiming an exemption in an amount greater than the capped amount allowed for the exemption.

Rousey v. Jacoway, 544 U.S. 320, 125 S.Ct. 1561, 161 L.Ed.2d 563 (2005)

Property of the estate—Exemptions—Under federal law—Code § 522(d)(10)(E):

Under Code § 522(d)(10)(E), which permits a debtor to exempt "a payment under a stock bonus, pension, profitsharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor," three elements must be met: (1) The right to receive payment must be from "a stock bonus, pension, profitsharing, annuity, or similar plan or contract"; (2) the right to receive payment must be "on account of illness, disability, death, age, or length of service"; and (3) even then, the right to receive payment may be exempted only "to the extent" that it is "reasonably necessary [to] support" the accountholder or his dependents.

Here, the Chapter 7 debtors' IRAs were exempt under § 522(d)(10)(E). The Court so stated in *Patterson v. Shumate*, 504 U.S. 753, 112 S.Ct. 2242, 119 L.Ed.2d 519 (1992) and reaffirmed that holding now. The phrase "on account of" means "because of," and the debtors' right to payment from IRAs was causally connected to their age because the substantial tax penalties for withdrawals before the age of 59½ limited the debtors' access to the funds in the IRAs. Moreover, the IRAs were "similar" to stock bonus, pension, profitsharing, or annuity plans or contracts because those plans, like the debtors' IRAs, provided a substitute for wages and were not mere savings accounts.

This was a unanimous decision for the debtors, who had lost at all levels below.

Statutory text: The following is excluded from the estate:

(1) any power that the debtor may exercise solely for the benefit of an entity other than the debtor;

Code § 541(b)(1)

Cases

Matter of Shurley, 115 F.3d 333 (5th Cir. 1997) (the debtor's power to designate the distribution of certain assets of a trust, under which the debtor was a beneficiary, was not property of the debtor's bankruptcy estate, where the power provided that the debtor may not "appoint assets to herself, her creditors, her estate, or the creditors of her estate")

In re Dawes, 2008 WL 4822526 (Bankr. D. Kan. 2008) (the debtor's power to appoint the beneficiaries of a portion of the assets of a trust was not property of the estate, where the power specifically provided that the debtor "shall not have the power to appoint any portion of such separate share, directly or indirectly, to or for the benefit of himself or herself, his or her creditors, his or her estate or the creditors of his or her estate")

Comment: This exclusion is limited to a power that does not allow the debtor to benefit him/herself.

Statutory text: The following is excluded from the estate:

> (6) funds used to purchase a tuition credit or certificate or contributed to an account in accordance with section 529(b)(1)(A) of the Internal Revenue Code of 1986 under a qualified State tuition program (as defined in section 529(b)(1) of such Code) not later than 365 days before the date of the filing of the petition in a case under this title, but--
>
> > (A) only if the designated beneficiary of the amounts paid or contributed to such tuition program was a child, stepchild, grandchild, or stepgrandchild of the debtor for the taxable year for which funds were paid or contributed;
> >
> > (B) with respect to the aggregate amount paid or contributed to such program having the same designated beneficiary, only so much of such amount as does not exceed the total contributions permitted under section 529(b)(7) of such Code with respect to such beneficiary, as adjusted beginning on the date of the filing of the petition in a case under this title by the annual increase or decrease (rounded to the nearest tenth of 1 percent) in the education expenditure category of the Consumer Price Index prepared by the Department of Labor; and
> >
> > (C) in the case of funds paid or contributed to such program having the same designated beneficiary not earlier than 720 days nor later than 365 days before such date, only so much of such funds as does not exceed $5,475 [FN1];

[FN1] Dollar amount as adjusted by the Judicial Conference of the United States. See Adjustment of Dollar Amounts notes set out under this section and 11 U.S.C.A. § 104.

Cases

Section 529 accounts held property of estate prior to BAPCPA:

Although Code § 541(b)(6), added by BAPCPA, expressly excludes, with certain exceptions, section 529 accounts from property of the estate, commented the Eight Circuit Court of Appeals, the section 529 accounts established by the debtor for his children were property of his estate, as his filing preceded BAPCPA's effective date, and, under Minnesota law, the debtor, not his children, was the owner of the account.

In re Addison, 540 F.3d 805 (8th Cir., Aug. 7, 2008), reh'g and reh'g en banc denied (Sept. 11, 2008)

Case numbers 07-2064, 07-2727

Exclusion of college savings accounts under Code § 541(b)(6), generally:

For funds to be excluded from property of the estate under Code § 541(b)(6), they must be contributed to a 529 account at least a year before the filing of the bankruptcy, and, even then, there is a monetary cap on the excluded funds contributed between 365 and 720 days

prior to the filing. It is only those funds contributed more than 720 days before filing that are excluded without a monetary limit.

In re Bourguignon, 416 B.R. 745 (Bankr. D. Idaho, Sept. 23, 2009)

(case no. 1:09-bk-766-TLM) (Chief Bankruptcy Judge Terry L. Myers)

See also

In re Quackenbush, 339 B.R. 845 (Bankr. S.D. N.Y. 2006) (§ 541(b)(6) did not apply to case filed six days prior to effective date of the BAPCPA)

In re Sanchez, 2006 WL 395225 (Bankr. D. Mass. 2006) (There was no basis for determining that funds deposited into a Section 529 Plan were excluded from property of the estate prior to the enactment of § 541(b)(6))

Code § 541(b)(7)

Statutory text: The following is excluded from the estate:

(7) any amount--

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

(i) to--

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

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

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

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

(ii) to a health insurance plan regulated by State law whether or not subject to such title; or

(B) received by an employer from employees for payment as contributions--

(i) to--

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

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

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

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

(ii) to a health insurance plan regulated by State law whether or not subject to such title;

Related Code sections:

§ 362(b)(19) (excluding, from the automatic stay, withholding by the debtor's employer of amounts the debtor has agreed to repay a loan from an ERISA-qualified IRA)

§ 522(b)(3)(C) (permitting debtors who elect state exemptions to exempt "retirement funds to the extent that those funds are in a fund or account that is exempt from taxation" under specified sections of the Internal Revenue Code)

§ 522(b)(4) (providing definitions to implement § 522(b)(3)(C) and § 522(d)(12))

§ 522(d)(12) (permitting debtors who elect federal exemptions to exempt "retirement funds to the extent that those funds are in a fund or account that is exempt from taxation" under specified sections of the Internal Revenue Code)

523(a)(18) (excepting from discharge debts to ERISA-compliant retirement accounts)

§ 541(c)(2) (providing that "[a] restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title")

§ 1322(f) (providing that a Chapter 13 plan may not materially alter the terms of a loan described in section 362(b)(19) and any amounts required to repay such loan shall not constitute "disposable income" under section 1325)

Cases

Code § 541(b)(7) has provoked few interpretive questions. One issue addressed in a few cases is whether the debtor's contributions remain excluded from the bankruptcy estate after they have been remitted to the debtor's retirement account, or whether the exclusion is operative only during the "gap period" between the withholding of the debtor's wages by the employer and the employer's remittance to the debtor's plan. The court in *In re Leahy*, 370 B.R. 620 (Bankr. D. Vt. 2007) explicitly holds that the exclusion follows the contributions into the account. A few other courts have stated this principle without analysis. See *In re Hunter*, 380 B.R. 753 (Bankr. S.D. Ohio, Jan. 24, 2008); *In re Thompson*, 350 B.R. 770 (Bankr. N.D. Ohio 2006), rev'd on other grounds, *Eisen v.*

Thompson, 370 B.R. 762 (N.D. Ohio 2007). Another court noted the issue without having the need to resolve it. See *In re Orr*, 2008 WL 244168 (Bankr. C.D. Ill., Jan. 28, 2008).

Since *Patterson v. Shumate*, 504 U.S. 753, 112 S. Ct. 2242, 119 L. Ed. 2d 519 (1992) construed § 541(c)(2) to exclude, from a debtor's bankruptcy estate, the debtor's interest in an "ERISA-qualified" pension plan, the question really is only relevant to retirement accounts encompassed by § 541(b)(7) but not by § 541(c)(2).

A number of courts have also recognized that the exclusion under § 541(b)(7) is only as to contributions within the legal limits for such contributions. See, e.g., *In re Leahy*, supra.

In re Lyon, 2010 WL 3777827 (Bankr. D. Ariz., Sept. 20, 2010), pages 67, 91, 95

(case no. 4:09-bk-30568) (Chief Bankruptcy Judge James M. Marlar) Text of opinion

- **Setoff—Need for relief from stay:** Under Code § 362(a)(7), a creditor having setoff rights in regard to a prepetition obligation must obtain relief from the automatic stay to complete the process. However, if a party has a right to setoff under applicable federal or state law, "cause" would then exist for relief from the automatic stay pursuant to Code § 362(d)(1). (pages 67, 91)

- **Setoff—Existence of right:** The debtor's deposit agreement with a credit union included an express pledge of the funds of the debtor's account as security for the credit union's loan to the debtor and therefore was sufficient, under the federal Truth in Lending Act and its implementing Regulation Z, to create a security interest in favor of the credit union in the funds in the account securing the credit union's loan to the debtor. Accordingly, the credit union had a right to setoff that it could enforce under Code § 553(a). (pages 91, 95)

In re Petersen, 437 B.R. 858 (D. Ariz., Sept. 27, 2010), pages 126, 147, 169, 192

(case no. 2:09-cv-01600-RCB) (District Judge Robert C. Broomfield) Text of opinion

- **Appellate procedure:** While, in general, an argument made for the first time on appeal is waived, a court may consider an issue raised for the first time on appeal "when the issue is one of law and does not depend on the factual record, or the record has been fully developed." *In re Hoopai*, 581 F.3d 1090 (9th Cir. 2009). (page 126)

- **Appellate procedure:** Decisions to allow or disallow a setoff under Code § 553 are subject to review for abuse of discretion. *In re Brown & Cole Stores, LLC*, 375 B.R. 873 (9th Cir. B.A.P. 2007). A bankruptcy court's application of the equitable doctrine of recoupment is also reviewed for an abuse of discretion. *In re Straightline Investments, Inc.*, 525 F.3d 870 (9th Cir. 2008). (page 126)

- **Proof of claim—Recoupment, generally:** In the Ninth Circuit, for equitable recoupment to apply, the competing claims must arise out of the same transaction or occurrence. The crucial factor in determining whether two events are part of the same transaction is whether there is a logical relationship between the two. The word "transaction" is given both a liberal and a flexible construction under that standard. Consequently, a "transaction" may include "a series of many occurrences, depending not so much upon the immediateness of their connection as upon their logical relationship." *In re TLC Hospitals, Inc.*, 224 F.3d 1008 (9th Cir. 2000). (page 147)

- **Property of the estate—Community property:** For purposes of Code § 541(a)(2), all community property not yet divided by a state court at the time of the bankruptcy filing is property of the bankruptcy estate. *In re Mantle*, 153 F.3d 1082 (9th Cir. 1998). And Arizona statutes did not sever the spouses' joint management of community property that rendered it property of the estate under § 541(a)(2). Accordingly, the bankruptcy court erred in ruling that the debtor's nonfiling husband was required to turn over only one-half of the parties' community property, where the debtor had commenced a martial dissolution proceeding prior to filing her bankruptcy petition, but the state martial dissolution court had not rendered an equitable distribution of the community property assets of which the Chapter 7 trustee sought turnover. (For the bankruptcy court's decision, see *In re Petersen*, 2009 WL 248021 (Bankr. D. Ariz., Jan. 30, 2009).) (page 169)

- **Property of the estate—Turnover—Application of equitable recoupment:** In ordering the Chapter 7 debtor's nonfiling husband to turn over certain of the parties' community property that was in the husband's possession, the bankruptcy court did not err in applying the doctrine of equitable recoupment and allowing the husband a credit for certain amounts owed him by the debtor under decrees of the state marital dissolution court. The bankruptcy court soundly found that there was a logical relationship between the debtor's bankruptcy and the parties' divorce proceeding so as to justify allowing the husband to recoup certain monies. (page 192)

Alleged spendthrift trust was not shown to be excluded from bankruptcy estate:

The court was unable to conclude that the Chapter 7 debtor's interest as a beneficiary of a trust was excluded from the estate as a spendthrift trust. Under New Mexico law, a spendthrift trust is valid only if it restrains both voluntary and involuntary transfer of a beneficiary's interest, and, here, the record did not contain a copy of the trust documents. Moreover, the debtor spent $75,000 to construct a barn on real property owned by the trust, and, under state law, a self-settled spendthrift trust is not valid.

Additionally, courts have recognized certain exceptions to the distinction between spendthrift trust assets and personal assets. For example, even if the required spendthrift boilerplate language is included in a trust instrument, a court may look at the actual conduct of the parties, and the parties' abilities and potential future conduct, to determine if the trust is in fact a spendthrift trust, and, here, the debtor allegedly had sole and absolute discretion over the trust. Secondly, where the debtor had commingled trust and personal assets, some courts had admitted the existence of the trust but shifted the burden to the debtor to specifically identify and trace trust assets in order to reclaim them.

In re Wiley, 2010 WL 5185448 (Bankr. D. N.M., Oct. 14, 2010)

(case no. 1:07-bk-13053; adv. proc. no. 1:08-ap-1120) (Chief Bankruptcy Judge James S. Starzynsk)

Estate's interest in joint tax refund is limited to debtor's interest:

Because only a Chapter 13 debtor's interest in a joint tax refund received by the debtor and his or her nonfiling spouse is property of the debtor's bankruptcy estate, a provision in a

confirmed Chapter 13 plan requiring the debtor to turn over all tax refunds received during the plan term to the Chapter 13 trustee requires the debtor to turn over only that portion of the refund that is estate property. A joint tax refund is apportioned to the spouses to the extent that each contributed to the overpaid tax. Moreover, a nonparty spouse is not bound by the plan or the court's plan confirmation order. See *In re Malewicz*, 2010 WL 4613119 (Bankr. E.D. N.Y., Nov. 4, 2010).

In re Rice, —- B.R. ——, 2010 WL 5559694 (Bankr. M.D. Fla., Dec. 23, 2010)

(case nos. 9:09-bk-8310, 9:09-bk-8888) (Bankruptcy Judge David H. Adams)

Postpetition trust distributions were not necessarily property of estate:

Although, under the terms of a testamentary spendthrift trust of which the debtor was a beneficiary, the debtor was entitled to receive distributions of the net income of the trust at least twice a year, a beneficiary of a spendthrift trust does not acquire or become entitled to any distribution until the trustee actually makes a distribution. Therefore, the bankruptcy court erred in ruling that future distributions from the trust to the debtor were property of the debtor's bankruptcy estate under Code § 541(a)(1) because, on the petition date, the debtor's right to receive the distributions was already established. Postpetition distributions are property of the estate only as provided in § 541(a)(5)(A), which brings into the estate property acquired by the debtor by bequest, devise or inheritance within 180 days postpetition.

In re Massillon, Case No. 10-24 (1st Cir. B.A.P., Jan. 11, 2011)

SIGNED.

Dated: January 19, 2011

JAMES M. MARLAR
Chief Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re: WALTER RICHARD THIEM and KAY A. THIEM, Debtors.	Chapter 7 No. 4:10-bk-19279-JMM **MEMORANDUM DECISION**

I. INTRODUCTION

In this matter of first impression, the chapter 7 trustee objects to the debtors' claimed exemption for an individual retirement account ("IRA") that Mrs. Thiem inherited as the beneficiary of her mother's IRA prior to bankruptcy.[1] Having considered the arguments as well as the amended Schedule C and the legal memoranda, the court herein sets forth its findings of fact and conclusions of law pursuant to FED. R. BANKR. P. 7052, overruling the trustee's objection and allowing the exemption in its entirety.

II. JURISDICTION

The allowance of an exemption from property of the estate is a core proceeding. The court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334(b) and 157(b).

[1] Although the Trustee objected to four exempted accounts, only the inherited account is still in controversy and Trustee has withdrawn her objections to the other three.

III. FACTS AND PROCEDURE

Richard and Kay Thiem (the "debtors") filed a voluntary chapter 7 petition on June 19, 2010. Mr. Thiem receives social security disability income while Mrs. Thiem is employed by the Tucson Medical Center.

In 2005, Mrs. Thiem's mother died, leaving her traditional IRA[2] to the debtor and the debtor's sister, who were the beneficiaries. Within 60 days of her mother's death, $10,723.24 from the mother's IRA, representing both sisters' interests, was transferred into an "inherited" IRA entitled "Kay A. Thiem Wells Fargo #xxx6594, Marjorie Ann Dymock DECD." Mrs. Thiem paid to her sister the sister's share of the money using the debtor's personal funds, while maintaining the original balance of funds in the IRA.

Between 2005 and the petition date, Mrs. Thiem took out only the required distributions from the inherited IRA, leaving a balance of $10,032.57 as of the petition date. Upon filing bankruptcy, the debtors claimed an exemption in the inherited IRA in the amount of $10,032.57 pursuant to Bankruptcy Code § 522(b)(3)[3] and the Arizona exemption for a retirement plan, ARIZ. REV. STAT. ("ARS") § 33-1126(B).

The chapter 7 trustee timely objected to the claimed exemption, citing case law which construed federal exemption statutes. The debtors responded, also citing case law which interpreted federal law. Following a hearing, and while the matter was under submission, the debtors filed an amended exemption claim under § 522(b)(3), pursuant to ARS §§ 33-1126(B) and 33-1126(A)(1). The trustee then filed an amended objection, to which the debtors responded.

There is no dispute that the mother's IRA qualified as an exempt IRA. The trustee objects, however, to the debtors' assertion that the funds in the inherited IRA retained their exempt status, or are exempt under either state or federal law. The trustee also asserts that the debtors are

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[2] A "traditional" IRA is any IRA that is not a Roth IRA or a Simple IRA. See IRS Publication 590 ("IRS Pub."), p. 7.1.

[3] This statute is Title 11 of the United States Code. On Schedule C, the debtors must either check box § 522(b)(2) (federal bankruptcy exemptions) or § 522(b)(3) (state or federal exemptions other than those under § 522(d)).

only entitled to a $5,361.62 exemption, if any, reflecting the original amount of Mrs. Thiem's half of the inherited funds.

IV. ISSUES

1. Whether the debtors can claim an exemption in the inherited IRA under either ARS § 33-1126(B) or § 522(b)(3)(C), or both.
2. Alternatively, whether the IRA is exempt under ARS § 33-1126(A)(1) as money received by a child "upon the life" of a deceased parent.

V. DISCUSSION

Upon the filing of a bankruptcy petition, an estate is created consisting of all of the legal or equitable interests of the debtor in property as of the commencement of the case "wherever located and by whomever held." 11 U.S.C. § 541(a)(1); In re Konnoff, 356 B.R. 201, 204 (9th Cir. BAP 2006); In re Pettit, 217 F.3d 1072, 1077 (9th Cir. 2000). Certain property that is initially included in the bankruptcy estate may be removed therefrom through the exemption process. 11 U.S.C. § 522.

A claimed exemption is presumptively valid, unless a party in interest objects and that objector satisfies its burden that the exemption is improperly claimed. See In re Nicholson, 435 B.R. 622, 620 (9th Cir. BAP 2010); 11 U.S.C. § 522(l); Fed. R. Bankr. P. 4003(c).[4]

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[4] There may be an unresolved issue regarding the burden of proof in exemptions claimed under state law, which was not briefed by the parties. In Raleigh v. Ill. Dep't of Revenue, 530 U.S. 15, 120 S.Ct. 1951, 147 L.Ed.2d 13 (2000), the Supreme Court held that in determining the validity of a proof of claim, specifically pursuant to state tax law, the bankruptcy court must apply the state's burden of proof rule because the burden of proof is a substantive aspect of the claim. Id., 530 U.S. at 20-21. It also noted, however, that Bankruptcy Rule 3001(f), which governs proofs of claims, "does not address the burden of proof when a trustee disputes a claim." Id. at 22 n.2.

The issue comes to light when comparing Judge Klein's concurrence in In re Davis, 323 B.R. 732 (9th Cir. BAP 2005) (opining that the burden of proof may also be different for an objection to a claim of exemption based on a non-federal ground), with dictum in Nicholson, 435

Arizona has opted out of the federal exemption scheme provided in § 522(d). See ARS § 33-1133(B). Debtors in Arizona are only permitted the use of federal non-bankruptcy exemptions and the Arizona exemptions. Hon. W. H. Brown, L. Ahern and N. Fraas MacLean, Bankruptcy Exemption Manual, § 3.01, p. 76 (2006).

A. The available exemption statutes for an IRA

There is one relevant exception to the opt-out rule. In enacting BAPCPA,[5] Congress created a new class of exemptions for certain retirement funds regardless of whether the state of domicile has opted out of the federal scheme for other property.[6] Of this class, § 522(b)(3)© is applicable in opt-out states and § 522(d)(12) applies in the federal exemption scheme. Id., § 2.17, p.60-61. The two provisions are identical and provide an exemption for:

> retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1986.

B.R. at 633 (citing to Raleigh and stating that [b]ecause Congress has regulated the allowance of exemptions in bankruptcy, the Code and Rules may alter burdens of proof relating to exemptions, even if those burdens are part of the 'substantive' right under state law.").

Here, neither party has addressed the burden of proof under these Arizona statutes, nor could the court find any definitive case law. For purposes of this decision, and in the absence of clarification from the appellate courts, this court will presume that the Supreme Court in Raleigh did not affect the ultimate burden of proof allocation upon the trustee under Rule 4003(c). Furthermore, based on the undisputed facts, and the court having found that the validity of the exemption claim was unrebutted, the court is able to resolve this matter of law without having to decide this issue. See In re Greenfield, 289 B.R. 146, 149 (Bankr. S.D. Cal. 2003).

[5] BAPCPA stands for the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Public Law 109-8, 119 Stat. 23. The amendments apply to cases filed on or after October 17, 2005. BAPCPA § 1501.

[6] Congress thus exercised its power to preempt state-court exemptions. See 4 COLLIER ON BANKRUPTCY ¶ 522.10[9] (the debtor's right to exempt retirement funds under § 522(b)(3)(C) "should prevail over any conflicting state exemption laws"). The new provisions are *in addition to* the federal exemption under § 522(d)(10)(E) which exempts "certain benefits that *are akin to future earnings* of the debtor," HR Rep. No. 595, 95th Cong., 1st Sess. 361-62 (1977) (emphasis added), including the debtor's "right to receive . . . a payment under a . . . pension . . . or similar plan or contract on account of illness, disability, death, age, or length of service, *to the extent reasonably necessary for the support of the debtor and any dependent of the debtor* . . ." 11 U.S.C. § 522(d)(10)(E) (emphasis added).

"Now, even if some states may not allow retirement plans to be exempted from the reach of creditors, Congress has made this exemption available to all debtors by placing the language in section 522(b)(3)© to eliminate the opt-out." Id. at 62. This new category of exemption rights "may be exercised by the debtor even if the debtor's state has opted out of the federal exemption scheme." 4 COLLIER ON BANKRUPTCY ¶ 522.10[9] at 522-90 (16th ed. 2010); In re Patrick, 411 B.R. 659, 663-64 (Bankr. C.D. Cal. 2008) (a § 522(b)(3)© election can be used in opt-out states such as California).

Congress' intent was "to expand the protection for tax-favored retirement plans or arrangements that may not be already protected under [§] 541(c)(2) pursuant to Patterson v. Shumate . . . or other state or Federal Law." HR Rep. No. 31, 109th Cong., 1st Sess. 224 (2005). In addition, such retirement fund may be claimed exempt even if it is only in "substantial compliance with" applicable requirements of the IRC, or if not, if the debtor can claim that he or she is not materially responsible for such failure of compliance. Id.; 11 U.S.C. § 522(b)(4)(A)-(B).

The debtor's exemption rights under § 522(b)(3)(C) also apply to certain direct (trustee-to-trustee) transfers, providing that funds so transferred "shall not cease to qualify for exemption under paragraph (3)(c) or subsection (d)(12) by reason of such direct transfer." 11 U.S.C. § 522(b)(4)(C) . In addition, the exemption rights continue to apply "to any distribution that qualifies as an eligible rollover distribution within the meaning of section 402(c) of the Internal Revenue Code, or an amount that is a distribution from a fund or account exempt from taxation under section . . . 408 . . . of the Internal Revenue Code, and is deposited to the extent allowed in such a fund or account not later than 60 days after the distribution of such amount." 4 COLLIER ON BANKRUPTCY, supra ¶ 522.10[9] at 522-91; 11 U.S.C. § 522(b)(4)(D).

In this case, both parties have also supported their arguments for and against exemption with the new federal exemption law. Therefore, the court deems the exemptions as also

claimed under § 522(b)(3)(C), including the provisions of § 522(b)(4), and this court may compare those statutes and look to case law which construes them.[7]

Under either federal or state law, exemptions are to be liberally construed in favor of the debtor who claims the exemption. In re Arrol, 170 F.3d 934, 937 (9th Cir. 1999); Gardenhire v. Glasser, 26 Ariz. 503, 503, 226 P. 911, 912 (1924); In re Herrscher, 121 Ariz. 29, 31 (Bankr. D. Ariz. 1989) (citing ARS § 1-211(B) ("Statutes shall be liberally construed to effect their objects and promote justice.")). The exemption laws in Arizona "were not created merely for the purpose of conferring a privilege on a debtor, but to shelter the family and thereby benefit the state." In re Hummel, ___ B.R.___, ____, 2010 WL 5076421 at *5 (9th Cir. BAP Nov. 19, 2010) (quoting In re Foreacre, 358 B.R. 384, 390 (Bankr. D. Ariz. 2006)). The statutory language may not be reduced or enlarged nor "tortured" in order to grant an exemption that the respective legislature did not intend to create. See id.; In re DeHaan, 275 B.R. 375 (Bankr. D. Idaho 2002).

In interpreting a statute, the plain language of a statute is determinative under federal law. Patterson v. Shumate, 504 U.S. 753, 757, 112 S.Ct. 2242, 2246, 119 L.Ed.2d 519 (1992). Likewise, the Arizona courts have instructed how to interpret their statutes:

> When interpreting a statute, we must first look to its language, the "best and most reliable index" of its meaning. Unless the legislature clearly expresses an intent to give a term a special meaning, we give the words used in statutes their plain and ordinary meaning. In determining the ordinary meaning of a word, we may refer to an established and widely used dictionary.

State v. Mahaney, 193 Ariz. 566, 568, 975 P.2d 156, 158 (Ct. App. 1999) (citations omitted).

The debtors claimed an exemption under ARS. § 33-1126(B), which provides, in pertinent part:

> B. Any money or other assets payable to a participant in or beneficiary of, or any interest of any participant or beneficiary in, a retirement plan under § 401(a), 403(a), 403(b), 408, 408A or 409 or a deferred compensation plan under § 457 of the United States internal revenue

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[7] The court sees no reason to require the debtors to formally amend Schedule C to recite § 522(b)(3)(C) as a basis for the exemption, since they already checked the § 522(b)(3) box, and invoking § 522(b)(3)(C) would have no impact on the extent to which other property is claimed as exempt. See In re Gill, 2007 WL 2990564 at *2 (Bankr. D. Dist. Col. Oct. 11, 2007).

> code [sic] of 1986, as amended . . . shall be exempt from any and all claims of creditors of the beneficiary or participant.

ARS § 33-1126(B) (2010 Thomas Reuters) (footnote omitted).

This statute is similar to § 522(b)(3)(C) and § 522(d)(12). The meaning of a state exemption is controlled by the applicable state law, and a bankruptcy court is bound by the state's construction of its statute. In re Palidora, 310 B.R. 164, 165-66 & n.4 (Bankr. D. Ariz. 2004) (citing In re Goldman, 70 F.3d 1028, 1029 (9th Cir. 1995)). Neither case law nor the legislative history reveal any useful information pertaining to the application of this statute to an inherited IRA.

B. Section 408 of the Internal Revenue Code

The federal and state statutes recognize an exemption for an IRA that is provided for under the Internal Revenue Code, 26 U.S.C. § 408 ("IRC § 408"), which section governs the creation, operation, and taxability of IRAs. See In re Merrill, 431 B.R. 239, 243 (Bankr. D. Idaho 2009) (citing In re McClelland, 2008 WL 89901 (Bankr. D. Idaho 2008)); 133 A.L.R. FED. 1, 68 (2010 Thompson Reuters). An IRA is defined as "a trust created or organized in the United States for the exclusive benefit of an individual or his beneficiaries," provided that the trust meets the requirements of that statute.[8] IRC § 408(a). Generally, any IRA is exempt from taxation under section 408. IRC § 408(e); 14 COLLIER ON BANKRUPTCY ¶ Intro.05[2][b] (15th ed. rev. 2010) ("The 2005 amendments to the Code provide the debtors will be permitted to exempt all funds in any account exempt from taxation under sections 401, 403, 408, 408A, 414, 457 and 501(a) of the Internal Revenue Code.").

There is no dispute that the mother's IRA qualified as an exempt IRA under either federal law or the Arizona statute. See Rousey v. Jacoway, 544 U.S. 320, 125 S.Ct. 1561, 161 L.Ed.2d 563 (2005); In re Bharucha, 115 B.R. 671 (Bankr. D. Ariz. 1990); In re Herrscher, 121

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[8] These requirements are such things as the amount of allowable annual contribution, prohibition on commingling or investment in life insurance contracts, that the trustee be a bank, etc. See IRC § 408(a)(1)-(6).

B.R. 29 (Bankr. D. Ariz. 1989). The question is whether Arizona and/or federal law would also recognize and extend an exemption for the inherited IRA. The court believes this question is answered by the requirements of IRC § 408, because the IRC creates an inherited IRA and treats the inherited IRA as tax deferred and subject to distribution rules.

Upon the death of an IRA owner, IRC § 408 provides for an "inherited" IRA:

> **(ii) Inherited individual retirement account or annuity.**– An individual retirement account or individual retirement annuity shall be treated as inherited if--
>
> (I) the individual for whose benefit the account or annuity is maintained acquired such account by reason of a death of another individual, and
>
> (II) such individual was not the surviving spouse of such other individual.

In order to maintain tax-exempt status, an inherited IRA must meet the following criteria:

> **Inherited from someone other than spouse.** If you inherit a traditional IRA from anyone other than your deceased spouse, you cannot treat the inherited IRA as your own. This means that you cannot make any contributions to the IRA. It also means you cannot roll over any amounts into or out of the inherited IRA. However, you can make a trustee-to-trustee transfer as long as the IRA into which amounts are being moved is set up and maintained in the name of the deceased IRA owner for the benefit of you as beneficiary.

IRS Pub. 590, p. 20 (2010).

The beneficiary is required to begin taking withdrawals--either annual distributions based on life expectancy within one year or the entire amount within five years--regardless of the beneficiary's age. See id. at 35; IRC § 408(a)(6); § 401(a); Treas. Reg., 26 C.F.R. § 1.408-2(b)(7), § 1.401(a)(9)-3. Unlike an original IRA, early withdrawals from an inherited IRA carry no penalty. IRS Pub. 590, p. 51, 64-65. Upon receipt, distributions to the beneficiary are taxable as ordinary income. 26 U.S.C. § 408(d)(1).

An inherited IRA may be transferred tax free in a direct trustee-to-trustee transfer. IRS Pub. 590, p. 20. "A taxpayer is not treated as having received a taxable distribution from an IRA if funds in the IRA are transferred from one account trustee directly to another account trustee

without the IRA owner or beneficiary ever gaining control or use of the funds." Jankelovits v. C.I.R., T.C. Memo. 2008-285, 2008 WL 5330811 (U.S. Tax Ct. 2008). "In the absence of payment or distribution, the transfer would not be a rollover contribution described in section 408(d)(3)(A) because such funds are not within the direct control and use of the participant. This conclusion would apply whether the bank trustee initiates or the IRA participant directs the transfer of funds." Rev. Rul. 78-406, 1978 WL 42152 (IRS RRU 1978). See also IRC § 402(c)(11), providing that a trustee-to-trustee transfer of a distribution from an employees' pension plan to an inherited IRA shall be treated as an eligible rollover distribution that is excluded from the distributee's taxable gross income.

Here, the debtors' counsel, at the November 4th hearing, maintained that there was a "trustee-to-trustee" transfer to the current IRA. See Minute Entry, ECF No. 41. While counsel's argument is not evidence, clearly, the new IRA is in the mother's name as well as the debtor-beneficiary's name. In addition, the balance of funds has only been slightly reduced, presumably by the required minimum distributions. The debtors maintained that, other than the initial transfer, they have not rolled over any amount from the account. The facts also reflect that they have not made any monetary contributions to augment the original funds (setting aside for the moment the trustee's legal argument on that point, which is considered and rejected below). Thus, the undisputed facts are consistent with a determination that Mrs. Thiem's IRA is an inherited IRA that was a direct transfer in compliance with the IRC.[9]

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[9] Prior to explaining that a trustee-to-trustee transfer had actually taken place, the debtors had alleged that the funds were "rolled" into the new account within 60 days of the mother's death. See Debtors' Mem. in Opp. 2, ECF No. 28. An inherited IRA cannot be rolled over or allowed to receive a rollover contribution. IRS Pub. 590, p. 24. Assuming, *arguendo,* that a cash distribution was "rolled" over, IRC § 408(d)(3)(A)(I) provides that rollovers are not included in the gross income of the *individual for whose benefit the account is maintained* if the entire amount received is paid into another IRA *for the benefit of such individual* not later than 60 days after receipt of the payment or distribution. See also § 522(b)(3)(C) and § 522(b)(4)(D) (exempting rollovers). Arguably, this section applies only where the original owner rolls over the money. See 26 C.F.R. § 1.408-1(c)(3) (distinguishing "individual on whose behalf an individual retirement account is established" from that same "individual's beneficiary"). Nonetheless, the court does not find that a rollover took place, here, and therefore does not need to reach a rollover contribution issue.

The trustee has not submitted any evidence to raise an issue concerning the aforementioned facts. For example, the trustee does not dispute that a direct transfer from the mother's IRA to the inherited IRA occurred, even while the trustee analogizes that the funds in the inherited IRA are equivalent to a "cash inheritance." See Trustee's Reply 2, ECF No. 39. The gravamen of the trustee's argument is that an inherited IRA is neither an exempt "retirement plan" under the Arizona statute nor exempt "retirement funds" under the federal statutes.

C. Case law - Two Camps

In the absence of any Arizona law on point, the trustee cites a series of cases from other jurisdictions which held that inherited IRAs are not exempt, while the debtors find support in contrary opinions. None of the statutes at issue in these cases specifically addressed inherited IRAs. Nor were the state statutes, if any, that were construed in these cases identical to ARS § 33-1126(B). None expressly provided an exemption for a plan "beneficiary," as does the Arizona law, although most provided an exemption for a person's "interest in" or "rights to" such a plan/fund, or words to that effect. All of the state statutes at issue provided an exemption for an IRA that qualified for tax exemption under IRC § 408, such that the Internal Revenue Service treatment of the IRA was the determining factor as to whether or not the funds in the IRA were exempt. Clearly, "[a] number of courts have wrestled mightily with the language of the IRS Code and its interplay with various state exemption statutes." In re Tabor, 433 B.R. 469, 474 (Bankr. M.D. Pa. 2010). This court finds the case law in support of an exemption for an inherited IRA to be more convincing, starting with the reasoning of In re McClelland, 2008 WL 89901 (Bankr. D. Idaho 2008).

In McClelland, the Idaho statute provided an exemption for "[t]he right of a person to a pension, annuity, or retirement allowance or disability allowance, or death benefits, or any optional benefit, or any other right accrued or accruing to any citizen of the state of Idaho under any employee benefit plan." An "employee benefit plan" included an IRA described in IRC § 408. Idaho Code § 11-604A. The debtor, in McClelland, was the sole beneficiary of her aunt's IRA and established an inherited IRA which she claimed as exempt under Idaho law. McClelland, 2008 WL

89901 at *2. The bankruptcy court allowed the exemption, noting that the Idaho legislature "painted with a broad brush" and "chose not to limit the scope of protection to retirement account owners only." Id. at *3-4. It further stated: "[T]o benefit from this exemption statute, a person need not actually earn the funds deposited in the retirement account or plan. All retirement income to which a person 'may become entitled' is exempt." Id. at *4.

Similarly, the Arizona statute does not limit the exemption to the person who contributed the funds, i.e., the owner or plan participant, but also entitles the beneficiary to receive the protection. In McClelland, the court had to interpret the broad language of the Idaho statute to extend to a beneficiary, whereas the Arizona statute expressly includes the beneficiary.

The trustee attempts to distinguish "retirement plan," as provided in the Arizona statute, from "retirement funds," as provided in § 522(b)(3)(C), therefore implying a required retirement purpose in ARS § 33-1126(B). The debtors, on the other hand, contend that the plain language of § 33-1126(B) does not require the beneficiary to use the plan funds for his or her own retirement purposes.[10]

The trustee raises valid policy concerns concerning inherited IRAs that, simply, could be cashed out. Nonetheless, the plain language of ARS § 33-1126(B) protects "any money or other assets payable to a participant in *or beneficiary of*, or *any interest* of any participant *or beneficiary in*, a retirement plan under § . . . 408 . . . from any and all claims of creditors of *the beneficiary* or participant." Id. (emphasis added). Therefore, under Arizona law, an inherited IRA is precisely the money payable to, or a beneficiary's interest in, a retirement plan that is exempt from process. Any distinction is lost.

The trustee urges the court to adopt the reasoning of In re Lacefield, case no. 2:03-bk-22470-CGC , an unpublished decision entered on July 20, 2004. In that case, the debtor inherited, upon her mother's death, the $483.62 a month her mother was receiving in retirement funds from

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[10] In any event, the debtors maintain that Mrs. Thiem is using the money for retirement purposes because she takes only the required distributions and is reinvesting the distributions into another retirement vehicle. With regard to the debtors' assertion that the IRA is being used for Mrs. Thiem's retirement purposes, there is little to no evidence of this before the court. Therefore, the court will not address that part of the argument, nor does it need to in order to resolve this matter.

the Indiana State Teacher's Retirement Fund. When the debtor filed for bankruptcy, she claimed an exemption for the payments under ARS § 33-1126(B) [formerly designated as subsection (C)], which provided an exemption for "[a]ny money or other assets payable to a participant in or beneficiary of, or any interest of any participant or beneficiary in, a [qualified] retirement plan." The court rejected the claim, stating, without further analysis:

> The key distinction here is that it was Debtor's mother's retirement fund and not Debtor's retirement fund. Debtor was not a participant in or a beneficiary of the retirement plan. Her mother was. Debtor receives these funds only as a result of her mother's death and solely as an inheritance.

Id. at 3.

The facts in Lacefield are distinguishable from the instant case. Mrs. Thiem is clearly a named beneficiary of her mother's IRA. IRS Pub. 590 states: "[i]f you inherit a traditional IRA, you are called a beneficiary. A beneficiary can be any person or entity the owner chooses to receive the benefits of the IRA after he or she dies." Id. at 18. See also IRC § 401(a)(9)(E) (defining "designated beneficiary" as "any individual designated as a beneficiary by the employee"); Treas. Reg., 26 C.F.R. § 1.408-2(b)(8). Under the Arizona statute, a "beneficiary" may claim an exemption in the funds payable to her from, or her beneficial interest in, another person's retirement plan that meets the requirements of IRC § 408.

The Lacefield decision was rendered prior to BAPCPA's amendments, which were enacted to ensure that debtors may exempt, under either federal or state exemptions, retirement funds to the extent that those funds are in a fund or account that is exempt from taxation under the enumerated sections of the IRC. Tax exemption extends to funds that are in an inherited IRA, as discussed above. Therefore, the holding of Lacefield is not helpful on this issue.

This court also agrees with the Tabor opinion. There, the debtor claimed an exemption for an inherited IRA account under Pennsylvania law and 11 U.S.C. § 522(b)(3)(C). The Pennsylvania statute provided an exemption for

> [a]ny retirement or annuity fund provided for under section . . . . 408, . . . of the Internal Revenue Code of 1986 . . . , the appreciation theron, the income therefrom, the benefits or annuity payable thereunder and transfers and rollovers between such funds.

Id. at 472.

Unable to locate any state court decision on the issue of whether inherited IRAs are exempt from process under the Pennsylvania law, the court held that it need not make a determination under state law and, instead, determined that the inherited IRA was exempt under § 522(b)(3)(C). Id. at 474. Noting that Congress in enacting BAPCPA had expanded the exemption status for retirement plans that are established under provisions of the IRS Code, the bankruptcy court concluded that the increased protection for such retirement funds extended to inherited IRAs (trustee-to-trustee transfers), pursuant to the plain and unambiguous language of § 522(b)(4)(C) .

There are only two requirements for an IRA to be exempt under § 522(b)(3) or the corresponding federal statute, § 522(d)(12), according to the Tabor court: "(1) the amount the debtor seeks to exempt must be retirement funds; and (2) the retirement funds must be in an account that is exempt from taxation under one of the provisions of the Internal Revenue Code set forth therein." Id. at 475 (quoting In re Nessa, 426 B.R. 312, 314 (8th Cir. BAP 2010) (§ 522(d)(12)). Both requirements were met, even though the retirement funds belonged originally to the debtor's deceased mother, the court concluded. Tabor, 433 B.R. at 476.

This court also looks to In re Kuchta, 434 B.R. 837 (Bankr. N.D. Ohio 2010). Ohio is an opt-out state and, therefore, the debtor was allowed to claim an exemption in an inherited IRA, which was created by a trustee-to-trustee transfer, under both Ohio law and § 522(b)(3)(C). Id. at 842.

The bankruptcy court found that the inherited IRA could not be exempt under state law because the statute expressly required that the debtor must have made the contributions to the IRA. Id. at 842-43. Nevertheless, the court concluded that the inherited IRA was exempt under § 522(b)(3)(C) as retirement funds exempt from taxation under IRC § 408. Id. at 844.

The line of cases that deny exemptions in inherited IRAs commonly conclude that inherited IRAs are (1) fundamentally different from a traditional IRA under the IRC and (2) lack a retirement purpose. These courts determined that an inherited IRA is (1) subject to an entirely different set of rules upon the use, distribution and taxation of the funds, and (2) no longer for used for retirement purposes but is "a liquid asset which may be accessed by [the debtor] at his discretion

without penalty, and which he *must* take as income within a relatively short period of time without regard for his retirement needs." In re Sims, 241 B.R. 467, 470 (Bankr. N.D. Okla. 1999) (Oklahoma law) ; see also In re Chilton, 426 B.R. 612 (Bankr. E.D. Tex. 2010) (§ 522(d) (12)); In re Ard, 435 B.R. 719 (Bankr. M.D. Fla. 2010) (Florida law and citing case law for § 522(d)(12), and citing Robertson v. Deeb, 16 So. 3d 936 (Ct. App. 2 Dist. 2009) (non-spousal inherited IRA not exempt from garnishment); In re Klipsch, 435 B.R. 586 (Bankr. S.D. Ind. 2010) (Indiana law); In re Jarboe, 365 B.R. 717 (Bankr. S.D. Tex. 2007) (Texas law); In re Taylor, 2006 WL 1275400, at *2 (Bankr. C.D. Ill. 2006) (Illinois law); In re Navarre, 332 B.R. 24 (Bankr. M.D. Ala. 2004) (Alabama law).

This court respectfully disagrees with these courts. Even though inherited IRAs are treated differently under the IRC, they are still protected from taxation for a time period that is provided under the IRC. In fact, the Internal Revenue Code and Regulations ensure that the original retirement funds will be protected and remain unchanged in character, e.g., by prohibiting contributions and rollovers to the new account. Therefore, it is not accurate to state that inherited IRAs do not meet the requirements for an IRA under § 408. Both ordinary and inherited IRAs are exempt from taxation, and that is all that is required by ARS § 33-1126(B) and 11 U.S.C. § 522. See Tabor, 433 B.R. at 469; see generally A. J. Golden, "Retirement Benefits and Creditor's Rights," SS007 ALI-ABA 289, 303 (2010).

Nor did any of the above cases analyze § 522(b)(3)(C) or § 522(b)(4)(C). The plain language of § 522(b)(4)(C) provides that transfers of the type that create an inherited IRA do not cause a loss of exemption eligibility. In Chilton, the debtors alternatively asserted that the transfer of funds from the deceased account to the debtor's account was a trustee-to-trustee transfer protected by § 522(b)(4)(C). The bankruptcy court did not address this poignant argument. Chilton, 426 B.R. at 621-22; see also Nessa, 426 B.R. at 315 n.3.

Secondly, another argument commonly made by these courts against allowing an exemption for an inherited IRA is a determination that the retirement funds must be the *debtor's* own retirement funds. See, e.g., Chilton, 426 B.R. at 617.

The debtors cite to Nessa. There, the Eighth Circuit Bankruptcy Appellate Panel concluded that such a requirement would "impermissibly limit the statute beyond its plain language." Nessa, 426 B.R. at 314. While the Chilton court warned that allowing the exemption would mean writing "retirement" out of "retirement funds," the Nessa court countered that disallowing the exemption would be writing *in* the "*debtor's* retirement funds" where the statute only says "retirement funds." See Chilton, 426 B.R. at 617; Nessa, 426 B.R. at 314.

This court agrees with Nessa and Tabor that neither § 522(b)(3)(C) nor § 522(d)(12) require the retirement funds to be those originally created by the debtor-beneficiary. Until Congress sees fit to amend or clarify this exemption, this court holds that an inherited IRA that complies with the IRC is, in name and substance, an account that meets the requirements of the Arizona and federal retirement exemption statutes at issue here.

Courts that have followed the reasoning of Nessa include Tabor, Kuchta and In re Weilhammer, 2010 WL 3431465 (Bankr. S.D. Cal. Aug. 30, 2010). As mentioned above, McClelland, a decision which predated Nessa, held that Idaho law did not limit its exemption to only those funds held by the person who contributed them to the account, and upheld the exemption in an inherited IRA. Therefore, this court does not perceive a "trend" to deny such exemptions at this time. See Jarboe, 365 B.R. at 721.

The trustee has raised several additional objections to the exemption, which will be dealt with as follows, in no particular order.

Objection 1: Only monies that are "payable" are exempt under ARS § 33-1126(B)

Section 33-1126(B) protects money that is "payable" to the beneficiary. The trustee contends that the debtor was already paid the monies out of her mother's IRA in 2005, and then merely "placed" the money into another IRA. Trustee's Reply 2, ECF No. 39. Therefore, the trustee contends that the facts do not fall within the exemption.

As stated above, the undisputed facts and law are consistent with an inherited IRA under the Internal Revenue Code. The new IRA retains the mother's name and is not designated

solely as Mrs. Thiem's account. Moreover, the funds in an inherited IRA may not be rolled over. IRC § 408 (d)(3)(C). The inherited IRA may be transferred into a traditional IRA for the benefit of the beneficiary by a direct trustee-to-trustee transfer. Such a transfer is considered neither a "rollover" nor a "distribution. " See IRS Pub. 590, p. 20. In fact, the direct transfer maintains the tax exempt nature of the funds in the new account. See id. ("Like the original owner, you generally will not owe tax on the assets in the IRA until you receive distributions from it."); IRC § 408(e); 11 U.S.C. § 522(b)(4)(C).

There is a presumption that Mrs. Thiem's IRA complies with the requirements of the IRC for a direct transfer of the inherited IRA, and the trustee has not rebutted that presumption with any evidence that it is not in compliance. See § 522(b)(4).

As such, the trustee's objection is not persuasive in light of the specific means provided by the IRC to protect the tax-exempt nature of the funds in an inherited IRA. Therefore, the court finds that the retirement funds in the inherited IRA are still "payable" to Mrs. Thiem.

Objection 2: An inherited IRA receives its exempt status from IRC § 402(c)(11)

The trustee contends that the inherited IRA's exemption is created under IRC § 402(c)(11). Since that section is not listed in ARS § 33-1126(B) (designating §§ 401(a), 403(a), 403(b), 408, 408A or 409), the trustee asserts that an inherited IRA is not exempt.

Section 402 governs the "[t]axibility of beneficiary of employees' trust." An employees' trust is described in IRC § 401(a). See IRC § 402(a). Section 402(c)(11) allows the beneficiary of an employee trust to move the inherited funds into an IRA account for his or her benefit via a trustee-to-trustee transfer without paying taxes on the distribution, by treating the transfer as an eligible rollover distribution and as an inherited IRA. I.R.C. § 402(c)(11)(A).

This type of analysis was also made by the Texas bankruptcy court in Chilton, 426 B.R. 612 (Bankr. E.D. Tex. 2010). The bankruptcy court first distinguished the tax treatment of retirement accounts versus the tax treatment of distributions. It held that an inherited IRA is merely "a vehicle for receiving *distribution* from a tax exempt account . . . ." Id. at 621. The court then

concluded that the inherited IRA's tax exempt status was created under IRC § 402(c)(11) and did not fall under the IRA account exemption of § 408(e)(1). Id.

Such an analysis is not in accord with the legislative history of this section, which, ironically, was described in depth in the prior Texas case of Jarboe. There, the court discussed the amendment adding subsection (c)(11) to § 402 by the Pension Protection Act ("PPA) in order to expand the types of retirement plans that may create an inherited IRA :

> Whereas previously only the transfer of a decedent's IRA could create an inherited IRA, now a trustee-to-trustee transfer of several types of retirement plans (i.e., not just IRAs but also employer-sponsored plans such as 403(a) plans, 403(b) plans, and 457(b) plans) may create inherited IRAs.
>
> . . . .
>
> [T]he PPA does nothing to change the tax treatment of inherited IRAs; rather it only levels the playing field for more kinds of non-spouse beneficiaries, eliminating the somewhat harsh tax treatment of non-spouse beneficiaries of employer-sponsored retirement plans. (Prior to the passage of the PPA, non-spouse beneficiaries of employer-sponsored retirement plans typically had to take distribution either in a lump sum or within five years . . . .)

Jarboe, 365 B.R. 717, 724 n.10; see also Pub. L. No. 109-280, 120 Stat. 780 (2006), section 829.

Legal authors have commented that Chilton engaged "in a very complex statutory analysis . . . [s]omething for which bankruptcy court judges are ill-equipped for statutes other than the Bankruptcy Code." See A. J. Golden, supra, Retirement Benefits and Creditor's Rights, SS007 ALI-ABA at 305. The authors then state: "In fact § 402(c)(11) simply authorizes a non-taxable trustee-to-trustee transfer [which would otherwise have been prevented by § 408(d)(3)(C)], so long as the IRA remains an inherited IRA; i.e., one maintained in the name of the decedent fbo the beneficiary." Id. (Alteration in original.)

In addition, IRC § 408(e), which states that "any" IRA is exempt from taxation, "does not distinguish between an inherited IRA and traditional types of IRAs." Nessa, 426 B.R. at 315. Therefore, this court has grounds to reject this argument, as well.

Objection 3: The debtor's payment to her sister was a prohibited "contribution"

The trustee contends that the tax exempt qualification of the inherited IRA was destroyed, either as to the entire fund or to half of it, when the debtor paid her sister her portion of the funds using the debtor's personal funds. In essence, the trustee maintains, that transaction was a prohibited "contribution" to the IRA which destroyed the nature of the inherited IRA.

Alternatively, the trustee contends that the exemption should be limited to Mrs. Thiem's half of the inheritance in the amount of $5,361.62.

An inherited IRA may not be treated as one's own. "This means that you cannot make any contributions to the IRA. It also means you cannot roll over any amounts into or out of the inherited IRA." IRS Pub. 590, p. 20.

The ordinary meaning of "contribution" is the act of contributing something, such as a payment, or "to give a part to a common fund." MERRIAM-WEBSTER'S COLLEGIATE DICTIONARY 272 (11th ed. 2004).

This court does not agree that Mrs. Thiem's payment to her sister was essentially a "contribution" of her personal funds to the IRA. The same funds, which were the mother's retirement funds, remained in the inherited IRA at all times. The arrangement between the two sisters was a distinct and separate transaction between two beneficiaries which did not affect the total amount or nature of the inherited IRA.

There are certain acts by a beneficiary, who is a fiduciary, that will cause a loss of the tax exemption, such as self-dealing, sale or lending of the money. See IRC § 408(e)(2) (citing IRC § 4975). The transaction between the two beneficiaries whereby Mrs. Thiem's sister essentially agreed to release her one-half interest in the inherited IRA for the cash payment from Mrs. Thiem was not such a prohibited transaction, under IRC § 4975, nor has the trustee contended that it was.

Therefore, the court holds that neither a contribution nor a prohibited transaction occurred to destroy the character of the IRA. The inherited IRA in its entirety is intact.

In summary, based on the foregoing analysis, the trustee has not rebutted the presumption that the assets in the inherited IRA are exempt under § 33-1126(B) and § 522(b)(3)(C).

Mrs. Thiem is a beneficiary of her mother's retirement plan. The inherited IRA contains retirement funds, and is exempt from taxation under IRC § 408. Thus, the statutory requirements are met.

D. The Alternate Claim under ARS § 33-1126(A)(1)

The debtors amended their Schedule C to claim an exemption in the inherited IRA pursuant to ARS § 33-1126(A)(1), which provides, in pertinent part:

> A. The following property of a debtor shall be exempt from execution, attachment or sale on any process issued from any court:
>
> 1. All money received by or payable to a surviving spouse or child upon the life of a deceased spouse, parent or legal guardian, not exceeding twenty thousand dollars.

The trustee maintained that this statute's reference to "money . . . payable . . . upon the life" only refers to life insurance, which is defined, elsewhere in the statutes as "insurance on human lives . . ." ARS § 20-254, and generally described as "insurance on the life of" someone. See ARS §§ 20-1257(A), 20-1603(3), 20-1131(A).

The court will overrule this objection on the following grounds. The legislative history reveals no useful information pertaining to the interpretation of the phrase at issue or the purpose behind the exemption. The legislature, however, knew how to write or amend subsection (A)(1) to limit it to the proceeds of life insurance policies if it had wanted to. In fact, subsection (A)(6) provides a certain exemption for "[t]he cash surrender value of life insurance policies . . ." Section (A)(1), however, is not limited to "life insurance policies."

When this statute was revised, in 1983, an article appeared in the Arizona Bar Journal (now Arizona Attorney), which presented two views of the new exemption law. Interestingly, in View 1, Professor Dale Beck Furnish wrote:

> Other changes included increasing from $10,000 to $20,000 the exemption for money received by [sic] surviving spouse or child "upon the life" of a deceased spouse, parent or legal guardian, *referring to life insurance* and liability claims.

D.B. Furnish, "Arizona's New Exemption Statute," 19 Ariz. B.J. No. 3, p. 32, 42 (1983) (emphasis added). However, in View 2, Mr. Thomas Salerno, Esq. wrote that the same exemption statute

> has been modified to allow a claimant to except funds up to $20,000 *received due to the death* of a deceased spouse, parent, or "legal guardian."

Id. at 48 (emphasis added).

An Arizona bankruptcy court has also interpreted the statute broadly. In Lacefield, an unpublished decision previously cited by the trustee because the bankruptcy court, there, had disallowed the debtor's exemption claim in an inherited pension under ARS § 33-1126(B), the court alternatively allowed the exemption under ARS § 33-1126(A)(1). The court found that the debtor was a "death beneficiary" as to those funds. In re Lacefield, case no. 2:03-bk-22470-CGC, at 4 (July, 20, 2004).

Mrs. Thiem received the funds in the inherited IRA due to the death of her mother. Therefore, this court will also interpret ARS §33-1126(A)(1) liberally as exempting Mrs. Thiem's inherited IRA, as an alternative basis for the exemption.

VI. CONCLUSION

Mrs. Thiem's inherited IRA, in the total amount of $10,032.57, is exempt under the Arizona exemption statute, ARS § 33-1126(B), which extends protection to monies payable to a beneficiary of a retirement plan which meets the requirements of the IRC. In addition, the retirement funds are exempt, for a debtor in an opt-out state, under § 522(b)(3)(C).

Alternatively, the inherited IRA are exempt funds received by a death beneficiary pursuant to ARS § 33-1126(A)(1).

DATED AND SIGNED ABOVE.

COPIES to be sent by the Bankruptcy Notification Center ("BNC") to the following:

Stephen Trezza, Attorney for Debtors

Trudy Nowak, Ch. 7 Trustee

Office of the U.S. Trustee

the Debtors' Amended Motion be and is hereby DENIED.

In re Marvin James CRATER and Fay B. Crater, Debtors.

James D. Murphey, Plaintiff,

v.

Marvin James Crater and Fay B. Crater, husband and wife, Defendants.

Bankruptcy No. 01-12851-PHX-RJH. Adversary No. 02-00007.

United States Bankruptcy Court, D. Arizona.

Dec. 17, 2002.

Creditor brought adversary proceeding to deny debtors' discharge in Chapter 7 based upon their prebankruptcy planning in converting exempt to nonexempt assets. On creditor's motion for summary judgment, the Bankruptcy Court, Randolph J. Haines, J., held that, unless creditor that seeks to deny debtor's discharge based upon his prebankruptcy exemption planning shows some deception or concealment, an insider transaction, a fraudulent conveyance, a secretly retained possession or benefit, or debtor explanations which lack credibility, presence of other badges of fraud which are not themselves intrinsically indicative of fraud are insufficient to shift to debtor the burden of going forward, even if all of the debtor's nonexempt assets are converted into exempt assets just after being sued and just before debtor files for bankruptcy.

Motion denied.

1. Bankruptcy ⟹3271

Denial of discharge is harsh result, and in keeping with"fresh start" policy of the Bankruptcy Code, courts should construe discharge exceptions liberally in favor of debtors and strictly against parties objecting to debtors' discharge. Bankr. Code, 11 U.S.C.A. § 727(a).

2. Bankruptcy ⟹3274

To prevail on complaint to deny debtor's discharge based upon his prepetition transfer of property with intent to hinder, delay or defraud creditor, complainant must demonstrate an actual intent to hinder, delay or defraud; constructive intent will not suffice. Bankr.Code, 11 U.S.C.A. § 727(a)(2)(A).

3. Bankruptcy ⟹3274, 3317(5)

While party seeking to deny debtor's discharge based upon his prepetition transfer of property with intent to hinder, delay or defraud creditor must demonstrate an actual, not just a constructive, intent on debtor's part, requisite intent need be shown only by a preponderance of evidence. Bankr.Code, 11 U.S.C.A. § 727(a)(2)(A).

4. Bankruptcy ⟹3274

To prevail on complaint to deny debtor's discharge based upon his prepetition transfer of property, complainant need not demonstrate that transfer was made with actual intent to defraud; intent to hinder or delay will suffice. Bankr.Code, 11 U.S.C.A. § 727(a)(2)(A).

5. Bankruptcy ⟹3274, 3315(2)

While party seeking to deny debtor's discharge based upon his prepetition transfer of property with intent to hinder,

delay or defraud creditor must demonstrate an actual, not just a constructive, intent on debtor's part, requisite intent may be inferred from circumstances surrounding the transfer. Bankr.Code, 11 U.S.C.A. § 727(a)(2)(A).

6. Bankruptcy ⚷2164.1

Mere presentation of facts that could sustain a factual finding that transfer was made with fraudulent intent, or that could establish prima facie case of fraud, will not necessarily suffice for complainant to prevail on motion for summary judgment on complaint to deny debtor's discharge based on his prepetition transfer of assets if, on undisputed facts, a fact finder could infer that debtor's intent was innocent. Bankr. Code, 11 U.S.C.A. § 727(a)(2)(A).

7. Bankruptcy ⚷3274

Even though debtor's prebankruptcy planning in intentionally converting nonexempt into exempt assets shortly before petition date necessarily entails an intent to hinder or delay creditors, such intent and conversion, by themselves, do not compel a denial of debtor's discharge based on his prepetition transfer of assets, absent extrinsic evidence of fraud. Bankr.Code, 11 U.S.C.A. § 727(a)(2)(A).

8. Bankruptcy ⚷3274

"Badges of fraud," such as court may consider, for denial-of-discharge purposes, in deciding whether debtor's prepetition transfer of assets was done with requisite intent to hinder, delay or defraud creditors, fall into three general categories consisting of (1) those badges which are themselves indicative of concealment, deception or fraudulent intent (such as debtor's retention of possession or control over property, or concealment of transfer); (2) those badges that do not implicitly suggest fraud, but that do suggest there must have been a motivation other than transaction itself because it was not an economically rational decision for debtor to make (such as debtor's transfer of essential assets of business or transfer for less than reasonably equivalent value, or to insider); and (3) those badges which may be innocent in themselves, or are merely timing factors that become suspicious only when combined with other factors (such as fact that transfer is made after debtor is sued or threatened with suit, involves essentially all of debtor's assets, or is made when debtor is, or has effect of rendering debtor, insolvent). Bankr.Code, 11 U.S.C.A. § 727(a)(2)(A).

9. Bankruptcy ⚷2164.1, 3315(2)

Court cannot infer that debtor's prepetition transfer was made with actual intent to hinder, delay or defraud creditors, as required for court to deny debtor's discharge on that ground, based solely on presence of "badges of fraud" which are not themselves intrinsically indicative of fraudulent intent, but which only suggest that there was some other noneconomic motive for transfer, or which become suspicious only when combined with other factors; such badges of fraud will suffice neither to sustain summary judgment for creditor objecting to debtor's discharge nor to shift the burden of going forward to debtor. Bankr.Code, 11 U.S.C.A. § 727(a)(2)(A).

10. Bankruptcy ⚷3274

Intentional nature of debtor's prepetition conversion of exempt to nonexempt assets, as part of his prebankruptcy exemption planning, is not alone sufficient basis to regard this conversion as ground to deny debtor's discharge based on his fraudulent prepetition transfer of assets; any such rule would reward ignorant debtors while punishing knowledgeable ones. Bankr.Code, 11 U.S.C.A. § 727(a)(2)(A).

11. Bankruptcy ⚷3276.1

Mere fact that debtor's prebankruptcy exemption planning, in converting exempt to nonexempt assets, involves all or essentially all of nonexempt property of debtor is not alone a sufficient basis to regard this conversion as ground to deny debtor's discharge based on his fraudulent prepetition transfer of assets; it is inappropriate for bankruptcy judges to attempt to determine when pigs become hogs, when legislature has failed to do so and has not invited courts to exercise that judgment. Bankr. Code, 11 U.S.C.A. § 727(a)(2)(A).

12. Bankruptcy ⚷3273.1

Neither timing factors nor uneconomic decision-making by debtors is sufficient to deny them a discharge upon account of their knowledgeable exemption planning, in converting exempt to nonexempt assets. Bankr.Code, 11 U.S.C.A. § 727(a)(2)(A).

13. Bankruptcy ⚷3315(2)

Unless creditor that seeks to deny debtor's discharge based upon his prebankruptcy exemption planning shows some deception or concealment, an insider transaction, a fraudulent conveyance, a secretly retained possession or benefit, or debtor explanations which lack credibility, presence of other badges of fraud which are not themselves intrinsically indicative of fraud are insufficient to shift to debtor the burden of going forward, even if all of the debtor's nonexempt assets are converted into exempt assets just after debtor is sued and just before debtor files for bankruptcy. Bankr.Code, 11 U.S.C.A. § 727(a)(2)(A).

Tim D. Coker, Esq., Robert Mothershead, P.C., Phoenix, AZ, for Plaintiff/Creditor.

William F. Doran, Esq., Phoenix, AZ, for Defendants/Debtors.

Louis Movitz, Carefree, AZ, Chapter 7 Trustee.

OPINION RE: OBJECTION TO DISCHARGE

RANDOLPH J. HAINES, Bankruptcy Judge.

This case concerns an objection to discharge due to the debtors' prebankruptcy sale of an asset and use of the proceeds to increase an exemption. The objecting creditor seeks summary judgment on his objection to discharge. Because the Court finds the undisputed facts do not establish any improper intent to hinder, delay or defraud creditors, other than an intent to utilize available exemptions when the need to do so became evident, the motion for summary judgment is denied.

Facts

The following facts are undisputed.

On July 12, 2001, Marvin and Fay Crater ("Debtors") were served with a suit filed by creditor James Murphey ("Murphey") for royalties due under a patent license. Murphey obtained a default judgment in that suit for more than $600,000 in October, 2001, although that judgment was subsequently vacated because it had been entered in violation of the automatic stay.

Debtors retained a bankruptcy attorney on July 26, 2001, who sent a letter informing Murphey that he had been retained to file Chapter 7 for the Debtors. On or about that same day the Debtors sold some stock they owned in Krispy Kream for about $40,000. On September 10, 2001, the Debtors used the proceeds of that sale to pay Chase Manhattan Mortgage ("Chase") approximately $40,000, which largely satisfied a second mortgage Chase held against their home. Debtors filed

this Chapter 7 case 17 days later, on September 27, 2001.

Murphey filed a timely complaint objecting to the Debtors' discharge. Among other grounds, the complaint objected pursuant to 11 U.S.C. § 727(a)(2)(A),[1] on the ground that the sale of the Krispy Kream stock was made with "intent to hinder, delay, or defraud a creditor," by essentially converting Debtors' nonexempt asset into an increased homestead exemption. Arizona has opted out of the federal exemptions[2] and permits a homestead exemption up to $100,000 in equity.[3] Debtors' Schedule D claims their home is worth $100,000 and is subject to a $32,700 first lien and a $2,577 second lien held by Chase. Consequently their current homestead exemption is approximately $64,712 in equity, whereas but for the application of the stock sale proceeds it would have been only $24,232, and the Chapter 7 Trustee would have had an additional $40,000 of unencumbered assets to distribute to creditors.

Murphey moved for summary judgment. His principal argument is that actual intent to hinder, delay or defraud creditors can be shown by circumstantial evidence, and that it is shown by the "badges of fraud" because the Debtors sold essentially all their nonexempt assets shortly after being sued, and used the proceeds to increase their homestead exemption shortly before filing bankruptcy.[4]

General Principles

The question of whether a discharge should be denied because a debtor converted nonexempt assets into exempt assets shortly before filing has been addressed in some significant cases in other circuits. *See, e.g., Smiley v. First Nat'l Bank of Belleville (In re Smiley)*, 864 F.2d 562 (7th Cir.1989); *Norwest Bank Nebraska, N.A. v. Tveten*, 848 F.2d 871 (8th Cir.1988); *Hanson v. First Nat'l Bank in Brookings*, 848 F.2d 866 (8th Cir.1988); *Ford v. Poston (In re Ford)*, 773 F.2d 52 (4th Cir. 1985); *First Texas Sav. Assoc., Inc. v. Reed (In re Reed)*, 700 F.2d 986 (5th Cir. 1983). But it does not appear to have been addressed by the Ninth Circuit at least since the adoption of the Bankruptcy Code.

There is, however, substantial Ninth Circuit case law addressing the elements, evidentiary standards, and burden of proof for denial of discharge under § 727(a)(2)(A).

[1] "Denial of discharge is a harsh result." *Bernard v. Sheaffer (In re Bernard)*, 96 F.3d 1279, 1283 (9th Cir.1996). "In keeping with the 'fresh start' purposes behind the Bankruptcy Code, courts should construe § 727 liberally in favor of debtors and strictly against parties objecting to discharge." *Id.* at 1281, citing *Devers v. Bank of Sheridan, Montana (In re Devers)*, 759 F.2d 751, 754 (9th Cir.1985).

Section 727(a)(2)(A) provides that a debtor may be denied a discharge if "the debtor, with intent to hinder, delay, or defraud a creditor, ... has transferred ... property of the debtor, within one year before the date of the filing of the petition;

1. Unless otherwise noted, all statutory and rule references are to the United States Bankruptcy Code, 11 U.S.C. §§ 101–1330, and the Federal Rules of Bankruptcy Procedure.

2. Arizona Revised Statutes ("A.R.S.") § 33–1133(B).

3. A.R.S. § 33–1101(A).

4. There is some indication in Murphey's motion that the transfer did not in fact occur until after the petition was filed. Debtor denies that, however, so to the extent Murphey relies on that argument there is a material issue of fact that precludes summary judgment.

..." Here is it undisputed that the Debtors transferred their Krispy Kream stock within one year of the petition, so the only issue is whether such transfer was made with the requisite "intent to hinder, delay or defraud a creditor."

[2–5] To a deny a discharge under § 727(a)(2)(A), the intent must be actual intent, as "[c]onstructive fraudulent intent cannot be the basis for denial of a discharge." *First Beverly Bank v. Adeeb (In re Adeeb)*, 787 F.2d 1339, 1343 (9th Cir. 1986); *Devers*, 759 F.2d at 753. But that requisite intent need only be shown by a preponderance of the evidence, not the heightened standard the common law often requires for a showing of fraud. *Grogan v. Garner*, 498 U.S. 279, 284, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). And an intent to *defraud* need not be shown, as "[i]ntent to hinder or delay is sufficient." *Bernard*, 96 F.3d at 1281. That intent, though it must be actual, may be inferred "from the circumstances surrounding the transaction." *Emmett Valley Assocs. v. Woodfield (In re Woodfield)*, 978 F.2d 516, 518 (9th Cir. 1992).

Although the "badges of fraud" that were recognized at common law and are now codified in the Uniform Fraudulent Transfer Act [5] for finding an actual fraudulent conveyance are not codified in the Bankruptcy Code either for that purpose or for denial of discharge under § 727(a)(2)(A), *Woodfield* seems to suggest that they are at least appropriate circumstances that may be considered as a basis to infer that intent. *Id.* Indeed, that opinion could be read to say that the presence of some of the badges of fraud may be sufficient to infer the requisite intent "unless some other convincing explanation appears." *Id.* But that was dictum because the opinion also noted that "[m]ore than a dry checklist of badges of fraud demonstrates the Debtor's intent, however," because those debtors admitted they "were trying to delay or prevent seizure of the assets," and they omitted them from their statement of affairs. *Id.* at 519.

Evidentiary Standards

The plaintiff, of course, always has the ultimate burden of proof. Bankruptcy Rule 4005. But depending on the procedural context, there are at least three possibly applicable evidentiary standards. The lowest of them is when the bankruptcy court has conducted a full trial and found that the discharge should be denied. Because the standard of review on appeal for the factual finding of the requisite intent is the clearly erroneous standard, *Devers*, 759 F.2d at 753, it will take only a modi-

5. *See, e.g.*, A.R.S. § 44–1004(B), codifying UFTA § 4(b):

"In determining actual intent under subsection A, paragraph 1, consideration may be given, among other factors, to whether:

1. The transfer or obligation was to an insider.
2. The debtor retained possession or control of the property transferred after the transfer.
3. The transfer or obligation was disclosed or concealed.
4. Before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit.
5. The transfer was of substantially all of the debtor's assets.
6. The debtor absconded.
7. The debtor removed or concealed assets.
8. The value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred.
9. The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred.
10. The transfer occurred shortly before or shortly after a substantial debt was incurred.
11. The debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor."

cum of evidence of fraudulent intent to sustain the bankruptcy court's finding. Possibly equal to that standard, but possibly a higher standard, is the strength of the evidence necessary at trial to shift the burden of going forward from the plaintiff to the debtor, to explain the innocence of his transactions and intent. The Fifth Circuit described that point as when plaintiff "makes a prima facie case." *Reed*, 700 F.2d at 992. In this precise context, *Reed* held that it is only upon a showing of fraud by the creditor, that the burden shifts to the Debtor to explain the transaction. *Id.* Finally, the highest standard is that required of a plaintiff to obtain summary judgment when the debtor has denied any fraudulent intent, because the court must then be convinced that no fact finder could infer that the debtor's intent was innocent. But generally "scienter should not be resolved by summary judgment," *Provenz v. Miller*, 102 F.3d 1478, 1489 (9th Cir.1996), so "credibility issues are to be left to the trier of fact to resolve on the basis of oral testimony *except* in extreme cases." *In re Chavin*, 150 F.3d 726, 728 (7th Cir.1998)(emphasis in original).

[6] Because this is summary judgment, plaintiff must satisfy that highest standard. Mere presentation of facts that could sustain a factual finding of fraudulent intent, or even establishment of a prima facie case, will not necessarily be sufficient to win summary judgment, if on such undisputed facts a fact finder could infer that the debtor's intent was innocent.

Exemption Planning Is Permissible, Absent Extrinsic Fraud

[7] So far as this Court has seen, the authorities are unanimous that even though an actual intent to convert nonexempt assets into exempt assets shortly before filing bankruptcy *is* necessarily an intent to hinder or delay creditors, such intent and conversion by themselves do not compel denial of discharge under § 727(a)(2)(A). The Ninth Circuit Bankruptcy Appellate Panel has so held. *Coughlin v. Cataldo (In re Cataldo)*, 224 B.R. 426, 429 (9th Cir. BAP 1998), quoting *Roosevelt v. Ray (In re Roosevelt)*, 176 B.R. 200, 208 (9th Cir. BAP 1994)("[I]t is clear that in the Ninth Circuit a debtor may convert non-exempt property into exempt property even on the eve of bankruptcy.")(dictum). This is because such a conclusion would be contrary to the very purpose of providing exemptions, and because the ability to make intelligent use of the exemptions was specifically addressed and permitted by the legislative history of the Code:

> As under current law, the debtor will be permitted to convert nonexempt property into exempt property before filing of the bankruptcy petition. This practice *is not* fraudulent as to creditors, and permits the debtor to make full use of the exemptions to which he is entitled under the law. (Emphasis in original).

H.R. REP. 95-595, at 361 (1977), *reprinted in*, 1978 U.S.C.C.A.N. 5963, 6317; S. REP. No. 95-989 at 76 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5862, *quoted in*, *Tveten*, 848 F.2d at 874; *Reed*, 700 F.2d at 990; and *Cataldo*, 224 B.R. at 429.

In this case, the exemption planning occurred by payment of a valid debt. This creates a second reason why such exemption planning is not fraudulent. When a debtor is insolvent, the payment of any one creditor may inherently delay others, and that may even be the debtor's actual intent in paying the one creditor, either to increase the equity in an exempt asset such as here, or simply to prefer that creditor over others. And yet it has always been the law that such an intent to prefer one creditor, while delaying others, does not make a preference into a fraudulent con-

veyance, even though it would technically fit the terms of that statute.[6] *Coder v. Arts*, 213 U.S. 223, 29 S.Ct. 436, 53 L.Ed. 772 (1909)(construing Act § 67e); *Irving Trust Co. v. Chase Nat'l Bank*, 65 F.2d 409, 410 (2d Cir.1933)("Pro tanto every preference hinders and delays [other creditors]. If the debtor is aware that it will necessarily have that result, the transfer would seem to be made with an intent to hinder, delay and defraud other creditors; yet the securing or paying of an actual debt, in good faith, without any design injurious to creditors beyond that implied in giving the preference, was not deemed a fraudulent conveyance under the principles of the common law and the statute of Elizabeth. Nor is it so under the Bankruptcy Act."(citations omitted)); 4 COLLIER ON BANKRUPTCY ¶ 67.37, at 535 (14th ed. 1978)("The intent to delay or hinder seemingly implicit in any *preferential* transfer by an insolvent debtor has, however, been held not to constitute the actual fraudulent intent required under former § 67e [the attempted codification of *Dean v. Davis*, 242 U.S. 438, 37 S.Ct. 130, 61 L.Ed. 419 (1917)]. This interpretation of the familiar words, 'with intent to hinder, delay or defraud,' surely holds true for [Act] § 67d(2)(d) [actual fraudulent conveyance]."); II GERRARD GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES § 382, at 662 (rev. ed. 1940)("[A] preference cannot be turned into a fraudulent conveyance by a mere finding that the debtor intended to defraud his creditors, if the other findings show only a preference and nothing more.").

The circuit courts that have addressed the issue also agree, however, that such a conversion of nonexempt into exempt assets can result in the denial of the discharge if there was extrinsic evidence of actual intent to defraud. *Reed*, 700 F.2d 986; *accord*, *Tveten*, 848 F.2d at 874 (discharge may be denied "if there was extrinsic evidence of the debtor's intent to defraud creditors"); *Cataldo*, 224 B.R. at 430 ("[In] Section 727(a) proceedings, many courts disregard both the amount claimed exempt and any evidence of the debtor's desire to shield assets, instead denying discharge 'only where the debtor has committed some act extrinsic to the conversion which hinders, delays or defrauds,'" quoting, *Smiley*, 864 F.2d at 567).[7]

These principles also reflect the law of the Ninth Circuit under the Act, which the legislative history quoted above was intended to incorporate into the Code.[8] Un-

6. There is now an exception to this broad statement in states that have adopted the Uniform Fraudulent Transfer Act § 5 as originally drafted, which makes insider preferences fraudulent. Section 5(b) of the UFTA provides: "A transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at that time, and the insider has reasonable cause to believe that the debtor was insolvent." Arizona, however, did not adopt that provision. *See* A.R.S. § 44-1005 (codifying UFTA § 5(a) and eliminating § 5(b)).

7. While the circuits are in apparent agreement on this principle, none of them seems to have noticed the difference between the Seventh Circuit's rule as stated in *Smiley*, which requires an extrinsic *act*, and the Fifth and Eighth Circuit formulations, which only require extrinsic *evidence* of the prohibited intent. Here, there is no act extrinsic to the conversion of exempt into nonexempt assets, yet the creditor argues that the timing of that act is such evidence of the prohibited intent. But if an extrinsic fraudulent or delaying act is required, why is not that act alone sufficient to deny the discharge wholly apart from the exemption planning?

8. In fact, one authority suggests that it was precisely these Ninth Circuit cases that were referred to in the legislative history quoted above, based on a letter from a California bankruptcy judge, who described this state of

der the Act, the Ninth Circuit held that the mere conversion of nonexempt assets to exempt assets, even on the eve of bankruptcy, would not without more result in a denial of the exemption.[9] *E.g., Wudrick v. Clements*, 451 F.2d 988 (9th Cir.1971)(upholding exemption for money borrowed against unencumbered vehicles and placed into a credit union where it was exempt under California law); *Goggin v. Dudley*, 166 F.2d 1023 (9th Cir.1948), *aff'g* 72 F.Supp. 943 (S.D.Cal.1947)(upholding exemption for $1,000 of exempt Building and Loan Association stock purchased one week prior to voluntary petition). But the exemption could be denied if there was other evidence of actual fraud. For example, if the money invested into an exempt asset were derived from the sale of stock that had been pledged to a bank and released on the debtor's fraudulent promise to apply the proceeds to the bank's loan, the trustee could use the strong arm clause to assert the rights of the defrauded bank and avoid the debtor's claimed homestead exemption. *Miguel v. Walsh*, 447 F.2d 724 (9th Cir.1971).

The Ninth Circuit authority most expansive on this issue is *Goggin v. Dudley*, which adopted the opinion of the District Court. In that case the debtor had purchased $1000 of exempt stock in a building and loan association just one week prior to filing a voluntary petition, when he was "heavily in debt and clearly insolvent." 72 F.Supp. at 944. The Trustee denied the exemption, which was affirmed by the Referee, but then reversed by the District Court, which was upheld by the Ninth Circuit. In reversing, the District Court noted that "If the mere acquisition of exempt property while insolvent were sufficient ground to destroy the exemption, the acquisition of any such property, within the four-months' period, could be nullified, and the protection which the state law gives to a debtor, even against the solemn money judgement of a court, would be denied him against creditors in bankruptcy." *Id.* at 947. And in response to the Referee's focus on the acquisition while insolvent, the District Court held that if such a fact could render the exemption fraudulent, it would read into the exemption restrictions that were not there:

> [The California exemption statute] does not say when building and loan stock must be acquired in order to be exempt. Nor does it say that the person shall be solvent at the time of acquisition. To sustain the Referee in this case, we would have to impose a time limit and make solvency a condition precedent to exemption. This would mean reading into the state statute restrictions which are not there. And this we cannot and should not do. And, as there is no showing of actual fraud, the stock is immune against the creditors and never passed to the trustee.

the law in the Ninth Circuit and noted the law was "in a state of utter confusion in other circuits." *In re Kravitz*, 225 B.R. 515, 518 (Bankr.D.Mass.1998).

9. These Ninth Circuit authorities under the Act technically dealt only with objections to the claimed exemption. For opt-out states under the Code, the availability of the exemption should be controlled by state law, whereas the denial of discharge under § 727(a)(2) is governed by federal law. This distinction is implicit in *Cataldo*, and is well illustrated by the two decisions in *Reed*, one of which upheld the exemption, and the other of which denied the discharge. *Driskill v. Reed (In re Reed)*, 12 B.R. 41 (Bankr.N.D.Tex.1981) and *Reed*, 700 F.2d 986. But the legislative history that all the authorities rely on, which says the conversion of nonexempt property into exempt property is not fraudulent as to creditors, really speaks to the § 727 issue and therefore makes these Ninth Circuit cases applicable to the § 727 context.

Id. at 947. The opinion had earlier summarized this conclusion: "The doctrine bearing upon conveyances made to hinder, delay, or defraud creditors has no application to the creation of a homestead." *Id.* at 946.

The issue these authorities leave open, and the determinative issue here, is whether proof of one or more of the badges of fraud may be used to infer the extrinsic actual fraud that is required to deny a discharge to a debtor who converted nonexempt into exempt assets.

Certain Badges of Fraud Alone Do Not Imply Actual Fraud

As noted above, the "badges of fraud" are not codified as appropriate grounds for denial of discharge pursuant to § 727(a)(2)(A). But they have been long recognized at common law as grounds for finding the identical statutory element that is found in § 727(a)(2)(A)—"actual intent to hinder, delay or defraud"—when it is an element of a fraudulent transfer. And *Woodfield* suggests, but does not hold, that the badges of fraud are relevant considerations for purposes of § 727(a)(2)(A).

The question is whether some of them, or which of them, may be sufficient to find the "actual fraud" that must accompany a conversion of nonexempt into exempt assets if it is to result in a denial of discharge.

[8] The badges of fraud may be categorized into three types. Some of the badges are themselves indicative of concealment, deception or fraudulent intent: 2. The debtor retained possession or control of the property transferred after the transfer;[10] 3. The transfer or obligation was . . . concealed; 6. The debtor absconded; and 7. The debtor removed or concealed assets.

A second category of badges consists of three of them that do not implicitly suggest fraud but do suggest there must have been a motivation other than the transaction itself because it was not an economically rational decision for a debtor to make but for its effect to hinder or delay creditors: 1. The transfer or obligation was to an insider;[11] 8. The value of the consideration received by the debtor was [not] reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred; 11. The debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

The third category, however, consists of badges that may be innocent in themselves, or are merely timing factors that become suspicious only when combined with other factors: 4. Before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit; 5. The transfer was of substantially

10. Transfer without change of possession was considered fraudulent at the inception of fraudulent conveyance law over 400 years ago. *See Twyne's Case,* 3 Coke Rep. 80b (1601). *See also* A.R.S. § 44-1061(A): "A sale made by a vendor of goods and chattels . . ., unless the sale or assignment is accompanied by an immediate delivery and followed by an actual and continued change of possession of the things sold or assigned, is prima facie evidence of fraud against creditors of the vendor . . . ."

11. A insider transfer suggests the debtor did not seek to maximize his economic benefit by exposing the asset to the market to obtain the highest possible price. But it could also fall in the first category, because insider sales may also facilitate a secret retention of possession, control or benefit. Of course it could also evidence an intent to benefit the insider, a potential classic fraudulent conveyance if made while insolvent without receipt of fair equivalent value. And under UFTA § 5(b), even payment of a valid insider debt while insolvent may be fraudulent. *See* note 6 *supra.*

all of the debtor's assets; 9. The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred; and 10. The transfer occurred shortly before or shortly after a substantial debt was incurred.

Here, the plaintiff creditor has established only that (1) the Debtors sold the asset shortly after being served with suit, (2) the asset was the Debtors' only significant, unencumbered nonexempt asset, and (3) the sale of the asset and the use of the proceeds to pay down a second home mortgage and thereby increase the equity protected by the homestead occurred shortly before the filing of bankruptcy and, implicitly, while insolvent. Thus the creditor has established badges 4 and 5 and 9, all of them in the third category.

Notably, none of the badges that the creditor has established here is implicitly indicative of fraudulent intent. They do not even fall into the second category of transactions that are suspicious because they lack an economically rational purpose. For example, the creditor has not shown that the Krispy Kream stock was appreciating, or generating dividends, in excess of the interest the debtor was paying on the second mortgage. Rather, they are merely timing factors.

If conversion of nonexempt into exempt assets should not itself result in denial of discharge, should it do so when it occurs shortly after the debtor has been sued or incurred a large debt, or is insolvent, or is about to file bankruptcy? If that were the rule, it would mean that prospective debtors could engage in exemption planning only up until the point where it appeared they might need to do so. As the court noted in *Goggin v. Dudley*, this would be to add a restriction to the exemption that the legislature (and Congress) did not impose, *i.e.*, certain assets are exempt only if purchased while solvent, while not owing substantial debts, or some significant period of time prior to levy of execution or bankruptcy. It would be particularly inappropriate to impose such a judge-made time condition on an exemption, such as the homestead, when the legislature did not do so but did so with respect to other exemptions. For example, while Arizona imposes no time limit on obtaining or declaring a homestead, it does require that life insurance policies must have been continuously maintained for two years in order to be exempt, and excludes from the exemption cash surrender values that were increased by premium payments within the prior two years in excess of the average annual premium paid during the previous three years. A.R.S. §§ 33–1126(A)(6) & (B). The Arizona legislature knows how to curb abusive exemption planning when it sees the need to do so.

Moreover, if intentional conversion of nonexempt into exempt assets is not *per se* fraudulent as to creditors, what is the additionally fraudulent [12] nature of the intent that is evidenced by such a conversion occurring shortly after being sued, while insolvent, and shortly before filing bankruptcy? It would seem to be merely evidence that the debtor intended to maximize his assets that would be shielded from creditors, and probably had one specific creditor in mind, and probably knew that his assets were insufficient to satisfy all his creditors. But such intent is nothing more than the intent to convert nonexempt into exempt assets, which all authorities agree is not fraudulent. So how could the timing of the conversion, or the pressure of a

12. The term "fraudulent" is used here generically to include also the prohibited intent to hinder or delay creditors.

single creditor, cause that same intent to result in a denial of discharge?

Indeed, what if the transaction did not make economic sense, standing alone? The scenario is not uncommon in the exemption planning discharge cases, and it yields conflicting results even within the same circuit, as one debtor may get a discharge despite buying an exempt $10,000 shotgun that he does not need,[13] but another is denied the opportunity to buy a homestead that he does not need.[14] For example, what if the Krispy Kream stock were generating income far in excess of the interest rate being paid on the second mortgage, and promised to do so for the foreseeable future? What would that say about the debtor's intent? It could certainly be argued that it disproves an "innocent" explanation of the transaction, *i.e.*, it belies an argument that the debtor thought it was a better use of his money to pay down his homestead mortgage. But what does that prove? It proves that the intent really was to maximize the exemption, even at a sacrifice of income. But that still is nothing more than an intent to convert nonexempt into exempt assets. All that the uneconomic nature of the transaction does is highlight the strength and focus of the intent, but if the intent is not objectionable, then neither should be the same intent when strongly felt and focused on a particular creditor.

[9] Consequently this Court tentatively concludes that those badges of fraud that are not intrinsically indicative of fraudulent intent are not sufficient evidence of actual fraud to compel a denial of discharge. To be more precise, those badges of fraud that fall into the second and third categories identified above are neither sufficient to sustain summary judgment for the creditor, nor to shift the burden of going forward to the debtor. In short, they do not establish a prima facie case for denial of discharge, even when conjoined with prebankruptcy exemption planning. They really do nothing more than demonstrate that the debtor engaged in otherwise permissible exemption planning only when it became apparent that it would be intelligent to do so, and was willing to sacrifice some asset values to achieve the exemption.

This tentative conclusion must be tested against the existing case law, both in the Ninth Circuit and elsewhere.

Ninth Circuit Cases Do Not Find Timing Factors and Uneconomic Transactions Sufficient to Establish Fraud.

The tentative conclusion is certainly consistent with, if not compelled by, Ninth Circuit precedent. *Goggin v. Dudley* essentially rejected timing factors as a basis to deny an exemption, and given § 727's legislative history indicating an intent to preserve the existing ability to convert nonexempt into exempt assets, there is no reason to conclude the result should be different under the Code. It is also consistent with *Miguel v. Walsh*, where there was actual extrinsic fraud, in that the debtor fraudulently induced the bank to part with its collateral on a promise to use its sale proceeds to pay down the bank's debt. And it is not inconsistent with *Woodfield*, where although the court relied on many of the third category timing badges, there also existed the suggestive fraudulent ele-

13. In *In re McCabe*, 280 B.R. 841 (Bankr. N.D.Iowa 2002), the debtor bought a $10,000 Belgian Browning shotgun which he fired once or twice, because he knew Iowa had no dollar limit on the exemption for a family gun, and yet he was allowed his discharge.

14. In *Jensen v. Dietz (In re Sholdan)*, 217 F.3d 1006 (8th Cir.2000), the ninety year old debtor moved out of assisted care facility into a homestead purchased with all his exempt assets, and the exemption was denied.

ment of an insider transaction, and there were explanations that lacked credibility and were therefore deceptive. *See* 978 F.2d at 518–19.

Wudrick could be read as establishing an even broader rule upholding exemptions and discharges. In *Wudrick*, the debtors in the two cases consolidated for decision both borrowed money against their cars to obtain the funds to put into the exempt credit union accounts. 451 F.2d at 989. It is highly likely, although the Ninth Circuit did not comment on it, that the interest rates the debtors had to pay on the auto loans exceeded the interest rates that could be earned on the savings accounts. If so, then the transactions were not economically rational decisions for the debtors to make, but for the obtaining of the exemption. The fact that the Ninth Circuit upheld the exemptions indicates that even the second category of badges of fraud—noneconomic decision making—is not sufficient to make a prima facie case to deny the discharge. Indeed, because the Ninth Circuit's opinion reversed the district court's affirmance of the referee's denial of the claimed exemption in one of the two cases, it may stand for the proposition that the second category of badges of fraud does not even constitute evidence of the requisite fraudulent intent.

It should be remembered that these Ninth Circuit Act cases have significance beyond the Ninth Circuit, because they were apparently the Act authorities the House and Senate Reports were referring to when they said "As under current law, the debtor will be permitted to convert nonexempt property into exempt property before filing of the bankruptcy petition." [15]

Most Other Circuit Decisions Are Consistent

[10, 11] The tentative conclusion is consistent with *Smiley v. First Nat'l Bank of Belleville (In re Smiley)*, 864 F.2d 562 (7th Cir.1989). The Seventh Circuit's analysis of the case law on this issue is useful in categorizing the cases into three camps. The first denies the discharge if the exemption planning was intentional, even without other evidence of fraud. The Seventh Circuit, like this Court, rejects that analysis as rewarding ignorant debtors and punishing knowledgeable debtors. 864 F.2d at 567. The second camp bases denial of discharge on the amount attempted to be exempted, essentially creating a judge-made cap on exemptions at the level the court concludes is necessary for the "fresh start," rather than the "head start." *Id.*, citing *In re Reed*, 11 B.R. 683, 688 (Bankr.N.D.Tex.1981). For the reasons eloquently set forth in the *Tveten* dissent, this Court agrees it is inappropriate for judges to determine when pigs become hogs [16] when the legislature has failed to do so and has not invited the courts to exercise that judgment.[17] Finally, there

15. *See* H.R. REP. 95-595, at 361 (1977), *reprinted in*, 1978 U.S.C.C.A.N. 5963, 6317; S. REP. No. 95-989 at 76 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5862, *quoted in*, *Tveten*, 848 F.2d at 874; *Reed*, 700 F.2d at 990; and *Cataldo*, 224 B.R. at 429. *See* note 8 *supra*.

16. The dissent in *Tveten* criticized the majority's reasoning by comparing it to that in *Albuquerque Nat'l Bank v. Zouhar (In re Zouhar)*, 10 B.R. 154, 157 (Bankr.D.N.M.1981), where the bankruptcy court denied the discharge based on the "principle of too much; phrased colloquially, when a pig becomes a hog it is slaughtered." *Tveten*, 848 F.2d at 879 (Arnold, J., dissenting).

17. In fact, this appears to be the issue that makes this area so difficult. Virtually all of the difficult cases deal with state exemption statutes that are unlimited in amount. The cases simply do not arise with any frequency, or at least do not reach the circuit courts, when the state legislature has imposed caps

are those cases, with which the *Smiley* court agreed, that did not limit debtors' full use of exemptions within the limits of the law. 864 F.2d at 567. The *Smiley* court ultimately concluded the discharge should be denied because the debtor not only invested money into an unlimited Kansas homestead, but lied to his creditors about the retained value of his assets that had been liquidated to generate those funds. *Id.* at 568. Because such false statements and concealment fall into the first category of fraudulent badges of fraud, it is consistent with this Court's tentative conclusion on the present facts, where there is no false statement or concealment of assets.

The conclusion is consistent with *Marine Midland Bus. Loans, Inc. v. Carey*, 938 F.2d 1073 (10th Cir.1991). The facts there were essentially the same as in this case, in that nonexempt assets were liquidated and the proceeds used to reduce the mortgage on the homestead. The debtor was left with a $300,000 exempt Oklahoma homestead subject only to a $30,000 mortgage. *Id.* at 1076. The bankruptcy and district courts found there was no improper intent, and the Tenth Circuit affirmed:

> The liquidation of the other assets used to pay down the home mortgage occurred over a two year period and was in the open; the activity and payment appears to be consistent with what has been approved by Congress to take advantage of exemptions. [Debtor] fully disclosed all payments and transfers in her bankruptcy schedules and at the meeting of creditors. [Debtor] retained no beneficial interest in any converted property. She did not obtain credit to purchase exempt property. Under these circumstances we cannot say that the district and bankruptcy courts erred in finding she did not intend to "hinder, delay, or defraud" her creditors or acted improperly in relation to her homestead.

Id. at 1078.

More difficult to harmonize under the analysis proposed here is *Ford v. Poston (In re Ford)*, 773 F.2d 52 (4th Cir.1985), but its result may have hinged primarily on the debtor's perceived lack of candor. There the debtor had owned land as his sole and separate property for over six months. When a creditor obtained a judgment against him, however, he deeded it the very next day to himself and his wife as tenants by the entireties, which under Virginia law put it beyond the reach of a creditor holding a debt against only one of the spouses. 773 F.2d at 53. After trial, the bankruptcy court denied the discharge, which the Fourth Circuit affirmed. Although the Fourth Circuit's opinion requires "*extrinsic* evidence of actual intent to defraud creditors," *id.* at 55 (emphasis in original), the bankruptcy court apparently relied almost solely on the timing of the transfer. It could be, however, that the bankruptcy court also relied on a finding that the debtor's explanation of the transaction—that he was merely correcting a mistake that had been made when he took title—was simply incredible, and therefore the debtor testified falsely and sought to conceal his true intent.[18] The

on exemptions. This case, however, is an exception to that general observation.

18. Perhaps *Ford* counsels that it would be unwise to grant *debtors* summary judgment in such cases where the only badge of fraud a creditor asserts relates to timing—because the debtor should be required to explain the transaction, and the discharge should be denied if the explanation is not credible. If so, that would mean that any badge of fraud could make a prima facie case sufficient to shift the burden of going forward to the debtor. But the rule suggested here would still mean that if the debtor testified honestly, like Mr. Tveten, then the creditor's case is insufficient to deny the discharge. But that issue is

Fourth Circuit's opinion seems to suggest that was the case, by describing the debtor's explanation as "conveniently choosing to correct, at that point in time, what was then a six-month old mistake." *Id.* Perhaps that lack of candor could be deemed sufficient evidence falling in the first category to warrant a denial of discharge.[19]

The tentative conclusion is consistent with *First Texas Sav. Assoc., Inc. v. Reed (In re Reed)*, 700 F.2d 986 (5th Cir.1983). As a threshold matter, it should be noted that *Reed* was not a granting of summary judgment to the objecting creditor, but an affirmance of the bankruptcy court's denial of discharge after trial, 700 F.2d at 992, so the evidentiary standard was much lower than is required here. But the facts in *Reed* also clearly included some that were intrinsically indicative of fraudulent intent, and many others that were not economically rational. Reed hid accounts from his creditors and sold assets, to insiders, for less than their acquisition cost only a short time before. Certainly such facts were sufficient to sustain a trial court's factual finding of fraudulent intent, particularly when coupled with what must have been the trial court's consideration of the debtor's demeanor.[20] Such facts may even be sufficient to make a prima facie case and shift the burden to the debtor to provide the innocent explanations of the transactions, and therefore to sustain summary judgment if the debtor fails to come forth with such an explanation.

The panel decision in *NCNB Texas Nat'l Bank v. Bowyer (In re Bowyer)*, 916 F.2d 1056 (5th Cir.1990), would have been more difficult to harmonize with this analysis, but it was reversed *en banc*. 932 F.2d 1100 (5th Cir.1991). The debtor there had liquidated nonexempt assets and used some of the proceeds on luxuries and some to pay down his homestead mortgage two weeks after engaging a bankruptcy lawyer and just two weeks before filing bankruptcy. The bankruptcy court allowed the discharge, but the Fifth Circuit panel reversed, concluding that the bankruptcy court had only found no intent to *defraud*, but had not addressed an intent to hinder or delay. 916 F.2d at 1060. The opinion referenced the "pig to hog" analysis but found "especially critical to finding extrinsic evidence of an intent to hinder or delay" was that the debtor's wife carried $18,000 of the proceeds in her purse rather than depositing it into the money market account at the plaintiff bank, and the homestead was paid down through a cashier's check payable to her rather than a personal check payable to the mortgage company, suggesting an effort to conceal the transactions from the plaintiff bank.

not presently before the Court, and therefore need not be decided now.

19. Another case that may have hinged primarily on debtor's apparent lack of candor is *Pomerantz v. Pomerantz (In re Pomerantz)*, 215 B.R. 261 (Bankr.S.D.Fla.1997). In that case the debtor purchased a Florida homestead within 20 days of the plaintiff obtaining summary judgment on a $250,000 debt. Debtor testified that she moved to Florida because she had received a job offer there, but then did not take the job for another 18 months, during which time she had virtually no other income and was living off of borrowing against the exempt asset. *Id.* at 264.

20. When Reed could not adequately account for $19,000 that he carried in cash he argued that it was but a small percentage of the amount of money he went through in that year. *Reed*, 700 F.2d at 989. He justified sales of assets for less than what he paid for them not long before by noting that if he had received more it would have been invested in exempt assets as well. *Id.* He did not explain his purchase of stock in Triple BS Corporation one month before filing bankruptcy, or the significance of the initials. *Id.* n. 1.

Id. But on rehearing *en banc*, the Fifth Circuit reversed itself and affirmed the bankruptcy court's factual finding of a lack of any extrinsic evidence of intent to defraud, distinguishing *Reed* because the fact finder there had found such intent, and the "debtor's conduct was more egregious" than Bowyer's. 932 F.2d at 1102.

Eighth Circuit Cases Are To the Contrary

But while the Fifth Circuit decisions can be seen as consistent with the proposed analysis, the Eight Circuit decisions cannot. *Norwest Bank Nebraska, N.A. v. Tveten (In re Tveten)*, 848 F.2d 871 (8th Cir.1988), seems to hold that it is sufficient to deny the discharge if the amount converted into exempt assets is "too much," and *Jensen v. Dietz (In re Sholdan)*, 217 F.3d 1006 (8th Cir.2000), seems to hold that the discharge may be denied if the investment in exempt assets was unwise, uneconomical or unusual from the debtor's perspective.

Tveten was an affirmance of the bankruptcy court's denial of discharge after trial, so it was the lowest standard summarized above. Nevertheless, the bankruptcy court had relied almost exclusively on the timing factors—the debtor's knowledge of a judgment against him, his rapidly deteriorating investments, and the rapidity with which he converted nonexempt into exempt assets in 17 separate transfers shortly before bankruptcy. About the only fact mentioned that falls outside the third, timing category is that a number of the transfers were to his parents and brother, *Id.* at 872, which raises two flags—the sale to a family member may be fraudulent in that it permits the debtor to retain possession or control of the asset, or may be uneconomic because of the likelihood that someone other than a family member might have paid more if the asset were adequately exposed to the market.

But one cannot read the *Tveten* opinion without concluding the majority was driven almost solely by the timing of the exemption planning and its size, almost $700,000. And that was not only how the *Tveten* dissent read the majority's analysis, but also how the Eighth Circuit subsequently read it. In *Panuska v. Johnson (In re Johnson)*, 880 F.2d 78, 82 (8th Cir. 1989), the court summarized the kind of extrinsic evidence of fraud necessary to deny a discharge, in terms consistent with the analysis proposed here: "further conduct intentionally designed to materially mislead or deceive creditors about the debtor's position; conveyances for less than fair value; or, the continued retention, benefit or use of property allegedly conveyed together with evidence that the conveyance was for inadequate consideration." But then it added:. "*Tveten* establishes that where an exemption, other than a homestead exemption, is not limited in amount, the amount of property converted into exempt forms and the form taken may be considered in determining whether fraudulent intent exists." Id. *Johnson* ultimately concluded that "*Tveten* does not apply to homestead exemptions absent traditional extrinsic evidence of fraud unrelated to the amount of money involved," and pointedly reminded "the lower courts that there is nothing fraudulent per se about making even significant use of other legal exemptions." *Id.* at 83. "The power sanctioned in *Tveten* should be reserved for exceptional cases and has no application to homestead exemptions." *Id.* at 84.

But then the Eighth Circuit retreated from *Johnson*. In *Jensen*, the debtor was ninety years old, afflicted with serious medical problems and living in an assisted care facility. 217 F.3d at 1010. When he was sued in a personal injury suit for an amount far in excess of his insurance cov-

erage, however, he liquidated his bank accounts and purchased a newly built house, even though the property taxes on the house were $2000 per year while the debtor was living on social security that left him with only $600 per year disposable income. *Id.* On those facts, the Eighth Circuit upheld the bankruptcy court's finding of "ample evidence extrinsic to the mere conversion of assets that showed fraudulent intent on the part of the debtor."[21] *Id.* at 1010–11. The Eighth Circuit's effort to summarize that extrinsic evidence that showed fraudulent intent was unenlightening:

> It is one thing to convert non-exempt assets into exempt property for the express purpose of holding it as a homestead and thereby putting the property beyond the reach of creditors. (citation omitted). However, it is quite another thing to acquire title to a house for no other reason than to defraud creditors.

Id. at 1011.

The facts in *Jensen* well fit the second category of the badges of fraud, because the debtor's investment in the homestead was either uneconomical or an unwise investment for that particular debtor. But the Eighth Circuit's opinion fails to demonstrate how that made the intent any more fraudulent than a clear intent to convert nonexempt into exempt assets. The closest it came to such an explanation was to label the transaction "rank injustice." *Id.* Indeed, the inability of the *Jensen* opinion to explain why converting assets into exempt property for the purpose of putting it beyond the reach of creditors is one thing, but purchasing a house for no other reason than to claim a homestead exemption is another, is a good demonstration that there is no such distinction to be drawn. As the dissent noted, the facts simply showed that the debtor "sought to protect as much of his assets as the law allowed," and none of the evidence was "extrinsic to [the debtor's] act of conversion," and "therefore [is] not evidence of fraud." *Id.* at 1011–12 (Arnold, J., dissenting).

Conclusion

[12] The Ninth Circuit cases discussed above may be sufficient to resolve the issue before the Court today. Neither timing factors nor uneconomic decision-making by debtors is sufficient to deny a discharge on account of knowledgeable exemption planning. They were not sufficient to deny exemptions under the Act, and even aside from the legislative history quoted above there is no basis to conclude that Congress intended a different result under the Code,[22] and certainly not to impose an even harsher remedy, complete denial of the discharge rather than denial of a claimed exemption.

It might also be sufficient to deny summary judgment on the basis that the requisite fraudulent intent is so individualistic and fact based that it cannot be determined without live testimony and the opportunity to judge the credibility of the debtor. *See In re Chavin*, 150 F.3d 726 (7th Cir.1998).

21. The objection was to the exemption, rather than to the discharge; the discharge was irrelevant because the debtor was deceased. The bankruptcy court relied on a fraudulent conveyance analysis and utilized the badges of fraud to find the fraudulent intent, which the Eighth Circuit approved, including the reliance on the debtor's age and the value of the house. *Id.* at 1009–10 & n. 5.

22. See *Dewsnup v. Timm*, 502 U.S. 410, 419, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992)("[T]his Court has been reluctant to accept arguments that would interpret the Code, however vague the particular language under consideration might be, to effect a major change in pre-Code practice that is not the subject of at least some discussion in the legislative history.").

[13] But the analysis suggests an even stronger rule—unless the creditor shows a deception or concealment, an insider transaction, a fraudulent conveyance, a secretly retained possession or benefit, or debtor explanations that lack credibility, the second and third categories of badges of fraud are not sufficient to shift to the debtor the burden of going forward, even if all of the debtor's nonexempt assets were converted into exempt assets just after being sued and just before filing bankruptcy.

There are many areas of bankruptcy law where Congress apparently intended bankruptcy judges to weigh the evidence and utilize their experience and judgment to decide individual cases on a case by case basis. It does so by using terms that are inherently incapable of fine definition, such as "good faith," "substantial abuse," "undue hardship," and the like. Case law in such areas tends to identify "factors" that in reality are merely a checklist of relevant facts or issues to consider, none of which is dispositive. Perhaps such areas of bankruptcy law are best dealt with as in the civil system, with each judge reading and applying the statute and its underlying policies and principles to each factual situation that comes up, without regard to what the last judge did on different facts. Reported decisions in such areas serve little useful purpose, and in fact may be counterproductive.[23]

But this is not one of those areas. Congress did not invite bankruptcy judges to grant or deny the discharge based on an amorphous, individualistic finding such as "reasonable" or "good faith." Instead, it made the requisite determination hinge on intent, something that common law precedent has successfully refined over the centuries, particularly in tort law and in criminal law. Consequently here is it appropriate for courts to seek to refine and define the requisite intent, so that the evolution of precedent may in the long rung yield predictable, practical rules.

And this is an area of law where that effort is particularly needed and important. As noted by the *Tveten* dissent, "[d]ebtors deserve more definite answers" than "each bankruptcy judge's sense of proportion." 848 F.2d at 879 (Arnold, J., dissenting). Without more definite answers, "debtors will be unable to know in advance how far the federal courts will allow them to exercise their rights under state law." *Id.* The result will be that some debtors who relied on well intentioned advice of counsel may be denied a discharge, the bankruptcy equivalent of the death penalty, while others receive an unconscionable benefit, perhaps through ignorance or perhaps through cunning. And as the *Tveten* dissent also emphasizes, for the judiciary to deny an exemption that the legislature has provided simply because the judge finds it out of proportion is to invade the province of the legislative branch. *Id.* at 878.

Both the second and third categories of the badges of fraud merely underscore that the debtor intended to take advantage of available exemptions. The timing factors make that more evident than if the exempt property were purchased before bankruptcy was imminent, and engaging in an otherwise uneconomic transaction eliminates another possible motive, but neither of these makes the intent any more than an intent to utilize available exemptions. And since all authorities (except perhaps the Eighth Circuit) agree that that intent is not penalized or forbidden by

23. *See* Lawrence Ponoroff, *The Dubious Role of Precedent in the Quest for First Principles in the Reform of the Bankruptcy Code: Some Lessons from the Civil Law and Realist Traditions,* 74 Am. Bankr.L.J. 173 (Spring 2000).

§ 727(a)(2)(A), that intent is not transformed into something more evil by its timing or even by the size of the transaction. Fortunately the Arizona legislature has spared both debtors and judges problems such as *Tveten*, by imposing dollar limits on almost all exemptions, and an additional timing limitation on the only one readily capable of substantial prebankruptcy exemption planning.[24]

Based on the foregoing, the Court concludes that the showing of only the timing badges of fraud is insufficient to support summary judgment for Murphey. Because Murphey has made no showing of a badge of fraud falling in the first category, Murphey's motion for summary judgment is denied.

In re Paul and Veda GARSKE, Debtors.

Veda Garske, et al., Plaintiffs,

v.

Arcadia Financial, Ltd., Defendant.

Bankruptcy No. 98-13427.
Adversary No. 00-1139.

United States Bankruptcy Court, N.D. California.

April 8, 2002.

Chapter 7 debtors, who retained a secured creditor's collateral without formally reaffirming the debt and thereafter became delinquent, brought class action against creditor alleging violation of discharge injunction. On creditor's motion for summary judgment, the Bankruptcy Court, Alan Jaroslovsky, J., held that telephone calls from creditor to Chapter 7 debtors after discharge, in which creditor threatened to repossess its collateral if delinquent payments were not brought current, did not violate discharge injunction.

Motion granted.

1. Bankruptcy ⟹2364

Telephone calls from creditor to Chapter 7 debtors after discharge, in which creditor threatened to repossess its collateral if delinquent payments were not brought current, did not violate discharge injunction; phone calls were not per se improper collection activity and there was no indication that creditor told or implied to any debtor that there would have been any consequence beyond repossession if payments were not current, there was no showing that creditor continued to contact any debtor after debtor told creditor to repossess its collateral, and phone calls were not used for improper purpose, nor did they stray into improper collection activity. Bankr.Code, 11 U.S.C.A. § 524(a)(2).

2. Bankruptcy ⟹2364

In order to violate the discharge injunction, a creditor must take action to collect a debt as a personal liability of the debtor. Bankr.Code, 11 U.S.C.A. § 524(a)(2).

Richard V. Day, Napa, CA, for Debtors.

24. A.R.S. §§ 33-1126(A)(6) & (B).

Law Enforcement Center in Pecos, Texas on July 11, 1989 while awaiting [trial] for the instant offense." It recommended that Garcia-Gil's offense level be increased by two levels pursuant to § 3C1.1 of the United States Sentencing Guidelines, because he had "attempted to impede the administration of justice during the prosecution of the instant offense." The district court accepted this recommendation. On appeal, Garcia-Gil challenges this increase, arguing only that "[a]n escape attempt based on the paltry facts known below can hardly be said to come under the aegis of § 3C1.1." Garcia-Gil has put forward nothing to convince us that the district court was clearly erroneous in finding that he attempted to escape from jail. Furthermore, we conclude that attempted or actual escapes do come under the aegis of § 3C1.1.

At the time of Garcia-Gil's offenses, § 3C1.1 covered defendants who "willfully impeded or obstructed, or attempted to impede or obstruct, the administration of justice during the investigation or prosecution" of their offenses. Does this definition include attempted escape pending trial? For offenses committed after November 1, 1990, the answer is yes. Application Note 3(e) provides that § 3C1.1 applies to "attempting to escape from custody before trial or sentencing." Prior to amendment, the commentary did not list attempted escape as an example of covered conduct, but it specifically noted that the examples listed were "not exclusive." Application Note 1 (replaced 1990). This non-exclusivity contemplates that the courts will scrutinize conduct for inclusion within § 3C1.1 as situations arise. Having considered the situation in this case, we conclude that an escape or an attempted escape may constitute the willful obstruction of justice for sentencing offenses committed before November 1, 1990. That the Sentencing Commission now explicitly agrees with this conclusion provides more, not less, support for our holding.

If the administration of justice includes the ability of the government to produce for scheduled judicial proceedings those persons lawfully in its custody, then the administration of justice is practically obstructed or impeded when such persons escape from custody, presumably never to appear in court. It follows that an attempt to escape is an attempt to obstruct or impede. Other circuits have reached similar conclusions. *See United States v. Teta*, 918 F.2d 1329, 1334-35 (7th Cir.1990) ("defendant's willful failure to appear"); *United States v. Perry*, 908 F.2d 56, 59 (6th Cir.) (defendant who "jumped bond before sentencing"), *cert. denied*, — U.S. —, 111 S.Ct. 565, 112 L.Ed.2d 571 (1990); *United States v. Avila*, 905 F.2d 295, 297 (9th Cir.1990) (defendant who "absconded from supervised [pretrial] release and remained a fugitive for five months"). If failing to appear, jumping bond, and absconding from pretrial release are obstructions of justice, so is escaping or attempting to escape from actual custody. The district court correctly applied § 3C1.1 and increased Garcia-Gil's sentence.

Finding no errors in the proceedings below, we sustain both the convictions and the sentences of defendants Rugerio Valdiosera-Godinez and Alejandro Garcia-Gil.

AFFIRMED.

In the Matter of Denis Edward BOWYER, Debtor.

NCNB TEXAS NATIONAL BANK, formerly First Republicbank Austin, Appellant,

v.

Denis Edward BOWYER, Appellee.

No. 89-7029.

United States Court of Appeals, Fifth Circuit.

May 23, 1991.

Rehearing and Rehearing En Banc Denied July 22, 1991.

Objection to Chapter 7 debtor's discharge was overruled by the United States

Bankruptcy Court for the Western District of Texas, and the District Court, James R. Nowlin, J., affirmed. On appeal, the Court of Appeals reversed and remanded, 916 F.2d 1056, but, on petition for rehearing, held that evidence supported finding that sale of gold and use of debtor's savings to repair his exempt residence were not transfers made to defraud, hinder or delay creditors.

Affirmed.

Barksdale, Circuit Judge, filed dissenting opinion.

1. Bankruptcy ⇐3317(5)

Bankruptcy court's finding in discharge proceeding that Chapter 7 debtor did not decide to file bankruptcy petition until October, 1987, after sale of gold "Mapleleafs" allegedly to defraud creditors, was supported by evidence, and thus, evidence supported finding that sale of gold and use of debtor's savings to repair his exempt residence were not transfers made to defraud, hinder or delay creditors so as to warrant denial of discharge; at about time of sale of assets, debtor and his wife withdrew $25,000 from savings and made advance, unscheduled payments on their note, which was incompatible with intent to default on note and file petition. Bankr. Code, 11 U.S.C.A. § 727(a)(2)(A).

2. Bankruptcy ⇐3317(5)

Determination that Chapter 7 debtor, whose wife withdrew $24,000 from savings and paid it on homestead mortgage approximately 15 days before bankruptcy petition was filed, did not have intent to delay or hinder creditors, as required for denial of discharge based on transfer of property with intent to hinder, delay, or defraud creditor, was supported by evidence. Bankr.Code, 11 U.S.C.A. § 727(a)(2)(A).

Joanalys B. Smith, Thomas T. Rogers, Small, Craig & Werkenthin, Austin, Tex., for appellant.

William C. Davidson, Jr., Austin, Tex., for appellee.

Appeal from the United States District Court For the Western District of Texas.

ON PETITION FOR REHEARING

(Opinion November 14, 1990, 5th Cir. 916 F.2d 1056)

Before WISDOM, DAVIS and BARKSDALE, Circuit Judges.

PER CURIAM:

On reflection, we are persuaded that we did not give the bankruptcy court's findings the required deference. When we give those findings the deference that is due them, we conclude that the bankruptcy court and the district court correctly granted discharge to Bowyer under the Bankruptcy Code.

I.

[1] The bankruptcy court's finding that Dr. Bowyer did not decide to file a bankruptcy petition until October 1987 is critical. If that finding is not clearly erroneous, the July and August 1987 transactions we relied on in our earlier opinion to deny Bowyer's discharge have limited relevance. More particularly, the bank's argument that the July sale of the gold Mapleleafs was a transfer with intent to hinder, delay or defraud a creditor loses its force unless Dr. Bowyer sold this asset to avoid having it fall into his bankrupt estate. If in July 1987 Dr. Bowyer intended to pay NCNB's note when due and had no plans to file bankruptcy, this sale and the expenditure of funds realized from that sale have little significance for our purposes. The same analysis applies to Dr. Bowyer's expenditure of approximately $7,000 in non-exempt funds on improvements to his home in July or August.[1]

On reconsideration, we conclude that the record adequately supports the bankruptcy court's finding that Dr. Bowyer did not decide to file a bankruptcy petition until

1. Dr. Bowyer spent most of this sum to install central heating and air conditioning in his home, hardly an extraordinary expense for one residing in Austin, Texas.

October 1987. One undisputed piece of evidence strongly supports this finding. In June and July 1987, Dr. Bowyer and his wife withdrew $25,000 from their savings and paid this sum to NCNB as advance, unscheduled payments on their note. We agree with the bankruptcy court that the Bowyer's $25,000 advance payments on their note in July is completely incompatible with an intent to default on the note and file a bankruptcy petition. We conclude therefore that the district court's finding that Bowyer did not intend to file a bankruptcy petition until October 1987 is not clearly erroneous. It follows that the district court did not err in concluding that Bowyer's sale of his gold Mapleleafs and the use of savings to repair his residence were not transfers made to defraud, hinder or delay creditors.

II.

[2] The only other transaction relied upon by NCNB to support its argument that Dr. Bowyer is not entitled to discharge was Bowyer's conversion of non-exempt funds to enhance his equity in his exempt residence. As stated in our original opinion, Bowyer's wife withdrew $24,000 from savings and paid it on their homestead mortgage approximately fifteen days before the bankruptcy petition was filed on October 28, 1987. The bankruptcy court and the district court correctly concluded that this transaction will not defeat Bowyer's discharge.

Collier on Bankruptcy states the well-settled rule that: "Under the former Act, the mere conversion of non-exempt property into exempt property on the eve of a bankruptcy was not of itself such fraud as will deprive the bankrupt of his right to exemptions." 3 *Collier on Bankruptcy* § 522.08[4] (15th ed. 1991). Before the Bankruptcy Code was adopted in 1978, strong arguments were made to change that rule so that property obtained in last minute conversions would be ineligible for exemption. Both the House and Senate Reports rejected those arguments:

> As under current law, the debtor will be permitted to convert non-exempt property into exempt property before filing a bankruptcy petition. The practice is not fraudulent as to creditors, and permits the debtor to make full use of the exemptions to which he is entitled under the law.

H.R.Rep. No. 595, 95th Cong., 1st Sess. 361 (1977), *reprinted in* 1978 U.S.Code Cong. & Admin.News 5963, 6317 (citation omitted); S.Rep. No. 989, 95th Cong., 2d Sess. 76 (1978), *reprinted in* 1978 U.S.Code Cong. & Admin.News 5787, 5862; see *Matter of Reed*, 700 F.2d 986, 990 (5th Cir. 1983).

Of course, conversion of non-exempt assets into exempt assets may be relevant where other evidence proves actual intent to defraud creditors. *See Reed*, 700 F.2d at 991. But in *Reed*, the debtor's conduct was much more egregious than the conduct of Bowyer in this case.[2] Also, the district court in *Reed* found as a matter of fact that the debtor intended to defraud his creditors. Critically, the factfinder in today's case found no such fraudulent intent.

The NCNB Bank made no specific argument to the bankruptcy court or the district court that Dr. Bowyer's transfers, while not fraudulent, were made with the intent to hinder or delay creditors. It is doubtful therefore that the bankruptcy court was placed on notice that a specific finding was necessary on the debtor's non-fraudulent intent to hinder or delay creditors. Even if we interpret the bank's pleadings as raising this issue, the district court's findings are sufficient to make it unnecessary to remand for additional findings on this point. The factual findings of the district

2. The *Reed* court summarizes Reed's conduct as follows:

> His rapid conversion of nonexempt assets to extinguish one home mortgage and to reduce another four months before bankruptcy, after arranging with his creditors to be free of payment obligations until the following year, speaks for itself as a transfer of property in fraud of creditors. His diversion of the daily receipts of Reed's Mens Wear into an account unknown to his creditors and management consultant and his subsequent use of the receipts to repay a loan that had been a vehicle for this conversion confirm his fraudulent motivation.

700 F.2d at 991–92.

court fully support its legal conclusion that Bowyer's $24,000 payment from non-exempt savings on his exempt homestead was legitimate pre-bankruptcy planning. Thus, that transaction cannot support a finding of intent to delay or hinder creditors.

We have carefully considered the additional arguments NCNB raised in its appeal which we did not reach in our earlier opinion.[3] For the reasons assigned by the bankruptcy court in its August 12, 1988 findings of fact and conclusions of law, we conclude that it correctly resolved these issues.

For the reasons stated above, Bowyer's application for rehearing is GRANTED and the judgment of the district court is AFFIRMED.

BARKSDALE, Circuit Judge, dissenting:

I respectfully dissent. Our original opinion, 916 F.2d 1056, correctly applied 11 U.S.C. § 727(a)(2)(A); we held that the bankruptcy and district courts erred by not holding that the conversion of non-exempt to exempt property was undertaken with the intent to hinder or delay a creditor.

Section 727(a)(2)(A) prohibits, under certain conditions, an action taken with "intent to *hinder, delay,* or defraud a creditor...." (Emphasis added.) As addressed in our original opinion, "the term 'defraud' does not subsume 'hinder or delay.'" 916 F.2d at 1059. And, at each stage of these proceedings, the Bank has contended that the conversion was, among other things, made with intent to hinder or to delay. As held in our previous opinion, the error arose out of focusing on intent to defraud, and failing to address separately intent to hinder or intent to delay.

By granting rehearing and affirming the judgment of the district court, the majority, I respectfully submit, continues this error.

3. The Bank contends that Bowyer: fraudulently or knowingly made a false oath or account, under 11 U.S.C. § 727(a)(4); did not satisfactorily explain the dissipation of assets, under 11 U.S.C. § 727(a)(5); made a false statement in writing, under 11 U.S.C. § 523(a)(2)(B); and obtained refinancing by actual fraud or misrepresentation, under 11 U.S.C. § 523(a)(2)(A).

LAKEDREAMS, a Texas partnership, Plaintiff-Appellee,

v.

Steve TAYLOR, d/b/a California T's, Defendant-Appellant.

No. 90-1472.

United States Court of Appeals, Fifth Circuit.

June 11, 1991.

In action for, inter alia, copyright infringement, the United States District Court, Northern District of Texas, Samuel Ray Cummings, J., granted preliminary injunction precluding alleged infringer from distributing shirts containing design and text substantially similar to that appearing in alleged owner's copyright application. Alleged infringer appealed. The Court of Appeals, Johnson, Circuit Judge, held that District Court did not abuse its discretion in issuing preliminary injunction.

Affirmed.

1. Federal Courts ⇐571, 572

To be appealable, order must be final, it must fall within specific class of interlocutory orders made appealable by statute, or it must fall within some jurisprudential exception. 28 U.S.C.A. §§ 1291, 1292(a).

2. Federal Courts ⇐577

Court of Appeals lacked jurisdiction to review district court's denial of alleged copyright infringer's motion to dismiss, even though motion was made during injunction hearing; there was no indication that district court consolidated preliminary injunction with trial on merits and order granting preliminary injunction made no

the allegations of the complaint. The conduct criticized by the judge was defense counsel's failure to divulge its $25,000 policy limit until the morning of trial. This conduct occurred well after the removal. As of the date of removal, both State Farm and its insured, Lee, were still in this case, because defendant Lee had not as yet been dismissed. The state court petition alleged that plaintiff sustained "neck and shoulder injuries, including the aggravation of an osteoarthritic condition and possibly a torn rotator cuff among other injuries." With Lee present in the suit, the plaintiff's possible damages could have exceeded the policy limits and indeed the $50,000 requirement for diversity jurisdiction.

[4] The plaintiff would disregard Mr. Lee, the second defendant, because he was never served. Yet Title 28 does not oblige a defendant to wait until all co-defendants are served before removing. A defendant may remove a case without joinder of a non-served, non-resident defendant. See 14A Wright, Miller & Cooper, Federal Practice and Procedure § 3731 at 509–10 (1985); see also 28 U.S.C.A. § 1448 (West 1973) (providing for service of process on unserved defendants after removal).

In this case, plaintiff requested judgment in no specific sum in the state court suit, consistent with Article 893 of the Louisiana Code of Civil Procedure. The defendant was unable to persuade plaintiff to stipulate that his damages were less than $50,000. At the time of the removal, defense counsel reasonably considered the potential for a judgment against Lee as well as State Farm, as counsel could not foresee Lee's dismissal. *Cf. St. Paul Mercury Indem. Co. v. Red Cab Co.*, 303 U.S. 283, 292–93, 58 S.Ct. 586, 592, 82 L.Ed. 845 (1938) (events occurring *after* removal which reduce amount in controversy do not oust district court's jurisdiction once it has attached); *Federal Savings & Loan Ins. Corp. v. Griffin*, 935 F.2d 691, 696 (5th Cir. 1991) (dismissal of a party *after* removal does not affect propriety of the removal), *cert. denied*, — U.S. —, 112 S.Ct. 1163, 117 L.Ed.2d 410 (1992).

We find no impropriety in State Farm's removal of the complaint as it appeared at the time of the removal and the district court erred in awarding attorneys fees against defendant.

[5] As for costs, we find nothing in the jurisprudence to suggest that the court abused its discretion in ordering defendant to pay costs of the proceedings. An award of costs has never been predicated on a finding of bad faith or negligent or frivolous removal. *See News-Texan, Inc. v. City of Garland*, 814 F.2d 216, 220 (5th Cir.1987); *Bucary*, 883 F.2d at 449. According to the above quoted commentary on the 1988 amendment, fees should be awarded only if it was improper for the defendant to remove; no such restriction on a court's discretion to award costs is suggested in the amendment.

The award of fees is therefore vacated, but the order awarding court costs is affirmed. Because the rest of this case has been remanded to state court, the district court has no further jurisdiction and remand to that court is unnecessary.

VACATED in part and AFFIRMED in part.

In the Matter of David Marvin SWIFT, d/b/a State Farm Insurance, Debtor.

David Marvin SWIFT, d/b/a State Farm Insurance, Appellant,

v.

The BANK OF SAN ANTONIO, Appellee.

No. 92-5698.

United States Court of Appeals, Fifth Circuit.

Oct. 8, 1993.

Rehearing Denied Nov. 3, 1993.

In Chapter 7 case, the Bankruptcy Court denied discharge on ground that debtor transferred, concealed or disposed of

property within one year before filing with intent to hinder, delay or defraud creditors. Debtor appealed. The United States District Court for the Western District of Texas, H.F. Garcia, J., 126 B.R. 725, affirmed. Debtor appealed. The Court of Appeals, Edith H. Jones, Circuit Judge, held that debtor's transactions with relatives immediately prior to filing bankruptcy which had effect of disposing of or encumbering debtor's only nonexempt assets was with intent to hinder, defraud, delay or conceal estate assets from creditors justifying denial of discharge.

Affirmed.

Bankruptcy ⚷3276.1, 3277

Chapter 7 debtor's transactions with relatives including prepaying alimony to ex-wife, transferring insurance policies to son who, after borrowing against them, transferred funds back to ex-wife who then loaned funds back to debtor who gave her promissory note day before bankruptcy, and borrowing money from daughter in exchange for promissory notes secured by debtor's interests in personal property was with intent to hinder, defraud, delay or conceal estate assets from his creditors justifying denial of discharge; debtor's rationale, among others, that he borrowed from relatives because he needed cash to fund bankruptcy proceeding was not believable since debtor's monthly cash flow from his insurance business continued to be substantial. Bankr.Code, 11 U.S.C.A. § 727(a)(2).

R. Mark Dietz, Dietz & Associates, Round Rock, TX, for appellant.

Michael G. Colvard, Martin, Shannon & Drought, San Antonio, TX, for appellee.

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

Before JONES and DeMOSS, Circuit Judges and BARBOUR *, District Judge.

EDITH H. JONES, Circuit Judge:

Appellant Swift is an insurance agent in San Antonio, Texas, who filed Chapter 7 bankruptcy on March 1, 1990. He has appealed the bankruptcy court's determination, affirmed by the district court, 126 B.R. 725 (Bankr.W.D.Tex.1991), that his discharge should be barred because he transferred, concealed or disposed of property within one year before filing with the intent to hinder, delay or defraud creditors. 11 U.S.C. § 727(a)(2). Finding no clear error in the court's findings of fact,[1] we affirm.

As a caution to those who might hope to take unfair advantage of the liberality of bankruptcy discharge provisions, the transactions in which Swift engaged just before bankruptcy should be summarized. Reviewing the evidence, the bankruptcy court concluded that Swift gambled and lost on the discharge of $2,000,000 in debt by engaging in "cute" transactions that involved approximately $20,000 of his estate. The net effect of these transactions, however, was to dispose of or encumber his only non-exempt assets. The court also concluded that Swift would not be shielded by the fact that he consulted with numerous attorneys before engaging in these transactions. As the court found, the transactions were not simply innocent pre-bankruptcy planning. *Matter of Reed*, 700 F.2d 986 (5th Cir.1983). The transactions, all accomplished within a couple of months before bankruptcy, were as follows:

1. Swift prepaid $5,000 in alimony or property settlement to his ex-wife. The payments would not have been due until after bankruptcy, and they would have been non-dischargeable, personal obligations of Swift. He used estate money to make the payments.

2. Swift used estate funds to prepay the remaining liability on his Chevrolet Suburban truck. Contrary to his representations,

* Chief Judge of the Southern District of Mississippi, sitting by designation.

1. This court has recently held that the burden of proof on objections to discharge is by the preponderance of the evidence. *In re Beaubouef*, 966 F.2d 174 (5th Cir.1992). The bankruptcy court applied this standard. The court also denied discharge based on 11 U.S.C. § 727(a)(4), but we do not reach that aspect of his decision.

this was not a payment in the ordinary course of business.

3. Despite having in hand a legal opinion that certain insurance renewal commissions were property of the estate, Swift underreported those commissions on his schedules. The court found $18,000 due in renewal commissions; Swift reported only $6,000.

4. Swift transferred insurance policies to his 20-year old son, who, after borrowing against them, transferred the funds to Swift's ex-wife. The ex-wife then loaned the funds back to Swift, who gave her a promissory note the day before bankruptcy. As the bankruptcy court put it, "it's kind of like what happens to a lemon; [Swift] just squeezed the juice out of it and then gave the rind back to the estate."

5. Swift's daughter loaned money to her father in exchange for a promissory note, secured by Swift's interest in his furniture and fixtures, renewal commissions, boat, motor and trailer.

In evaluating Swift's intention, the court observed his evasiveness and deception, not only at trial but also in the filing of his schedules and in his testimony at the section 341 creditors' meeting. The court did not believe Swift's rationale, among others, that he borrowed from relatives because he needed cash to fund the bankruptcy proceeding; Swift's monthly cash flow from his insurance business continued to be substantial.

Based on these transactions and his credibility decision, the bankruptcy court did not clearly err in concluding that Swift completed them with intent to hinder, defraud, delay or conceal estate assets from his creditors. As the court pointed out, nearly every asset in his estate had been tampered with before bankruptcy. Unfortunately, the line between legitimate pre-bankruptcy planning and intent to defraud creditors contrary to section 727(a)(2) is not clear. *Northwest Bank Nebraska, N.A. v. Tveten*, 848 F.2d 871, 879 (8th Cir.1988) (Arnold, J., dissenting). One court simply stated, "there is a principle of too much; phrased colloquially, when a pig becomes a hog it is slaughtered." *In re Zouhar*, 10 B.R. 154, 157 (Bankr.D.N.M.1981). As the finder of fact, the bankruptcy court has the primary duty to distinguish hogs from pigs. *Compare Matter of Bowyer*, 916 F.2d 1056 (5th Cir.1990) (reversing bankruptcy court), op. on reh., 932 F.2d 1100 (5th Cir.1991) (affirming bankruptcy court and finding intent to hinder, delay or defraud creditors on facts before it).

The judgments of the bankruptcy and district courts are AFFIRMED.

Michael K. TOPALIAN, et al., Plaintiffs,

Roy Jacobs, Jr., Richard H. Manuel, and Bobby W. McDonald, Plaintiffs-Appellants,

and

Armando Lopez, Appellant,

v.

John N. EHRMAN, etc., et al., Defendants-Appellees.

No. 91-2818.

United States Court of Appeals, Fifth Circuit.

Oct. 12, 1993.

Rehearing Denied Nov. 9, 1993.

The United States District Court for the Southern District of Texas, Norman W. Black, Chief Judge, imposed sanctions in amount of $1,000 each on plaintiff investors in securities action, who were officers and directors of one of the defendant companies, and imposed sanction in excess of $300,000 on investors' attorney, and investors and their attorney appealed. The Court of Appeals, DeMoss, Circuit Judge, held that: (1) Rule 11 sanctions against investors were permissible since district court had discretion to impose sanctions against nonsigning represented parties for violations of rule by their attorney, and (2) sanction in excess of $300,000 against attorney required very specific factual bases from which Court of Appeals

III. *Conclusion*

For the foregoing reasons, the mortgage executed by Debtor on January 13, 2005 in favor of Defendants was not a preferential transfer in violation of 11 U.S.C. § 547(b). Plaintiff's Motion for Summary Judgment is denied and Defendants' Motion for Summary Judgment is granted. Plaintiff's Complaint is dismissed.

In re Charlene I. VANGEN, Debtor.

No. 05–13793–7.

United States Bankruptcy Court,
W.D. Wisconsin.

Nov. 23, 2005.

Background: Chapter 7 trustee and creditor, debtor's former husband, objected to debtor's claim of a Wisconsin exemption in retirement-related annuities, asserting that she had engaged in impermissible pre-bankruptcy exemption planning.

Holdings: The Bankruptcy Court, Thomas S. Utschig, J., held that:

(1) absent extrinsic evidence of fraud, a debtor's conversion of nonexempt assets into exempt assets will not, by itself, be regarded as evidence of fraudulent intent, as would warrant denial of the exemption under Wisconsin law, and

(2) here, plaintiffs failed to present sufficient extrinsic evidence of fraud to overcome the general rule that a debtor may arrange her affairs so as to take full advantage of the exemptions available to her under state law.

Objection denied.

1. Exemptions ⟹49

Under Wisconsin law, all that is required for an annuity to fall within the exemption for retirement benefits is that it qualify for tax-deferred status under the federal Internal Revenue Code. W.S.A. 815.18(3)(j).

2. Exemptions ⟹37

Unlike the federal exemption for a debtor's right to receive a payment under an annuity, the Wisconsin exemption for such annuities places no restriction on the amount claimed as exempt. 11 U.S.C.A. § 522(d)(10); W.S.A. 815.18(3)(j).

3. Exemptions ⟹104

Under Wisconsin law, an exemption may be denied where the asset in question was procured, concealed, or transferred with the intention of defrauding creditors. W.S.A. 815.18(10).

4. Bankruptcy ⟹3271

Bankruptcy relief is intended to afford the "honest but unfortunate" debtor the proverbial "fresh start."

5. Bankruptcy ⟹2363.1, 2761

Although part of a debtor's "fresh start" is the notion that the debtor may retain certain assets in order to begin a new financial life, the law also recognizes that there is a point at which the fresh start becomes an impermissible "head start."

6. Exemptions ⟹10

Debtors are to be permitted the full use of available exemptions and will not be penalized for ordering their affairs in such a manner as to take best advantage of the exemptions legally afforded to them.

7. Exemptions ⟹104

Pursuant to the Seventh Circuit's *Smiley* decision, extrinsic signs of fraud

indicating fraudulent intent on the part of a debtor engaging in exemption planning include: (1) whether debtor obtained credit in order to purchase exempt property, (2) whether the conversion occurred after the entry of a large judgment against debtor, (3) whether debtor had engaged in a pattern of "sharp dealing" prior to bankruptcy, and (4) whether the conversion rendered debtor insolvent.

8. Exemptions ⚷104

Among the *Bogue* factors considered in determining whether a debtor's conversion of assets from nonexempt to exempt justifies denial of the exemption under Wisconsin law are the amount of the exemption, the proximity of the time of conversion to the time of filing bankruptcy, the source of the funds, whether the debtor misled creditors during the conversion process, the purpose of the conversion, and whether the conveyances were for less than fair consideration. W.S.A. 815.18(10).

9. Bankruptcy ⚷2798

Bankruptcy Code contemplates that the simple practice of taking advantage of exemption laws is not fraudulent per se; there must be additional, or "extrinsic," evidence of fraud.

10. Exemptions ⚷104

In determining whether, under Wisconsin law, a debtor's conversion of nonexempt property to exempt property was done with fraudulent intent, so as to warrant denial of the exemption, it is not the acquisition of exempt property which is the principal component of the court's inquiry but, rather, the surrounding circumstances; there must be some demonstrable behavior which triggers the notion that the debtor has procured, concealed, or transferred assets with the intention of defrauding creditors. W.S.A. 815.18(10).

11. Exemptions ⚷104

Whether a debtor has procured, concealed, or transferred assets with the intention of defrauding creditors, so as to warrant denial of a claimed exemption under Wisconsin law, is a fact-intensive inquiry which must rest upon an examination of the particular case. W.S.A. 815.18(10).

12. Exemptions ⚷104

Absent extrinsic evidence of fraud, a debtor's conversion of nonexempt assets into exempt assets will not, by itself, be regarded as evidence of fraudulent intent, as would warrant denial of the exemption under Wisconsin law, even if done on the eve of bankruptcy and with the express purpose of placing that property beyond the reach of creditors. W.S.A. 815.18(10).

13. Exemptions ⚷49

Wisconsin exemption for retirement benefits has no standard for limiting an annuity to a judicially determined "reasonable amount." W.S.A. 815.18(3)(j).

14. Exemptions ⚷104

Parties objecting to claim of Wisconsin exemption in retirement-related annuities by Chapter 7 debtor, who admittedly converted nonexempt assets to exempt assets in anticipation of bankruptcy, failed to present sufficient extrinsic evidence of fraud to overcome general rule that a debtor may arrange her affairs so as to take full advantage of available state-law exemptions; although debtor's $136,000.00 exemption was larger than exemptions claimed in some prior cases, it was not exorbitant considering that it was to serve as debtor's principal source of retirement income, debtor did not obtain the funds through theft or wrongful appropriation, but by converting assets she already owned, the equity in her home and her interest in a commercial building, into an exempt asset, debtor sold her interest in the commercial building for fair market

value, and while debtor may have sought to place assets beyond creditor's reach, her motivation in doing so was to create a retirement fund. W.S.A. 815.18(3)(j), (10).

Galen W. Pittman, Galen W. Pittman, S.C., La Crosse, WI, for Debtor.

James W. McNeilly, Jr., Bosshard Parke, Ltd., La Crosse, WI, Chapter 7 Trustee.

Timothy S. Jacobson, Kevin M. Connelly, O'Flaherty Heim Egan, Ltd., La Crosse, WI, for Creditor.

MEMORANDUM OPINION, FINDINGS OF FACT, AND CONCLUSIONS OF LAW

THOMAS S. UTSCHIG, Bankruptcy Judge.

When the debtor filed bankruptcy, she listed several retirement accounts and annuities among her assets. She also claimed these accounts as exempt on her Schedule C. Both the chapter 7 trustee and a creditor, Larry Vangen, have objected to the debtor's exemption claims and contend that the exemption should be denied, at least in part, because the debtor engaged in impermissible pre-bankruptcy planning and converted nonexempt assets into the assets now claimed as exempt. This case poses intriguing questions regarding the issue of "exemption planning." It also represents the truth of the old saw that divorce is never final, as it has its genesis in the dissolution of the debtor's marriage some twelve years ago.

The debtor was married to the creditor, Larry Vangen. They were divorced in 1993. At the time of the divorce, Larry Vangen was a named defendant in litigation relating to Hawkins, Ash, Baptie & Co., the accounting firm in which he is a partner. The principal allegation in that state court lawsuit, styled *Management Computer Services, Inc. v. Hawkins, Ash, Baptie & Co., et al.*, was that HABCO and its partners conspired to utilize the plaintiff's software without compensation in the licensing of turnkey computer operations, and the plaintiff sought a significant amount of damages. As the divorce court recognized, were liability to be assessed against HABCO in the litigation, that obligation would pass through to the individual partners as well. In the context of dividing the parties' assets and liabilities, the court found the lawsuit to be "a difficult issue" for both parties. In its August 10, 1993, findings of fact, conclusions of law, and judgment of divorce, the court stated:

> As the court understands the lawsuit, there are allegations that the partnership made a substantial amount of money from breaching a contract. Obviously, the respondent was one of the people who benefitted by having an increased income from that breach. The petitioner [Charlene Vangen, the debtor in this case] also benefitted from that additional income. If she was the beneficiary of income that the parties should not have received because it came from a contract that was breached, then she should bear the detriment if there is one. If the respondent was a plaintiff in a lawsuit and was perhaps to receive or be the beneficiary of a $5 million verdict in his favor, the Court suspects that the petitioner would certainly assert that she was entitled to a portion of that money since it accrued during the course of the marriage. The fact that this lawsuit is a liability rather than an asset does not change the legal reasoning, particularly because it appears that the amount that is going to be paid or may be paid to settle the lawsuit is based on the amount of income that the respondent in fact

received during that period of time. There is certainly a direct connection.

Consequently, the divorce court therefore determined that the debtor was "responsible for one-half of whatever liability the respondent has." The lawsuit, however, was not resolved by way of a settlement as contemplated by the divorce court. Instead, it went to trial, and the jury found in favor of the plaintiff. The awards were indeed substantial, including a significant amount of punitive damages which were not directly related to the "amount of income that the respondent in fact received during that period of time." The HABCO defendants appealed the judgment, which wound its way through the state court appellate system, but ultimately HABCO and its partners were obligated to pay a sizeable judgment. Larry Vangen's share of the obligation amounted to approximately $800,000; pursuant to the divorce decree, the debtor was responsible for one-half of this debt, or approximately $400,000.

The debtor subsequently asked the divorce court to reconsider its earlier order, which the court refused to do. In November of 2004, the divorce court determined that the original divorce decree would be enforced and that the debtor was still responsible for one-half of Larry Vangen's total litigation-related liability, even though it would appear difficult to conclude that the resulting obligation was in fact casually connected to the "increased income" the debtor purportedly received during the marriage.[1]

[1, 2] Shortly after the hearing before the divorce court, the debtor began consulting with attorneys regarding her options, bankruptcy among them. The debtor mortgaged her home (which had a small lien against it at the time) and sold an interest in a building leased to HABCO. She placed the $136,000 she received as a result in retirement-related annuities and filed bankruptcy. In her bankruptcy schedules, she claimed these retirement funds as exempt under Wis. Stat. § 815.18(3)(j). This section provides that debtors may claim as exempt assets which are held under "any retirement, pension, disability, death benefit, stock bonus, profit sharing plan, annuity, individual retirement account, individual retirement annuity, Keogh, 401–K or similar plan...." All that is required for an annuity to be exempt under this section is that it qualify for tax-deferred status under the Federal Internal Revenue Code. *In re Bruski*, 226 B.R. 422, 425 (Bankr.W.D.Wis.1998). And unlike the federal exemption found in 11 U.S.C. § 522(d)(10), the Wisconsin exemption for such annuities places no restriction on the amount claimed as exempt. *Id.*

[3] Larry Vangen and the bankruptcy trustee both objected to her exemption claims. They contend that her "pre-bankruptcy planning" justifies denial of the exemption under Wis. Stat. § 815.18(10), which provides that an exemption may be denied where the asset in question was procured, concealed, or transferred with the intention of defrauding creditors.[2] The debtor concedes that she purchased the annuities while considering whether to file bankruptcy. However, she denies that she engaged in any behavior which could

1. Indeed, to the extent that Larry Vangen's $800,000 judgment debt included punitive damages, such damages do not necessarily reflect the amount of income Vangen "actually received" as a result of any breach.

2. The section specifically provides that "[a]ny or all of the exemptions granted by this section may be denied if, in the discretion of the court having jurisdiction, the debtor procured, concealed, or transferred assets with the intention of defrauding creditors."

be considered fraudulent, and contends that her principal concern was her retirement, especially since she was worried about the viability of any payout under her husband's retirement plan.

The objection to the debtor's exemption is premised upon a few basic facts. First of all, in November of 2004, the debtor's home was worth approximately $200,000; the only lien against her homestead was a first mortgage in the amount of $35,800. She also owned a fractional interest in the building which was leased to HABCO. She consulted with attorneys, after which she refinanced the mortgage on her homestead and received some $130,000. She paid off the first mortgage on her home, paid a few other creditors, and then invested the balance in the AXA Equitable annuity listed on her schedules. A few weeks before she filed bankruptcy, the debtor sold her interest in the HABCO building to her son for the sum of $60,000. Again, she paid a few other bills from the proceeds and then invested the balance in the AXA annuity.

[4, 5] The creditor complains that the debtor "drained" the nonexempt equity from her assets in anticipation of bankruptcy. In that regard, bankruptcy relief is intended to afford the "honest but unfortunate" debtor with the proverbial "fresh start." *See Grogan v. Garner*, 498 U.S. 279, 286, 111 S.Ct. 654, 659, 112 L.Ed.2d 755 (1991). Part of that fresh start is the notion that a debtor may retain certain assets in order to begin a new financial life. However, the law also recognizes that there is a point at which the fresh start becomes an impermissible "head start." The question before the Court is whether the debtor has crossed the line into that forbidden territory.

During the trial in this matter, the debtor essentially acknowledged that both the equity in her home and the interest in the HABCO building would not have been exempt assets. The debtor stated that she had purchased the annuity for retirement purposes. The creditor and the trustee contend that she did so with the anticipation of filing bankruptcy and point to the fact that, during testimony, the debtor conceded that the specific annuity in question was purchased with the expectation that it could be claimed as exempt.

[6] So-called "exemption planning" exists within something of a legal "gray area" in which competing interests conspire to blur the border between the acceptable and the impermissible. Despite the recognition that certain conduct may constitute fraud or be regarded as unreasonable, the law permits debtors to take advantage of the exemptions available to them. Indeed, debtors are to be permitted the "full use" of the available exemptions and will not be penalized for ordering their affairs in such a manner as to take best advantage of the exemptions legally afforded to them. *In re Smiley*, 864 F.2d 562, 567 (7th Cir.1989); *see also Bruski*, 226 B.R. at 425. As Judge Learned Hand stated in a similar context, "[T]here is nothing sinister in so arranging one's affairs as to keep taxes as low as possible." *Commissioner v. Newman*, 159 F.2d 848, 850–51 (2d Cir.1947).

[7] In *Smiley*, the Seventh Circuit wrestled with the issue of exemption planning in the context of the debtor's discharge, and concluded that the conversion of assets from nonexempt to exempt within the year preceding bankruptcy was not automatically fraudulent to creditors. Instead, the court stated that in order to find fraudulent intent, a court must look to "extrinsic signs of fraud," including:

1. Whether the debtor obtained credit in order to purchase exempt property;

2. Whether the conversion occurred after the entry of a large judgment against the debtor;

3. Whether the debtor had engaged in a pattern of "sharp dealing" prior to the bankruptcy; and

4. Whether the conversion rendered the debtor insolvent.

See Smiley, 864 F.2d at 567.

[8] In the case of *In re Bogue*, 240 B.R. 742 (Bankr.E.D.Wis.1999), the court examined a number of factors when considering whether a debtor's conversion of assets from nonexempt to exempt ran afoul of the prohibition found in Wis. Stat. § 815.18(10). Among them were the amount of the exemption, the proximity of the time of conversion to the time of filing bankruptcy, the source of the funds, whether the debtor misled creditors during the conversion process, the purpose of the conversion, and whether the conveyances were for less than fair consideration. *Id.* at 750–51.

[9] To creditors, it is unlikely that any conversion of nonexempt assets into exempt ones would be considered "fair" or "just." But the bankruptcy code contemplates that the simple practice of taking advantage of exemption laws is not fraudulent per se; there must be additional, or "extrinsic," evidence of fraud.[3] State law reflects a similar perspective. For example, in the case of *Paulman v. Pemberton (In re Paulman)*, 246 Wis.2d 909, 633 N.W.2d 715 (Wis.App.2001), the Wisconsin Court of Appeals noted that while the state's homestead exemption is to be "liberally construed," the exemption did not apply to instances where the exemption had been acquired by "conversion, theft, or other wrongful appropriation." In that case, the defendant had purchased a home with funds he conceded had been converted not from his own nonexempt assets but instead from his mother's property; consequently, the exemption was inapplicable. *Id.*, 246 Wis.2d 909, 633 N.W.2d at 719–20.

[10, 11] While *Paulman* was not decided under Wis. Stat. § 815.18(10), it is nonetheless illustrative of the fact that it is not the *acquisition* of exempt property which is the principal component of the court's inquiry, but rather the surrounding circumstances. There must be some demonstrable behavior which triggers the notion that the debtor has "procured, concealed, or transferred assets with the intention of defrauding creditors." This is a fact-intensive inquiry which must rest upon an examination of the particular case. In that regard, the Eighth Circuit's companion cases of *In re Johnson*, 880 F.2d 78 (8th Cir.1989), and *Norwest Bank Nebraska, N.A. v. Tveten*, 848 F.2d 871 (8th Cir. 1988), are quite instructive.

Johnson and Tveten, the debtors in the respective cases, were partners in certain real estate developments which were highly leveraged and ultimately failed. When the developments failed, Tveten became liable for over $19 million, which was far more than he was able to pay. Johnson likewise became responsible for a portion of the debt. Both began converting nonexempt assets into exempt assets. Tveten liquidated virtually all of his nonexempt assets and converted some $700,000 into

3. For example, the report of the House Judiciary Committee on the Bankruptcy Code of 1978 indicates:

> As under current law, the debtor will be permitted to convert nonexempt property into exempt property before filing a bankruptcy petition. *See Hearings*, Pt. III, at 1355–58. The practice is not fraudulent as to creditors, and permits the debtor to make full use of the exemptions to which he is entitled under the law.

H.R.Rep. No. 595, 95th Cong., 2d Sess. 361, *reprinted in* 1978 U.S.Code Cong. & Admin.News 5963, 6317.

life insurance or annuity contracts. Johnson converted some $400,000 into exempt property, including his homestead and annuities and individual retirement accounts. In Johnson's case, the appellate court agreed that there was no fraud as to the homestead exemption but remanded for further proceedings regarding some of the other exemptions.[4] In Tveten's case, the court affirmed the denial of his discharge.

Importantly, however, the court made a number of statements which are relevant to the present inquiry. For example, in *Johnson* the court stated that "we remind the lower courts that there is nothing fraudulent per se about making even significant use of other legal exemptions. Ultimately, fixed dollar limits on the use of exemptions must be set by legislatures." *Johnson*, 880 F.2d at 83. Likewise, in *Tveten*, the court stated that the debtor should not be penalized for merely doing that which the law allows him to do, and reaffirmed the idea that there must be "some facts or circumstances which are extrinsic to the mere facts of conversion of nonexempt assets into exempt." *Tveten*, 848 F.2d at 875.

While *Johnson* and *Tveten* involved the issue of whether excessive exemption planning could result in the denial of a debtor's discharge, the case of *Hanson v. First Nat'l Bank*, 848 F.2d 866 (8th Cir.1988), presented the court with an objection to the exemptions the debtors claimed under state law. In that case, immediately prior to filing bankruptcy the debtors consulted an attorney. On advice of counsel, the debtors sold their nonexempt property, including a car, two vans, and a motor home, to their son for fair market value (as determined by an independent appraisal). They used the proceeds of those sales to purchase life insurance policies, which they subsequently claimed as exempt. A creditor objected to the exemption claims, contending that the conversion of nonexempt assets to exempt assets on the eve of bankruptcy demonstrated fraudulent intent and justified the denial of the exemptions.

[12] The court disagreed and permitted the debtors to claim the exemptions. In doing so, it reaffirmed the fundamental notion that

> [A] debtor's conversion of non-exempt property to exempt property on the eve of bankruptcy for the express purpose of placing that property beyond the reach of creditors, without more, will not deprive the debtor of the exemption to which he otherwise would be entitled.

Id. at 868. The only exception to this principle is where the debtor acts with "actual intent" to defraud creditors; if such intent is proven, the exemption may be denied. *Id.* Absent extrinsic evidence of fraud, however, the conversion of nonexempt assets into exempt assets will not by *itself* be regarded as evidence of fraudulent intent. *Id.* It is important to understand this basic principle in the context of this case, as it largely determines the outcome.

[13] As this Court noted in *Bruski*, and as the Eighth Circuit noted in *Johnson*, the establishment of monetary limits on exemptions is largely the province of the legislature, not the judiciary. At the

4. Johnson's discharge was subsequently denied on remand. *See In re Johnson*, 124 B.R. 290 (Bankr.D.Minn.1991). The court made a number of very specific factual findings regarding the debtor's "actual intent" and concluded that the debtor intended to defraud creditors. Among the findings were the fact that the debtor had cashed his life insurance policies immediately after the bankruptcy filing, and that various exempt musical instruments (including a harpsichord and a piano) purchased with nonexempt funds could not be played by the debtor and were either stored in his basement or at another location.

same time, the Court recognizes the notion that there is a distinction between a fresh start and a "head start," and the colloquial characterization that in the context of exemption planning, "when a pig becomes a hog it is slaughtered." *See In re Zouhar*, 10 B.R. 154, 157 (Bankr.D.N.M.1981). As evidence that the debtor has gone too far in her exemption planning, the creditor and the trustee point to the fact that she has sought to exempt considerably more than the debtors in *Bruski* and *Bogue*. But the Wisconsin exemption has no standard for limiting an annuity to a judicially determined "reasonable amount," even though such provisions can be found elsewhere in the Wisconsin exemption statutes (for example, in the exemptions afforded life insurance claims, personal injury claims, and wrongful death claims).

[14] Consequently, the issue in this case is whether there is "extrinsic evidence" that the debtor "procured, concealed, or transferred assets with the intention of defrauding creditors." Considering the non-exclusive list of factors mentioned by the court in *Bogue*, it is true that the exemption here involves more than has been claimed exempt in some prior cases.[5] At the same time, $136,000 is not a particularly sizeable sum when one considers that it may well serve as the debtor's principal source of retirement income.[6] Admittedly, the debtor funded the annuities in question in anticipation of filing bankruptcy. But that fact is of minimal importance since there must be evidence *beyond* the mere conversion of nonexempt property into exempt assets, whether in anticipation of bankruptcy or not.

As for the source of the funds, there is no basis for considering the money the debtor used to fund the annuities to have been "tainted" in any way. Unlike the defendant in *Paulman*, for example, there was no evidence that the debtor obtained the funds through conversion, theft, or wrongful appropriation. In *Hanson*, the court noted an extrinsic example of fraudulent intent might be an instance in which the debtor had "obtain[ed] goods on credit, [sold] them, and then place[d] the money into exempt property." 848 F.2d at 869. Here, while the debtor admittedly mortgaged her homestead to fund the annuity, in doing so she simply converted an asset she already owned (*i.e.*, the equity in her home) into an exempt asset. That is hardly an example of the sort of fraudulent intent contemplated by *Hanson* and similar cases.

Likewise, there is no evidence that she sold her interest in the HABCO building for anything other than fair market value. The debtor simply sold an asset at a fair price and used the money to take advantage of an exemption afforded her by Wisconsin law. That is not evidence, extrinsic or otherwise, of fraudulent intent. The creditor also complains that the debtor somehow "misled" him while she established and funded the annuities. This seems somewhat disingenuous, as the debtor has always maintained that she was incapable of paying the debt. Further, she testified that while there may have been discussions about mediation, she subsequently learned that there would be little, if any, opportunity to significantly re-

5. For example, in *Bogue* the debtor sought to exempt $17,800, while the debtors in *Bruski* claimed $16,000 as exempt.

6. There was testimony regarding the debtor's concerns about the stability of Larry Vangen's retirement, which would be largely based on a payout from HABCO which would require funding from future operations. The debtor was concerned that the business might not be able to sustain these payments.

duce the amount of her liability. As such, she saw little reason to proceed with those discussions and opted to file bankruptcy. There is no evidence that she made any misrepresentations to the creditor, or that he was in any manner forestalled or agreed to forbear in any collection efforts as a result of any misrepresentations.

The debtor may well have sought to place assets beyond the reach of the creditor, but her motivation in doing so was to create a retirement fund for her future. In that regard, the amount involved is certainly not exorbitant, as it will undoubtedly only provide her with a relatively modest income. None of her actions evidence any particular fraudulent intent. Instead, it was simply part of what the debtor obviously hoped would be the final chapter in a divorce-related controversy that has festered for twelve years. Based on the evidence presented at trial, the Court cannot conclude that the trustee and the creditor have presented sufficient "extrinsic" evidence of fraud to overcome the general perspective that the debtor is entitled to arrange her affairs in such a manner as to take full advantage of the exemptions available to her under state law. The objection to her exemption is denied.

This decision shall constitute findings of fact and conclusions of law pursuant to Bankruptcy Rule 7052 and Rule 52 of the Federal Rules of Civil Procedure.

In re Michael J. LINDELL and Karen A. Lindell a/s/f Twin Silver, Inc., Debtors.

Dwight R.J. Lindquist, Trustee for the Chapter 7 Bankruptcy Estate of Michael J. Lindell and Karen A. Lindell, Plaintiff,

v.

JNG Corporation, Robert J. Weierke, and Twin Silver, Inc., Defendants.

Bankruptcy No. 04–41269.
Adversary No. 04–4353.

United States Bankruptcy Court, D. Minnesota.

Sept. 29, 2005.

Background: Chapter 7 trustee brought adversary proceeding to avoid, on veil-piercing and constructive fraudulent transfer theories, a prepetition sale of promissory note owned by debtors' corporation.

Holdings: The Bankruptcy Court, Robert J. Kressel, J., held that:

(1) corporate veil could be pierced, for purpose of avoiding, as constructively fraudulent transfer of "interest of the debtors in property," a sale of promissory note by debtors' wholly owned corporation;

(2) payment of $50,000 for promissory note that, at time of sale, had outstanding balance of $263,398.10 did not constitute "reasonably equivalent value"; and

(3) trustee was entitled to recover from good faith transferee the difference between value of note at time of transfer and consideration that transferee had paid.

So ordered.

19 Collier Bankr.Cas.2d 247, 17 Bankr.Ct.Dec. 1195,
Bankr. L. Rep. P 72,317

Kenneth Maynard HANSON & Lucille Esther Hanson, Appellees,
v.
FIRST NATIONAL BANK IN BROOKINGS, a Corporation, Appellant.

No. 87-5314.

United States Court of Appeals,
Eighth Circuit.

Submitted April 14, 1988.
Decided June 2, 1988.

Jim Kessler, Brookings, S.D., for appellant.

Kyle L. Engel, Sioux Falls, S.D., for appellees.

Before ARNOLD, WOLLMAN and TIMBERS,* Circuit Judges.

TIMBERS, Circuit Judge.

A creditor bank appeals from a district court order entered June 15, 1987 in the District of South Dakota, John B. Jones, District Judge, affirming the bankruptcy court's order which rejected the creditor's challenge to the debtors' claimed exemptions. On appeal, the creditor asserts that there was extrinsic evidence establishing the debtors' intent to defraud their creditors. We disagree. We hold that the bankruptcy court was not clearly erroneous in finding no fraudulent intent. We affirm.

I.

We summarize only those facts and prior proceedings believed necessary to an understanding of the issues raised on appeal.

On November 30, 1983 appellees Kenneth Hanson and his wife Lucille Hanson (the "Hansons" or "debtors"), residents of South Dakota, filed a voluntary joint bankruptcy petition pursuant to Chapter 7 of the Bankruptcy Code. Appellant First National Bank in Brookings ("First National") is the principal creditor of appellees. The instant appeal arises out of First National's objections to the exemptions claimed by the Hansons.

First National loaned money to the Hansons who were farmers. The Hansons sustained financial problems which led to their default on the loans. Before filing for bankruptcy, the Hansons consulted an attorney. On the advice of counsel, the Hansons had appraised and sold certain of their property which would not be exempt under South Dakota law. They sold to their son, Ronald Hanson, a car, two vans, and a motor home for a total of $27,115, the amount for which the property was appraised. Ronald had purchased the property with money he obtained from a

bank loan. The debtors also sold some of their household goods and furnishings to Kenneth's brother, Allen Hanson, for $7,300, the appraised value.

A couple weeks prior to filing their bankruptcy petition, the Hansons used these proceeds to purchase life insurance policies with cash surrender values of $9,977 and $9,978 and, two days before filing their petition, had prepaid $11,033 on their homestead real estate mortgage which was held by First National. This property was exempt from their creditors' reach. Under South Dakota law, a debtor may exempt the proceeds of life insurance policies up to a total of $20,000, S.D.Codified Laws Ann. Sec. 58-12-4 (1978); and he also may exempt his homestead. S.D.Codified Laws Ann. Sec. 43-45-3 (1983).

First National objected to these exemptions, claiming that the debtors had converted non-exempt property to exempt property on the eve of bankruptcy with intent to defraud their creditors. At the hearing before the bankruptcy court on September 10, 1984, First National asserted that none of the property allegedly sold ever was transferred to the buyers. The debtors testified that the vehicles sold to their son, Ronald, were stored at their home because Ronald still lived with them while he was working part time and attending school part time. Part of the agreement, the debtors testified, included their permission to store the vehicles on their property. While the debtors said they occasionally used the vehicles, they did so only with express permission of their son. Ronald subsequently sold the motor home to a third party. The household goods and furnishings were stored in the Hansons' home, they said, because Allen Hanson, Kenneth's brother, was then living in Anchorage, Alaska, and could not retrieve the property immediately after the sale. First National did not assert, nor does it assert on appeal before us, that the transfers were for less than fair market value. The bankruptcy court from the bench denied First National's motion which objected to the exemptions. The court found that the Hansons had done what was permissible under the law and that their actions did not constitute extrinsic evidence of fraud.

First National appealed to the federal district court. Oral argument was heard on June 8, 1987. In a memorandum opinion and order entered June 15, 1987, the district court affirmed the bankruptcy court's order, concluding that it was not clearly erroneous. The instant appeal followed. The sole issue on appeal is whether the Hansons should not be allowed to claim their life insurance and homestead exemption as a product of fraudulent conveyances. We affirm.

II.

We shall summarize only those facts, controlling law, and prior proceedings believed necessary to an understanding of the issues raised on appeal.

Under the Bankruptcy Code (the "Code"), a debtor is entitled to exempt certain property from the claims of his creditors. The Code permits a debtor to exempt either under the provisions of the Code itself if not forbidden by state law, 11 U.S.C. Sec. 522(b) & (d) (1982 & Supp. IV 1986), or under the provisions of state law and federal law other than the minimum allowances in the Code. 11 U.S.C. Sec. 522(b)(2). When the debtor claims a state-created exemption, the scope of the claim is determined by state law.

It is well established that under the Code, a debtor's conversion of non-exempt property to exempt property on the eve of bankruptcy for the express purpose of placing that property beyond the reach of creditors, without more, will not deprive the debtor of the exemption to which he otherwise would be entitled. Ford v. Poston, 773 F.2d 52, 54 (4th Cir.1985); In re Lindberg, 735 F.2d 1087, 1090 (8th Cir.), cert. denied sub nom. Armstrong v. Lindberg, 469 U.S. 1073 (1984); In re Reed, 700 F.2d 986, 990 (5th Cir.1983); Forsberg v. Security State Bank, 15 F.2d 499, 501 (8th Cir.1926). A leading bankruptcy commentator explains that this rule is just because "The result which would obtain if debtors were not allowed to convert property into allowable exempt property would be extremely harsh, especially in those jurisdictions where the exemption allowance is minimal." 3 Collier on Bankruptcy p 522.08, at 40 (15th ed. 1984). Nevertheless, this rule is not absolute. Where the debtor acts with actual intent to defraud creditors, his exemptions will be denied. Ford, supra, 773 F.2d at 55; In re Reed, supra, 700 F.2d at 990. Since fraudulent intent rarely is susceptible of direct proof, courts long have accepted extrinsic evidence of fraud. Absent extrinsic evidence of fraud, however, the debtor's mere conversion of non-exempt property to exempt property, even while insolvent, is not evidence of fraudulent intent as to creditors.

The crux of the issue on the instant appeal is whether there was extrinsic evidence to establish that the Hansons transferred the property with intent to defraud their creditors. We may reverse the bankruptcy court's finding as to the debtors' actual intent only if it is clearly erroneous. E.g., McCormick v. Security State Bank, 822 F.2d 806, 808 (8th Cir.1987); In re Reed, supra, 700 F.2d at 990; In re Cadarette, 601 F.2d 648, 650 (2d Cir.1979).

In In re Olson, 45 B.R. 501 (1984), debtors with a defunct business had placed non-exempt funds into their homestead asset, which was exempt property, just prior to filing their bankruptcy petition. The debtors, 55 and 56 years old, testified, on the advice of their attorney, that the reason they paid off the mortgages was to protect their homestead and to reduce their monthly living expenses, since they believed they would have difficulty finding employment after terminating their business. The bankruptcy court found that the debtors did not commit a fraudulent conveyance. The court permitted the debtors to exempt their entire homestead after finding that the debtors prior to bankruptcy used their savings to satisfy their mortgages, no business assets having been used and no debts having been incurred.

First National asserts here that the Hansons while insolvent committed a "classic badge of fraud" by transferring their property to family members and at the same time retaining the use and enjoyment of that property. First National asserts that the controlling case is Cadarette, supra. We disagree.

In Cadarette, the debtor, whose business was on the brink of financial collapse, transferred title to his expensive automobile, boat and trailer to his fiancee without consideration three weeks before filing his bankruptcy petition. The district court, reversing the decision of the bankruptcy court, held that the debtor's discharge was denied because of his fraudulent intent to shield his assets from his creditors. The Second Circuit, in affirming the district court, found a number of factors clearly evidencing the debtor's fraudulent intent. The court found significant, among other things, that "someone facing dire financial straits would choose to make a gift of a valuable and highly marketable automobile"; that eight days after the alleged transfer of the car a service

charge of $399 was paid not by the alleged new owner but by the debtor, who further depleted his business assets by paying with a company check; that the debtor's fiancee lived only two houses away from him; and that he retained a key to the car and continued to use the car to the same extent as he previously had used it. 601 F.2d at 651.

We find the instant case quite different from the situation in Cadarette. First National does not dispute the fact that the purchasers paid fair market value. The vehicles and household goods were not gifts. Title appears to have been transferred correctly. In the instant case, the debtors had reasonable explanations as to why the property they sold remained on their premises. Of particular significance, their son purchased the vehicles with a bank loan taken in his name and he subsequently resold the motor home to a third party, keeping all of the proceeds himself. The sale to family members, standing on its own, does not establish extrinsic evidence of fraud. First National also asserts that the Hansons' schedules filed in the bankruptcy proceeding listing their assets contained numerous items identical to those they purportedly sold to Allen Hanson. This issue was not raised in the bankruptcy court, the finder of fact; nor is there any indication in the record that it was brought to the attention of the district court. Accordingly, First National has waived its right to raise this additional issue. We decline to address it on appeal.

The bankruptcy court found that First National did not establish any indicia of fraud: the Hansons did not borrow money to place into exempt properties; they accounted for the cash they received from the sales; they had a preexisting homestead; and they did not obtain goods on credit, sell them, and then place the money into exempt property. They sold the property for its fair market value and then used this money to take advantage of some of the limited exemptions available under South Dakota law on the advice of counsel.

III.

To summarize:

We hold that the bankruptcy court was not clearly erroneous in finding no fraudulent intent by the Hansons and permitting them to claim their full exemptions. We believe that the instant case falls within the myriad of cases which have permitted such a conversion.

AFFIRMED.

ARNOLD, Circuit Judge, concurring.

I agree with the result reached by the Court and with almost all of its opinion. I write separately to indicate some variation in reasoning and also to compare this case with the companion case of Norwest Bank Nebraska, N.A. v. Tveten, 848 F.2d 871, also decided today by this panel.

In general, as the Court says, citing Forsberg v. Security State Bank, 15 F.2d 499 (8th Cir.1926), "a debtor's conversion of non-exempt property to exempt property on the eve of bankruptcy for the express purpose of placing that property beyond the reach of creditors, without more, will not deprive the debtor of the exemption to which he otherwise would be entitled." Ante, at 868. And this is so even if the conversion of property into exempt form takes place while the debtor is

insolvent. The result is otherwise, of course, if there is "extrinsic evidence of fraud," ante, at 868, but the word "extrinsic" must mean some evidence other than the conversion of the property into exempt form itself, the debtor's insolvency, and the debtor's purpose to put the property beyond the reach of creditors. Otherwise, the entire Forsberg rule would be swallowed up in the exception for "extrinsic fraud."

The Court is entirely correct in holding that there is no extrinsic fraud here. The money placed into exempt property was not borrowed, the cash received from the sales was accounted for, and the property was sold for fair market value. The fact that the sale was to family members, "standing on its own, does not establish extrinsic evidence of fraud." Ante, at 869.

With all of this I agree completely, but exactly the same statements can be made, just as accurately, with respect to Dr. Tveten's case. So far as I can tell, there are only three differences between Dr. Tveten and the Hansons, and all of them are legally irrelevant: (1) Dr. Tveten is a physician, and the Hansons are farmers; (2) Dr. Tveten attempted to claim exempt status for about $700,000 worth of property, while the Hansons are claiming it for about $31,000 worth of property; and (3) the Minnesota exemption statute whose shelter Dr. Tveten sought had no dollar limit, while the South Dakota statute exempting the proceeds of life-insurance policies, S.D.Codified Laws Ann. Sec. 58-12-4 (1978), is limited to $20,000. The first of these three differences--the occupation of the parties--is plainly immaterial, and no one contends otherwise. The second--the amounts of money involved--is also irrelevant, in my view, because the relevant statute contains no dollar limit, and for judges to set one involves essentially a legislative decision not suitable for the judicial branch. The relevant statute for present purposes is 11 U.S.C. Sec. 522(b)(2)(A), which authorizes debtors to claim exemptions available under "State or local law," and says nothing about any dollar limitations, by contrast to 11 U.S.C. Sec. 522(d), the federal schedule of exemptions, which contains a number of dollar limitations.) The third difference--that between the Minnesota and South Dakota statutes--is also legally immaterial, and for a closely related reason. The federal exemption statute, just referred to, simply incorporates state and local exemption laws without regard to whether those laws contain dollar limitations of their own.

The Court attempts to reconcile the results in the two cases by characterizing the question presented as one of fact--whether the conversion was undertaken with fraudulent intent, or with an intent to delay or hinder creditors. In Tveten, the Bankruptcy Court found fraudulent intent, whereas in Hanson it did not. Neither finding is clearly erroneous, the Court says, so both judgments are affirmed. This analysis collapses upon examination. For in Tveten the major indicium of fraudulent intent relied on by the Bankruptcy Court was Dr. Tveten's avowed purpose to place the assets in question out of the reach of his creditors, a purpose that, as a matter of law, cannot amount to fraudulent intent, as the Court's opinion in Hanson explicitly states. Ante, at 868. The result, in practice, appears to be this: a debtor will be allowed to convert property into exempt form, or not, depending on findings of fact made in the court of first instance, the Bankruptcy Court, and these findings will turn on whether the Bankruptcy Court regards the amount of money involved as too much. With all deference, that is not a rule of law. It is simply a license to make distinctions among debtors based on subjective considerations that will vary more widely than the length of the chancellor's foot.

19 Collier Bankr.Cas.2d 287, 17 Bankr.Ct.Dec. 1205,
Bankr. L. Rep. P 72,316

NORWEST BANK NEBRASKA, N.A., Business Development Corporation of Nebraska and Harold J. Panuska, as Trustee for the Harold J. Panuska Profit Sharing Trust and the Harold J. Panuska Employee Trust Fund, Appellees,
v.
Omar A. TVETEN, Appellant.

No. 87-5312.

United States Court of Appeals,
Eighth Circuit.

Submitted April 14, 1988.
Decided June 2, 1988.
Rehearing and Rehearing En Banc Denied Aug. 9, 1988.

Cass S. Weil, St. Paul, Minn., for appellant.

Gordon B. Conn, Jr., Minneapolis, Minn., for appellees.

Before ARNOLD, WOLLMAN and TIMBERS,* Circuit Judges.

TIMBERS, Circuit Judge.

Appellant Omar A. Tveten, a physician who owed creditors almost $19,000,000, mostly in the form of personal guaranties on a number of investments whose value had deteriorated greatly, petitioned for Chapter 11 bankruptcy. He had converted almost all of his non-exempt property, with a value of about $700,000, into exempt property that could not be reached by his creditors. The bankruptcy court, on the basis of its findings of fact and conclusions of law, entered an order on February 27, 1987, denying a discharge in view of its finding that Tveten intended to defraud, delay, and hinder his creditors. The district court, in an order entered July 10, 1987 in the District of Minnesota, Diana E. Murphy, District Judge, affirmed the bankruptcy court's order. On appeal, Tveten asserts that his transfers merely constituted astute pre-bankruptcy planning. We hold that the bankruptcy court was not clearly erroneous in inferring fraudulent intent on the part of Tveten. We affirm.

I.

We shall summarize only those facts and prior proceedings believed necessary to an understanding of the issues raised on appeal.

Tveten is a 59 year old physician in general practice. He is the sole shareholder of Omar A. Tveten, P.A., a professional corporation. He has no dependents. He began investing in various real estate developments. These investments initially were quite successful. Various physician

friends of Tveten joined him in organizing a corporation to invest in these ventures. These investments were highly leveraged. The physicians, including Tveten, personally had guaranteed the debt arising out of these investments. In mid-1985, Tveten's investments began to sour. He became personally liable for an amount close to $19,000,000--well beyond his ability to pay. Appellees Norwest Bank Nebraska, N.A. ("Norwest Bank"), Business Development Corporation of Nebraska ("Business Development"), and Harold J. Panuska ("Panuska") as trustee of the Harold J. Panuska Profit Sharing Trust and the Harold J. Panuska Employee Trust Fund, became creditors of Tveten as a result of his various investment ventures.

Tveten filed a Chapter 11 petition on January 7, 1986. Meanwhile, several creditors already had commenced lawsuits against him. Panuska had obtained a $139,657 judgment against him on October 9, 1985. Norwest Bank and Business Development had commenced an action against him but had not obtained judgment when Tveten filed for bankruptcy. On the date the Chapter 11 petition was filed, Tveten owed his creditors close to $19,000,000.

Before filing for bankruptcy, Tveten consulted counsel. As part of his pre-bankruptcy planning, he liquidated almost all of his non-exempt property, converting it into exempt property worth approximately $700,000. This was accomplished through some seventeen separate transfers. The non-exempt property he liquidated included land sold to his parents and his brother, respectively, for $70,000 and $75,732 in cash; life insurance policies and annuities with a for-profit company with cash values totalling $96,307.58; his net salary and bonuses of $27,820.91; his KEOGH plan and individual retirement fund of $20,487.35; his corporation's profit-sharing plan worth $325,774.51; and a home sold for $50,000.1 All of the liquidated property was converted into life insurance or annuity contracts with the Lutheran Brotherhood, a fraternal benefit association, which, under Minnesota law, cannot be attached by creditors. Tveten concedes that the purpose of these transfers was to shield his assets from creditors. Minnesota law provides that creditors cannot attach any money or other benefits payable by a fraternal benefit association. Minn.Stat. Secs. 550.37, 64B.18 (1986). Unlike most exemption provisions in other states, the Minnesota exemption has no monetary limit. Indeed, under this exemption, Tveten attempted to place $700,000 worth of his property out of his creditors' reach.

Tveten sought a discharge with respect to $18,920,000 of his debts. Appellees objected to Tveten's discharge. In its order of February 27, 1987, the bankruptcy court concluded that, although Tveten's conversion of non-exempt property to exempt property just before petitioning for bankruptcy, standing alone, would not justify denial of a discharge, his inferred intent to defraud would.2 The bankruptcy court held that, even if the exemptions were permissible, Tveten had abused the protections permitted a debtor under the Bankruptcy Code (the "Code"). His awareness of Panuska's judgment against him and of several pending lawsuits, his rapidly deteriorating business investments, and his exposure to extensive liability well beyond his ability to pay, all were cited by the court in its description of the circumstances under which Tveten converted his property. Moreover, the court concluded that Tveten intended to hinder and delay his creditors. Accordingly, the bankruptcy court denied Tveten a discharge.

Tveten appealed from the bankruptcy court order to the federal district court. In a memorandum opinion and order entered July 10, 1987, the district court affirmed the denial of a discharge, concluding that the bankruptcy court's finding as to Tveten's intent was not clearly erroneous.3

The instant appeal followed. Basically, Tveten asserts on appeal that as a matter of law we should reject the factors relied on by the bankruptcy court to infer that Tveten intended to delay, hinder and defraud creditors. We disagree. We affirm.

II.

The sole issue on appeal is whether Tveten properly was denied a discharge in view of the transfers alleged to have been in fraud of creditors.

At the outset, it is necessary to distinguish between (1) a debtor's right to exempt certain property from the claims of his creditors and (2) his right to a discharge of his debts. The Code permits a debtor to exempt property either pursuant to the provisions of the Code if not forbidden by state law, 11 U.S.C. Sec. 522(b) & (d) (1982 & Supp. IV 1986), or pursuant to the provisions of state law and federal law other than the minimum allowances in the Code. 11 U.S.C. Sec. 522(b)(2). When the debtor claims a state-created exemption, the scope of the claim is determined by state law. It is well established that under the Code the conversion of non-exempt to exempt property for the purpose of placing the property out of the reach of creditors, without more, will not deprive the debtor of the exemption to which he otherwise would be entitled. E.g., Ford v. Poston, 773 F.2d 52, 54 (4th Cir.1985); In re Lindberg, 735 F.2d 1087, 1090 (8th Cir.), cert. denied sub nom. Armstrong v. Lindberg, 469 U.S. 1073 (1984); In re Reed, 700 F.2d 986, 990 (5th Cir.1983); 3 Collier on Bankruptcy p 522.08, at 36-37 (15th ed. 1984). Both the House and Senate Reports regarding the debtor's right to claim exemptions state:

"As under current law, the debtor will be permitted to convert nonexempt property into exempt property before filing a bankruptcy petition. The practice is not fraudulent as to creditors, and permits the debtor to make full use of the exemptions to which he is entitled under the law."

H.R.Rep. No. 595, 95th Cong., 1st Sess. 361 (1977), reprinted in 1978 U.S.Code Cong. & Ad.News 5963, 6317; S.Rep. No. 989, 95th Cong., 2d Sess. 76 (1978), reprinted in 1978 U.S.Code Cong. & Ad.News 5787, 5862. The rationale behind this policy is that "[t]he result which would obtain if debtors were not allowed to convert property into allowable exempt property would be extremely harsh, especially in those jurisdictions where the exemption allowance is minimal." 3 Collier on Bankruptcy, supra, p 522.08, at 40. This blanket approval of conversion is qualified, however, by denial of discharge if there was extrinsic evidence of the debtor's intent to defraud creditors. E.g., Ford, supra, 773 F.2d at 55; In re Reed, supra, 700 F.2d at 990.4

A debtor's right to a discharge, however, unlike his right to an exemption, is determined by federal, not state, law. Reed, 700 F.2d at 991. The Code provides that a debtor may be denied a discharge under Chapter 7 if, among other things, he has transferred property "with intent to hinder, delay, or defraud a creditor" within one year before the date of the filing of the petition. 11 U.S.C. Sec. 727(a)(2) (1982 & Supp. IV 1986). Although Tveten filed for bankruptcy under Chapter 11, the proscription against discharging a debtor with fraudulent intent in a Chapter 7 proceeding is equally applicable against a debtor applying for a Chapter 11 discharge. The reason for this is that the Code provides that confirmation of a plan does not discharge a Chapter

11 debtor if "the debtor would be denied a discharge under section 727(a) of this title if the case were a case under chapter 7 of this title." 11 U.S.C. Sec. 1141(d)(3)(C) (1982).

Although the determination as to whether a discharge should be granted or denied is governed by federal law, the standard applied consistently by the courts is the same as that used to determine whether an exemption is permissible, i.e. absent extrinsic evidence of fraud, mere conversion of non-exempt property to exempt property is not fraudulent as to creditors even if the motivation behind the conversion is to place those assets beyond the reach of creditors. Ford, supra, 773 F.2d at 55; In re Reed, supra, 700 F.2d at 990; Forsberg v. Security State Bank, 15 F.2d 499 (8th Cir.1926).

As the bankruptcy court correctly found here, therefore, the issue in the instant case revolves around whether there was extrinsic evidence to demonstrate that Tveten transferred his property on the eve of bankruptcy with intent to defraud his creditors. The bankruptcy court's finding that there was such intent to defraud may be reversed by us only if clearly erroneous. McCormick v. Security State Bank, 822 F.2d 806, 808 (8th Cir.1987); In re Reed, supra, 700 F.2d at 990; In re Cadarette, 601 F.2d 648, 650 (2d Cir.1979).

There are a number of cases in which the debtor converted non-exempt property to exempt property on the eve of bankruptcy and was granted a discharge because there was no extrinsic evidence of the debtor's intent to defraud. In Forsberg, supra, an old decision of our Court, a debtor was granted a discharge despite his trade of non-exempt cattle for exempt hogs while insolvent and in contemplation of bankruptcy. Although we found that the trade was effected so that the debtor could increase his exemptions, the debtor "should [not] be penalized for merely doing what the law allows him to do." 15 F.2d at 501. We concluded that "before the existence of such fraudulent purpose can be properly found, there must appear in evidence some facts or circumstances which are extrinsic to the mere facts of conversion of nonexempt assets into exempt and which are indicative of such fraudulent purpose." Id. at 502. Accord, In re Adlman, 541 F.2d 999 (2d Cir.1976); In re Ellingson, 63 B.R. 271 (N.D.Iowa 1986).

There also are a number of cases, however, in which the courts have denied discharges after concluding that there was extrinsic evidence of the debtor's fraudulent intent. In Ford, supra, the debtor had executed a deed of correction transferring a tract of land to himself and his wife as tenants by the entirety. The debtor had testified that his parents originally had conveyed the land to the debtor alone, and that this was a mistake that he corrected by executing a deed of correction. Under relevant state law, the debtor's action removed the property from the reach of his creditors who were not also creditors of his wife. The Fourth Circuit, in upholding the denial of a discharge, found significant the fact that this "mistake" in the original transfer of the property was "corrected" the day after an unsecured creditor obtained judgment against the debtor. 773 F.2d at 55. The Fourth Circuit held that the bankruptcy court, in denying a discharge, was not clearly erroneous in finding the requisite intent to defraud, after "[h]aving heard ... [the debtor's] testimony at trial and having considered the circumstances surrounding the transfer". Id. In In re Reed, supra, shortly after the debtor had arranged with his creditors to be free from the payment obligations until the following year, he rapidly had converted non-exempt assets to extinguish one home mortgage and to reduce another four months before bankruptcy, and had diverted receipts from his business into an account not divulged to his creditors. The Fifth Circuit concluded that the debtor's "whole pattern of conduct evinces that intent." 700 F.2d at 991. The court went further and stated:

"It would constitute a perversion of the purposes of the Bankruptcy Code to permit a debtor earning $180,000 a year to convert every one of his major nonexempt assets into sheltered property on the eve of bankruptcy with actual intent to defraud his creditors and then emerge washed clean of future obligation by carefully concocted immersion in bankruptcy waters."

Id. at 992.

In most, if not all, cases determining whether discharge was properly granted or denied to a debtor who practiced "pre-bankruptcy planning", the point of reference has been the state exemptions if the debtor was claiming under them. Although discharge was not denied if the debtor merely converted his non-exempt property into exempt property as permitted under state law, the exemptions involved in these cases comported with federal policy to give the debtor a "fresh start"--by limiting the monetary value of the exemptions. This policy has been explicit, or at least implicit, in these cases. In Forsberg, supra, for example, we stated that it is not fraudulent for an individual who knows he is insolvent to convert non-exempt property into exempt property, thereby placing the property out of the reach of creditors

"because the statutes granting exemptions have made no such exceptions, and because the policy of such statutes is to favor the debtors, at the expense of the creditors, in the limited amounts allowed to them, by preventing the forced loss of the home and of the necessities of subsistence, and because such statutes are construed liberally in favor of the exemption."

Forsberg, supra, 15 F.2d at 501 (emphasis added). Similarly, in In re Ellingson, supra, 63 B.R. 271, in holding that the debtors' conversion of non-exempt cash and farm machinery did not provide grounds for denial of a discharge, the court relied on the social policies behind the exemptions. The court found that the debtors' improvement of their homestead was consistent with several of these policies, such as protecting the family unit from impoverishment, relieving society from the burden of supplying subsidized housing, and providing the debtors with a means to survive during the period following their bankruptcy filing when they might have little or no income. The court held that exemptions should further one or more of the following social policies:

" '(1) To provide the debtor with property necessary for his physical survival; (2) To protect the dignity and the cultural and religious identity of the debtor; (3) To enable the debtor to rehabilitate himself financially and earn income in the future; (4) To protect the debtor's family from the adverse consequences of impoverishment; (5) To shift the burden of providing the debtor and his family with minimal financial support from society to the debtor's creditors.' "

Id. at 277-78 (quoting Resnick, Prudent Planning or Fraudulent Transfer?, 31 Rutgers L.R. 615, 621); see also In re Adlman, supra, 541 F.2d at 1003; In re Zouhar, 10 B.R. 154, 156 (Bankr.D.N.Mex.1981).
25

In the instant case, however, the state exemption relied on by Tveten was unlimited, with the potential for unlimited abuse. Indeed, this case presents a situation in which the debtor liquidated almost his entire net worth of $700,000 and converted it to non-exempt property in seventeen transfers on the eve of bankruptcy while his creditors, to whom he owed close to $19,000,000, would be left to divide the little that remained in his estate. Borrowing the phrase used by

another court, Tveten "did not want a mere fresh start, he wanted a head start." In re Zouhar, supra, 10 B.R. at 156 (emphasis in original). His attempt to shield property worth approximately $700,000 goes well beyond the purpose for which exemptions are permitted. Tveten's reliance on his attorney's advice does not protect him here, since that protection applies only to the extent that the reliance was reasonable. In re Bateman, 646 F.2d 1220, 1224 (8th Cir.1981).

The bankruptcy court, as affirmed by the district court, examined Tveten's entire pattern of conduct and found that he had demonstrated fraudulent intent. We agree. While state law governs the legitimacy of Tveten's exemptions, it is federal law that governs his discharge. Permitting Tveten, who earns over $60,000 annually, to convert all of his major non-exempt assets into sheltered property on the eve of bankruptcy with actual intent to defraud his creditors "would constitute a perversion of the purposes of the Bankruptcy Code". In re Reed, supra, 700 F.2d at 992. Tveten still is entitled to retain, free from creditors' claims, property rightfully exempt under relevant state law.5

We distinguish our decision in Hanson v. First National Bank, 848 F.2d 866 (8th Cir.1988), decided today. Hanson involves a creditor's objection to two of the debtors' claimed exemptions under South Dakota law, a matter governed by state law. The complaint centered on the Hansons' sale, while insolvent, of non-exempt property to family members for fair market value and their use of the proceeds to prepay their preexisting mortgage and to purchase life insurance policies in the limited amounts permissible under relevant state law. The bankruptcy court found no extrinsic evidence of fraud. The district court, in a memorandum opinion and order entered June 15, 1987, affirmed. We also affirmed, concluding that the case fell within the myriad of cases which have permitted such a conversion on the eve of bankruptcy.

III.

To summarize:

We hold that the bankruptcy court was not clearly erroneous in inferring fraudulent intent on the part of the debtor, rather than astute pre-bankruptcy planning, with respect to his transfers on the eve of bankruptcy which were intended to defraud, delay and hinder his creditors.

Affirmed.

ARNOLD, Circuit Judge, dissenting.

The Court reaches a result that appeals to one's general sense of righteousness. I believe, however, that it is contrary to clearly established law, and I therefore respectfully dissent.

Dr. Tveten has never made any bones about what he is doing, or trying to do, in this case. He deliberately set out to convert as much property as possible into a form exempt from attachment by creditors under Minnesota law. Such a design necessarily involves an attempt to delay or hinder creditors, in the ordinary, non-legal sense of those words, but, under long-standing principles embodied both in judicial decisions and in statute, such a purpose is not unlawful. The governing authority in this Court is Forsberg v. Security State Bank, 15 F.2d 499 (8th Cir.1926). There we said:

It is well settled that it is not a fraudulent act by an individual who knows he is insolvent to convert a part of his property which is not exempt into property which is exempt, for the purpose of claiming his exemptions therein, and of thereby placing it out of the reach of his creditors.

Id. at 501. Thus, under the controlling law of this Circuit, someone who is insolvent may convert property into exempt form for the very purpose of placing that property beyond the reach of his creditors.

A debtor's right to make full use of statutory exemptions is fundamental to bankruptcy law. To unsecured creditors, a debtor's conversion of his assets into exempt categories of property will always appear unfair, but this apparent unfairness is simply a consequence of the existence of exemptions under the jurisdiction's bankruptcy law. In an early case in this Circuit, Judge Walter H. Sanborn, one of the patriarchs of this Court, explained:

An insolvent debtor may use with impunity any of his property that is free from the liens and equitable interests of his creditors to purchase a homestead.... If he takes property that is not exempt from judicial sale and applies it to this purpose, he merely avails himself of a plain provision of the constitution or the statute enacted for [his] benefit.... He takes nothing from the creditors by this action in which they have any vested right. The constitution or statute exempting the homestead from the judgments of creditors is in force when they extend the credit to him, and they do so in the face of the fact that he has this right. Nor can the use of property that is not exempt from execution to procure a homestead be held to be a fraud upon the creditors ..., because that which the law expressly sanctions and permits cannot be a legal fraud.

First National Bank of Humboldt v. Glass, 79 F. 706, 707 (8th Cir.1897) (emphasis added)

The same principle was confirmed by Congress when it enacted the Bankruptcy Code of 1978. The report of the House Judiciary Committee states as follows:

As under current law, the debtor will be permitted to convert nonexempt property into exempt property before filing a bankruptcy petition. See Hearings, Pt. III, at 1355-58. The practice is not fraudulent as to creditors, and permits the debtor to make full use of the exemptions to which he is entitled under the law.

H.R.Rep. No. 595, 95th Cong., 2d Sess. 361, reprinted in 1978 U.S.Code Cong. & Admin.News 5963, 6317. The same language appears in S.Rep. No. 989, 95th Cong., 2d Sess. 76 (1978), reprinted in 1978 U.S.Code Cong. & Admin.News 5787, 5862. In the hearings referred to in the House Committee report, two federal judges, concerned about the "outrageous" implications of existing law, specifically urged Congress to incorporate provisions in the new Bankruptcy Code which would make pre-bankruptcy conversion of assets fraudulent as a matter of federal law. See Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. on the Judiciary, 94th Cong., 1st & 2nd Sess., ser. 27, pt. 3, pp. 1355-58 (1975-76). The fact that Congress declined to change existing law, when presented with the same objections to the propriety of debtor tactics like Tveten's that the Court now expresses, indicates that Congress did not intend Sec. 727(a)(2) to proscribe such conduct. The House Report's language plainly says that debtors may convert nonexempt property into exempt property, that

doing so is not fraudulent, and that debtors may make "full use" of any applicable exemption. Recent cases in our Court have reiterated this principle. E.g., In re Lindberg, 735 F.2d 1087, 1090 (8th Cir.), cert. denied sub nom. Armstrong v. Lindberg, 469 U.S. 1073, 105 S.Ct. 566, 83 L.Ed.2d 507 (1984).

To be sure, if there is extrinsic evidence of fraud, or of a purpose to hinder or delay creditors, discharge may and should be denied, but "extrinsic," in this context, must mean something beyond the mere conversion of assets into exempt form for the purpose of putting them out of the reach of one's creditors. If Tveten had lied to his creditors, like the debtor in McCormick v. Security State Bank, 822 F.2d 806 (8th Cir.1987), or misled them in some way, like the debtor in In re Reed, 700 F.2d 986 (5th Cir.1983), or transferred property for less than fair value to a third party, like the debtor in Ford v. Poston, 773 F.2d 52 (4th Cir.1985), we would have a very different case. There is absolutely no evidence of that sort of misconduct in this record, and the Court's opinion filed today cites none.

One is tempted to speculate what the result would have been in this case if the amount of assets converted had been $7,000, instead of $700,000. Indeed, the large amount of money involved is the only difference I can see between this case and Forsberg. It is true that the Forsberg opinion referred to "the limited amounts allowed to" debtors by exemptions, 15 F.2d at 501, but whether exemptions are limited in amount is a legislative question ordinarily to be decided by the people's elected representatives, in this case the Minnesota Legislature.1 Where courts punish debtors simply for claiming exemptions within statutory limits, troubling problems arise in separating judicial from legislative power. As Judge Kishel explained in his excellent opinion in In re Johnson, 80 B.R. 953 (Bankr.D.Minn.1987)2:

The legislative branch alone determines what is necessary ... to meet a debtor's needs, by establishing the nature and value of the property subject to claims exemption.... To deny discharge for a debtor's non-fraudulent invocation of these protections is, overtly or covertly, to make a political and/or value judgment on these legislative determinations. To equate a non-fraudulent intent to 'place assets beyond the reach of creditors' with an invidious intent to 'hinder or delay creditors' is ultimately to frustrate statutory exemption rights by causing a chilling effect on the full exercise of those rights. A court which causes such a chilling effect is, in a very real sense, invading legislative prerogatives by substituting its own judgment for that of the legislature. At 963 (footnote omitted).

If there ought to be a dollar limit, and I am inclined to think that there should be, and if practices such as those engaged in by the debtor here can become abusive, and I admit that they can, the problem is simply not one susceptible of a judicial solution according to manageable objective standards. A good statement of the kind of judicial reasoning that must underlie the result the Court reaches today appears in In re Zouhar, 10 B.R. 154 (Bankr.D.N.M.1981), where the amount of assets converted was $130,000. The Bankruptcy Court denied discharge, stating, among other things, that " 'there is a principle of too much; phrased colloquially, when a pig becomes a hog it is slaughtered.' " Id. at 157. If I were a member of the Minnesota Legislature, I might well vote in favor of a bill to place an over-all dollar maximum on any exemption.3 But sitting as a judge, by what criteria do I determine when this pig becomes a hog? If $700,000 is too much, what about $70,000? Would it matter if the debtor were a farmer, as in Forsberg,

rather than a physician? (I ask the question because the appellee creditor's brief mentions the debtor's profession, which ought to be legally irrelevant, several times.)

Debtors deserve more definite answers to these questions than the Court's opinion provides. In effect, the Court today leaves the distinction between permissible and impermissible claims of exemption to each bankruptcy judge's own sense of proportion. As a result, debtors will be unable to know in advance how far the federal courts will allow them to exercise their rights under state law.

Where state law creates an unlimited exemption, the result may be that wealthy debtors like Tveten enjoy a windfall that appears unconscionable, and contrary to the policy of the bankruptcy law. I fully agree with Judge Kishel, however, that

[this] result ... cannot be laid at [the] Debtor's feet; it must be laid at the feet of the state legislature. Debtor did nothing more than exercise a prerogative that was fully his under law. It cannot be said that his actions have so tainted him or his bankruptcy petition as to merit denial of discharge.

Johnson, supra, at 963 (footnote omitted). I submit that Tveten did nothing more fraudulent than seek to take advantage of a state law of which the federal courts disapprove.

I would reverse this judgment and hold that the debtor's actions in converting property into exempt form do not bar a discharge in bankruptcy.

Of the Second Circuit, by designation

There were no claims that these transfers were for less than market value

2

Several creditors also objected to Tveten's claimed exemptions. In response, the bankruptcy court, by order entered September 16, 1986, certified the question to the Minnesota Supreme Court. The bankruptcy court decided that it need not wait for the Supreme Court's decision, since the determinative factor on the issue of discharge was Tveten's intent

3

Before the district court entered its order, the Supreme Court of Minnesota held in a decision entered March 27, 1987, that annuities and life insurance contracts issued by a fraternal benefit society were exempt under Minnesota law, but that these statutory provisions violated the Minnesota Constitution. In re Tveten, 402 N.W.2d 551 (Minn.1987). Accordingly, Tveten no longer will be able to claim these exemptions. Following the opinion of the Supreme Court of Minnesota, Tveten claimed an exemption for his pension in the amount of approximately $200,000. He and his creditors settled this issue before the bankruptcy court. He will retain this property as exempt

4

This exception comports with congressional intent. Both the House and Senate Reports use the phrase "[a]s under current law". Under existing law prior to the passage of the 1978 Act, courts also had applied this exception. Ford, supra, 773 F.2d at 55; In re Reed, supra, 700 F.2d at 990

5

Supra note 3

1

In First Nat'l Bank of Humboldt, supra, the debtor's homestead was originally in Nebraska, which by statute limited the homestead exemption to land worth $2,000. The debtor sold his homestead for $6,000 and used the money to buy a new home in Kansas, where the homestead exemption was unlimited in dollar amount. The debtor had this new Kansas homestead conveyed to his wife. See 79 F. at 706-07. This tactic succeeded, and the creditor's attempt to reach the Kansas land was rebuffed by this Court

2

Counsel in this case have advised us that an appeal in Johnson is now pending in the District Court

3

There is some irony in the fact that the exemption sought by the debtor in this case, that for benefits under annuities or life-insurance policies issued by fraternal associations, has been held unconstitutional under two provisions of the Minnesota Constitution. One such provision, Article 1, Section 12, provides that "[a] reasonable amount of property shall be exempt...." The Supreme Court of Minnesota has held that the exemption statute involved in the present case is unconstitutional precisely because it contains no dollar limit. In re Tveten, 402 N.W.2d 551, 556-58 (Minn.1987). So the principle of limitation has been upheld, the debtor has in any event lost the exemption he sought, but he also loses his discharge under today's decision

Back up

C

United States Bankruptcy Appellate Panel
of the Ninth Circuit.

In re Ronda Liane HUMMEL, Debtor.
Trudy A. Nowak, Chapter 7 Trustee, Appellant,
v.
Ronda Liane Hummel, Appellee.
In re Joan A. Tober, Debtor.
Beth Lang, Chapter 7 Trustee, Appellant,
v.
Joan A. Tober, Appellee.

BAP Nos. AZ-10-1202-JuBaPa, AZ-10-1206-JuBaPa.
Bankruptcy Nos. 10-02018-EWH, 09-32894-EWH.
Argued and Submitted on Oct. 22, 2010.
Decided Nov. 19, 2010.

Background: In separate Chapter 7 cases, trustee objected to exemptions claimed by debtors in cash surrender values of insurance policy or annuity contract that debtors had purchased for benefit of their adult, nondependent children. The United States Bankruptcy Court for the District of Arizona, Eileen W. Hollowell, J., overruled trustees' objection, and trustees appealed.

Holding: On issue of first impression in Arizona, the Bankruptcy Appellate Panel, Jury, J., held that under Arizona law as predicted by bankruptcy court in that state, exemption applied only if the spouse, child, parent, brother, sister or other family member named as beneficiary of insurance policy or annuity contract was a dependent of debtor.

Reversed.

West Headnotes

[1] Bankruptcy 51 ⚷3782

51 Bankruptcy
51XIX Review
51XIX(B) Review of Bankruptcy Court
51k3782 k. Conclusions of law; de novo review. Most Cited Cases

Bankruptcy Appellate Panel (BAP) reviews bankruptcy court's conclusions on questions of law and of statutory interpretation de novo.

[2] Exemptions 163 ⚷37

163 Exemptions
163I Nature and Extent
163I(C) Property and Rights Exempt
163k37 k. Specific exemptions in general. Most Cited Cases

Exemptions 163 ⚷50(1)

163 Exemptions
163I Nature and Extent
163I(C) Property and Rights Exempt
163k50 Life, Health, and Accident Insurance
163k50(1) k. In general. Most Cited Cases

Under Arizona law as predicted by bankruptcy court in that state, phrase "any other dependent family member," as used in Arizona statute granting debtors an exemption in cash surrender value of any insurance policies or annuity contracts which they own, and which name as a beneficiary "the debtor's surviving spouse, child, parent, brother or sister, or any other dependent family member," was not in nature of independent phrase identifying a separate class of beneficiaries, but also modified the words preceding it, such that exemption applied only if the spouse, child, parent, brother, sister or other family member named as beneficiary was a dependent of debtor; thus, debtors were not entitled to exempt cash surrender values of insurance policies or annuity contracts benefiting an adult, nondependent child. A.R.S. § 33-1126(A)(6, 7).

[3] Federal Courts 170B ⚷382.1

170B Federal Courts
170BVI State Laws as Rules of Decision
170BVI(B) Decisions of State Courts as Authority

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170Bk382 Court Rendering Decision
170Bk382.1 k. In general. Most Cited Cases

Federal Courts 170B ⚷386

170B Federal Courts
170BVI State Laws as Rules of Decision
170BVI(B) Decisions of State Courts as Authority
170Bk386 k. State constitutions and statutes, validity and construction. Most Cited Cases

In construing state statute in absence of any controlling state precedent, federal court must interpret statute as it believes the highest state court would.

[4] Statutes 361 ⚷188

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k187 Meaning of Language
361k188 k. In general. Most Cited Cases

When interpreting statute, Arizona courts look to its plain language as best indicator of legislature's intent.

[5] Statutes 361 ⚷190

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k187 Meaning of Language
361k190 k. Existence of ambiguity. Most Cited Cases

Under Arizona law, if meaning of statutory language is clear and unambiguous, courts do not employ any other methods of construction.

[6] Statutes 361 ⚷196

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k187 Meaning of Language
361k196 k. Relative and qualifying terms, and their relation to antecedents. Most Cited Cases

When several words in statute are followed by a clause which is applicable as much to the first and other words as to the last, a natural construction of language demands that the clause be read as applicable to all.

[7] Statutes 361 ⚷217.3

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k213 Extrinsic Aids to Construction
361k217.3 k. Legislative hearings, reports, etc. Most Cited Cases

Under Arizona law, Senate fact sheets are viewed as relevant legislative history and as reflective, though not dispositive, of legislative intent.

[8] Exemptions 163 ⚷4

163 Exemptions
163I Nature and Extent
163I(A) Nature, Creation, Duration, and Effect in General
163k4 k. Construction of exemption laws in general. Most Cited Cases

Under Arizona law, exemption statutes are to be construed liberally in debtor's favor.

[9] Exemptions 163 ⚷3

163 Exemptions
163I Nature and Extent
163I(A) Nature, Creation, Duration, and Effect in General
163k3 k. Constitutional and statutory provisions. Most Cited Cases

Under Arizona law, exemption statutes are enacted, not merely for purpose of conferring a privilege on debtor, but to shelter the family and thereby benefit state.

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[10] Exemptions 163 ⚷4

163 Exemptions
163I Nature and Extent
163I(A) Nature, Creation, Duration, and Effect in General
163k4 k. Construction of exemption laws in general. Most Cited Cases

Bankruptcy court's role in interpreting Arizona exemption statute was restricted to an interpretation of exemption statute as written.

Appellant Trudy A. Nowak, Esq., Rochester, NY, argued for herself and appellant Beth Lang.

Alan R. Solot, Esq., Tucson, AZ, argued for appellees Ronda L. Hummel and Joan A. Tober.

Before: JURY, BAUER,[FN1] and PAPPAS, Bankruptcy Judges.

OPINION

JURY, Bankruptcy Judge.

*1 Chapter 7 [FN2] trustee Trudy A. Nowak ("Nowak") appeals the bankruptcy court's order overruling her objection to debtor Ronda L. Hummel's ("Hummel") exemption under Ariz.Rev.Stat. § 33-1126(A)(6) and § 20-1131(D) (BAP No. 10-1202).

Chapter 7 trustee Beth Lang ("Lang") appeals the bankruptcy court's order overruling her objection to debtor Joan A. Tober's ("Tober") exemption under Ariz.Rev.Stat. § 33-1126(A)(7) (BAP No. 10-1206).

Both appeals involve the construction of the identical phrases contained in Ariz.Rev.Stat. §§ 33-1126(A)(6) [FN3] and (7), which allow a debtor to exempt the cash surrender value of life insurance policies and proceeds of annuity contracts if they name certain beneficiaries. At issue is whether either subsection of the statute requires that a child named as a beneficiary also be a dependent of the debtor in order for the debtor to obtain the exemption.

As a matter of first impression in Arizona, we hold that the statute imposes such a requirement and REVERSE the bankruptcy court's order in each appeal.

I. BACKGROUND

The Hummel Bankruptcy-BAP No. 10-1202

On January 27, 2010, Hummel filed her chapter 7 petition. Nowak was appointed the chapter 7 trustee. At the time Hummel filed her petition, she owned three Prudential Whole Life Insurance Policies with cash surrender values of $27,608.02, $3,266.82, and $10,188.01. Hummel listed the policies in her Schedule B and claimed them 100% exempt in Schedule C under Ariz.Rev.Stat. § 33-1126(A)(6) and § 20-1131(D). Hummel named her adult, nondependent daughter as the beneficiary under each policy. Hummel did not list her daughter as a dependent in her Schedule I or tax returns.

Nowak objected to Hummel's exemption in the cash surrender value of the policies on the ground that the exemption did not apply if the named beneficiary was an adult, nondependent child of the debtor. The bankruptcy court overruled her objection by order entered on May 26, 2010. Nowak timely appealed.

The Tober Bankruptcy-BAP No. 10-1206

On December 21, 2009, Tober filed her chapter 7 petition. Lang was appointed the chapter 7 trustee. When Tober filed her petition she owned a Nationwide Annuity valued at $33,316.52, which she listed in her Schedule B and claimed 100% exempt in Schedule C under Ariz.Rev.Stat. § 33-1126(A)(7). Tober named her adult, nondependant daughter as the beneficiary in the annuity contract. Tober did not list her daughter as a dependent in her Schedule I or tax returns.

Lang objected to Tober's exemption in the annuity contract on the ground that the exemption did not apply if the named beneficiary was an adult, nondependent child of the debtor. The bankruptcy court overruled her objection by order entered on May 26, 2010. Lang timely appealed.

II. JURISDICTION

The bankruptcy court had jurisdiction pursuant to 28 U.S.C. §§ 1334 over this core proceeding under § 157(b)(2)(B). We have jurisdiction under 28 U.S.C. § 158.

III. ISSUE

*2 Whether Ariz.Rev.Stat. § 33-1126(A)(6) and (7) require that a child of the debtor named as a bene-

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ficiary under a life insurance policy or an annuity contract also be a dependent of the debtor in order for the debtor to obtain the exemption.

IV. STANDARDS OF REVIEW

[1] We review the bankruptcy court's conclusions of law and questions of statutory interpretation de novo. *Clear Channel Outdoor, Inc. v. Knupfer (In re PW, LLC)*, 391 B.R. 25, 32 (9th Cir. BAP 2008).

V. DISCUSSION

[2] Section 541(a)(1) of the Bankruptcy Code provides that "property of the estate" includes "all legal or equitable interests of the debtor in property as of the commencement of the case." It is undisputed that debtors Hummel and Tober owned the property they claimed exempt which became part of their respective estates.

The Bankruptcy Code permits a debtor to exempt from property of the estate certain property for which an exemption is available under either state or federal law. § 522(b). Arizona has opted out of the federal exemptions, leaving debtors in Arizona to resort to the state law exemptions. *See* Ariz.Rev.Stat. § 33-1133(B). Therefore, substantive issues regarding the allowance or disallowance of the claimed exemptions at issue in this appeal are governed by Arizona law. *Turner v. Marshack (In re Turner)*, 186 B.R. 108, 113 (9th Cir. BAP 1995).

For Arizona residents, the exemption of certain insurance and annuity benefits or proceeds is governed by Ariz.Rev.Stat. § 33-1126 which provides in relevant part:

> A. The following property of a debtor [FN4] shall be exempt from execution, attachment or sale on any process issued from any court:
>
> ....
>
> 6. The cash surrender value of life insurance policies where for a continuous unexpired period of two years such policies have been owned by a debtor and have *named as beneficiary the debtor's surviving spouse, child, parent, brother or sister, or any other dependent family member,* in the proportion that the policy names any such beneficiary.... For the purposes of this paragraph "dependent" means a family member who is dependent on the insured debtor for not less than half support.[FN5]
>
> 7. An annuity contract where for a continuous unexpired period of two years such contract has been owned by a debtor and has *named as beneficiary the debtor, debtor's surviving spouse, child, parent, brother or sister, or any other dependent family member....* For the purposes of this paragraph, "dependent" means a family member who is dependent on the debtor for not less than half support. (Emphasis added).

The trustees contend that the listed beneficiaries in each subsection (surviving spouse, child, parent, etc.) are, in effect, a subset of the subsequent phrase "other dependent family members." In essence, the trustees urge us to view the word "other" as a connecting modifier and, thus, all beneficiaries specifically listed in the statute, and "any others", must be (1) family members and (2) dependent on the debtor. On the other hand, debtors assert that the phrase "any other dependent family member" constitutes a separate class of beneficiaries from those previously listed. Under this view, the word "other" would seem to be one of differentiation. *See Jama v. Immigration & Customs Enforcement*, 543 U.S. 335, 343 n. 3, 125 S.Ct. 694, 160 L.Ed.2d 708 (2005) (noting that "both 'other' and 'another' are just as likely to be words of differentiation as they are to be words of connection").

*3 [3][4][5] No Arizona court has addressed the question before us. In the absence of a controlling decision we interpret the statute as we believe the highest state court would. *Hal Roach Studios, Inc. v. Richard Feiner & Co.*, 896 F.2d 1542, 1548 (9th Cir.1990). When interpreting a statute, Arizona courts look to its plain language as the best indicator of the legislature's intent. *Ariz. Tile, L.L.C. v. Berger*, 223 Ariz. 491, 224 P.3d 988, 992 (2010). If the meaning of the statutory language is clear and unambiguous, the court does not employ any other methods of construction. *Id.* We conclude the statutory language at issue in this appeal is ambiguous because it is susceptible to plausible, although contradictory, interpretations. Accordingly, we employ other methods of statutory construction to ascertain the legislature's intent. *See Hayes v. Cont'l Ins. Co.*, 178 Ariz. 264, 872 P.2d 668, 672 (1994).

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[6] When a statute contains a list, as here, we are mindful that the legislature in drafting the statute could not possibly specify all the family members who may be named as beneficiaries. Thus, in reading the statute, we use the rule of statutory construction that "[w]hen several words are followed by a clause which is applicable as much to the first and other words as to the last, the natural construction of the language demands that the clause be read as applicable to all." *Porto Rico Ry., Light & Power Co. v. Mor,* 253 U.S. 345, 348, 40 S.Ct. 516, 64 L.Ed. 944 (1920). While not dispositive, application of this rule lends support to the trustees' position. Under a "natural construction," the phrase "dependent family member" applies as much to the previously enumerated family members (surviving spouse, parent, child, etc.) as it does to "any other" family member. Moreover, this construction gives meaning both to the specific words listing family members and the general words that extend the provisions of the statute to everyone embraced in that class-"any other dependent family member."

We also examined the legislative history for each of the subsections at issue. [FN6] Ariz.Rev.Stat. § 33-1126(A)(7) was added to Ariz.Rev.Stat. § 33-1126 in 2005. The legislative history we reviewed reveals no useful information pertaining to the interpretation of the phrase at issue or the purpose behind the annuity contract exemption. However, our review of the legislative history for the 1992 amendment of subsection (A)(6) (formerly (A)(5)) regarding the exemption for the cash surrender value of life insurance policies provides us with some meaningful guidance.[FN7]

Prior to 1992, Ariz.Rev.Stat. § 33-1126(A)(6) provided in relevant part:

> A. The following property of a debtor shall be exempt from execution, attachment or sale on any process issued from any court:
>
> ....
>
> (5) The cash surrender value of Life insurance policies where for a continued unexpired period of one year such policies have been owned by a debtor and have named as beneficiary the debtor's surviving spouse, child, parent, brother, or sister, or *any dependent....* A "dependent" means a *person* who is dependent upon the insured for not less than one-half of his support. (Emphasis added).

*4 The proposed amendments to subsection (A)(6) were contained in Senate Bill 1060 and served to eliminate per dependent limits on life insurance proceeds as well as adjusting the dollar amount of the exemption upward to $100,000. Moreover, the beneficiary phrase was changed from "debtor's surviving spouse, child, parent, brother, or sister, or any dependent" to "debtor's surviving spouse, child, parent, brother or sister, or any *other* dependent *family member.*" In addition, the meaning of dependent was changed from "dependent means a person" to "dependent means a *family member.*"

[7] The revised Senate Fact Sheet for Senate Bill 1060, prepared by Senate staff almost a month after the legislature had passed the 1992 bill, provides more convincing evidence that the family member or members named as beneficiaries must also be dependents. The Fact Sheet stated the bill's purpose:

> Exempts up to $100,000 of the proceeds from life insurance policies from the claims of creditors in the case of bankruptcy or other court proceedings *when a dependent family member has been named beneficiary* of those proceeds.

The Fact Sheet also furnished the following background on the bill:

> Currently, under the Arizona insurance statutes, if a *dependent family member* has been named the beneficiary of a life insurance policy for a continuous two-year period, up to $2000 of the proceeds from the policy are exempted from the claims of creditors' in the event of bankruptcy or other court proceeding, with a minimum of $5,000 and a maximum of $10,000 for all dependents combined.

Amended Fact Sheet for S.B. 1060, 40th Leg., 2d Sess., at 1 (Ariz. March 2, 1992).[FN8]

Senate Committee Minutes reflecting consideration of the amendments to Senate Bill 1060 included this summary of the bill:

> [U]nder current State law when a creditor makes an attempt to recover debt in a court proceeding, such as bankruptcy, the cash surrender value of a life insurance policy is subject to the claim of a creditor.

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> However, certain portions are exempt when *a dependent family member had been named beneficiary.* This bill eliminates the requirement that the *dependent family member* must be named beneficiary for a continuous two year period and eliminates the $2,000 per dependent limit which is protected from a claim by a creditors. All money named for a *dependent beneficiary* would be exempt.

Senate Minutes of Comm. on Commerce and Labor, 40th Leg., 2d Sess. (Ariz. Feb. 5, 1992).

In short, the only inference permissible from the excerpts we cite support the trustees' position; namely, that the cash surrender value of life insurance policies and proceeds from annuity contracts were intended to protect those family members who were dependent on the debtor. We appropriately make this inference from the explicit purpose of the statute which was set forth in the amended Senate Fact Sheet and also from the changes to the statutory language-the addition of the words "family member" after "any dependent" as well as the change in wording from "a dependent means a person" to "a dependent means a family member." Accordingly, we conclude that the legislative history is determinative of the legislative intent behind Ariz.Rev.Stat. § 33-1126(A)(6).[FN9]

*5 When Ariz.Rev.Stat. § 33-1126 was amended in 2005 to include the exemption for annuity contracts under (A)(7), the legislature adopted almost identical language as that in (A)(6) with respect to named beneficiaries. Therefore, in the absence of a contrary intent-which we could not find-we construe the language contained in both subsections and that of the Insurance Code (Ariz.Rev.Stat.20-1131(D)) in the same manner.

[8][9][10] We are mindful of the rule that exemption statutes are to be construed liberally in the debtor's favor. *In re Hoffpauir,* 125 B.R. 269, 271 (Bankr.D.Ariz.1990). Our construction of the statute, however, does not run afoul of the liberal construction rule because debtors who qualify for the exemption are entitled to exempt an unlimited dollar amount under both subsection (A)(6) and (A)(7). Moreover, this result is consistent with the purpose behind the exemption laws in Arizona which "were not created merely for the purpose of conferring a privilege on a debtor, but to shelter the family and thereby benefit the state." *In re Foreacre,* 358 B.R. 384, 390 (Bankr.D.Ariz.2006) (referring to homestead exemption). In any event, our role on review is restricted to an interpretation of the exemption statute as written. *Hoffpauir,* 125 B.R. at 271 (court is not authorized to reduce or enlarge exemptions).

Accordingly, we hold that Ariz.Rev.Stat. § 20-1131(D) and § 33-1126(A)(6) and (7) require that the child of a debtor named as a beneficiary must be a dependent in order for the debtor to obtain an exemption under those sections.

VI. CONCLUSION

For the reasons stated above, we REVERSE the bankruptcy court's order in each appeal.

FN1. Hon. Catherine E. Bauer, Bankruptcy Judge for the Central District of California, sitting by designation.

FN2. Unless otherwise indicated, all chapter, section and rule references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037.

FN3. The corresponding exemption for the cash surrender value of life insurance policies in Arizona's Insurance Code at Ariz.Rev.Stat. § 20-1131(D) contains the identical phrase as that under Ariz.Rev.Stat. § 33-1126(A)(6). Therefore, our discussion in reference to the cash surrender value of life insurance policies under Ariz.Rev.Stat. § 33-1126(A)(6) is equally applicable to the exemption in Ariz.Rev.Stat. § 20-1131(D).

FN4. " 'Debtor' means an individual whether married or single utilizing property described in this article for personal, family or household use." Ariz.Rev.Stat. § 33-1121.

FN5. The Insurance Code exemption contained in Ariz.Rev.Stat. § 20-1131(D) provides in relevant part:

> If, for a continuous, unexpired period of two years, a policy of life insurance has *named as beneficiary the insured's surviv-*

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> *ing spouse, child, parent, brother, sister or any other dependent family member,* then, in event of bankruptcy or in any proceeding before any court in this state, the cash surrender value of the insurance, in the proportion that the policy names any such beneficiary, shall be exempt from claims and demands of all creditors.... For the purposes of this subsection, "dependent" means a family member who is dependent on the insured for not less than half support. (Emphasis added).

FN6. Neither party submitted any legislative history to explain the meaning or purpose behind the life insurance or annuity contract exemptions at issue nor were these records introduced in the bankruptcy court. Nonetheless, we can take judicial notice of the records under Fed.R.Evid. 201(b). *See also, Hayes,* 872 P.2d at 673 n. 5. We obtained the records directly from the Arizona State Senate Resource Center.

FN7. Ariz.Rev.Stat. § 20-1131(D) contained in the Arizona Insurance Code was added in 1963. It too was amended in 1992 at the same time as Ariz.Rev.Stat. § 33-1126(A)(6). The amendment for Ariz.Rev.Stat. § 20-1131(D) eliminated the $5,000 minimum and $10,000 maximum limits for all dependents combined and brought the definition of a dependent in line with that under Ariz.Rev.Stat. § 33-1126(A)(6).

FN8. In Arizona, Senate fact sheets are viewed as "relevant legislative history and as reflective, though not dispositive, of legislative intent." *State v. Payne,* 223 Ariz. 555, 225 P.3d 1131, 1139 n. 5 (2009).

FN9. For this reason, we are unpersuaded by the out-of-state case law cited by the parties that construed similar exemption statutes.

9th Cir.BAP (Ariz.),2010.
In re Hummel
--- B.R. ----, 2010 WL 5076421 (9th Cir.BAP (Ariz.)), 10 Cal. Daily Op. Serv. 15,747, 2010 Daily Journal D.A.R. 18,736

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DISTRICT OF ARIZONA ANNUAL CONFERENCE

MARCH 11, 2011

Panel 2

Ways & Means? Pre-Bankruptcy Planning for Individuals Chapter 7, 11, or 13

Honorable Charles G. Case, Edward Bernativicius, Warren Stapleton, Steven Jerome

1. **"Issues in Individual Chapter 11 Cases" – Honorable Charles G. Case, II**
2. **Individual Chapter 11s – The Case of Dr. Gupta – Warren Stapleton**
3. **Analysis of Consumer vs. Non-Consumer Debts in Chapter 7 (with associated cases) - Ed Bernativicius**

Issues in Individual Chapter 11 Bankruptcies

Honorable Charles G. Case II

I. Continued Vitality of the Absolute Priority Rule in Individual Chapter 11 Cases

BAPCPA's amendment to § 1129(b)(2)(B)(ii) and the addition of §1115 have led to extremely divergent opinions about whether the absolute priority rule continues to apply in post-BAPCPA individual Chapter 11 cases. Pre-BAPCPA, § 1129(b)(2)(B)(ii) provided that a plan is "fair and equitable" as to unsecured creditors, and thus, confirmable under the cramdown provisions, only if 1) the plan pays creditors the present value of their claim, or 2) the junior claims and interests do not retain any property of the estate on account of their claims or interests. BAPCPA changed the operation of this portion of the so-called absolute priority rule, and provided that individual Chapter 11 debtors may retain property "included in the estate under section 1115" even if unsecured creditors are not paid the present value of their claims.[1]

Under § 1115, "property of the estate includes, in addition to the property specified in section 541—

(a) all property of the kind specified in section 541 that the debtor acquires after the commencement of the case…; and

(b) earnings from services performed by the debtor after the commencement of the case…."

Until recently, the case law was fairly consistent, interpreting § 1129(b)(2)(B)(ii) to permit an individual Chapter 11 debtor to retain all property referred to by § 1115, including property added to the estate by § 541, without requiring the debtor to pay unsecured creditors the present value of their claims. However, two bankruptcy courts in California recently ruled the other way, finding that the reference in § 1129(b)(2)(B)(ii) permitted the debtor to retain only that property which was included in the estate by § 1115 (and not property already included in the estate under § 541) if the debtor did not propose to pay unsecured creditors the present value of their claims. The result of the divergence of opinion is that some courts find that the absolute priority rule remains in effect in individual Chapter 11 cases to some extent, while other courts find that BAPCPA abolished the absolute priority altogether, allowing debtors to retain all property of the estate without paying unsecured creditors the present value of their claims.

A. BAPCPA Abolished Absolute Priority Rule in Individual Chapter 11 Cases- In re Shat

The recent decision in *In re Shat*[2] surveyed the history of the absolute priority rule, BAPCPA, and prior cases on this issue, and concluded that Congress intended to abolish the absolute priority rule in individual Chapter 11 cases. The *Shat* court relied on the view that the

[1] 11 U.S.C. § 1129(b)(2)(B)(ii).
[2] 424 B.R. 854 (Bankr. D. Nev. 2010).

changes to Chapter 11 in BAPCPA were intended to make individual Chapter 11 cases more like Chapter 13 cases, which has not included any sort of absolute priority rule since 1952. The court also relied on several earlier cases which found that a narrower reading of the amendment to § 1129(b)(2)(B)(ii), discussed below, would have little effect on the debtor's ability to reorganize,[3] and that the exception in § 1129(b)(2)(B)(ii) should be read in line with the broad inclusive language of § 1115.[4] The *Shat* court noted the "almost trivial" result of the narrower reading of § 1129(b)(2)(B)(ii), which would seemingly only protect the value of earnings payable after the fifth anniversary of the plan confirmation. In the end, the court concluded that these factors indicated that Congress intended to abolish the absolute priority rule in individual Chapter 11 cases, closer aligning treatment of individuals under Chapter 11 with the treatment of debtors in Chapter 13.

B. BAPCPA Did Not Abolish the Absolute Priority Rule in Individual Chapter 11 Cases- In re Karlovich

Until early 2010, the case law on this issue appeared to be unanimous. However, since April of 2010, two courts have decided that BAPCPA, to some extent, left the absolute priority rule intact in individual Chapter 11 cases.

In April 2010, the court in *In re Gbadebo*[5] issued an opinion concluding that BAPCPA modified, but did not completely abrogate the absolute priority rule in individual Chapter 11 cases. The *Gbadebo* court found that the addition of the phrase "in addition to the property specified in section 541" in § 1115 was included to ensure that it was clear that § 1115 did not overrule § 541's inclusion of prepetition property within property of the estate. Further, the addition of provisions designed to make individual Chapter 11 cases more like Chapter 13 cases were not persuasive evidence that Congress intended to abolish the absolute priority rule. Indeed, each of those provisions imposed greater burdens on debtors, in an attempt to provide a greater payout to creditors. Abolition of the absolute priority rule would effectuate the opposite result. Last, the court noted that complete abolition of the absolute priority rule in the manner proposed by *Shat* and others would lead to a practical anomaly. Debtors would be required to send impaired unsecured creditors ballots, but could ignore them and retain all pre and postpetition property. Thus, the *Gbadebo* court determined that the absolute priority rule was modified by BAPCPA, allowing the debtor to retain only property and earnings acquired post-petition.

Although disagreeing with the analysis in *Gbadebo*, the court in *In re Karlovich*[6] agreed with *Gbadebo's* outcome. The *Karlovich* court found that § 1129(b)(2)(B)(ii) plainly and unambiguously limits the application of the absolute priority rule by permitting the debtor to retain only those items listed in subsections (a) and (b) of § 1115 if the debtor does not propose

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[3] *Citing In re Roedmeier*, 374 B.R. 264 (Bankr. D. Kan. 2007).
[4] *Citing In re Tegeder*, 369 B.R. 477 (Bankr. D. Neb. 2007).
[5] 431 B.R. 222 (Bankr. N.D. Cal. 2010).
[6] 2010 WL 5418872 (Bankr. S.D. Cal. Nov. 16, 2010).

to pay unsecured creditors the present value of their claims. Sections 1129(b)(2)(B)(ii) and 1115 simply codify the absolute priority rule, applying the rule consistently in individual and non-individual Chapter 11 cases. Aside from the plain meaning of the statute, the court concluded that it was unlikely that Congress intended to abrogate the absolute priority rule, since it could have done so by easily adding "except with respect to individuals" at the beginning of § 1129(b)(2)(B)(ii). The plain meaning, the court concluded, permitted the debtor to retain only post-petition property specified in § 1115 without paying unsecured creditors the present value of their claim.

II. Additional Individual Chapter 11 Plan Issues

Whether the absolute priority rule was abrogated by BAPCPA or not, Chapter 11 debtors still face substantial difficulties not present in a Chapter 13 cases. For example:

1) The Chapter 11 debtor has an "exclusivity period" during which only the debtor may file plan. However, any party in interest may file a plan if the debtor has not filed a plan within 120 days of an order for relief, or does not have the plan accepted within 180 days of the order for relief.[7] The "exclusivity period' may be extended for cause, but in no event may exceed 18 months to file a plan and 20 months to obtain approval;[8]
2) The Chapter 11 must file monthly operating reports pursuant to § 1116(4), Fed. R. Bank. P. 2015, and Local Rule 2015-1.
3) An undersecured creditor may prevent a Chapter 11 debtor from stripping the unsecured portion of its claim, by making an election under § 1111(b) to have the entire claim treated as secured;
4) The Chapter 11 debtor must obtain the affirmative vote of at least one impaired class, as required by 1129(a)(10) in order to obtain confirmation of its plan; and
5) The Chapter 11 debtor must comply with § 1129(a)(15) which requires debtors to pay their full projected disposable income to creditors for <u>the longer of</u> 5 years or the term of the plan in the event that any unsecured creditor objects to the plan.
6) Cash collateral issues are more likely to be litigated in a Chapter 11 case.

[7] 11 U.S.C. § 1121(c)(2)-(3).
[8] 11 U.S.C. § 1121(d).

Individual Chapter 11s

The Case of the Drs. Gupta

000283 Bankruptcy

Hypothetical Exploration of the Issues— The Guptas are 50 year old doctors. Their gross income is approximately $500,000 per year.

- Assets:
  - $600,000 home
  - BMW $35,000
  - Ferrari $90,000
  - Interest in Gupta MD, PLLC $2,000,000(?)
  - Boat $75,000
  - 401ks $550,000
  - Trading account $25,000
  - Summer cabin $175,000
  - Interest in Simpson & Gupta Real Estate Investment, LLC ($0) S&G owns 4 office buildings worth a combined $5 million.
  - Engagement ring $14,000
  - Jewelry $2,000
  - Coin collection $2,500

- Liabilities
  - $900,000 mortgage
  - BMW loan $25,000
  - Ferrari loan $70,000
  - Personal guarantee of LOC $800,000 secured by blanket lien.
  - Co-obligor on office lease $300,000 still owing.
  - Boat loan $62,000
  - 401k loan for $100,000
  - Summer cabin mortgage $250,000
  - Malpractice action (gross negligence/punitive damages) $1,500,000 (est.) (in discovery)
  - Business partner litigation (embezzlement) (in discovery) $350,000.
  - Attorneys' fees from business partner litigation $100,000
  - Consumer debt $55,000
  - Personal guarantees of the 4 office buildings in the amount of $14 million. (only one of S&G's buildings can currently meet the monthly obligations).

What is the end game?

- Why is the Debtor in your office and can a bankruptcy provide the outcome that he/she desires?
  - What if the Guptas want to reduce the principal on their mortgage?
  - What about getting them free of the lawsuits?
  - Is there a workout strategy that could get them there short of bankruptcy – Avoiding bankruptcy is expensive, but it's almost always worth it.
- What does the Debtor have, and what does he/she want to keep?
- Will the Debtor have enough income or assets to reorganize?
- If Chapter 11, can you rough pencil a treatment for the relevant classes and the dollar amounts in each class?
- Can the Debtor pay your fees? ($10,000 minimum retainer – even for a relatively small case – and adjust upward for strength of opposition and the amount of administration likely to be necessary).

Do I have a Chapter 11 Case?

- Could the Debtor qualify for Chapter 7?
  - Advantages of Chapter 7: Cheaper, provides the Debtor access to post-petition income free of creditors, over very quickly (emotional component)
  - Means test.
- Could the Debtor qualify for Chapter 13?
  - $336,900 in liquidated, noncontingent, unsecured debts and/or $1,010,650 in liquidated, noncontingent, secured debts.

Chapter 13 v. Chapter 11

- Why choose a Chapter 13?
  - Easier for practitioner to administer.
  - Much, much less expensive.
  - May be classification (consumer debt, interest on non-dischargeable claims) or dischargeability advantages – assuming Debtor completes payment civil penalties, securities violations, and prior debts may be discharged.
  - Disposable income test in Chapter 13 and Chapter 11 virtually the same.
- Why not choose a Chapter 13?
  - No debt restrictions.
  - No Chapter 13 Trustee, and the Debtor can control the estate, but the Debtor requires much more attorney supervision.
  - No ability to modify the personal residence secured loans in Chapter 11. 11 U.S.C. Section 1123(b)(5). Does not appear that this can be 'finessed.'
  - Be aware of cash collateral (rare, but possible), executory contract, and utility issues that you may not face in a Chapter 13 in the same procedural context.

The Guptas and Chapter 13

- Are the Guptas eligible for Chapter 13?
  - Which debts are liquidated?
  - Which debts are contingent?
  - Are the lawsuits or personal guarantees liquidated or contingent?
  - Are they over the cap?
  - What happens if we file for 13 and we end up over the cap?
- Are there any advantages to Chapter 13?
  - What if instead of personal guarantees the Guptas were directors in Stapleton & Jerome, LLC an investment company. Suppose further that Stapleton & Jerome misplaced a substantial portion of the $14 million invested by their investors and that the SEC has commenced an investigation that could result in civil fines that could exceed $4 million.

Cash collateral issues?

- Drs. Gupta have membership interests in the PLLC (their practices). They personally guaranteed the LOC. The LOC is secured by a blanket lien.
- Can the lender enter the personal bankruptcy and make a cash collateral fight?
- What if the Drs. were less careful and did not actually have a PLLC? What if the bank took security in the receivables of their practice?
- What about the lease? If the PLLC is valid, can the Drs. reject the lease?

Requirements of an Individual Chapter 11 Plan

- Proposed in good faith and not by any means forbidden by law.
- No unfair classification, i.e., similar debts receive the same classification or the same treatment. (Classification is important because you need at least one impaired accepting class.)
- In the impaired classes, each holder has (a) accepted the treatment proposed under the plan OR (b) will receive more than the creditor would receive in a Chapter 7. (This goes back to the beginning, what does your client want to keep, and can they afford to pay for it during the term of the plan.)
- Special treatment required for the administrative and priority claims. Can your client satisfy these requirements?
- At least one impaired class accepts (insiders do not count) and the Debtor can satisfy the cramdown standard in Section 1129(b).
- Paid UST's fees and child support current.
- In individual Chapter 11, and an unsecured creditor objects, Debtor's distributions under the plan must exceed the projected disposable income (under Section 1325(b)(2)) for five years.
- 1111(b) election for investment houses

How much do the Guptas have to pay to get their discharge? – the liquidation analysis

- Payment for the equity in the assets. What are the possible issues?
  - BMW equity $10,000
  - Ferrari equity $15,000
  - Boat equity $13,000
  - What about their practices? Gupta MD, PLLC? $2,000,000. How do you establish that value? (What kinds of evidence?) Owes $800,000 LOC.
- What if the summer home is worth $300,000?
  - Can they be compelled to sell it?
  - Does it violate good faith to retain it?

Cramdown in Individual Chapter 11

- For secured claims it must be: (1) retention of lien; and (2) payments of the value of the allowed amount of the secured claim; OR sale with liens to attach to the proceeds; OR indubitable equivalent.
- Standard for interest rates: *In re American Homepatient, Inc.*, 420 F.3d 559 (6th Cir. 2005) (In Chapter 11, first look for what efficient market would produce and if no efficient market then use formula approach from *Till v. SCS Credit Corp.*, 541 U.S. 465, 124 S.Ct. 1951 (2004)).
- For unsecured claims it must be: (1) you get the allowed amount of the claim (not likely) OR (2) if unsecured claim not being paid in full then no junior class, i.e., your client, will receive or retain anything under the plan EXCEPT your client can retain property of the estate (under Section 1115) subject to the 5-year disposable income requirement in Section 1129(a)(15).

Disposable Income Section 1325(b)(2) (and 707(b)(2))

- Current monthly income minus living expenses, expenses for child support, charitable contributions (up to 15% gross), and, if the debtor is engaged in a business, for the payment of expenditures necessary for the continuation and preservation of the business. *See* 11 USC 707(b)(2).
- Standards for living expenses. IRS website http://www.irs.gov/individuals/article/0,,id=96543,00.html Be sure to visit the Arizona housing & utilities, food & clothing (national), Arizona transportation, and out of pocket health care.
- Also includes payments for Chapter 13 admin expenses (not available in individual Chapter 11).
- Also includes payments of secured claims. Not just the house and car, but other secured claims as well. *See, e.g., In re Kagenveama*, 541 F.3d 868 (9th Cir. 2008) (affirming Judge Case decision). *But see In re Martin*, 373 B.R. 731 (Bankr. D. Utah 2007) (holding payment on ski boat within ambit of 'expense' under 707(b)(2) but keeping a recreational watercraft while shorting unsecured creditors was considered bad faith – Chapter 13 plan denied).
- Also includes payments on priority claims.

The Guptas and disposable income – how much can they pay?

- Monthly Gross Income: $42,000 per month
- Taxes $14,000 per month
- Living expenses for a family of three (one child already out of the house).
  - Food & Clothing $1,152/mo
  - Housing & Utilities $1,549/mo
  - Transportation $524/mo
  - Out-of-pocket healthcare $60/mo
  - Total: $3,285
- Secured claims
  - House $7,000/mo
  - BMW & Ferrari $1,750/mo
  - Boat $900/mo
  - Summer cabin $2,000/mo
- Insurance and everything else $3,000
- What about the 401k loan?
- $31,935 (some double-counting). $10,000 per month for creditors.

Handling non-dischargeability issues.

- Evaluation of the merits.
- In Chapter 11 cases, Debtors lawyer typically handles the non-dischargeability issues.
- Non-estate assets can be used. In the Guptas' case, the 401k. Possibly money from Gupta MD, PLLC – assuming that they have paid enough to retain their interests (at least the liquidation value of the property).

The Individual Debtor's Responsibilities in the Chapter 11

- Does the Debtor know what to do in the Chapter 11 case with respect to bank accounts, credit cards, sales of assets?
- Does the Debtor understand the need for monthly operating reports and the payment of quarterly fees?
- A good idea to have a form letter (example provided) to protect yourself.
- Encourage open communication at the meeting with the UST analyst.

When does your client receive a discharge?

- Upon completion of all payments under the Plan and after notice and hearing (objections can trip up the discharge).
- Or upon motion for a discharge AND you have distributed more than creditor would have received in Chapter 7 AND modification of the plan is not practicable. 11 USC 1141(d)(5)(B).
- Practical questions about documenting that your client has made all the requisite plan payments. Particularly relevant in Chapter 11 because no trustee supervision and nothing prevents you from closing the case well before the plan is completed. How will the Guptas prove that they have made all of the required plan payments?

A word about creativity & mistakes

- Amending the schedules – when should it be done?
- Spend some time thinking about the problem areas (or people) in your case. (Ex-spouses, business partners.)
- Don't forget to use the court website for local rules, judge's procedures, and UST's information.
- When you are tempted to push the boundaries of the language of the statute/rule, ask yourself these questions?
- Can I construct a policy argument (hopefully using bankruptcy rationales) to support my position?
- How can I communicate the justice of my position to the Court?
- Does the outcome that I am asking for leave a level playing field? (The Court may say, if that is the rule how is the creditor going to be able to protect itself?)
- If I have 'oversold' an outcome to my client, what is the best way to communicate that 'new' information to my client.

March 11, 2011

Analysis of Consumer vs. Non-consumer debts in chapter 7.

By: Edward K. Bernatavicius

In considering eligibility for protection under Chapter 7 of the Bankruptcy Code and whether a debtor is subject to the provisions of 11 U.S.C. § 707(b), an initial determination must be made as to whether some or all of the debtor's debts constitute primarily consumer debts.

Consumer debt is one incurred by an individual primarily for personal, family, or household purpose. 11 U.S.C. § 101(8). The word "debt" is defined by 11 U.S.C. §101(12) to mean a "liability on a claim." A "claim" is defined by 11 U.S.C. § 101(5)(A) as "right to payment, whether or not such right is . . . secured or unsecured. *See also In re Kelly,* 841 F.2d 908, 912 (9th Cir. 1988).

Thus, in analyzing whether a debtor's liabilities are consumer debts, one must look to both the debtor's secured and unsecured debts. *Id.* at 912 (stating that "[a] literal reading of the Code's simple language leads inexorably to the conclusion that consumer debt includes secured debt"); *see also In re Price*, 353 F.3d 1135, 1139 (9th Cir. 2004) (citing *Kelly* that consumer debt "includes all secured debt incurred for personal, family or household purpose").

Whether a particular debt is excluded from inclusion as consumer debt depends on the purpose of that debt. *See Price*, 353 F.3d at 1139.

Three approaches are used by courts to evaluate whether debts are incurred primarily for a consumer purpose.

1. *Overall ratio of consumer to non-consumer debts is greater than 50 percent.* See In re Stewart, 175 F.3d 796 (10th Cir. 1999); In re Booth, 858 F.2d 1051 (5th Cir. 1988); In re Kelly, 841 F.2d 908 (9th Cir. 1988).

2. *Number of consumer debts more than one-half of the total debts.* See In re Higginbotham, 111 B.R. 955 (Bankr. N.D. Okla. 1990).

3. *Consider both the percentage of consumer debt and the number of consumer debts.* See In re Vianese, 192 B.R. 61 (Bankr. N.D.N.Y. 1996); see generally Annotation, What Are "Primarily Consumer Debts" Under 11 U.S.C. §707(b), 101 A.L.R. 771 (1991).

The 9th Circuit currently follows the approach that evaluates the percentage consumer to non-consumer debts. Although the Bankruptcy Code does not quantify the term "primarily" the Ninth Circuit has determined that standard is met when more than half the dollar amount owed is consumer debt. *Id.*; *see Kelly*, 841 F.2d at 913. This

determination relies on a plain definition of the word "primarily" to mean "for the most part," or that more than half of the dollar amount owed.

Secured Debts

I. **Mortgages**.

As in the analysis above, mortgages secured by real property are included in the consumer debt determination. The Court in *Kelly* stated, "The statutory scheme so clearly contemplates that consumer debt include debt secured by real property that there is no room left for any other conclusion." *Id.* at 912. The *Kelly* Court went on to determine that while the mortgage secured by real property was not automatically excluded from consumer debt, it was not automatically included either. The Court ultimately had to make a determination as to the purpose of the debt. *Id.* at 913.

The *Kelly* Court determined the debtor's mortgage consisted of a $95,000.00 first lien that the debtor assumed when the home was purchased and a $32,000.00 home equity line of credit for $32,000.00 that was used for home improvements and repayment of credit card debts. *Id.* The Court held both the first lien and home equity line to be consumer debts stating, "It is difficult to conceive of any expenditure that serves a "family . . . or household purpose" more directly than does the purchase of a home and making of improvements thereon." *Id.*

Similarly, in *Price,* the Ninth Circuit held the debtor's two mortgages securing the debtor's personal residence to be consumer debt. The debtor's first loan of $120,000.00 secured the debt to purchase the residence and the second loan in the amount of $21,511.00 was secured to finance home improvements. *Price*, 353 F.3d at 1139. Thus the Court held "[t]here is no question that the secured debt at issue was incurred primarily for personal, family or household purpose and must be considered "consumer debt" for the purposes of §707(b)." *Id.*

Conversely, a mortgage debt that a chapter 7 debtor incurred to acquire improved land adjacent to his residence, which he then rented out, was incurred principally as an investment, in order to obtain a source of rental income. Although the newly acquired property facilitated debtor's access to his own home, the mortgage debt was held not be in the nature of "consumer debt" within the meaning of "substantial abuse" provision of §707(b). *In re Pedigo*, 296 B.R. 485 (Bankr. S.D. Ind. 2003); *see also Matter of Booth*, 858 F.2d 1051 (5th Cir. 1988) (applying "the profit motive test" to hold that only one of the debtor's three loans was consumer in nature, while the nature of the second and third loans were non-consumer).

Unsecured Debts

I. Tax Debts.

Personal income tax debts are considered non-consumer in nature. Courts have found personal income tax to be distinct in nature from consumer debt for the following reasons:

1) Consumer debts and tax debts are not incurred in the same way. Consumer debts are incurred voluntarily whereas personal income tax is imposed on the individual.

2) Consumer debts are incurred for personal, family or household purposes whereas taxes are assessed for the public wealth.

3) Consumer debts arise from consumption whereas taxes arise from the earning of money.

For examples of Courts discussing this issue see the following: *In re Westberry*, 215 F.3d 589 (6th Cir. 2000); *In re Brashers,* 216 B.R. 59 (Bankr. N.D. Okla. 1998); and *In Re Traub,* 140 B.R. 286 (Bankr. D.N.M. 1992).

II. Domestic Support Obligations.

Courts have ruled that domestic support obligations owed by a debtor are consumer debts. Courts generally hold that such an obligation is for the benefit and support of a former spouse and is not owed for any profit motive. *See In re Stewart*, 175 F.3d 796 (10th Cir. 1999); *In re Hall*, 258 B.R. 45 (Bankr. M.D. Fla. 2001).

III. Personal Injury and Tort Debts.

Judgment debts are not consumer debts. As shown in the cases below, courts have emphasized that consumer debts are voluntarily incurred for personal, family or household purposes. The two cases below involve an automobile judgment liability where the courts have found that these judgment debts are not consumer debts.

The Court in *In re White*, 49 B.R. 869 (Bankr. N.C. 1985) held that a judgment debt which arose from an automobile accident attributable to the debtor's negligence was not consumer debt for purposes of dismissal of a Chapter 7 bankruptcy case under § 707(b) because the automobile accident liability was incidental to the personal aim of gaining transportation. The accident liability is not a common debt because the debtor, while negligent, aimed only to gain transportation and not to do another person harm by use of his vehicle.

Similarly, in *In re Marshalek*, 158 B.R. 704 (Bankr. N.D. Ohio 1993), the Court held that the judgment resulting from a vehicular accident is not *per se* "consumer debt" because the debtor did not voluntarily incur civil judgments against him and did not incur judgment debts primarily for personal, family or household purpose, within meaning of §707(b).

In analyzing tort type debts, the consideration falls squarely on the fact that these debts are not voluntarily incurred and the main goal behind having incurred the debt has no personal, family or household purpose. Frequently, tort type debts have fallen outside the scope of consumer debts.

IV. **Student Loans**.

The assessment of whether a student loan is considered primarily consumer or non-consumer is fact specific in nature. One should look to see how the loan was used (i.e. family expenses = consumer v.s. educational expenses = non-consumer).

The Court in *In re Stewart*, 175 F.3d 796 (10th Cir. 1999) determined the debtor used the loans primarily to pay for his living expenses and the living expenses of his family, therefore the student loans were used for personal, family or household purposes and were consumer debts.

Noting the importance of the need for evidence to support the debtor's assertion, the Court in *In re Vianese*, 192 B.R. 61 (Bankr. N.D.N.Y 1996) held that where there was no testimony regarding how the student loan was used, the student loan would be considered consumer debt.

V. **Credit Cards**. Personal Credit Cards Claimed for Non-Consumer or Business Purpose.

Where a debtor claims that credit card debt was accumulated for investment, business or non-consumer purposes, the ultimate determination will be fact sensitive and based on the evidence presented in each case.

In re Jones, Slip CopyWL 102442 (Bkrtcy.E.D.N.C., 2009) the Court adopted a "totality of the circumstances approach" to determine whether the debts were primarily consumer debts. *See Neufeld v. Freeman*, 794 F.2d 149, 152(4th Cir. 1986), and *In re Green*, 934 F. 2d 568 (4th Cir. 1991). At trial on the United States Trustee's Motion to Dismiss Case pursuant to 11 U.S.C. §707(b)(1), Mr. Jones' uncontroverted testimony was that $28,000.00 of his second mortgage and 95% of his credit card debt was attributable to his business. Based on the uncontroverted testimony the Court determined the debt to be non-consumer and the Motion to Dismiss was denied. *Id.*

In re Almendinger, 56 B.R. 97 (Bankr. N.D. Ohio 1985) the debtor had accumulated $119,486.00 of credit card debt. The majority of these debts were to pay off investment losses, with very few goods and services being obtained through credit card purchases. The court held in this case that the overall value of the debt was such that it could not be considered primarily consumer debt.

Conclusion.

The above analysis provides a basic framework for consideration as to whether a debtor's debts are primarily consumer debts.

In re Thomas G. KELLY III and Pauline A. Kelly, Debtor.

Robert W. and Carolyn B. ZOLG and Tucson Realty & Trust Company, Appellants,

and

United States of America, Intervenor,

v.

Thomas G. KELLY III and Pauline A. Kelly, Appellees,

and

Alan Solot, Trustee in Bankruptcy.

No. 87-1560.

United States Court of Appeals, Ninth Circuit.

Argued and Submitted Aug. 13, 1987.

Decided March 2, 1988.

The Bankruptcy Court dismissed debtors' Chapter 7 petition as substantial abuse of the Bankruptcy Code. Debtors moved for reconsideration. After second hearing, the Bankruptcy Court, 57 B.R. 586, reaffirmed dismissal. Debtors appealed. The Bankruptcy Appellate Panel for the Ninth Circuit, 70 B.R. 109, reversed and remanded. Appeal was taken. The Court of Appeals, Kozinski, Circuit Judge, held that: (1) debtors' debts were primarily consumer debts; (2) debtors' ability to repay debts, standing alone, justified dismissal; (3) statute permitting dismissal of Chapter 7 petitions where debts are primarily consumer debts and where granting relief would be substantial abuse of Chapter 7 provisions was not unconstitutionally vague; and (4) bankruptcy court's power to order hearing on issue of dismissal did not deny debtors neutral and impartial arbiter.

Reversed and remanded.

1. Bankruptcy ⇐3811

Decision affirming or reversing final order of bankruptcy court is deemed "final," for purposes of appealability; however, where bankruptcy appellate panel remands for further factual findings on "a central issue," decision is not appealable. 28 U.S.C.A. § 158(d).

See publication Words and Phrases for other judicial constructions and definitions.

2. Bankruptcy ⇐3811

Bankruptcy appellate panel's decision, which reversed final order of bankruptcy court dismissing Chapter 7 petition and which remanded for "a determination of the nature of the unsecured debt" and for reconsideration of proper test for substantial abuse, was "final," for appealability purposes; underlying facts were not disputed and legal issues predominated questions on remand. Bankr.Code, 11 U.S.C.A. § 701 et seq.; 28 U.S.C.A. § 158(d).

3. Statutes ⇐217.4

Where statutory language is clear and precisely addresses relevant issue, resort to legislative history is inappropriate.

4. Bankruptcy ⇐2254

"Consumer debt," within meaning of statute permitting dismissal of Chapter 7 petition where debts are primarily consumer debts and where granting relief would be substantial abuse of Chapter 7 provisions, can include debt secured by real property; purpose of debt determines whether debt is "consumer debt." Bankr. Code, 11 U.S.C.A. §§ 101(4)(A), (7, 11), 521(2), 707(b).

See publication Words and Phrases for other judicial constructions and definitions.

5. Statutes ⇐216, 217.3

To extent legislative history may be considered in construing statute, the official committee reports provide the authoritative guide; stray comments by individual legislators cannot be attributed to the full legislative body.

6. Statutes ⇐184

Policy arguments are irrevelant to interpretation of unambiguous statute.

7. Bankruptcy ⇐2125

Bankruptcy judges have no power to ignore plain language of statute in order to

reach results in keeping with notions of equity.

8. Bankruptcy ⇐2254

Mortgage debts, which consisted of lien assumed at purchase of home and home equity line of credit incurred for home improvements and repayment of credit card debts, were "consumer debt," within meaning of statute permitting dismissal of Chapter 7 petition where debts are primarily consumer debts and where granting relief would be substantial abuse of Chapter 7 provisions. Bankr.Code, 11 U.S.C.A. §§ 101(4)(A), (7, 11), 521(2), 701 et seq., 707(b).

9. Bankruptcy ⇐2254

Second home equity line of credit securing loan from bank to debtor's professional corporation was not "consumer debt," within meaning of statute permitting dismissal of Chapter 7 petition where debts are primarily consumer debts and where granting relief would be substantial abuse of Chapter 7 provisions; debt incurred for business ventures or other profit-seeking activities is plainly not consumer debt. Bankr.Code, 11 U.S.C.A. §§ 101(4)(A), (7, 11), 521(2), 701 et seq., 707(b).

10. Bankruptcy ⇐2254

Debt for attorney's fees incurred in state court litigation commenced by debtors for purpose of recovering money allegedly overpaid in purchasing home was "consumer debt," within meaning of statute permitting dismissal of Chapter 7 petition where debts are primarily consumer debts and where granting relief would be substantial abuse of Chapter 7 provisions. Bankr.Code, 11 U.S.C.A. §§ 101(4)(A), (7, 11), 521(2), 701 et seq., 707(b).

11. Bankruptcy ⇐2254

Chapter 7 debtors have "primarily" consumer debts, for purposes of statute permitting dismissal of Chapter 7 petition where debts are primarily consumer debts and where granting relief would be substantial abuse of Chapter 7 provisions, where more than half of the dollar amount of their debts is consumer debt. Bankr. Code, 11 U.S.C.A. §§ 701 et seq., 707(b).

12. Bankruptcy ⇐2254

Debtor's ability to pay debts when due, as determined by ability to fund Chapter 13 plan, is primary factor to be considered in determining whether granting relief would be substantial abuse within meaning of statute permitting dismissal of Chapter 7 petition where debts are primarily consumer debts and where granting relief would be substantial abuse of Chapter 7 provisions. Bankr.Code, 11 U.S.C.A. §§ 701 et seq., 707(b), 1301 et seq.

13. Bankruptcy ⇐2254

Chapter 7 debtors' ability to repay their debts, which were primarily consumer debts, standing alone, justified dismissal of petition as substantial abuse of Chapter 7; bankruptcy court had determined that debtors could repay, out of disposable income, approximately 99% of their unsecured debt in only three years. Bankr.Code, 11 U.S. C.A. §§ 701 et seq., 707(b).

14. Bankruptcy ⇐2254

In determining debtor's ability to repay debts, for purposes of applying statute permitting dismissal of Chapter 7 petition for substantial abuse, court will look to whether debtor's claimed expenditures were reasonably necessary for maintenance or support of debtor or dependent of debtor. Bankr.Code, §§ 701 et seq., 707(b), 1325(b).

15. Constitutional Law ⇐82(1)

Laws, such as Bankruptcy Code, that regulate economic activity not involving constitutionally protected conduct are subject to quite lenient tests for constitutional sufficiency.

16. Bankruptcy ⇐2013

There was no constitutional infirmity in leaving to discretion of bankruptcy court application of presumption in favor of granting bankruptcy relief under statute permitting dismissal of Chapter 7 petition where debts are primarily consumer debts and where granting relief would be substantial abuse of Chapter 7 provisions. Bankr.Code, 11 U.S.C.A. §§ 701, 707(b).

17. Constitutional Law ⇐82(4)

The Constitution does not require the legislature to incorporate dictionary into every statute in order to insulate statute from vagueness challenges.

18. Bankruptcy ⇐2013

Statute permitting dismissal of Chapter 7 case where debts are primarily con-

sumer debts and where granting of relief would be substantial abuse of Chapter 7 provisions was not unconstitutionally vague. Bankr.Code, 11 U.S.C.A. §§ 701 et seq., 707(b).

19. Bankruptcy ⇐2013, 2264(1)

Bankruptcy court's power to order hearing on issue of dismissal did not deny debtors neutral and impartial arbiter and did not render unconstitutional statute permitting dismissal of Chapter 7 petition where debts are primarily consumer debts and where granting of relief would be substantial abuse of Chapter 7 provisions. Bankr.Code, 11 U.S.C.A. §§ 701 et seq., 707(b).

20. Bankruptcy ⇐2264(1)

Presumption in favor of granting bankruptcy relief, under statute permitting dismissal of Chapter 7 petition where debts are primarily consumer debts and where granting relief would be substantial abuse of Chapter 7 provisions, did not place on bankruptcy court burden of producing evidence; rather, presumption was reminder to bankruptcy court that Congress favors granting of relief and that court should give benefit of doubt to debtor. Bankr. Code, 11 U.S.C.A. §§ 701 et seq., 707(b).

21. Bankruptcy ⇐2187

Appellants were not entitled to award of attorney's fees against Chapter 7 debtors for debtors' alleged bad faith in litigating appeal of dismissal of petition for substantial abuse. Bankr.Code, 11 U.S.C.A. §§ 701 et seq., 707(b); 28 U.S.C.A. §§ 1912, 1927; F.R.A.P.Rule 38, 28 U.S.C.A.

Michael McGrath, Stompoly & Stroud, Tucson, Ariz., for appellants.

Thomas G. Kelly III, Blaser, Kelly & Don, Tucson, Ariz., for appellees.

Scott A. Harbottle, Civil Div., Dept. of Justice, Washington, D.C., for intervenor.

Appeal from the Bankruptcy Appellate Panel for the Ninth Circuit.

Before SCHROEDER, POOLE and KOZINSKI, Circuit Judges.

KOZINSKI, Circuit Judge:

We consider whether the bankruptcy appellate panel erred in reversing the bankruptcy court's dismissal of appellees' chapter 7 bankruptcy petition as a "substantial abuse" of the Bankruptcy Code.

Background

Robert and Carolyn Zolg sold their home to the Kellys; Tucson Realty acted as the real estate agent for this transaction. Subsequently, the Kellys sued the Zolgs and Tucson Realty, charging fraud and breach of contract and seeking damages for loss of the benefit of their bargain, repairs to the house, punitive damages and attorney's fees. On September 6, 1983, the Arizona Superior Court found for the defendants on all counts and awarded them attorney's fees and costs in the amount of $16,369.90, plus interest from the date of judgment.

The Kellys appealed. In lieu of a supersedeas bond, as called for by Arizona law, they posted security in the form of a $17,056.90 irrevocable reserve against their home equity credit line with the Valley National Bank (VNB). The Arizona Superior Court stayed execution on the judgment until December 31, 1984, when the line of credit was scheduled to expire, but the court's order provided that the stay would remain in effect thereafter if the credit agreement was extended. Clerk's Record (CR) 15 exh. C. VNB promised to extend the agreement for an additional year if the Kellys' credit remained satisfactory, and the line of credit was in fact so extended. CR 15 ¶ 6 & exh. B.

The Arizona Court of Appeals affirmed the judgment against the Kellys on February 8, 1985, and awarded defendants an additional $5,610.73 in attorney's fees and costs. Not long thereafter, without notifying defendants or seeking permission from the court, Kelly instructed VNB to cease holding the reserve for the Zolgs and Tucson Realty. Excerpt of Record (ER) at 61-62, 79.

The Arizona Supreme Court denied the Kellys' petition for review on June 12, 1985. Having exhausted all recourse in the state courts, the Kellys turned to the federal courts, filing a petition for relief under chapter 7 of the Bankruptcy Code. In their petition the Kellys listed $181,350 in assets, $147,000 in debt secured by mortgages against their home, and $25,000 in unsecured debt owed to the Zolgs, Tucson Realty, and the other defendants in the original state court action. Before filing for bankruptcy, the Kellys paid off all their other

unsecured creditors, consolidating some of this debt into their secured line of credit with VNB. ER at 67a, 69–70; CR 18 at 38–46. Shortly after filing this petition, Kelly sold back his one-third interest in his law firm, Blaser, Kelly & Don, P.C., for the nominal sum of $100.

On August 30, 1985, Kelly was examined pursuant to Bankruptcy Rule 2004. Thereafter, on October 16, 1985, the bankruptcy judge on his own motion held a hearing to determine whether the Kellys' petition should be dismissed under 11 U.S.C. § 707(b). The court found that the Kellys owed "primarily consumer debts" and that granting their petition would be a "substantial abuse" of the Code because they could easily pay all of their debts. Accordingly, the bankruptcy court dismissed the petition. The Kellys moved for reconsideration, and after a second hearing on January 18, 1986, the court reaffirmed the dismissal. *In re Kelly*, 57 B.R. 586 (Bankr.D. Ariz.1986) (Scanland, J.).

The Kellys appealed, arguing (1) that section 707(b) is unconstitutional; (2) that they did not have "primarily consumer debts" because most of their debts were secured by real estate mortgages; and (3) that their ability to repay all their unsecured debts was irrelevant to the question of whether granting their petition would be a "substantial abuse." The BAP agreed with the second contention and reversed. *Kelly v. Solot (In re Kelly)*, 70 B.R. 109 (Bankr. 9th Cir.1986). The Zolgs and Tucson Realty in turn appealed to this court, and the United States intervened to defend the constitutionality of section 707(b).

I. Jurisdiction

Our jurisdiction over appeals from the BAP is limited to "appeals from all final decisions, judgments, orders and decrees." 28 U.S.C. § 158(d) (Supp. III 1985). In determining whether a decision is final, "[w]e look, first, to see whether the order of the bankruptcy court was final, and second, to whether the decision of the BAP is final. Both decisions must be final." *King v. Stanton (In re Stanton)*, 766 F.2d 1283, 1285 (9th Cir.1985) (citations and footnote omitted). Turning first to the bankruptcy court's order, it is obvious that a dismissal of a debtor's bankruptcy petition is final, terminating, as it does, all litigation in the case. The more difficult question is whether the BAP's reversal of that dismissal is also final.

[1] A decision affirming or reversing a final order of a bankruptcy court is also deemed final for purposes of appealability. *In re Stanton*, 766 F.2d at 1287. However, where the BAP remands for further factual findings on "a central issue," the decision is not appealable, because review of such decisions would violate the traditional "policy disfavoring piecemeal appeals." *Id.*

[2] Here, the BAP reversed a final order of the bankruptcy court and remanded for "a determination of the nature of the unsecured debt" and for reconsideration of the proper test for substantial abuse. 70 B.R. at 112, 113. The latter question is clearly one of law. As for the former, the only matter left unresolved was whether appellants' judgment for attorney's fees qualifies as a "consumer debt" under 11 U.S.C. § 101(7). Since the underlying facts are not disputed,[1] the question is one in which legal issues predominate and is thus subject to de novo review. *United States v. McConney*, 728 F.2d 1195, 1199–1204 (9th Cir.) (en banc), *cert. denied*, 469 U.S. 824, 105 S.Ct. 101, 83 L.Ed.2d 46 (1984). The policies of judicial efficiency and finality are best served by our resolving the question now.

II. Section 707(b) Dismissal

Title III of the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub.L. No. 98–353, 98 Stat. 355 (the 1984 Act) added the so-called consumer credit amendments to the Bankruptcy Code as it had been originally enacted by the Bankruptcy Reform Act of 1978, Pub.L. No. 95–598, 92 Stat. 2549 (the 1978 Act). Included in these amendments was new subsection 707(b), which provided:

> After notice and a hearing, the court, on its own motion and not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debt-

1. Although the bankruptcy court record does not contain a full exegesis of the factual setting giving rise to the litigation which resulted in the award of attorney's fees, we take judicial notice of the Arizona Court of Appeals' memorandum opinion setting forth the facts and issues in that case. Fed.R.Evid. 201.

or under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter [7]. There shall be a presumption in favor of granting the relief requested by the debtor.

11 U.S.C. § 707(b) (Supp. III 1985).[2] The Kellys dispute the applicability of this provision to their case.

A. *Primarily Consumer Debts*

1. The first question we must address is whether some or all of the Kellys' debts constitute "consumer debts" within the meaning of the Code. As an initial matter, the Kellys argue that debts secured by real property are never consumer debts, relying on floor statements made in the House and Senate prior to the enactment of the 1978 Act. *See* 124 Cong.Rec. S17,406 (daily ed. Oct. 6, 1978) (statement of Sen. DeConcini) ("[a] consumer debt does not include a debt to any extent the debt is secured by real property"); 124 Cong.Rec. 32,393 (1978) (statement of Rep. Edwards) (same). Since approximately 85 percent of the Kellys' debt is secured by real property (their home), they contend that they cannot have "primarily consumer debts" and thus are exempt from dismissal under section 707(b).

[3] This argument stands the process of statutory interpretation on its head, resorting to legislative history without first considering the language of the statute. As the Supreme Court has noted, "legislative history, ... by traditional canons of interpretation[,] is irrelevant to an unambiguous statute." *United Air Lines, Inc. v. McMann*, 434 U.S. 192, 199, 98 S.Ct. 444, 448, 54 L.Ed.2d 402 (1977); *accord Valentine v. Mobil Oil Corp.*, 789 F.2d 1888, 1891 (9th Cir.1986). Here, resort to legislative history is not appropriate because the statutory language is clear and precisely addresses this situation.

[4] The Code defines "consumer debt" as "debt incurred by an individual primarily for a personal, family, or household purpose." 11 U.S.C. § 101(7) (1982). "Debt" means "liability on a claim," 11 U.S.C. § 101(11) (1982), and "claim," in turn, is broadly defined as any "right to payment, whether or not such right is ... *secured, or unsecured.*" 11 U.S.C. § 101(4)(A) (1982) (emphasis added). A literal reading of the Code's simple language leads inexorably to the conclusion that consumer debt includes secured debt. Indeed, section 521(2) of the Code, also added by the 1984 Act, makes special provision for "consumer debts which are secured by property of the estate," an unambiguous indication that Congress intended that the "secured or unsecured" language of the definition apply to consumer debts.

[5] Nor is there any indication that debts secured by real property are to be treated differently. To the contrary, section 524 of the Code explicitly recognizes that consumer debt may be secured by real property, making different provisions for the reaffirmation of consumer debt depending on whether or not it is "consumer debt secured by real property." 11 U.S.C. §§ 524(c)(6)(B), (d)(2) (Supp. III 1985). The statutory scheme so clearly contemplates that consumer debt include debt secured by real property that there is no room left for any other conclusion. *See* 4 *Collier on Bankruptcy* ¶ 707.06, at 707-16 (15th ed. 1987) (*Collier*).[3]

2. Section 707(b) was later amended by the Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub.L. No. 99-554, title II, § 219(b), 100 Stat. 3101 (1986 Act), to permit the United States Trustee to request a dismissal hearing.

3. Even if the statutory language were ambiguous, we would find the Kellys' analysis of the legislative history unconvincing. To the extent that legislative history may be considered, it is the official committee reports that provide the authoritative expression of legislative intent. *Garcia v. United States*, 469 U.S. 70, 76, 105 S.Ct. 479, 483, 83 L.Ed.2d 472 (1984); *Zuber v. Allen*, 396 U.S. 168, 186, 90 S.Ct. 314, 324, 24 L.Ed.2d 345 (1969). The committee reports on the 1978 Act make no reference to the supposed exclusion of debt secured by real property from the definition of consumer debt. *See* S.Rep. No. 989, 95th Cong., 2d Sess. 22 (1978), *reprinted in* 1978 U.S.Code Cong. & Admin.News 5787, 5808; H.R.Rep. No. 595, 95th Cong., 1st Sess. 309 (1977), *reprinted in* 1978 U.S.Code Cong. & Admin.News 5963, 6266. Stray comments by individual legislators, not otherwise supported by statutory language or committee reports, cannot be attributed to the full body that voted on the bill. The opposite inference is far more likely.

[6,7] The Kellys argue that this interpretation would render petitions of most consumer debtors subject to dismissal, because most consumers have the largest portion of their debt secured by real property. Such policy arguments are, of course, beside the point once Congress has spoken. In any event, the argument is spurious. The existence of substantial consumer debt does not, in itself, result in dismissal. The court may dismiss the petition only if granting relief would be a "substantial abuse." Those debtors who are, for no fraudulent or improper reasons, truly in need of a "fresh start" will not be subject to 707(b) dismissal. This is precisely what Congress had in mind. *See* pp. 913–14 *infra*.[4]

[8] 2. While secured debt is not automatically excluded from consumer debt, it is not automatically included either. We must look to the purpose of the debt in determining whether it falls within the statutory definition. Of the Kellys' mortgage debts, $95,000 consists of a lien they assumed in purchasing their home and $32,000 represents a home equity line of credit incurred for home improvements and the repayment of credit card debts. ER at 102; CR 18 at 38–43. All these fit comfortably within the Code's definition of consumer debt.[5] It is difficult to conceive of any expenditure that serves a "family ... or household purpose" more directly than does the purchase of a home and the making of improvements thereon.

[9] The Kellys also claim to have a second home equity line of credit on which they owe approximately $20,000. The sole evidence concerning the nature of this debt is Kelly's affidavit which describes it as securing a loan from VNB to his professional corporation. Debt incurred for business ventures or other profit-seeking activities is plainly not consumer debt for purposes of section 707(b). *In re Bell*, 65 B.R. 575, 577 (Bankr.E.D.Mich.1986).

[10] The Kellys' only remaining debt is the $25,000 they owe to the Zolgs and Tucson Realty for attorney's fees incurred in the state court litigation. That lawsuit was commenced by the Kellys for the purpose of recovering money allegedly overpaid in purchasing their home. The litigation thus served primarily a "family" or "household" purpose within the meaning of section 101(7). A debt for attorney's fees incurred in attempting to further this purpose, like any other debt so incurred, qualifies as a consumer debt.

[11] The ultimate question we must decide under section 707(b) is, of course, whether debtors have "*primarily* consumer debts." "Primarily" means "for the most part." *Webster's Ninth New Collegiate Dictionary* 934 (1984). Thus, when "the most part"—i.e., more than half—of the dollar amount owed is consumer debt, the statutory threshold is passed. Here that standard is easily met. Of the Kellys' $172,000 indebtedness, $152,000 (approximately 88 percent) is consumer debt. They have primarily consumer debts within the meaning of section 707(b).

B. *Substantial Abuse*

1. The second prerequisite to dismissal under section 707(b) is a finding that granting the debtor's petition would be a "substantial abuse" of chapter 7. With the

4. In fact, it is the interpretation urged by the Kellys that would frustrate congressional intent. Since many debtors do have large mortgage debts, a blanket rule excluding such debt from the category of consumer debt would completely insulate a very substantial number of debtors from section 707(b) dismissal.

The BAP attempted to avoid this problem by excluding mortgage debt from the section 707(b) calculus altogether, and instead considering only the ratio of unsecured consumer debt to unsecured non-consumer debt. Nothing in the statute provides the slightest support for this approach. Bankruptcy judges have no more power than any others to ignore the plain language of a statute in order to reach a result more in keeping with their notions of equity. *In re Shoreline Concrete Co.*, 831 F.2d 903, 905 (9th Cir.1987).

5. The Kellys argue that the $95,000 first mortgage is not to be counted in determining their total debt load because it is non-recourse. This contention is frivolous. The title to the Kellys' home is subject to this lien, and they make monthly payments on the debt. BR at 15, 64–65. Were they to default on such payments, the lienholder could sell their home in a foreclosure or trustee's sale to collect the $95,000. This clearly qualifies as a consumer debt within the meaning of 11 U.S.C. §§ 101(4), (11).

singular exception of the BAP below, the unanimous conclusion of bankruptcy courts has been that the principal factor to be considered in determining substantial abuse is the debtor's ability to repay the debts for which a discharge is sought. *See, e.g., In re Walton*, 69 B.R. 150, 154 (E.D.Mo.1986); *In re Cord*, 68 B.R. 5, 7 (Bankr.W.D.Mo.1986); *In re Gaukler*, 68 B.R. 224, 225 (Bankr.D.N.D.1986); *In re Kress*, 57 B.R. 874, 878 (Bankr.D.N.D. 1985); *In re Hudson*, 56 B.R. 415, 419 (Bankr.N.D.Ohio 1985); *In re Grant*, 51 B.R. 385, 391 (Bankr.N.D.Ohio 1985); *In re Edwards*, 50 B.R. 988, 986–87 (Bankr.S.D. N.Y.1985); *In re White*, 49 B.R. 869, 874 (Bankr.W.D.N.C.1985); *see also In re Bryant*, 47 B.R. 21, 24–26 (Bankr.W.D.N.C. 1984) (dismissing petition where debtor was able to pay debts and had not truthfully reported his financial condition); 4 *Collier* ¶ 707.07 (primary factor is ability to repay debts; other factors include failure to fully disclose financial condition and indication that debtor has not suffered any calamity but merely desires to avoid paying debts); 3 *Collier* ¶ 521.06[4], at 521–26. In determining ability to pay, courts have looked to the debtor's ability to fund a chapter 13 plan. *See, e.g., Walton*, 69 B.R. at 154; *Hudson*, 56 B.R. at 420; *Grant*, 51 B.R. at 391.

The Kellys point to the legislative history of the statute which they claim demonstrates that ability to pay is not a relevant consideration in determining substantial abuse. *See* 130 Cong.Rec. S7624 (daily ed. June 19, 1984) ("under [the 1984 Act], the availability of bankruptcy relief would not be limited by a future earnings standard") (statement of Sen. Metzenbaum); 130 Cong.Rec. H7489 (daily ed. June 29, 1984) ("the Consumer Credit amendments ... contain no threshold or future income test") (statement of Rep. Rodino).[6] Even if such floor statements were indicative of legislative intent, *but see* p. 912 n. 3 *supra*, the Kellys misinterpret these statements and the intent of Congress in passing the 1984 Act.

[12] The consumer credit amendments approved by Congress in 1984 were adapted from provisions first proposed in an earlier Senate bill, S. 445. As originally introduced in February 1983, S. 445 contained a formula for determining the precise point where a debtor's ability to pay some debts would preclude chapter 7 relief. As a result of efforts by Senator Metzenbaum and others, however, this formula was eliminated by the Senate Judiciary Committee in favor of the substantial abuse formulation which was ultimately adopted and codified by the 1984 Act as section 707(b). The statements cited by the Kellys referred to the fact that the bill no longer contained a threshold formula; they do not suggest that a debtor's ability to repay his debts is no longer the primary consideration in determining whether there is abuse. Indeed, the committee report on the final version of S. 445[7] states clearly that dismissal for substantial abuse is intended to "uphold[] creditors' interests in obtaining repayment where such repayment would not be a burden," and that "if a debtor can meet his debts without difficulty as they come due, use of Chapter 7 would represent a substantial abuse." S.Rep. No. 65, 98th Cong., 1st Sess. 53, 54 (1983). Accordingly, we hold that the debtor's ability to pay his debts when due, as determined by his ability to fund a chapter 13 plan, is the primary factor to be considered in determining whether granting relief would be a substantial abuse.

[13] 2. The rule adopted by the overwhelming majority of the courts considering the issue appears to be that a debtor's ability to pay his debts will, standing alone, justify a section 707(b) dismissal. *See Cord*, 68 B.R. at 7 (debtors who are able to pay their debts neither need nor deserve protection of chapter 7); *Hudson*, 56 B.R. at 419 (substantial abuse occurs whenever debtor has ability to repay substantial portion of his debts under chapter 13); *Edwards*, 50 B.R. at 987 (ability to pay principal amount of debts in three years is per se

6. As usual, the Congressional Record contains ample support on both sides of the issue. *See, e.g.*, 130 Cong.Rec. H7499 (daily ed. June 29, 1984) (substantial abuse occurs if "the debtor is found capable of fulfilling the terms of a chapter 13 repayment agreement") (statement of Rep. Anderson); 130 Cong.Rec. S6090 (daily ed. May 21, 1984) (statement of Sen. Hatch); *id.* at S6087 (statement of Sen. Heflin); 130 Cong.Rec. H1808 (daily ed. March 21, 1984) (statement of Rep. Roukema); *see also* 4 *Collier* ¶ 707.04, at 707–12 n. 4.

7. There were no committee reports on the 1984 Act. Therefore, the report on S. 445 is the best available evidence of Congress' intent in enacting section 707(b).

substantial abuse).[8] We find this approach fully in keeping with Congress's intent in enacting section 707(b), and accordingly adopt it. This is not to say that inability to pay will shield a debtor from section 707(b) dismissal where bad faith is otherwise shown. But a finding that a debtor is able to pay his debts, standing alone, supports a conclusion of substantial abuse.

[14] The Kellys are clearly able to repay their debts. They admitted to an excess of income over expenses in the amount of some $440 per month, and the bankruptcy judge found that half of their claimed $500-per-month expenditure for "recreation" was excessive. 57 B.R. at 540.[9] Combining these two figures, the court found that the Kellys could repay, out of disposable income, approximately 99 percent of their unsecured debt in only three years. *Id.* The bankruptcy court was amply justified in dismissing the petition under section 707(b) as a substantial abuse of chapter 7.

III. Constitutionality of Section 707(b)

The Kellys raise various constitutional challenges to section 707(b). Although the BAP found it unnecessary to address these claims, it nonetheless opined that "[the Kellys'] due process arguments are troublesome." 70 B.R. at 110. We do not find them so.

A. *Vagueness*

[15] The Kellys first raise a volley of arguments to the effect that section 707(b) is void for vagueness. But laws that regulate economic activity not involving constitutionally protected conduct are subject to a quite lenient test for constitutional sufficiency. *See Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc.*, 455 U.S. 489, 497, 102 S.Ct. 1186, 1192, 71 L.Ed.2d 362 (1982); *Papachristou v. City of Jacksonville*, 405 U.S. 156, 162, 92 S.Ct. 839, 843, 31 L.Ed.2d 110 (1972). The Bankruptcy Code is such a law. *In re Talmadge*, 832 F.2d 1120, 1125 (9th Cir.1987). Considering the Kellys' contentions in this light, we find them to be lacking in merit.

1. The Kellys first argue that section 707(b) is constitutionally inadequate because it fails to require notice to the debtors that fully informs them of all the matters to be considered at the hearing and of the facts on which the court will rely in resolving them. This contention is frivolous. The due process clause requires only such notice as is "reasonably calculated ... to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections." *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314, 70 S.Ct. 652, 657, 94 L.Ed. 865 (1950). Section 707(b) provides that the court may dismiss a petition under its provisions "[a]fter notice and a hearing," a phrase defined as "such notice ... and such opportunity for a hearing as is appropriate in the particular circumstances." 11 U.S.C. § 102(1)(A) (1982). In conformity with these statutory and constitutional strictures, the bankruptcy judge gave the Kellys more than a month's notice, informing them of the hearing and the nature of the issue to be considered, and instructing them to "appear ... to show cause, if any they have, why such proceedings should not be dismissed." ER at 39. The Code provides for, and the Kellys received, constitutionally adequate notice.

The Kellys argue, however, that they were unable to ascertain what facts would be considered at the hearing. This contention is untenable. Section 707(b) permits dismissal only after the court finds that the debtor had "primarily consumer debts" and

8. *But see In re Deaton*, 65 B.R. 663, 664-65 (Bankr.S.D.Ohio 1986) ("the mere ability to fund a Chapter 13 plan is not sufficient to constitute 'substantial abuse'").

9. The bankruptcy judge was, if anything, unduly generous in this regard. The sole support for the $500 figure was Kelly's explanation that this was for "going out to dinner, entertaining people[,] ... buying toys for the kids or going to the movies, that sort of thing." ER at 82. None of these items qualify as "reasonably necessary ... for the maintenance or support of the debtor or a dependent of the debtor," 11 U.S.C. § 1325(b)(2)(A) (Supp. III 1985), and thus permitting a debtor to retain this income would be grounds for rejection of a chapter 13 plan. 11 U.S.C. § 1325(b). The same test is appropriate in determining which of the expenses claimed by the debtor could in reality be devoted to debt servicing for purposes of determining the debtor's ability to repay his debts under section 707(b).

engaged in "substantial abuse." Both of these terms are defined by the Code, legislative history and case law; debtors are therefore on reasonable notice of the facts relevant to these determinations. Even if the Kellys had for some reason been unaware of the relevant considerations at their first hearing, they could not have remained in the dark by the time of the second hearing, held by the court in response to their motion for reconsideration. The Kellys had by then read the judge's original order dismissing their petition and therefore knew exactly the facts and law the court deemed relevant. The bankruptcy judge generously allowed them to present additional evidence at this hearing, but they chose to rely solely on previously submitted evidence and Kelly's affidavit.[10] Their argument that they were "placed ... in the untenable position of not knowing what evidence to present at the hearing ordered by the Court," Appellees' Answering Brief at 12, is quite simply disingenuous.

[16] 2. The Kellys also claim that section 707(b) is unconstitutionally vague because it fails to specify the procedures for the presentation of evidence and rebuttal of the statutory presumption in favor of granting relief. With respect to the presentation of evidence, the Bankruptcy Rules incorporate the Federal Rules of Evidence, as well as Federal Rules of Civil Procedure 43 and 44 governing precisely this issue. Bankr.R. 9017. As for the presumption, we are unable to discern any constitutional infirmity in leaving its application to the discretion of the trial court. The Kellys' claim to the contrary is entirely without merit.

3. The Kellys' final vagueness objection to section 707(b) is that the terms "primarily consumer debt" and "substantial abuse" are not adequately defined. Although they admit that "consumer debt" is defined in 11 U.S.C. § 101(7), they argue that the definition is ambiguous because it fails to indicate whether mortgage debts are consumer debts. As discussed above, however, the statute addresses this point directly. *See* pp. 911–13 *supra*.

[17, 18] The term "primarily consumer debts" is not separately defined in the Code. But the Code does define "consumer debt," and the modifier "primarily" is not a word that is ambiguous or difficult to understand. The Constitution does not require the legislature to incorporate *Webster's* into each statute in order to insulate it from vagueness challenges.

The Code also contains no definition of "substantial abuse." As the United States points out in its brief as intervenor, however, the Supreme Court has upheld statutes that contain equally undefined standards of decision. *See, e.g., Nash v. United States*, 229 U.S. 373, 376–78, 33 S.Ct. 780, 781, 57 L.Ed. 1232 (1913) ("unreasonable" restraints of trade). The legislative history of the statute clearly indicates that ability to repay debts is the primary factor to be considered in applying this phrase, and the bankruptcy courts have had no difficulty in fashioning a relatively uniform approach to resolving this question. *See Thomas v. Union Carbide Agric. Prods. Co.*, 473 U.S. 568, 593, 105 S.Ct. 3325, 3339, 87 L.Ed.2d 409 (1985) (statutory "term that appears vague on its face 'may derive much meaningful content from the purpose of the Act, its factual background, and the statutory context'") (quoting *American Power & Light Co. v. SEC*, 329 U.S. 90, 104, 67 S.Ct. 133, 142, 91 L.Ed. 103 (1946)). As Kelly, an experienced lawyer, should well have known, section 707(b) is simply not void for vagueness.

B. *Due Process*

[19] The Kellys also object to the fact that, at the time their petition was filed, section 707(b) granted the bankruptcy judge sole discretion to institute dismissal proceedings.[11] They claim that this placed the court in an adversarial position, particularly because the presumption in favor of

10. At this hearing, the following exchange took place:

THE COURT: ... I would be willing to take any evidence you would want to give.

MR. BREEN [attorney for Kellys]: Well, as far as the facts, Your Honor, we were satisfied with the affidavit of the Kellys explaining how the debt structure was, which was attached to the motion, and then the legal arguments about respective income.

CR 38 at 4.

11. The Code was amended in 1986 to authorize United States Trustees to initiate such proceedings as well. *See* p. 911 n. 2 *supra*.

granting relief supposedly requires the court to come forward with evidence justifying dismissal. They rely on *In re Murchison*, 349 U.S. 133, 75 S.Ct. 623, 99 L.Ed. 942 (1955), which held that a judge could not try witnesses, who had appeared before him while he sat as a one-man grand jury, for criminal contempt based on the judge's own investigations, because "[h]aving been part of [the accusatory] process a judge cannot be, in the very nature of things, wholly disinterested in the conviction or acquittal of those accused." *Id.* at 137, 75 S.Ct. at 625–26.

The result in *Murchison* was based in part on the criminal nature of the proceedings, *id.*, and in part on the fear that the extensive and often one-sided evidence presented in the secret grand jury proceedings could "weigh far more heavily with [the judge] than any testimony given in the open hearings," *id.* at 138, 75 S.Ct. at 626. Neither of these considerations is present in the bankruptcy context. Indeed, the authority granted the bankruptcy judge under section 707(b) is no different from that granted federal judges in a number of similar situations, none of which raises any due process concerns. *See, e.g., Sacher v. United States*, 343 U.S. 1, 9, 72 S.Ct. 451, 455, 96 L.Ed. 717 (1952) (upholding district court's imposition of criminal contempt sanctions, without hearing, on parties who committed disruptive conduct during trial before sanctioning judge); *Clark v. Paul Gray, Inc.*, 306 U.S. 583, 588, 59 S.Ct. 744, 748, 83 L.Ed. 1001 (1939) (issue of subject matter jurisdiction raised sua sponte); Fed. R.Civ.P. 11 (court on its own motion may impose sanctions for frivolous pleadings); Fed.R.Civ.P. 12(h)(3) (court must sua sponte dismiss actions whenever it appears that subject matter jurisdiction is lacking); Fed.R.Civ.P. 16(f) (court on its own motion may impose sanctions for failure to comply with discovery orders); Fed.R.Crim.P. 42 (criminal contempt may be punished summarily at instance of judge; judge may preside at contempt hearing unless contempt charged "involves disrespect to or criticism of" that judge).

There is simply no basis for the Kellys' novel contention that a judge's power to order a hearing on the issue of dismissal denies debtors a neutral and impartial arbiter. As with sua sponte orders concerning jurisdiction, contempt and sanctions, the court acquires no stake in the litigation merely by ordering a hearing.

[20] Our conclusion is not affected by the fact that the statute gives debtors the benefit of a presumption in favor of granting relief. This presumption does not place on the judge the burden of producing evidence. Rather, when the issue of section 707(b) dismissal is raised, the debtor and, if appropriate, other parties as well are free to present evidence on the relevant issues. The court remains at all times above the level of advocacy. Seen in this light, the presumption is in reality a caution and a reminder to the bankruptcy court that the Code and Congress favor the granting of bankruptcy relief, and that accordingly "the court should give the benefit of any doubt to the debtor and dismiss a case only when a substantial abuse is clearly present." 4 *Collier* § 707.08, at 707–19.

It is ironic that the Kellys should be raising a constitutional objection to this provision. Congress carefully reserved to the court the power to institute such proceedings precisely to protect debtors from possible harassment by creditors. *See* 4 *Collier* ¶ 707.05. Congress violated no constitutional protections in adopting this approach. Section 707(b) is constitutional on its face and as applied to the Kellys in this case.

IV. Attorney's Fees

[21] The Zolgs and Tucson Realty seek an award of attorney's fees against the Kellys for their bad faith in litigating this appeal. Because the Zolgs and Tucson Realty are appellants before us, we cannot award them fees under 28 U.S.C. § 1912 (1982) (damages and costs may be allowed to prevailing *appellees*), or Federal Rule of Appellate Procedure 38 (fees may be awarded to prevailing *appellees*). We decline to make such an award under 28 U.S.C. § 1927 (1982) or our inherent equitable powers. We express no opinion, however, as to whether appellants may be entitled to an award of attorney's fees in the courts below.

Conclusion

The judgment of the BAP is REVERSED and the case is REMANDED to the bankruptcy court for further proceedings in accordance with this opinion.

KEY NUMBER SYSTEM

in October 1998 that the acquisition would not add earnings per share. As the district court concluded, the statement showed that the acquisition would entail some costs, not that the costs would exceed the predicted benefits.

AFFIRMED.

In re Thomas W. PRICE, Debtor,

Thomas W. Price, Appellant,

v.

United States Trustee, Appellee.

No. 02-16458.

United States Court of Appeals, Ninth Circuit.

Argued and Submitted Oct. 6, 2003.

Filed Jan. 7, 2004.

Background: United States Trustee (UST) moved to dismiss Chapter 7 case as substantial abuse of provisions of that chapter. The United States Bankruptcy Court for the District of Nevada, Bert M. Goldwater, J., granted dismissal motion, and debtor appealed. The Bankruptcy Appellate Panel (BAP), Brandt, J., 280 B.R. 499, affirmed, and debtor appealed.

Holdings: The Court of Appeals, Thomas, Circuit Judge, held that:

(1) debtor's purchase money mortgage debt was "consumer debt," for purposes of the Bankruptcy Code's "substantial abuse" dismissal provision, and

(2) the bankruptcy court did not err in dismissing the petition for substantial abuse based on findings that debtor had primarily consumer debts and had the ability to fund a Chapter 13 plan, despite evidence that the debt to be discharged primarily consisted of commercial debt.

Affirmed.

1. Bankruptcy ⚷3811

Court of Appeals reviews the decisions of the Bankruptcy Appellate Panel (BAP) de novo.

2. Bankruptcy ⚷3782, 3786

Court of Appeals reviews the bankruptcy court's conclusions of law de novo and its factual findings for clear error.

3. Bankruptcy ⚷3784

Court of Appeals reviews a bankruptcy court's decision to dismiss a case for abuse of discretion.

4. Bankruptcy ⚷2254

Bankruptcy Code allows a court to dismiss a Chapter 7 bankruptcy case, either sua sponte or upon suggestion of the United States Trustee (UST), when an individual has primarily consumer debt and the court finds that granting relief would be a substantial abuse of the provisions of the chapter. Bankr.Code, 11 U.S.C.A. § 707(b).

5. Bankruptcy ⚷2253

Congress added the "substantial abuse" dismissal provision to the Bankruptcy Code in response to concerns that some debtors who could easily pay their creditors might resort to Chapter 7 to avoid their obligations. Bankr.Code, 11 U.S.C.A. § 707(b).

6. Bankruptcy ⚷2254

First prerequisite to dismissal under the Bankruptcy Code's "substantial abuse" dismissal provision is that the debtor have primarily consumer debt; the second requirement is a finding by the court that granting debtor's petition would be a "sub-

stantial abuse" of Chapter 7. Bankr.Code, 11 U.S.C.A. § 707(b).

7. Bankruptcy ⚷2254

Under the Ninth Circuit's *Kelly* decision, whether or not a particular secured debt is excluded from inclusion as "consumer debt" under the Bankruptcy Code's "substantial abuse" dismissal provision depends on the purpose of the debt. Bankr. Code, 11 U.S.C.A. § 707(b).

8. Bankruptcy ⚷2254

For purposes of the Bankruptcy Code's "substantial abuse" dismissal provision, "consumer debt" includes all secured debt incurred for personal, family, or household purposes. Bankr.Code, 11 U.S.C.A. §§ 101(8), 707(b).

See publication Words and Phrases for other judicial constructions and definitions.

9. Bankruptcy ⚷2254

Chapter 7 debtor's mortgage debts, including his purchase money mortgage, were properly included in the calculation of "consumer debt," for purposes of the Bankruptcy Code's "substantial abuse" dismissal provision; debtor's personal residence was secured by two mortgages, the first, in the amount of $120,000, securing debt incurred to purchase the home, and the second, in the amount of $21,511, securing debt incurred to finance household improvements, and there was no question that the secured debt at issue was incurred primarily for a personal, family, or household purpose. Bankr.Code, 11 U.S.C.A. §§ 101(8), 707(b).

10. Bankruptcy ⚷2021.1

Statutes ⚷223.4

Generalized expressions of federal policy contained in other federal statutes do not take precedence over specific provisions of the Bankruptcy Code.

11. Bankruptcy ⚷2254

Under the rubric established by the Ninth Circuit's *Kelly* decision, a debtor is considered to have "primarily consumer debts" under the Bankruptcy Code's "substantial abuse" dismissal provision when consumer debts constitute more than half of the total debt. Bankr.Code, 11 U.S.C.A. § 707(b).

12. Bankruptcy ⚷2254

Courts examine the totality of the circumstances in determining whether "substantial abuse" exists in a particular Chapter 7 case, utilizing such criteria as: (1) whether debtor has a likelihood of sufficient future income to fund a Chapter 11, 12, or 13 plan which would pay a substantial portion of unsecured claims, (2) whether debtor's petition was filed as a consequence of illness, disability, unemployment, or some other calamity, (3) whether the schedules suggest debtor obtained cash advancements and consumer goods on credit exceeding his or her ability to repay them, (4) whether debtor's proposed family budget is excessive or extravagant, (5) whether debtor's statement of income and expenses is misrepresentative of debtor's financial condition, and (6) whether debtor has engaged in eve-of-bankruptcy purchases. Bankr.Code, 11 U.S.C.A. § 707(b).

13. Bankruptcy ⚷2253

Primary factor defining substantial abuse is Chapter 7 debtor's ability to pay his debts as determined by the ability to fund a Chapter 13 plan. Bankr.Code, 11 U.S.C.A. § 707(b).

14. Bankruptcy ⚷2253

While Chapter 7 debtor's ability to pay his debts will, standing alone, justify dismissal under the Bankruptcy Code's "substantial abuse" dismissal provision, debtor's ability to pay his or her debts does not compel such a dismissal of the petition as a matter of law. Bankr.Code, 11 U.S.C.A. § 707(b).

15. Bankruptcy ⚷2253

Bankruptcy court could make a finding of "substantial abuse" under the facts of a particular case even if debtor did not have the ability to fund a Chapter 13 plan. Bankr.Code, 11 U.S.C.A. § 707(b).

16. Statutes ⚷188

In construing a statute, the court begins with the understanding that Congress says in a statute what it means and means in a statute what it says there.

17. Statutes ⚷190

If statutory language is unambiguous, then the court's judicial inquiry is complete.

18. Bankruptcy ⚷2254

Bankruptcy court did not err in dismissing Chapter 7 petition for substantial abuse based on findings that debtor had primarily consumer debts and had the ability to fund a Chapter 13 plan, despite evidence that the debt to be discharged primarily consisted of commercial debt. Bankr.Code, 11 U.S.C.A. § 707(b).

John A. White, Jr., Reno, NV, for the appellant.

Nicholas Strozza and William B. Cossitt, Office of the United States Trustee, United States Department of Justice, Reno, NV, for the appellee.

Appeal from the Ninth Circuit Bankruptcy Appellate Panel; Klein, Brandt and Ryan, Bankruptcy Judges, Presiding. BAP No. NV-01-01627-BKRy.

Before MARY M. SCHROEDER, Chief Judge, SIDNEY R. THOMAS, and RICHARD R. CLIFTON, Circuit Judges.

THOMAS, Circuit Judge.

In this appeal, we consider whether the bankruptcy court appropriately dismissed a Chapter 7 bankruptcy for substantial abuse pursuant to 11 U.S.C. § 707(b). Under the circumstances presented by this case, we conclude that it did.

I

Thomas Price is a computer consultant. In addition, during the relevant period, he and his wife operated several women's clothing stores in Reno, Nevada. Price had financed these stores through cash and credit card advances. The businesses failed, along with his own computer consulting business. Price estimates that he and his wife lost approximately $250,000 during this period of time. After the business failures and after Price and his wife divorced, Price began working as an employee of JAT Computer Consulting services, earning a salary of $115,000 a year. Price filed a voluntary petition in bankruptcy under Chapter 7 of the United States Bankruptcy Code.

In his bankruptcy schedules, Price listed total debts of $322,552.81, $167,469 of which was secured debt, $19,356.50 priority debt, and $135,727.31 unsecured nonpriority debt. Additionally, $141,511 is secured on Price's residence, and he claimed exemption to $12,667.34 based on the residence's $155,000 market value. He listed a gross income of over $10,700 per month and nets over $7,200 in monthly income.

Accompanying his petition, Price included an exhibit claiming $101,690.95 in total business debt, and $72,150.86 in personal debt. Price excluded from these figures $141,511 in debt secured on his residence and $7,200 in priority debt owed to his former wife. Price's petition claimed that "business debts predominate if debt secured by exempt home is excluded." Price's petition also indicated that he had $4,775.97 in current monthly expenditures, which left $2,497.37 in disposable monthly income.

Based on these facts, the United States Trustee sought to dismiss Price's petition for substantial abuse under 11 U.S.C. § 707(b). After notice and a hearing, the bankruptcy court concluded that Price's debts were primarily consumer, and that granting relief as sought by the petition would be an abuse of Chapter 7 because Price had the ability to pay his debts. As a result, the petition was dismissed unless Price filed a Chapter 13 bankruptcy within 30 days. The bankruptcy court entered a final order dismissing the petition. Price timely appealed the dismissal to the Bankruptcy Appellate Panel, which affirmed the order of the bankruptcy court. This timely appeal followed.

[1–3] We review the decisions of the Bankruptcy Appellate Panel *de novo*. *Hanf v. Summers (In re Summers)*, 332 F.3d 1240, 1242 (9th Cir.2003). We review the bankruptcy court's conclusions of law *de novo* and its factual findings for clear error. *Id.* (citing *Einstein/Noah Bagel Corp. v. Smith (In re BCE West, L.P.)*, 319 F.3d 1166, 1170 (9th Cir.2003)). We review a bankruptcy court's decision to dismiss a case for abuse of discretion. *Leavitt v. Soto (In re Leavitt)*, 171 F.3d 1219, 1223 (9th Cir.1999).

II

[4, 5] Section 707(b) of the Bankruptcy Code allows a court to dismiss a Chapter 7 bankruptcy case, either *sua sponte* or upon suggestion of the United States Trustee, when an individual has primarily consumer debt and the court finds that granting relief would be a substantial abuse of the provisions of the chapter. Specifically, § 707(b) provides:

> After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter. There shall be a presumption in favor of granting the relief requested by the debtor. In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to any qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4)).

Congress added this section to the Code "in response to concerns that some debtors who could easily pay their creditors might resort to chapter 7 to avoid their obligations." 6 *Collier on Bankruptcy* ¶ 707.04, at 707–15 (Alan N. Resnick et al. eds., 15th ed.2001); *see also* S.Rep. No. 98–65, at 54 (1983).

[6] The first prerequisite to dismissal under section 707(b) is that the debtor have primarily consumer debt; the second requirement is a finding by the court that granting the debtor's petition would be a "substantial abuse" of Chapter 7. *Zolg v. Kelly (In re Kelly)*, 841 F.2d 908, 912–13 (9th Cir.1988).

A

Price concedes that his debt as listed in his schedules is primarily consumer debt. However, he contends that his mortgage debts should not be included in the calculation of "consumer debts." We specifically rejected this notion in *Kelly*, noting that "[t]he statutory scheme so clearly contemplates that consumer debt include debt secured by real property that there is no room left for any other conclusion." *Id.* at 912. Price claims that this holding was

dicta in *Kelly* that we may disregard. Clearly, it was not.

[7–10] Under *Kelly*, whether or not a particular secured debt is excluded from inclusion as "consumer debt" under § 707(b) depends on the purpose of the debt. *Id.* at 913. Under the Bankruptcy Code, "consumer debt" is "debt incurred by an individual primarily for a personal, family or household purpose[.]" § 101(8). As we held in *Kelly*, this includes all secured debt incurred for personal, family, or household purposes. *Id.* In this case, Price's personal residence was secured by two mortgages. The first, in the amount of $120,000, secured debt incurred to purchase the home; the second, in the amount of $21,511, secured debt incurred to finance household improvements. Thus, there is no question that the secured debt at issue was incurred "primarily for a personal, family or household purpose" and must be considered "consumer debt" for the purposes of § 707(b).

Price argues that, even if residential mortgages are considered consumer debt, purchase money mortgages should be exempt from inclusion. He contends that inclusion of purchase money mortgage debt in § 707(b) improperly discriminates against homeowners in violation of federal housing policies favoring home ownership. He relies upon the Homeless Assistance Housing Assistance Supportive Housing Program, 42 U.S.C. §§ 11381–11389, and the home mortgage interest deduction provided in the Internal Revenue Code § 163(h), as examples of federal housing policy that would be thwarted by considering purchase money mortgage debt as consumer debt under § 707(b). Price cites no authority for this proposition, and there is none. Generalized expressions of federal policy contained in other federal statutes do not take precedence over specific provisions of the Bankruptcy Code. *See United States v. Padilla (In re Padilla)*, 222 F.3d 1184, 1192 (9th Cir.2000); *Am. Bicycle Ass'n v. United States (In re Am. Bicycle Ass'n)*, 895 F.2d 1277, 1280 (9th Cir.1990).

Moreover, we have rejected the claim that § 707(b) necessarily discriminates against homeowners. In *Kelly*, we explained that the existence of primarily consumer debt alone does not result in dismissal under § 707(b), because the bankruptcy court must still make a finding of substantial abuse. Consequently, a debtor truly in need of a fresh start will not be subject to dismissal. 841 F.2d at 913. Thus, Price's arguments are unavailing.

[11] Under the rubric established by *Kelly*, a debtor is considered to have "primarily consumer debts" under § 707(b) when consumer debts constitute more than half of the total debt. Here, when the debt securing Price's residence is included, well over half the total debt reported is consumer debt. Thus, the first requirement of § 707(b) is satisfied.

B

[12] The remaining substantive issue is whether Price meets the substantial abuse standard of Section 707(b). The term "substantial abuse" is not defined in the Bankruptcy Code. Rather, courts have examined the totality of the circumstances in determining whether substantial abuse exists in a particular case, utilizing criteria such as the following:

(1) Whether the debtor has a likelihood of sufficient future income to fund a Chapter 11, 12, or 13 plan which would pay a substantial portion of the unsecured claims;

(2) Whether the debtor's petition was filed as a consequence of illness, disability, unemployment, or some other calamity;

(3) Whether the schedules suggest the debtor obtained cash advancements and consumer goods on credit exceeding his or her ability to repay them;
(4) Whether the debtor's proposed family budget is excessive or extravagant;
(5) Whether the debtor's statement of income and expenses is misrepresentative of the debtor's financial condition; and
(6) Whether the debtor has engaged in eve-of-bankruptcy purchases.

3 *Norton Bankruptcy Law and Practice 2d* § 67:5, at 67–10 (William L. Norton, Jr. et al. eds., 1997).

[13] The primary factor defining substantial abuse is the debtor's ability to pay his debts as determined by the ability to fund a Chapter 13 plan. Thus, we have concluded that a "debtor's ability to pay his debts will, standing alone, justify a section 707(b) dismissal." *Kelly*, 841 F.2d at 914.

[14, 15] The United States Trustee argues that we need not reach any of the issues raised by Price because Congress created a bright line test: that dismissal is required whenever a debtor is able to fund a Chapter 13 plan. However, the text of the section and its legislative history belie this interpretation. Indeed, Congress specifically rejected such proposals. *See* 6 *Collier* ¶ 707.04, at 707–16. Rather, Congress committed the question of what constitutes substantial abuse to the discretion of bankruptcy judges within the context of the Code. Section 707(b) provides that the court "may" dismiss a case "if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter." Put another way, while "debtor's ability to pay his debts will, standing alone, justify a section 707(b) dismissal," *Kelly*, 841 F.2d at 914, the debtor's ability to pay his or her debts does not *compel* a section 707(b) dismissal of the petition as a matter of law. In addition, as *Kelly* noted, a bankruptcy court could make a finding of substantial abuse under the facts of a particular case even if the debtor did not have the ability to fund a Chapter 13 plan. *Id.* at 914–15. Thus, *Kelly* did not establish an absolute, *per se* rule. Rather, *Kelly* quite appropriately held that ability to fund a Chapter 13 plan is the most important consideration under § 707(b), and that a finding of ability to pay alone is sufficient to sustain a § 707(b) dismissal.

In this case, the bankruptcy court relied upon Price's ability to pay his debts to make a finding of substantial abuse. Although the court was not compelled to make the finding, it was well justified in relying on this finding in ordering dismissal of the petition under § 707(b).

C

Price contends the bankruptcy court erred in making a finding of substantial abuse in this case because the debts he seeks to discharge in his Chapter 7 petition are primarily trade debts. He argues that the philosophy of § 707(b) is the protection of consumer creditors. Thus, he reasons, a finding of substantial abuse cannot be made when the debt to be discharged is primarily commercial. In short, he would have us construe the requirement that the debtor be one "whose debts are primarily consumer debts" to mean a debtor "whose debts *to be discharged* are primarily consumer debts."

[16, 17] In construing a statute, "we begin with the understanding that Congress 'says in a statute what it means and means in a statute what it says there.'" *Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6, 120 S.Ct. 1942, 147 L.Ed.2d 1 (2000) (quoting *Conn. Nat'l Bank v. Germain*, 503 U.S. 249, 254, 112 S.Ct. 1146, 117 L.Ed.2d 391

(1992)). If the statutory language is unambiguous, then our "judicial inquiry is complete." *Rubin v. United States*, 449 U.S. 424, 430, 101 S.Ct. 698, 66 L.Ed.2d 633 (1981).

[18] In this case, the statutory language is unambiguous. Indeed, we examined the specific statutory language in question in *Kelly* and found it "clear." 841 F.2d at 912. Adopting Price's interpretation would amount to rewriting the statute. If Congress had intended to impose such a restriction on the court's power to dismiss a case for substantial abuse, it easily could have done so. Given the plain words of the statute, we cannot conclude that Congress meant "primarily consumer debts" to refer only to those debts sought to be discharged rather than the aggregate debts listed on the bankruptcy schedules.

Contrary to Price's assertion, *United States v. Padilla (In re Padilla)*, 222 F.3d 1184 (9th Cir.2000), does not compel a different conclusion. Price contends that *Padilla* "makes it crystal clear that the framers of § 707(b) had no intention of preventing a consumer from using the bankruptcy code to discharge his trade debt." *Padilla* did not involve § 707(b). It held that bad faith *per se* does not constitute cause for dismissal under § 707(a). *Id.* at 1194. It is true that *Padilla* discussed the general rationale underpinning § 707; however, it did not hold that a dismissal for substantial abuse under § 707(b) cannot occur if the debt to be discharged is primarily trade debt. There is nothing in *Padilla* that is inconsistent with *Kelly*, nor is there anything in *Padilla* that would preclude a finding of substantial abuse in a consumer debtor bankruptcy when the debts sought to be discharged were primarily trade debt.

III

In sum, the bankruptcy court was entirely justified in dismissing the petition for substantial abuse under 11 U.S.C. § 707(b) based on findings that the debtor had primarily consumer debts and had the ability to fund a Chapter 13 plan, despite evidence that the debt to be discharged primarily consisted of commercial debt.

AFFIRMED.

John DOE, and Jane Doe, Plaintiffs–Appellees,

v.

George J. TENET, Individually and as Director of Central Intelligence and Director of the Central Intelligence Agency; United States of America, Defendants–Appellants.

No. 01–35419.

United States Court of Appeals, Ninth Circuit.

Jan. 7, 2004.

Steven W. Hale, Esq., Perkins Coie LLP, Seattle, WA, for Plaintiffs–Appellees.

Freddi Lipstein, Esq., Department of Justice, Washington, DC, for Defendants–Appellants.

Before CANBY, BERZON and TALLMAN, Circuit Judges.

Dissent by Judge KLEINFELD.

ORDER

The majority of the panel has voted to deny appellee's petition for rehearing and petition for rehearing en banc. Judge Canby votes to deny the petition for re-

Supreme Court of the United States
Jan **HAMILTON**, Chapter 13 Trustee, Petitioner,
v.
Stephanie Kay **LANNING**.

No. 08-998.
Argued March 22, 2010.
Decided June 7, 2010.

Background: Chapter 13 trustee objected to confirmation of plan proposed by above-median-income debtor on ground that debtor was not committing all of her "projected disposable income" to the repayment of creditors. The United States Bankruptcy Court for the District of Kansas, Janice Miller Karlin, J., 2007 WL 1451999, denied objection, and trustee appealed. The Bankruptcy Appellate Panel (BAP), Richard L. Bohanon, J., 380 B.R. 17, affirmed. Trustee appealed. The Court of Appeals for the Tenth Circuit, Brorby, Senior Circuit Judge, 545 F.3d 1269, affirmed. Certiorari was granted.

Holding: The Supreme Court, Justice Alito, held that when a bankruptcy court calculates a Chapter 13 debtor's projected disposable income, the court may account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation.

Affirmed.

Justice Scalia filed a dissenting opinion.

West Headnotes

[1] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

Bankruptcy 51 ⚷3710(2)

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3710 Amount of Repayment; De Minimis Repayment
51k3710(2) k. Payment in full. Most Cited Cases

If a trustee or an unsecured creditor objects to a Chapter 13 debtor's plan, a bankruptcy court may not approve the plan unless the plan provides for the full repayment of unsecured claims or provides that all of the debtor's "projected disposable income" to be received over the duration of the plan will be applied to make payments in accordance with the terms of the plan. 11 U.S.C.A. § 1325(b)(1).

[2] Bankruptcy 51 ⚷2021.1

51 Bankruptcy
51I In General
51I(B) Constitutional and Statutory Provisions
51k2021 Construction and Operation
51k2021.1 k. In general. Most Cited Cases

Under the Bankruptcy Code, as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), "current monthly income" is calculated by averaging a debtor's monthly income during the six-month look-back period, which generally consists of the six full months preceding the filing of the bankruptcy petition. 11 U.S.C.A. § 101(10A)(A)(i).

[3] Bankruptcy 51 ⚷2021.1

51 Bankruptcy
51I In General
51I(B) Constitutional and Statutory Provisions
51k2021 Construction and Operation
51k2021.1 k. In general. Most Cited Cases

If a debtor does not file the required Schedule I, the bankruptcy court, in calculating the debtor's "current monthly income," may select a different

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six-month period than the six full months preceding the filing of the bankruptcy petition. 11 U.S.C.A. § 101(10A)(A)(ii).

[4] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

Under the Bankruptcy Code, as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), for purposes of calculating the disposable income of a Chapter 13 debtor whose income is below the median for his or her state, the phrase "amounts reasonably necessary to be expended" for the debtor's maintenance and support includes the full amount needed for "maintenance or support," but for a debtor with income that exceeds the state median, only certain specified expenses are included. 11 U.S.C.A. §§ 707(b)(2), 1325(b)(2), (b)(2)(A)(i), (b)(3)(A).

[5] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

When a bankruptcy court calculates a Chapter 13 debtor's "projected disposable income," the court may account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation. 11 U.S.C.A. § 1325(b)(1)(B).

[6] Statutes 361 ⚷188

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k187 Meaning of Language
361k188 k. In general. Most Cited Cases

When terms used in a statute are undefined, the court gives them their ordinary meaning.

[7] Statutes 361 ⚷199

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k187 Meaning of Language
361k199 k. Particular words and phrases. Most Cited Cases

When, in a statute, Congress wishes to mandate simple multiplication, it does so unambiguously, most commonly by using the term "multiplied."

[8] Bankruptcy 51 ⚷2021.1

51 Bankruptcy
51I In General
51I(B) Constitutional and Statutory Provisions
51k2021 Construction and Operation
51k2021.1 k. In general. Most Cited Cases

Courts will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.

[9] Bankruptcy 51 ⚷3715(10)

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3715 Acceptance and Confirmation
51k3715(9) Effect
51k3715(10) k. Conclusiveness; res judicata; collateral estoppel. Most Cited Cases

"Effective date" of a Chapter 13 plan is the date on which the plan is confirmed and becomes binding. 11 U.S.C.A. § 1327(a).

[10] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

Court taking the proper, forward-looking ap-

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proach to determining a Chapter 13 debtor's "projected disposable income" should begin by calculating disposable income, and in most cases, nothing more is required; it is only in unusual cases that a court may go further and take into account other known or virtually certain information about the debtor's future income or expenses. 11 U.S.C.A. § 1325(b)(1)(B), (b)(2).

[11] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

Chapter 13 plan cannot be confirmed unless the debtor will be able to make all payments under the plan and comply with the plan. 11 U.S.C.A. § 1325(a)(6).

[12] Bankruptcy 51 ⚷2322.5

51 Bankruptcy
51III The Case
51III(F) Schedules and Statement of Affairs
51k2322.5 k. Income and expenditures. Most Cited Cases

Debtor seeking additional time to file a schedule of income must submit the request within 45 days after filing the bankruptcy petition, and the court may not grant an extension of more than 45 days. 11 U.S.C.A. § 521(i)(3).

**2466 Syllabus* [FN*]

FN* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

Debtors filing for protection under Chapter 13 of the Bankruptcy Code must agree to a court-approved plan under which they pay creditors out of their future income. If the bankruptcy trustee or an unsecured creditor objects, a bankruptcy court may not approve the plan unless it provides for the full repayment of unsecured claims or "provides that all of the debtor's projected disposable income to be received" over the plan's duration "will be applied to make payments" in accordance with plan terms. 11 U.S.C. § 1325(b)(1). Before enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), the Code loosely defined "disposable income." Though it did not define "projected disposable income," most bankruptcy courts calculated it using a mechanical approach, multiplying monthly income by the number of months in the plan and then determining the "disposable" portion of the result. In exceptional cases, those courts also took into account foreseeable changes in a debtor's income or expenses. BAPCPA defines "disposable income" as "current monthly income received by the debtor" less "amounts reasonably necessary to be expended" for, *e.g.*, the debtor's maintenance and support. § 1325(b)(2)(A)(i). "Current monthly income," in turn, is calculated by averaging the debtor's monthly income during a 6-month look-back period preceding the petition's filing. See § 101(10A)(A)(i). If a debtor's income is below the median for his or her State, "amounts reasonably necessary" include the full amount needed for "maintenance or support," see § 1325(b)(2)(A)(i), but if the debtor's income exceeds the state median, only certain specified expenses are included, see §§ 707(b)(2), 1325(b)(3)(A).

A one-time buyout from respondent's former employer caused her current monthly income for the six months preceding her Chapter 13 petition to exceed her State's median income. However, based on the income from her new job, which was below the state median, and her expenses, she reported a monthly disposable income of $149.03. She thus filed a plan that would have required her to pay $144 per month for 36 months. Petitioner, the Chapter 13 trustee, objected to confirmation of the plan because the proposed payment amount was less than the full amount of the claims against respondent, and because she had not committed all of her "projected disposable income" to repaying creditors. Petitioner claimed that the mechanical approach was the proper way to ***2467** calculate projected disposable income, and that using that approach, respondent should pay $756 per month for 60 months. Her actual income was insufficient to make such payments.

The Bankruptcy Court endorsed a $144 payment over a 60-month period, concluding that "projected"

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requires courts to consider the debtor's actual income. The Tenth Circuit Bankruptcy Appellate Panel affirmed, as did the Tenth Circuit, which held that a court calculating "projected disposable income" should begin with the "presumption" that the figure yielded by the mechanical approach is correct, but that this figure may be rebutted by evidence of a substantial change in the debtor's circumstances.

Held: When a bankruptcy court calculates a debtor's projected disposable income, the court may account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation. Pp. 2471 - 2478.

(a) Respondent has the better interpretation of "projected disposable income." First, such a forward-looking approach is supported by the ordinary meaning of "projected." See *Asgrow Seed Co. v. Winterboer*, 513 U.S. 179, 187, 115 S.Ct. 788, 130 L.Ed.2d 682. In ordinary usage future occurrences are not "projected" based on the assumption that the past will necessarily repeat itself. While a projection takes past events into account, adjustments are often made based on other factors that may affect the outcome. Second, "projected" appears in many federal statutes, yet Congress rarely uses it to mean simple multiplication. See, *e.g.*, 7 U.S.C. § 1301(b)(8)(B). By contrast, as the Bankruptcy Code shows, Congress can make its mandate of simple multiplication unambiguous-commonly using the term "multiplied." See, *e.g.*, 11 U.S.C. § 1325(b)(3). Third, under pre-BAPCPA case law, the general rule was that courts would multiply a debtor's current monthly income by the number of months in the commitment period as the first step in determining projected disposable income, but would also have discretion to account for known or virtually certain changes in the debtor's income. This is significant, since the Court "will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure," *Travelers Casualty & Surety Co. of America v. Pacific Gas & Elec. Co.*, 549 U.S. 443, 454, 127 S.Ct. 1199, 167 L.Ed.2d 178, and Congress did not amend the term "projected disposable income" in 2005. Pp. 2471 - 2474.

(b) The mechanical approach also clashes with § 1325's terms. First, § 1325(b)(1)(B)'s reference to projected disposable income "to be received in the applicable commitment period" strongly favors the forward-looking approach. Because respondent would have far less than $756 per month in disposable income during the plan period, petitioner's projection does not accurately reflect disposable income "to be received." In such circumstances, the mechanical approach effectively reads that phrase out of the statute. Second, § 1325(b)(1)'s direction to courts to determine projected disposable income "as of the effective date of the plan,"-*i.e.*, the confirmation date-is more consistent with the view that they are to consider postfiling information about a debtor's financial situation. Had Congress intended for projected disposable income to be no more than a multiple of disposable income, it could have specified the plan's *filing* date as the effective date. Third, § 1325(b)(1)(B)'s requirement that projected disposable income "will be applied to make payments" is rendered a hollow command if, as of the plan's effective date, the ***2468** debtor lacks the means to pay creditors in the calculated monthly amounts. P. 2474.

(c) The arguments supporting the mechanical approach are unpersuasive. The claim that the Code's detailed and precise "disposable income" definition would have no purpose without the mechanical approach overlooks the important role that this statutory formula plays under the forward-looking approach, which begins with a disposable income calculation. The Tenth Circuit's rebuttable "presumption" analysis simply heeds the ordinary meaning of "projected." This Court rejects petitioner's argument that only the mechanical approach is consistent with § 1129(a)(15)(B), which refers to "projected disposable income of the debtor (as defined in section 1325(b)(2))." And the Court declines to infer from the fact that § 1325(b)(3) incorporates § 707-which allows courts to consider "special circumstances," but only with respect to calculating expenses-that Congress intended to eliminate, *sub silentio*, the discretion that courts previously exercised to account for known or virtually certain changes. Pp. 2474 - 2475.

(d) Petitioner's proposed strategies for avoiding or mitigating the harsh results that the mechanical approach may produce for debtors-a debtor could delay filing a petition so as to place any extraordinary income outside the 6-month period; a debtor with unusually high income during that period could seek leave to delay filing a schedule of current income and ask the bankruptcy court to select a 6-month period more representative of the debtor's future disposable in-

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come; a debtor could dismiss the petition and refile at a later, more favorable date; and respondent might have been able to obtain relief by filing under Chapter 7 or converting her Chapter 13 petition to one under Chapter 7-are all flawed. Pp. 2475 - 2478.

545 F.3d 1269, affirmed.

ALITO, J., delivered the opinion of the Court, in which ROBERTS, C.J., and STEVENS, KENNEDY, THOMAS, GINSBURG, BREYER, and SOTOMAYOR, JJ., joined. SCALIA, J., filed a dissenting opinion.

Jan Hamilton, Topeka, KS, for petitioner.

Thomas C. Goldstein, Washington, DC, for respondent.

Sarah Harrington for United States as amicus curiae, by special leave of the Court, supporting the respondent.

Jan Hamilton, Trustee, Counsel of Record, Teresa L. Rhodd, Staff Attorney, Chapter 13 Trustee's Office, Topeka, KS, for petitioner.

Amy Howe, Kevin K. Russell, Howe & Russell, P.C., Bethesda, MD, G. Eric Brunstad, Jr., Collin O'Connor Udell, Matthew J. Delude, Dechert LLP, Hartford, CT, Thomas C. Goldstein, Counsel of Record, Patricia A. Millett, Peter J. Gurfein, Robert K. Ozols, Brian M. Rothschild, Daniel J. Harris, Russell L. Wininger, Akin, Gump, Strauss, Hauer & Feld LLP, Washington, DC, for respondent.

For U.S. Supreme Court briefs, see:2009 WL 5017534 (Pet.Brief)2010 WL 342041 (Resp.Brief)2010 WL 740751 (Reply.Brief)

Justice ALITO delivered the opinion of the Court.

Chapter 13 of the Bankruptcy Code provides bankruptcy protection to "individual[s] with regular income" whose debts fall within statutory limits. 11 U.S.C. §§ 101(30), 109(e). Unlike debtors who file under Chapter 7 and must liquidate their nonexempt assets in order to pay ***2469** creditors, see §§ 704(a)(1), 726, Chapter 13 debtors are permitted to keep their property, but they must agree to a court-approved plan under which they pay creditors out of their future income, see §§ 1306(b), 1321, 1322(a)(1), 1328(a). A bankruptcy trustee oversees the filing and execution of a Chapter 13 debtor's plan. § 1322(a)(1); see also 28 U.S.C. § 586(a)(3).

Section 1325 of Title 11 specifies circumstances under which a bankruptcy court "shall" and "may not" confirm a plan. § 1325(a), (b). If an unsecured creditor or the bankruptcy trustee objects to confirmation, § 1325(b)(1) requires the debtor either to pay unsecured creditors in full or to pay all "projected disposable income" to be received by the debtor over the duration of the plan.

We granted certiorari to decide how a bankruptcy court should calculate a debtor's "projected disposable income." Some lower courts have taken what the parties term the "mechanical approach," while most have adopted what has been called the "forward-looking approach." We hold that the "forward-looking approach" is correct.

I

[1] As previously noted, § 1325 provides that if a trustee or an unsecured creditor objects to a Chapter 13 debtor's plan, a bankruptcy court may not approve the plan unless it provides for the full repayment of unsecured claims or "provides that all of the debtor's projected disposable income to be received" over the duration of the plan "will be applied to make payments" in accordance with the terms of the plan. 11 U.S.C. § 1325(b)(1); see also § 1325(b)(1) (2000 ed.). Before the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), 119 Stat. 23, the Bankruptcy Code (Code) loosely defined "disposable income" as "income which is received by the debtor and which is not reasonably necessary to be expended" for the "maintenance or support of the debtor," for qualifying charitable contributions, or for business expenditures. § 1325(b)(2)(A), (B).

The Code did not define the term "projected disposable income," and in most cases, bankruptcy courts used a mechanical approach in calculating projected disposable income. That is, they first multiplied monthly income by the number of months in the plan and then determined what portion of the result was "excess" or "disposable." See 2 K. Lundin, Chapter 13 Bankruptcy § 164.1, p. 164-1, and n. 4 (3d ed.2000) (hereinafter Lundin (2000 ed.)) (citing cases).

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In exceptional cases, however, bankruptcy courts took into account foreseeable changes in a debtor's income or expenses. See *In re Heath*, 182 B.R. 557, 559-561 (9th Cir. BAP 1995); *In re Richardson*, 283 B.R. 783, 799 (Bkrtcy.Kan.2002); Tr. of Oral Arg. 7. Accord, 1 Lundin § 35.10, at 35-14 (2000 ed.) ("The debtor should take some care to project estimated future income on Schedule I to include anticipated increases or decreases [in income] so that the schedule will be consistent with any evidence of income the debtor would offer at a contested confirmation hearing").

[2][3][4] BAPCPA left the term "projected disposable income" undefined but specified in some detail how "disposable income" is to be calculated. "Disposable income" is now defined as "current monthly income received by the debtor" less "amounts reasonably necessary to be expended" for the debtor's maintenance and support, for qualifying charitable contributions, and for business expenditures. § 1325(b)(2)(A)(i) and (ii) (2006 ed.). ***2470** "Current monthly income," in turn, is calculated by averaging the debtor's monthly income during what the parties refer to as the 6-month look-back period, which generally consists of the six full months preceding the filing of the bankruptcy petition. See § 101(10A)(A)(i).[FN1] The phrase "amounts reasonably necessary to be expended" in § 1325(b)(2) is also newly defined. For a debtor whose income is below the median for his or her State, the phrase includes the full amount needed for "maintenance or support," see § 1325(b)(2)(A)(i), but for a debtor with income that exceeds the state median, only certain specified expenses are included,[FN2] see §§ 707(b)(2), 1325(b)(3)(A).

FN1. However, if a debtor does not file the required schedule (Schedule I), the bankruptcy court may select a different 6-month period. See § 101(10A)(A)(ii).

FN2. The formula for above-median-income debtors is known as the "means test" and is reflected in a schedule (Form 22C) that a Chapter 13 debtor must file. See Fed. Rule Bkrtcy. Proc. Official Form 22C (2009); *In re Liverman*, 383 B.R. 604, 606, n. 1, 608-609 (Bkrtcy.N.J.2008).

II

A

Respondent had $36,793.36 in unsecured debt when she filed for Chapter 13 bankruptcy protection in October 2006. In the six months before her filing, she received a one-time buyout from her former employer, and this payment greatly inflated her gross income for April 2006 (to $11,990.03) and for May 2006 (to $15,356.42). App. 84, 107. As a result of these payments, respondent's current monthly income, as averaged from April through October 2006, was $5,343.70-a figure that exceeds the median income for a family of one in Kansas. See *id.*, at 78. Respondent's monthly expenses, calculated pursuant to § 707(b)(2), were $4,228.71. *Id.*, at 83. She reported a monthly "disposable income" of $1,114.98 on Form 22C. *Ibid.*

On the form used for reporting monthly income (Schedule I), she reported income from her new job of $1,922 per month-which is below the state median. *Id.*, at 66; see also *id.*, at 78. On the form used for reporting monthly expenses (Schedule J), she reported actual monthly expenses of $1,772.97. *Id.*, at 68. Subtracting the Schedule J figure from the Schedule I figure resulted in monthly disposable income of $149.03.

Respondent filed a plan that would have required her to pay $144 per month for 36 months. See *id.*, at 93. Petitioner, a private Chapter 13 trustee, objected to confirmation of the plan because the amount respondent proposed to pay was less than the full amount of the claims against her, see § 1325(b)(1)(A), and because, in petitioner's view, respondent was not committing all of her "projected disposable income" to the repayment of creditors, see § 1325(b)(1)(B). According to petitioner, the proper way to calculate projected disposable income was simply to multiply disposable income, as calculated on Form 22C, by the number of months in the commitment period. Employing this mechanical approach, petitioner calculated that creditors would be paid in full if respondent made monthly payments of $756 for a period of 60 months. *Id.*, at 108. There is no dispute that respondent's actual income was insufficient to make payments in that amount. Tr. of Oral Arg. 3-4.

B

The Bankruptcy Court endorsed respondent's proposed monthly payment of $144 but required a 60-month plan period. ***2471**No. 06-41037 etc., 2007

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WL 1451999, *8 (Bkrtcy.Kan.2007). The court agreed with the majority view that the word "projected" in § 1325(b)(1)(B) requires courts "to consider at confirmation the debtor's *actual* income as it was reported on Schedule I." *Id.*, at *5 (emphasis added). This conclusion was warranted by the text of § 1325(b)(1), the Bankruptcy Court reasoned, and was necessary to avoid the absurd result of denying bankruptcy protection to individuals with deteriorating finances in the six months before filing. *Ibid.*

Petitioner appealed to the Tenth Circuit Bankruptcy Appellate Panel, which affirmed. 380 B.R. 17, 19 (2007). The Panel noted that, although Congress redefined "disposable income" in 2005, it chose not to alter the pre-existing term "projected disposable income." *Id.*, at 24. Thus, the Panel concluded, there was no reason to believe that Congress intended to alter the pre-BAPCPA practice under which bankruptcy courts determined projected disposable income by reference to Schedules I and J but considered other evidence when there was reason to believe that the schedules did not reflect a debtor's actual ability to pay. *Ibid.*

The Tenth Circuit affirmed. 545 F.3d 1269, 1270 (2008). According to the Tenth Circuit, a court, in calculating "projected disposable income," should begin with the "presumption" that the figure yielded by the mechanical approach is correct, but the Court concluded that this figure may be rebutted by evidence of a substantial change in the debtor's circumstances. *Id.*, at 1278-1279.

This petition followed, and we granted certiorari. 558 U.S. ----, 130 S.Ct. 487, 175 L.Ed.2d 343 (2009).

III

A

[5] The parties differ sharply in their interpretation of § 1325's reference to "projected disposable income." Petitioner, advocating the mechanical approach, contends that "projected disposable income" means past average monthly disposable income multiplied by the number of months in a debtor's plan. Respondent, who favors the forward-looking approach, agrees that the method outlined by petitioner should be determinative in most cases, but she argues that in exceptional cases, where significant changes in a debtor's financial circumstances are known or virtually certain, a bankruptcy court has discretion to make an appropriate adjustment. Respondent has the stronger argument.

[6] First, respondent's argument is supported by the ordinary meaning of the term "projected." "When terms used in a statute are undefined, we give them their ordinary meaning." *Asgrow Seed Co. v. Winterboer*, 513 U.S. 179, 187, 115 S.Ct. 788, 130 L.Ed.2d 682 (1995). Here, the term "projected" is not defined, and in ordinary usage future occurrences are not "projected" based on the assumption that the past will necessarily repeat itself. For example, projections concerning a company's future sales or the future cash flow from a license take into account anticipated events that may change past trends. See, *e.g.*, *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 316, 127 S.Ct. 2499, 168 L.Ed.2d 179 (2007) (describing adjustments to "projected sales" in light of falling demand); *Innovair Aviation, Ltd. v. United States*, 83 Fed.Cl. 498, 502, 504-506 (2008) (calculating projected cash flow and noting that past sales are "not necessarily the number of sales" that will be made in the future). On the night of an election, experts do not "project" the percentage of the votes that a candidate will receive by simply assuming that the candidate***2472** will get the same percentage as he or she won in the first few reporting precincts. And sports analysts do not project that a team's winning percentage at the end of a new season will be the same as the team's winning percentage last year or the team's winning percentage at the end of the first month of competition. While a projection takes past events into account, adjustments are often made based on other factors that may affect the final outcome. See *In re Kibbe*, 361 B.R. 302, 312, n. 9 (1st Cir. BAP 2007) (contrasting "multiplied," which "requires only mathematical acumen," with "projected," which requires "mathematic acumen adjusted by deliberation and discretion").

Second, the word "projected" appears in many federal statutes, yet Congress rarely has used it to mean simple multiplication. For example, the Agricultural Adjustment Act of 1938 defined "projected national yield," "projected county yield," and "projected farm yield" as entailing historical averages "adjusted for abnormal weather conditions," "trends in yields," and "any significant changes in production practices." 7 U.S.C. § 1301(b)(8)(B), (13)(J), (K).[FN3]

FN3. See also, *e.g.*, 8 U.S.C. § 1364(a), (c)(2) (requiring the triennial immigration-impact

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report to include information "projected for the succeeding five-year period, based on reasonable estimates substantiated by the best available evidence"); 10 U.S.C.A. § 2433a(a)(2)(B) (2010 Cum.Supp.) ("projected cost of completing the [defense acquisition] program based on reasonable modification of [current] requirements"); 15 U.S.C. § 719c(c)(2) (2006 ed.) ("projected natural gas supply and demand"); 25 U.S.C. § 2009(c)(1), (2) (requiring the Director of the Office of Indian Education Programs to submit an annual report containing certain projections and "a description of the methods and formulas used to calculate the amounts projected").

[7] By contrast, we need look no further than the Bankruptcy Code to see that when Congress wishes to mandate simple multiplication, it does so unambiguously-most commonly by using the term "multiplied." See, *e.g.*, 11 U.S.C. § 1325(b)(3) ("current monthly income, when multiplied by 12"); §§ 704(b)(2), 707(b)(6), (7)(A) (same); § 707(b)(2)(A)(i), (B)(iv) ("multiplied by 60"). Accord, 2 U.S.C. § 58(b)(1)(B) ("multiplied by the number of months in such year"); 5 U.S.C. § 8415(a) ("multiplied by such individual's total service"); 42 U.S.C. § 403(f)(3) ("multiplied by the number of months in such year").

Third, pre-BAPCPA case law points in favor of the "forward-looking" approach. Prior to BAPCPA, the general rule was that courts would multiply a debtor's current monthly income by the number of months in the commitment period as the first step in determining projected disposable income. See, *e.g.*, *In re Killough*, 900 F.2d 61, 62-63 (C.A.5 1990) *(per curiam)*; *In re Anderson*, 21 F.3d 355, 357 (C.A.9 1994); *In re Solomon*, 67 F.3d 1128, 1132 (C.A.4 1995). See 2 Lundin § 164.1, at 164-1 (2000 ed.) ("Most courts focus on the debtor's current income and extend current income (and expenditures) over the life of the plan to calculate projected disposable income"). But courts also had discretion to account for known or virtually certain changes in the debtor's income. See *Heath*, 182 B.R., at 559-561; *Richardson*, 283 B.R., at 799; *In re James*, 260 B.R. 498, 514-515 (Bkrtcy. Idaho 2001); *In re Jobe*, 197 B.R. 823, 826-827 (Bkrtcy.W.D.Tex.1996); *In re Crompton*, 73 B.R. 800, 808 (Bkrtcy.E.D.Pa.1987); see also *In re Schyma*, 68 B.R. 52, 63 (Bkrtcy.Minn.1985) ("[T]he prospect of dividends ... is not so certain as to require Debtors or the Court to consider them as regular or disposable income"); *In re Krull*, 54 B.R. 375, 378 (Bkrtcy.Colo.1985) ("Since there are ***2473** no changes in income which can be clearly foreseen, the Court must simply multiply the debtor's current disposable income by 36 in order to determine his 'projected' income").[FN4] This judicial discretion was well documented in contemporary bankruptcy treatises. See 8 Collier on Bankruptcy ¶ 1325.08[4][a], p. 1325-50 (15th ed. rev.2004) (hereinafter Collier) ("As a practical matter, *unless there are changes which can be clearly foreseen*, the court must simply multiply the debtor's known monthly income by 36 and determine whether the amount to be paid under the plan equals or exceeds that amount" (emphasis added)); 3 W. Norton, Bankruptcy Law and Practice § 75.10, p. 64 (1991) ("It has been held that the court should focus upon present monthly income and expenditures and, *absent extraordinary circumstances*, project these current amounts over the life of the plan to determine projected disposable income" (emphasis added)); 2 Lundin § 164.1, at 164-28 to 164-31 (2000 ed.) (describing how reported decisions treated anticipated changes in income, particularly where such changes were "too speculative to be projected"); see also *In re Greer*, 388 B.R. 889, 892 (Bkrtcy.C.D.Ill.2008) (" 'As a practical matter, unless there are changes which can be clearly foreseen, the court must simply multiply the debtor's current monthly income by thirty-six' " (quoting 5 Collier ¶ 1325.08[4][a] (15th ed. rev.1995))); *James, supra*, at 514 (same) (quoting 8 Collier ¶ 1325.08[4] [a] (15th ed. rev.2000)); *Crompton, supra*, at 808 (same) (citing 5 Collier ¶ 1325.08[4][a], [b], at 1325-47 to 1325-48 (15th ed.1986)). Accord, 8 Collier ¶ 1325.08[4][b], at 1325-60 (15th ed. rev.2007) ("As with the income side of the budget, the court must simply use the debtor's current expenses, *unless a change in them is virtually certain*" (emphasis added)). Indeed, petitioner concedes that courts possessed this discretion prior to BAPCPA. Tr. of Oral Arg. 7.

FN4. When pre-BAPCPA courts declined to make adjustments based on possible changes in a debtor's future income or expenses, they did so because the changes were not sufficiently foreseeable, not because they concluded that they lacked discretion to depart from a strictly mechanical approach. In *In re Solomon*, 67 F.3d 1128 (1995), for example, the Fourth Circuit refused to make such an

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adjustment because it deemed disbursements from an individual retirement account during the plan period to be "speculative" and "hypothetical." *Id.*, at 1132. There is no reason to assume that the result would have been the same if future disbursements had been more assured. That was certainly true of *In re Killough*, 900 F.2d 61 (1990), in which the Fifth Circuit declined to require inclusion of overtime pay in projected disposable income because it "was not definite enough." *Id.*, at 65; see also *id.*, at 66 ("[T]here may be instances where income obtained through working overtime can and should appropriately be included in a debtor's projected disposable income"). See also *Education Assistance Corp. v. Zellner*, 827 F.2d 1222, 1226 (C.A.8 1987) (affirming bankruptcy court's exclusion of future tax returns and salary increases from debtor's projected disposable income because they were "speculative").

[8] Pre-BAPCPA bankruptcy practice is telling because we " 'will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure.' " *Travelers Casualty & Surety Co. of America v. Pacific Gas & Elec. Co.*, 549 U.S. 443, 454, 127 S.Ct. 1199, 167 L.Ed.2d 178 (2007); *Lamie v. United States Trustee*, 540 U.S. 526, 539, 124 S.Ct. 1023, 157 L.Ed.2d 1024 (2004); *Cohen v. de la Cruz*, 523 U.S. 213, 221, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998); see also *Grogan v. Garner*, 498 U.S. 279, 290, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991); *Kelly v. Robinson*, 479 U.S. 36, 47, 107 S.Ct. 353, 93 L.Ed.2d 216 (1986). Congress did not amend the term "projected disposable income" in 2005, and pre-BAPCPA bankruptcy***2474** practice reflected a widely acknowledged and well-documented view that courts may take into account known or virtually certain changes to debtors' income or expenses when projecting disposable income. In light of this historical practice, we would expect that, had Congress intended for "projected" to carry a specialized-and indeed, unusual-meaning in Chapter 13, Congress would have said so expressly. Cf., *e.g.*, 26 U.S.C. § 279(c)(3)(A), (B) (expressly defining "projected earnings" as reflecting a 3-year historical average).

B

The mechanical approach also clashes repeatedly with the terms of 11 U.S.C. § 1325.

First, § 1325(b)(1)(B)'s reference to projected disposable income "to be received in the applicable commitment period" strongly favors the forward-looking approach. There is no dispute that respondent would in fact receive far less than $756 per month in disposable income during the plan period, so petitioner's projection does not accurately reflect "income to be received" during that period. See *In re Nowlin*, 576 F.3d 258, 263 (C.A.5 2009). The mechanical approach effectively reads this phrase out of the statute when a debtor's current disposable income is substantially higher than the income that the debtor predictably will receive during the plan period. See *Kawaauhau v. Geiger*, 523 U.S. 57, 62, 118 S.Ct. 974, 140 L.Ed.2d 90 (1998) ("[W]e are hesitant to adopt an interpretation of a congressional enactment which renders superfluous another portion of that same law" (internal quotation marks omitted)).

[9] Second, § 1325(b)(1) directs courts to determine projected disposable income "as of the effective date of the plan," which is the date on which the plan is confirmed and becomes binding, see § 1327(a). Had Congress intended for projected disposable income to be nothing more than a multiple of disposable income in all cases, we see no reason why Congress would not have required courts to determine that value as of the *filing* date of the plan. See Fed. Rule Bkrtcy. Proc. 3015(b) (requiring that a plan be filed within 14 days of the filing of a petition), online at http:// www. uscourts. gov/ Rules And Policies/ Federal Rulemaking/ Overview/ Bankruptcy Rules. aspx (all Internet materials as visited June 3, 2010, and available in Clerk of Court's case file). In the very next section of the Code, for example, Congress specified that a debtor shall commence payments "not later than 30 days after the *date of the filing of the plan*." § 1326(a)(1) (emphasis added). Congress' decision to require courts to measure projected disposable income "as of the *effective* date of the plan" is more consistent with the view that Congress expected courts to consider postfiling information about the debtor's financial circumstances. See 545 F.3d, at 1279 ("[D]etermining whether or not a debtor has committed all projected disposable income to repayment of the unsecured creditors 'as of the effective date of the plan' suggests consideration of the debtor's actual financial circumstances as of the effective date of the

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plan").

Third, the requirement that projected disposable income "will be applied to make payments" is most naturally read to contemplate that the debtor will actually pay creditors in the calculated monthly amounts. § 1325(b)(1)(B). But when, as of the effective date of a plan, the debtor lacks the means to do so, this language is rendered a hollow command.

C

[10] The arguments advanced in favor of the mechanical approach are unpersuasive.***2475** Noting that the Code now provides a detailed and precise definition of "disposable income," proponents of the mechanical approach maintain that any departure from this method leaves that definition " 'with no apparent purpose.' " *In re Kagenveama,* 541 F.3d 868, 873 (C.A.9 2008). This argument overlooks the important role that the statutory formula for calculating "disposable income" plays under the forward-looking approach. As the Tenth Circuit recognized in this case, a court taking the forward-looking approach should begin by calculating disposable income, and in most cases, nothing more is required. It is only in unusual cases that a court may go further and take into account other known or virtually certain information about the debtor's future income or expenses.[FN5]

FN5. For the same reason, the phrase "[f]or purposes of this subsection" in § 1325(b)(2) is not rendered superfluous by the forward-looking approach.

Petitioner faults the Tenth Circuit for referring to a rebuttable "presumption" that the figure produced by the mechanical approach accurately represents a debtor's "projected disposable income." See 545 F.3d, at 1278-1279. Petitioner notes that the Code makes no reference to any such presumption but that related Code provisions expressly create other rebuttable presumptions. See § 707(b)(2)(A)(i) and (B)(i). He thus suggests that the Tenth Circuit improperly supplemented the text of the Code.

The Tenth Circuit's analysis, however, simply heeds the ordinary meaning of the term "projected." As noted, a person making a projection uses past occurrences as a starting point, and that is precisely what the Tenth Circuit prescribed. See, *e.g., Nowlin, supra,* at 260, 263.

Petitioner argues that only the mechanical approach is consistent with § 1129(a)(15)(B), which refers to "projected disposable income of the debtor (as defined in section 1325(b)(2))." This cross-reference, petitioner argues, shows that Congress intended for the term "projected disposable income" to incorporate, presumably in all contexts, the defined term "disposable income." It is evident that § 1129(a)(15)(B) refers to the defined term "disposable income," see § 1325(b)(2), but that fact offers no insight into the meaning of the word "projected" in §§ 1129(a)(15)(B) and 1325(b)(1)(B). We fail to see how that word acquires a specialized meaning as a result of this cross-reference-particularly where both §§ 1129(a)(15)(B) and 1325(b)(1)(B) refer to projected disposable income "to be received" during the relevant period. See *supra,* at 11.

Petitioner also notes that § 707 allows courts to take "special circumstances" into consideration, but that § 1325(b)(3) incorporates § 707 only with respect to calculating expenses. See *In re Wilson,* 397 B.R. 299, 314-315 (Bkrtcy.M.D.N.C.2008). Thus, he argues, a "special circumstances" exception should not be inferred with respect to the debtor's income. We decline to infer from § 1325's incorporation of § 707 that Congress intended to eliminate, *sub silentio,* the discretion that courts previously exercised when projecting disposable income to account for known or virtually certain changes. Accord, *In re Liverman,* 383 B.R. 604, 613, and n. 15 (Bkrtcy.N.J.2008).

D

[11] In cases in which a debtor's disposable income during the 6-month look-back period is either substantially lower or higher than the debtor's disposable income during the plan period, the mechanical approach would produce senseless results ***2476** that we do not think Congress intended. In cases in which the debtor's disposable income is higher during the plan period, the mechanical approach would deny creditors payments that the debtor could easily make. And where, as in the present case, the debtor's disposable income during the plan period is substantially lower, the mechanical approach would deny the protection of Chapter 13 to debtors who meet the chapter's main eligibility requirements. Here, for example, respondent is an "individual whose income is sufficiently stable and regular" to allow her "to make payments under a plan," § 101(30), and her debts fall

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below the limits set out in § 109(e). But if the mechanical approach were used, she could not file a confirmable plan. Under § 1325(a)(6), a plan cannot be confirmed unless "the debtor will be able to make all payments under the plan and comply with the plan." And as petitioner concedes, respondent could not possibly make the payments that the mechanical approach prescribes.

In order to avoid or at least to mitigate the harsh results that the mechanical approach may produce for debtors, petitioner advances several possible escape strategies. He proposes no comparable strategies for creditors harmed by the mechanical approach, and in any event none of the maneuvers that he proposes for debtors is satisfactory.

1

Petitioner first suggests that a debtor may delay filing a petition so as to place any extraordinary income outside the 6-month look-back period. We see at least two problems with this proposal.

First, delay is often not a viable option for a debtor sliding into bankruptcy.

> "Potential Chapter 13 debtors typically find a lawyer's office when they are one step from financial Armageddon: There is a foreclosure sale of the debtor's home the next day; the debtor's only car was mysteriously repossessed in the dark of last night; a garnishment has reduced the debtor's take-home pay below the ordinary requirements of food and rent. Instantaneous relief is expected, if not necessary." K. Lundin & W. Brown, Chapter 13 Bankruptcy § 3.1 [2] (4th ed. rev.2009), http://www.ch 13 online. com/ Subscriber/ Chapter_ 13_ Bankruptcy_ 4 th_ Lundin_ Brown. htm.

See also *id.*, § 38.1 ("Debtor's counsel often has little discretion when to file the Chapter 13 case").

Second, even when a debtor is able to delay filing a petition, such delay could be risky if it gives the appearance of bad faith. See 11 U.S.C. § 1325(a)(7) (requiring, as a condition of confirmation, that "the action of the debtor in filing the petition was in good faith"); see also, *e.g.*, *In re Myers*, 491 F.3d 120, 125 (C.A.3 2007) (citing " 'the timing of the petition' " as a factor to be considered in assessing a debtor's compliance with the good-faith requirement). Accord, *Neufeld v. Freeman*, 794 F.2d 149, 153 (C.A.4 1986) (a debtor's prepetition conduct may inform the court's good-faith inquiry).

2

[12] Petitioner next argues that a debtor with unusually high income during the 6 months prior to the filing of a petition, could seek leave to delay filing a schedule of current income (Schedule I) and then ask the bankruptcy court to exercise its authority under § 101(10A)(A)(ii) to select a 6-month period that is more representative of the debtor's future disposable income. We see little merit in this convoluted strategy. If the Code required the use of the mechanical approach in all cases, this strategy would improperly undermine what the Code demands. And if, ***2477** as we believe, the Code does not insist upon rigid adherence to the mechanical approach in all cases, this strategy is not needed. In any event, even if this strategy were allowed, it would not help all debtors whose disposable income during the plan period is sharply lower than their previous disposable income.[FN6]

> FN6. Under 11 U.S.C. § 521(i)(3), a debtor seeking additional time to file a schedule of income must submit the request within 45 days after filing the petition, and the court may not grant an extension of more than 45 days.

3

Petitioner suggests that a debtor can dismiss the petition and refile at a later, more favorable date. But petitioner offers only the tepid assurance that courts "generally" do not find this practice to be abusive. Brief for Petitioner 53. This questionable stratagem plainly circumvents the statutory limits on a court's ability to shift the look-back period, see *supra*, at 2477, and n. 6, and should give debtors pause.[FN7] Cf. *In re Glenn*, 288 B.R. 516, 520 (Bkrtcy.E.D.Tenn.2002) (noting that courts should consider, among other factors, "whether this is the first or [a] subsequent filin[g]" when assessing a debtor's compliance with the good-faith requirement).

> FN7. For example, a debtor otherwise eligible for Chapter 13 protection may become ineligible if "at any time in the preceding 180 days" "the case was dismissed by the court for willful failure of the debtor to abide by

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> orders of the court, or to appear before the court in proper prosecution of the case," or "the debtor requested and obtained the voluntary dismissal of the case following the filing of a request for relief from the automatic stay provided by section 362 of this title." § 109(g).

4

Petitioner argues that respondent might have been able to obtain relief by filing under Chapter 7 or by converting her Chapter 13 petition to one under Chapter 7. The availability of Chapter 7 to debtors like respondent who have above-median incomes is limited. In respondent's case, a presumption of abuse would attach under § 707(b)(2)(A)(i) because her disposable income, "multiplied by 60," exceeds the amounts specified in subclauses (I) and (II). See also § 707(b)(1) (allowing a court to dismiss a petition filed by a debtor "whose debts are primarily consumer debts ... if it finds that the granting of relief would be an abuse of the provisions of this chapter"); App. 86-88 ("Notice to Individual Consumer Debtor under § 342(b) of the Bankruptcy Code") ("If your income is greater than the median income for your state of residence and family size, in some cases, creditors have the right to file a motion requesting that the court dismiss your case under § 707(b) of the Code"). Nevertheless, petitioner argues, respondent might have been able to overcome this presumption by claiming that her case involves "special circumstances" within the meaning of § 707(b)(2)(B)(i). Section 707 identifies as examples of "special circumstances" a "serious medical condition or a call or order to active duty in the Armed Forces," *ibid.*, and petitioner directs us to no authority for the proposition that a prepetition decline in income would qualify as a "special circumstance." In any event, the "special circumstances" exception is available only to the extent that "there is no reasonable alternative," *ibid.*, a proposition we reject with our interpretation of § 1325(b)(1) today.[FN8]

> FN8. Petitioner also suggests that some Chapter 13 debtors may be able to plead "special circumstances" on the expense side of the calculation by virtue of BAPCPA's incorporation of the Chapter 7 means test into Chapter 13. See § 707(b)(2)(B)(i), (ii). This is no help to debtors like respondent, whose income has changed but whose expenses are constant.

***2478** In sum, each of the strategies that petitioner identifies for mitigating the anomalous effects of the mechanical approach is flawed. There is no reason to think that Congress meant for any of these strategies to operate as a safety valve for the mechanical approach.

IV

We find petitioner's remaining arguments unpersuasive. Consistent with the text of § 1325 and pre-BAPCPA practice, we hold that when a bankruptcy court calculates a debtor's projected disposable income, the court may account for changes in the debtor's income or expenses that are known or virtually certain at the time of confirmation. We therefore affirm the decision of the Court of Appeals.

It is so ordered.

Justice SCALIA, dissenting.

The Bankruptcy Code requires a debtor seeking relief under Chapter 13, unless he will repay his unsecured creditors in full, to pay them all of his "projected disposable income" over the life of his repayment plan. 11 U.S.C. § 1325(b)(1)(B). The Code provides a formula for "project[ing]" what a debtor's "disposable income" will be, which so far as his earnings are concerned turns only on his past income. The Court concludes that this formula should not apply in "exceptional cases" where "known or virtually certain" changes in the debtor's circumstances make it a poor predictor. *Ante,* at 2471. Because that conclusion is contrary to the Code's text, I respectfully dissent.

I

A

A bankruptcy court cannot confirm a Chapter 13 plan over the objection of the trustee unless, as of the plan's effective date, either (A) the property to be distributed on account of the unsecured claim at issue exceeds its amount or (B) the "the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan." § 1325(b)(1)(B). The Code does not define "projected disposable income," but it does define "disposable income." The next paragraph of § 1325(b) provides that "[f]or purposes of this

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subsection, the term 'disposable income' means current monthly income received by the debtor," excluding certain payments received for child support, "less amounts reasonably necessary to be expended" on three categories of expenses. § 1325(b)(2). The Code in turn defines "current monthly income" as "the average monthly income from all sources that the debtor receives ... derived during the 6-month period ending on" one of two dates.[FN1] § 101(10A)(A). Whichever date applies, a debtor's "current monthly income," and thus the income component of his "disposable income," is a sum certain, a rate fixed once for all based on historical figures.

FN1. If the debtor files a schedule of current income, as ordinarily required by § 521(a)(1)(B)(ii), then the 6-month period ends on the last day of the month preceding the date the case is commenced, § 101(10A)(A)(i)-that is, when the petition is filed, §§ 301(a), 302(a), 303(b). If the debtor does not file such a schedule on time-which the bankruptcy court apparently may excuse him from doing, § 521(a)(1)(B)(ii)-the 6-month period ends on the date the bankruptcy court determines the debtor's current income. § 101(10A)(A)(ii).

***2479** This definition of "disposable income" applies to the use of that term in the longer phrase "projected disposable income" in § 1325(b)(1)(B), since the definition says that it applies to subsection (b). Cf. § 1129(a)(15)(B) (referring to "the projected disposable income of the debtor (as defined in section 1325(b)(2))"). The puzzle is what to make of the word "projected."

In the Court's view, this modifier makes all the difference. Projections, it explains, ordinarily account for later developments, not just past data. *Ante,* at 2471 - 2472. Thus, the Court concludes, in determining "projected disposable income" a bankruptcy court may depart from § 1325(b)(2)'s inflexible formula, at least in "exceptional cases," to account for "significant changes" in the debtor's circumstances, either actual or anticipated. *Ante,* at 2471.

That interpretation runs aground because it either renders superfluous text Congress included or requires adding text Congress did not. It would be pointless to define disposable income in such detail, based on data during a specific 6-month period, if a court were free to set the resulting figure aside whenever it appears to be a poor predictor. And since "disposable income" appears nowhere else in § 1325(b), then unless § 1325(b)(2)'s definition applies to "projected disposable income" in § 1325(b)(1)(B), it does not apply at all.

The Court insists its interpretation does not render § 1325(b)(2)'s incorporation of "current monthly income" a nullity: A bankruptcy court must still *begin* with that figure, but is simply free to fiddle with it if a "significant" change in the debtor's circumstances is "known or virtually certain." *Ante,* at 2471, 2474 - 2475. That construction conveniently avoids superfluity, but only by utterly abandoning the text the Court purports to construe. Nothing in the text supports treating the definition of disposable income Congress supplied as a suggestion. And even if the word "projected" did allow (or direct) a court to disregard § 1325(b)(2)'s fixed formula and to consider other data, there would be no basis in the text for the restrictions the Court reads in, regarding when and to what extent a court may (or must) do so. If the statute authorizes estimations, it authorizes them in *every* case, not just those where changes to the debtor's income are both "significant" and either "known or virtually certain." *Ibid.* If the evidence indicates it is merely more likely than not that the debtor's income will increase by some minimal amount, there is no reading of the word "projected" that permits (or requires) a court to ignore that change. The Court, in short, can arrive at its compromise construction only by rewriting the statute.

B

The only reasonable reading that avoids deleting words Congress enacted, or adding others it did not, is this: Setting aside expenses excludable under § 1325(b)(2)(A) and (B), which are not at issue here, a court must calculate the debtor's "projected disposable income" by multiplying his current monthly income by the number of months in the "applicable commitment period." The word "projected" in this context, I agree, most sensibly refers to a calculation, prediction, or estimation of future events, see Brief for United States as *Amicus Curiae* 12-13 (collecting dictionary definitions); see also Webster's New International Dictionary 1978 (2d ed.1957). But one assuredly can calculate, predict, or estimate future figures based on the past. And here Congress has commanded that a

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specific historical figure shall be the basis for the projection.

***2480** The Court rejects this reading as unrealistic. A projection, the Court explains, may be based in *part* on past data, but "adjustments are often made based on other factors that may affect the final outcome." *Ante,* at 2472. Past performance is no guarantee of future results. No gambler would bet the farm using "project[ions]" that are based only on a football team's play *before* its star quarterback was injured. And no pundit would keep his post if he "projected" election results relying only on prior cycles, ignoring recent polls. So too, the Court appears to reason, it makes no sense to say a court "project[s]" a debtor's "disposable income" when it considers only what he earned in a specific 6-month period in the past. *Ante,* at 2471 - 2472.

Such analogies do not establish that carrying current monthly income forward to determine a debtor's future ability to pay is not a "projection." They show only that relying exclusively on past data for the projection may be a bad idea. One who is asked to predict future results, but is armed with no other information than prior performance, can still make a projection; it may simply be off the mark. Congress, of course, could have tried to prevent that possibility by prescribing, as it has done in other contexts, that a debtor's projected disposable income be determined based on the "best available evidence," 8 U.S.C. § 1364(c)(2), or "any ... relevant information," 25 U.S.C. § 2009(c)(1). But it included no such prescription here, and instead identified the data a court should consider. Perhaps Congress concluded that other information a bankruptcy court might consider is too uncertain or too easily manipulated. Or perhaps it thought the cost of considering such information outweighed the benefits. Cf. 7 U.S.C. § 1301(b)(13)(J)-(M) (requiring national and local "projected" yields of various crops to be adjusted only for abnormal weather, trends in yields, and production practices, apparently to the exclusion of other presumably relevant variables such as a sudden increase or decrease in the number of producers, farm subsidies, etc.). In all events, neither the reasons for nor the wisdom of the projection method Congress chose has any bearing on what the statute means.

The Court contends that if Congress really meant courts to multiply a static figure by a set number of months, it would have used the word "multiplied," as it has done elsewhere-indeed, elsewhere in the same subsection, see, *e.g.,* 11 U.S.C. § 1325(b)(3)-instead of the word "projected." [FN2] *Ante,* at 2472. I do not dispute that, as a general matter, we should presume that Congress does not ordinarily use two words in the same context to denote the same thing. But if forced to choose between (A) assuming Congress enacted text that serves no purpose at all, (B) ascribing an unheard-of meaning to the word "projected" (loaded with made-to-order restrictions) simply to avoid undesirable results, or (C) assuming Congress employed synonyms to express a single idea, the last is obviously the least evil.

FN2. Of course, since the number of months in the commitment period may vary, Congress could not simply have substituted a single word, but would have had to write "disposable income multiplied by the number of months in the applicable commitment period" or some such phrase.

In any event, we are not put to that choice here. While under my reading a court must determine the *income* half of the "projected disposable income" equation by multiplying a fixed number, that is not necessarily true of the *expenses* excludable under § 1325(b)(2)(A) and (B). Unlike the ***2481** debtor's current monthly income, none of the three types of expenses-payments for the support of the debtor and his dependents, charitable contributions, and expenses to keep an existing business above water-is explicitly defined in terms of historical figures (at least for debtors with incomes below the state median). The first of those cannot possibly (in many cases) be determined based on the same 6-month period from which current monthly income is derived,[FN3] and the texts of the other two are consistent with determining expenses based on expectations. See § 1325(b)(2)(A)(ii) (charitable expenses to qualified entities limited to "15 percent of gross income of the debtor for the year in which the contributions are made"); § 1325(b)(2)(B) ("expenditures necessary for the continuation, preservation, and operation" of a business in which the debtor is engaged).

FN3. For a debtor whose income is below the state median, excludable expenses include domestic-support obligations "that first becom[e] payable after the date the petition is

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> filed," § 1325(b)(2)(A)(i)-that is, *after* the six-month window relevant to the debtor's current monthly income has closed (unless the debtor does not file a current-income schedule), see § 101(10A)(A)(i).

In short, a debtor's projected disposable income consists of two parts: one (current monthly income) that is fixed once for all based on historical data, and another (the enumerated expenses) that at least arguably depends on estimations of the debtor's future circumstances. The statute thus requires the court to predict the difference between two figures, each of which depends on the duration of the commitment period, and one of which also turns partly on facts besides historical data. In light of all this, it seems to me not at all unusual to describe this process as projection, not merely multiplication.

C

The Court's remaining arguments about the statute's meaning are easily dispatched. A "mechanical" reading of projected disposable income, it contends, renders superfluous the phrase "to be received in the applicable commitment period" in § 1325(b)(1)(B). *Ante,* at 2474. Not at all. That phrase defines the period for which a debtor's disposable income must be calculated (*i.e.,* the period over which the projection extends), and thus the amount the debtor must ultimately pay his unsecured creditors.

Similarly insubstantial is the Court's claim regarding the requirement that the plan provide that the debtor's projected disposable income "will be applied to make payments" toward unsecured creditors' claims, § 1325(b)(1)(B). The Court says this requirement makes no sense unless the debtor is actually able to pay an amount equal to his projected disposable income. *Ante,* at 2474 - 2475. But it makes no sense only if one assumes that the debtor is entitled to confirmation in the first place; and that assumption is wrong. The requirement that the debtor pay at least his projected disposable income is a *prerequisite* to confirmation. The "will be applied" proviso does not require a debtor to pay what he cannot; it simply withholds Chapter 13 relief when he cannot pay.

The Court also argues that § 1325(b)(1)'s directive to determine projected disposable income "as of the effective date of the plan" makes no sense if mere multiplication of existing numbers is required. *Ante,* at 2474 - 2475. As I have explained, however, "projected disposable income" may in some cases require more than multiplication (as to expenses), and the estimations involved may vary from the date of the plan's filing until the date it ***2482** takes effect. Moreover, the provision also applies to the alternative avenue to confirmation in § 1325(b)(1)(A), which requires that "the value of the property to be distributed under the plan" to an unsecured creditor equals or exceeds the creditor's claim. As to that requirement, the effective-date requirement makes perfect sense.

Text aside, the Court also observes that Circuit practice prior to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), 119 Stat. 23, aligns with the atextual approach the Court adopts today. *Ante,* at 2472 - 2474. That is unsurprising, since the prior version of the relevant provisions was completely consistent with that approach. The Court is correct that BAPCPA "did not amend the term 'projected disposable income,' " *ante,* at 2473. But it *did* amend the *definition* of that term. Before 2005, § 1325(b)(2) defined "disposable income" simply as "income which is received by the debtor and which is not reasonably necessary to be expended" on the same basic types of expenses excluded by the current statute. § 1325(b)(2) (2000 ed.). Nothing in that terse definition compelled a court to rely exclusively on past data, let alone a specific 6-month period. But in BAPCPA-the same Act in which Congress defined "current monthly income" in § 101(10A)(A)-Congress redefined "disposable income" in § 1325(b)(2) to incorporate that backward-looking definition. See Pub.L. 109-8, § 102(b), (h), 119 Stat. 32-34. Given these significant changes, the fact that the Court's approach conforms with pre-BAPCPA practice not only does not recommend it, see *e.g., Pennsylvania Dept. of Public Welfare v. Davenport,* 495 U.S. 552, 563-564, 110 S.Ct. 2126, 109 L.Ed.2d 588 (1990), but renders it suspect.

II

Unable to assemble a compelling case based on what the statute says, the Court falls back on the "senseless results" it would produce-results the Court "do [es] not think Congress intended." *Ante,* at 2475 - 2476. Even if it were true that a "mechanical" reading resulted in undesirable outcomes, that would make no difference. *Lewis v. Chicago,* 560 U.S. ----, ----, 130 S.Ct. 2191, ----, ---- L.Ed.2d ---- (2010) (slip op., at 11). For even assuming (though I do not believe it)

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that we could know which results Congress thought it was achieving (or avoiding) apart from the only congressional expression of its thoughts, the text, those results would be entirely irrelevant to what the statute means.

In any event, the effects the Court fears are neither as inevitable nor as "senseless" as the Court portrays. The Court's first concern is that if actual or anticipated changes in the debtor's earnings are ignored, then a debtor whose income increases after the critical 6-month window will not be required to pay all he can afford. *Ante,* at 2475 - 2476. But as **Lanning** points out, Brief for Respondent 22-23, Chapter 13 authorizes the Bankruptcy Court, at the request of unsecured creditors, to modify the plan "[a]t any time after confirmation" to "increase ... the amount of payments" on a class of claims or "reduce the time for such payments." § 1329(a)(1)-(2) (2006 ed.). The Court offers no explanation of why modification would not be available in such instances, and sufficient to resolve the concern.

The Court also cringes at the prospect that a debtor whose income suddenly *declines* after the 6-month window or who, as in this case, receives a one-off windfall during that window, will be barred from Chapter 13 relief because he will be unable to devote his "disposable income" (which turns on his prior earnings) to paying his unsecured creditors going forward. *Ante,* ***2483** at 2475 - 2476. At least for debtors whose circumstances deteriorate *after* confirmation, however, the Code already provides an answer. Just as a creditor can request an upward modification in light of postconfirmation developments, so too can a debtor ask for a downward adjustment. § 1329(a). Cf. § 1329(b)(1) (requiring that modifications meet requirements of §§ 1322(a)-(b), 1323(c), and 1325(a), but not § 1325(b)).

Moreover, even apart from the availability of modification it requires little imagination to see why Congress might want to withhold relief from debtors whose situations have suddenly deteriorated (after or even toward the end of the 6-month window), or who in the midst of dire straits have been blessed (within the 6-month window) by an influx of unusually high income. Bankruptcy protection is not a birthright, and Congress could reasonably conclude that those who have just hit the skids do not yet need a reprieve from repaying their debts; perhaps they will recover. And perhaps the debtor who has received a one-time bonus will thereby be enabled to stay afloat. How long to wait before throwing the debtor a lifeline is inherently a policy choice. Congress confined the calculation of current monthly income to a 6-month period (ordinarily ending before the case is commenced), but it could have picked 2 or 12 months (or a different end date) instead. Whatever the wisdom of the window it chose, we should not assume it did not know what it was doing and accordingly refuse to give effect to its words.

Even if one insists on making provision for such debtors, the Court is wrong to write off four alternative strategies the trustee suggests, Brief for Petitioner 50-54:

• Presumably some debtors whose income has only recently been reduced, or who have just received a jolt that causes a temporary uptick in their average income, can delay filing a Chapter 13 petition until their "current monthly income" catches up with their present circumstances. The Court speculates that delay might "giv[e] the appearance of bad faith," *ante,* at 2476 (citing § 1325(a)(7)), but it offers no explanation of why that is so, and no authority supporting it.[FN4]

FN4. Neither of the two Court of Appeals cases the Court cites- *In re Myers,* 491 F.3d 120, 125 (C.A.3 2007), and *Neufeld v. Freeman,* 794 F.2d 149, 153 (C.A.4 1986)-involved a debtor's delaying his petition until his circumstances would permit the court to confirm a repayment plan.

• Even if bad faith were a real worry, or if it were essential to a debtor's prospects that he invoke § 362's automatic stay immediately, the debtor might ask the bankruptcy court to excuse him from filing a statement of current income, so that it determines his "currently monthly income" at a later date. See § 101(10A)(A)(ii). The Court dismisses this alternative, explaining that if the Code requires a mechanical approach this solution would "improperly undermine" it, and if the Code allows exceptions for changed circumstances the solution is unnecessary. *Ante,* at 2476 - 2477. The second premise is correct, but the first is not. Congress does not pursue its purposes at all costs. *Rodriguez v. United States,* 480 U.S. 522, 525-526, 107 S.Ct. 1391, 94 L.Ed.2d 533 (1987) *(per curiam).* Here it may have struck the very balance the

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Court thinks critical by creating a fixed formula but leaving leeway as to the time to which it applies.[FN5]

FN5. The Court observes that not every debtor will benefit from this exception, *ante,* at 2476 - 2477, and n. 6, since § 521(i)(3) provides that a bankruptcy court may not grant a request (which may be made *after* the deadline for filing the current-income schedule) for an extension of more than 45 days to file such a schedule. But the statute appears to assume that a court may excuse the filing of such a schedule altogether: A debtor is required to file a schedule in the first instance "*unless* the court orders otherwise," § 521(a)(1)(B) (emphasis added). And § 101(10A)(A)(ii)'s provision of a method for calculating current monthly income "if the debtor does not file the schedule of current income required by section 521(a)(1)(B)(ii)" makes little sense unless a court can excuse the failure to do so, since an *unexcused* failure to do so would be a basis for dismissing the case, see § 521(i). Allowing courts to excuse such schedules does not render superfluous § 521(i)(3)'s authorization for limited extensions, since that applies to extensions sought up to 45 days *after* the filing deadline, whereas § 521(a)(1)(B) seems to apply only *before* the deadline.

***2484** • A debtor who learns after filing that he will be unable to repay his full projected disposable income might also be able to dismiss his case and refile it later. § 1307(b). The Court worries that this alternative also might be deemed abusive, again with no pertinent authority for the speculation.[FN6] Its concern is based primarily on its belief that this "circumvents the statutory limits on a court's ability to shift the look-back period." *Ante,* at 2477. That belief is mistaken, both because the Court exaggerates the statutory limitations on adjusting the look-back period, and because, just as it does not defeat the disposable-income formula's rigidity to allow adjustments regarding the time of determining that figure, it would not undermine the limitations on adjustment applicable in a pending case to allow the debtor to dismiss and refile.[FN7]

FN6. The sole authority the Court supplies-a single Bankruptcy Court decision predating BAPCPA-provides no support. See *In re Glenn,* 288 B.R. 516, 519-521 (Bkrtcy.E.D.Tenn.2002). Although acknowledging that "[m]ultiple filings by a debtor are not, in and of themselves, improper," the court did note that "whether this is the first or subsequent filin[g]" by the debtor is one among the "totality of the circumstances" to be considered in a good-faith analysis. *Id.,* at 520 (internal quotation marks omitted). The debtor in the case at hand had filed three previous Chapter 13 petitions, "each on the eve of a scheduled foreclosure," and according to the court "never had any intention of following through with any of the Chapter 13 cases," but had used the bankruptcy process "to hold [his creditor] hostage, while remaining in his residence without paying for it." *Id.,* at 520-521.

FN7. The Court also notes that the Code precludes a debtor who has had a case pending in the last 180 days from refiling if his prior case was dismissed because he willfully failed to obey the court's orders or to appear before the court, § 109(g)(1), or if he voluntarily dismissed the prior suit "following the filing of a request for relief from the automatic stay" under § 362, § 109(g)(2). *Ante,* at 2477, n. 7. But the Court does not explain why these barriers have any bearing on whether refiling for bankruptcy would be abusive when the barriers *do not apply.*

• A debtor unable to pursue any of these avenues to Chapter 13 might still seek relief under Chapter 7. The Court declares this cold comfort, noting that some debtors-including **Lanning**-will have incomes *too high* to qualify for Chapter 7. *Ante,* at 2477 - 2478. Some such debtors, however, may be able to show "special circumstances," § 707(b)(2)(B), and still take advantage of Chapter 7. Aside from noting the absence of authority on the issue, the Court's answer is unsatisfyingly circular: It notes that the special-circumstances exception is available only if the debtor has "no reasonable alternative," § 707(b)(2)(B)(i), which will not be true after today given the Court's holding that bankruptcy courts can consider changes in a debtor's income. As for those who cannot establish special circumstances, it is hard to understand why there is cause for concern. Con-

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gress has evidently concluded that such debtors do not need the last-ditch relief of liquidation, and that they are not suitable candidates for repaying their debts (at least in part) under Chapter 13's ***2485** protective umbrella. We have neither reason nor warrant to second-guess either determination.

* * *

Underlying the Court's interpretation is an understandable urge: Sometimes the best reading of a text yields results that one thinks must be a mistake, and bending that reading just a little bit will allow all the pieces to fit together. But taking liberties with text in light of outcome makes sense only if we assume that we know better than Congress which outcomes are mistaken. And by refusing to hold that Congress meant what it said, but see *Connecticut Nat. Bank v. Germain*, 503 U.S. 249, 253-254, 112 S.Ct. 1146, 117 L.Ed.2d 391 (1992), we deprive it of the ability to say what it means in the future. It may be that no interpretation of § 1325(b)(1)(B) is entirely satisfying. But it is in the hard cases, even more than the easy ones, that we should faithfully apply our settled interpretive principles, and trust that Congress will correct the law if what it previously prescribed is wrong.

I respectfully dissent.

U.S.,2010.
Hamilton v. Lanning
130 S.Ct. 2464, 177 L.Ed.2d 23, 78 USLW 4518, Bankr. L. Rep. P 81,780, 10 Cal. Daily Op. Serv. 6973, 2010 Daily Journal D.A.R. 8299, 22 Fla. L. Weekly Fed. S 427

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H

Supreme Court of the United States
Jason M. RANSOM, Petitioner
v.
FIA CARD SERVICES, N.A., fka MBNA America Bank, N.A.

No. 09-907.
Argued Oct. 4, 2010.
Decided Jan. 11, 2011.

Background: Unsecured creditor objected to confirmation of above-median-income Chapter 13 debtor's proposed plan as not satisfying the Bankruptcy Code's "projected disposable income" requirement. The United States Bankruptcy Court for the District of Nevada, Bruce A. Markell, J., entered order sustaining creditor's objection, and debtor appealed. The Bankruptcy Appellate Panel (BAP), Dunn, J., 380 B.R. 799, affirmed, and debtor appealed. The Court of Appeals for the Ninth Circuit, Trott, Circuit Judge, 577 F.3d 1026, affirmed. Certiorari was granted.

Holdings: The Supreme Court, Justice Kagan, held that:
(1) a debtor who does not make loan or lease payments may not take the car-ownership deduction in calculating his projected disposable income under the means test, abrogating *In re Washburn*, 579 F.3d 934, *In re Tate*, 571 F.3d 423, and *In re Ross-Tousey*, 549 F.3d 1148, and
(2) the car-ownership category encompasses the costs of a car loan or lease and nothing more.

Affirmed.

Justice Scalia filed a dissenting opinion.

West Headnotes

[1] Bankruptcy 51 ⚷2022

51 Bankruptcy
51I In General
51I(B) Constitutional and Statutory Provisions
51k2021 Construction and Operation
51k2022 k. Purpose. Most Cited Cases

Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) to correct perceived abuses of the bankruptcy system.

[2] Bankruptcy 51 ⚷2264(1)

51 Bankruptcy
51III The Case
51III(C) Voluntary Cases
51k2259 Dismissal
51k2264 Proceedings; Motion or Sua Sponte Action
51k2264(1) k. In general. Most Cited Cases

Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

In enacting the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), Congress adopted the means test to help ensure that debtors who can pay creditors do pay them. 11 U.S.C.A. §§ 707(b)(2), 1325(b).

[3] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

Bankruptcy 51 ⚷3713

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3713 k. Time for completion; extension or modification. Most Cited Cases

In Chapter 13 proceedings, the "means test" provides a formula to calculate a debtor's projected disposable in-

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come, which the debtor must devote to reimbursing creditors under a court-approved plan generally lasting from three to five years. 11 U.S.C.A. § 1325(b)(1)(B), (b)(4).

[4] Bankruptcy 51 ⚷2251

51 Bankruptcy
51III The Case
51III(C) Voluntary Cases
51k2251 k. In general. Most Cited Cases

Bankruptcy 51 ⚷3441

51 Bankruptcy
51XI Liquidation, Distribution, and Closing
51k3441 k. In general. Most Cited Cases

Individuals who file for bankruptcy relief under Chapter 7 liquidate their nonexempt assets, rather than dedicate their future income, to repay creditors. 11 U.S.C.A. §§ 704(a)(1), 726.

[5] Bankruptcy 51 ⚷2264(1)

51 Bankruptcy
51III The Case
51III(C) Voluntary Cases
51k2259 Dismissal
51k2264 Proceedings; Motion or Sua Sponte Action
51k2264(1) k. In general. Most Cited Cases

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. 11 U.S.C.A. § 707(b)(2)(A)(i).

[6] Bankruptcy 51 ⚷2264(1)

51 Bankruptcy
51III The Case
51III(C) Voluntary Cases
51k2259 Dismissal
51k2264 Proceedings; Motion or Sua Sponte Action
51k2264(1) k. In general. Most Cited Cases

Bankruptcy 51 ⚷2332

51 Bankruptcy
51III The Case
51III(G) Conversion
51k2332 k. Conversion to debt adjustment. Most Cited Cases

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. 11 U.S.C.A. § 707(b)(1).

[7] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

Under the Bankruptcy Code, a Chapter 13 debtor's "disposable income" is "current monthly income" less "amounts reasonably necessary to be expended" for "maintenance or support," business expenditures, and certain charitable contributions. 11 U.S.C.A. § 1325(b)(2)(A)(i, ii).

[8] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

For a Chapter 13 debtor whose income is above the median for his state, the means test identifies which expenses qualify as "amounts reasonably necessary to be expended," thereby supplanting the pre-Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) practice of calculating debtors' reasonable expenses on a case-by-case basis, which led to varying and often inconsistent determinations. 11 U.S.C.A. §§ 707(b)(2), 1325(b).

[9] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan

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51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

Under the means test, an above-median-income Chapter 13 debtor calculating his "reasonably necessary" expenses is directed to claim allowances for defined living expenses, as well as for secured and priority debt. 11 U.S.C.A. §§ 707(b)(2)(A)(ii-iv), 1325(b).

[10] Bankruptcy 51 ⚷2021.1

51 Bankruptcy
51I In General
51I(B) Constitutional and Statutory Provisions
51k2021 Construction and Operation
51k2021.1 k. In general. Most Cited Cases

Court's interpretation of the Bankruptcy Code starts where all such inquiries must begin: with the language of the statute itself.

[11] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

Above-median-income Chapter 13 debtor who does not make loan or lease payments may not take the car-ownership deduction in calculating the projected disposable income that must be devoted to the payment of unsecured creditors, in order for the bankruptcy court to confirm, over an unsecured creditor's objection, a plan that provides for less than a 100% dividend on unsecured claims; abrogating *In re Washburn*, 579 F.3d 934, *In re Tate*, 571 F.3d 423, and *In re Ross-Tousey*, 549 F.3d 1148. 11 U.S.C.A. §§ 707(b)(2)(A)(ii)(I), 1325(b).

[12] Bankruptcy 51 ⚷2021.1

51 Bankruptcy
51I In General
51I(B) Constitutional and Statutory Provisions
51k2021 Construction and Operation
51k2021.1 k. In general. Most Cited Cases

Where the Bankruptcy Code does not define a term, courts look to the ordinary meaning of the term.

[13] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

Expense amount is "applicable," within the plain meaning of the section of the Bankruptcy Code setting forth the "means test" used in calculating a debtor's projected disposable income, when it is appropriate, relevant, suitable, or fit. 11 U.S.C.A. §§ 707(b)(2)(A)(ii)(I), 1325(b).

[14] Statutes 361 ⚷206

361 Statutes
361VI Construction and Operation
361VI(A) General Rules of Construction
361k204 Statute as a Whole, and Intrinsic Aids to Construction
361k206 k. Giving effect to entire statute. Most Cited Cases

Each word in a statute should carry meaning.

[15] Bankruptcy 51 ⚷2264(1)

51 Bankruptcy
51III The Case
51III(C) Voluntary Cases
51k2259 Dismissal
51k2264 Proceedings; Motion or Sua Sponte Action
51k2264(1) k. In general. Most Cited Cases

Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

Congress intended the means test to approximate the debtor's reasonable expenditures on essential items. 11

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U.S.C.A. §§ 707(b)(2), 1325(b).

[16] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

Because the means test does not apply to Chapter 13 debtors whose incomes are below the median, those debtors must prove on a case-by-case basis that each claimed expense is reasonably necessary. 11 U.S.C.A. §§ 707(b)(2), 1325(b)(2), (3).

[17] Bankruptcy 51 ⚷2264(1)

51 Bankruptcy
51III The Case
51III(C) Voluntary Cases
51k2259 Dismissal
51k2264 Proceedings; Motion or Sua Sponte Action
51k2264(1) k. In general. Most Cited Cases

Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

Congress designed the means test to measure debtors' disposable income and, in that way, to ensure that debtors repay creditors the maximum they can afford. 11 U.S.C.A. §§ 707(b)(2), 1325(b).

[18] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

For purposes of the means test used in calculating a debtor's projected disposable income, the car-ownership category of the Internal Revenue Service's (IRS's) Local Standards encompasses the costs of a car loan or lease and nothing more. 11 U.S.C.A. §§ 707(b)(2)(A)(ii)(I), 1325(b).

[19] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

For purposes of the means test used in calculating a debtor's projected disposable income, the operating-costs category of the Internal Revenue Service's (IRS's) Local Standards includes payments for vehicle insurance, maintenance, fuel, state and local registration, required inspection, parking fees, tolls, and driver's license. 11 U.S.C.A. §§ 707(b)(2)(A)(ii)(I), 1325(b).

[20] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

For purposes of the means test used in calculating a debtor's projected disposable income, taxes associated with car ownership are categorized by the Internal Revenue Service (IRS) as an "Other Necessary Expens[e]," for which a debtor may take a deduction. 11 U.S.C.A. §§ 707(b)(2)(A)(ii)(I), 1325(b).

[21] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

For purposes of the means test used in calculating a debtor's projected disposable income, a debtor who owns a car free and clear is entitled to claim the "Operating Costs" deduction for all the expenses of driving, even though such a person is not entitled to claim the "Ownership Costs" deduction. 11 U.S.C.A. §§ 707(b)(2)(A)(ii)(I), 1325(b)(2).

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[22] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

Although the Bankruptcy Code does not incorporate the Internal Revenue Service's (IRS's) Collection Financial Standards, that is, the explanatory guidelines to the IRS's National and Local Standards tables, courts may consult the guidelines in interpreting the Standards, for purposes of the means test used in calculating a debtor's projected disposable income, though the guidelines cannot control if they are at odds with the statutory language. 11 U.S.C.A. §§ 707(b)(2)(A)(ii)(I), 1325(b).

[23] Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

For purposes of the means test used in calculating a debtor's projected disposable income, if a debtor's actual expenses exceed the amounts listed in the Internal Revenue Service's (IRS's) National and Local Standards tables, the debtor may claim an allowance only for the specified sum, rather than for his real expenditures, while for the Other Necessary Expense categories, the debtor may deduct his actual expenses, no matter how high they are. 11 U.S.C.A. §§ 707(b)(2)(A)(ii)(I), 1325(b).

[24] Bankruptcy 51 ⚷3713

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3713 k. Time for completion; extension or modification. Most Cited Cases

If a Chapter 13 debtor's car payments cease during the life of the plan, just as if other financial circumstances change, an unsecured creditor may move to modify the plan to increase the amount the debtor must repay. 11 U.S.C.A. § 1329(a)(1).

[25] Bankruptcy 51 ⚷2264(1)

51 Bankruptcy
51III The Case
51III(C) Voluntary Cases
51k2259 Dismissal
51k2264 Proceedings; Motion or Sua Sponte Action
51k2264(1) k. In general. Most Cited Cases

Bankruptcy 51 ⚷3705

51 Bankruptcy
51XVIII Individual Debt Adjustment
51k3704 Plan
51k3705 k. Claims and assets; propriety and feasibility in general. Most Cited Cases

Bankruptcy Code's means test deductions serve merely to ensure that debtors in bankruptcy can afford essential items. 11 U.S.C.A. §§ 707(b)(2)(A)(ii)(I), 1325(b).

**719 Syllabus* [FN*]

FN* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 50 L.Ed. 499.

Chapter 13 of the Bankruptcy Code uses a statutory formula known as the "means test" to help ensure that debtors who *can* pay creditors *do* pay them. The means test instructs a debtor to determine his "disposable income"-the amount he has available to reimburse creditors-by deducting from his current monthly income "amounts reasonably necessary to be expended" for, *inter alia,* "maintenance or support." 11 U.S.C. § 1325(b)(2)(A)(i). For a debtor whose income is above the median for his State, the means test indentifies which expenses qualify as "amounts reasonably necessary to be expended." As relevant here, the statute provides that "[t]he debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued

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by the Internal Revenue Service [IRS] for the area in which the debtor resides." § 707(b)(2)(A)(ii)(I).

The Standards are tables listing standardized expense amounts for basic necessities, which the IRS prepares to help calculate taxpayers' ability to pay overdue taxes. The IRS also creates supplemental guidelines known as the "Collection Financial Standards," which describe how to use the tables and what the amounts listed in them mean. The Local Standards include an allowance for transportation expenses, divided into vehicle "Ownership Costs" and vehicle "Operating Costs." The Collection Financial Standards explain that "Ownership Costs" cover monthly loan or lease payments on an automobile; the expense amounts listed are based on nationwide car financing data. The Collection Financial Standards further state that a taxpayer who has no car payment may not claim an allowance for ownership costs.

When petitioner Ransom filed for Chapter 13 bankruptcy relief, he listed respondent (FIA) as an unsecured creditor. Among his assets, Ransom reported a car that he owns free of any debt. In determining his monthly expenses, he nonetheless claimed a car-ownership deduction of $471, the full amount specified in the "Ownership Costs" table, as well as a separate $388 deduction for car-operating costs. Based on his means-test calculations, **Ransom** proposed a bankruptcy plan that would result in repayment of approximately 25% of his unsecured debt. FIA objected on the ground that the plan did not direct all of **Ransom's** disposable income to unsecured creditors. FIA contended that **Ransom** should not have claimed the car-ownership allowance because he does not make loan or lease payments on his car. Agreeing, the Bankruptcy Court denied confirmation of the plan. The Ninth Circuit Bankruptcy Appellate Panel and the Ninth Circuit affirmed.

Held: A debtor who does not make loan or lease payments may not take the car-ownership deduction. Pp. 723 - 730.

(a) This Court's interpretation begins with the language of the Bankruptcy Code, which provides that a debtor may claim only "applicable" expense amounts listed in the Standards. Because the Code does not define the key word "applicable," the term carries its ordinary meaning of appropriate, relevant, suitable, or fit. What makes an expense amount "applicable" in ***720** this sense is most naturally understood to be its correspondence to an individual debtor's financial circumstances. Congress established a filter, permitting a debtor to claim a deduction from a National or Local Standard table only if that deduction is appropriate for him. And a deduction is so appropriate only if the debtor will incur the kind of expense covered by the table during the life of the plan. Had Congress not wanted to separate debtors who qualify for an allowance from those who do not, it could have omitted the term "applicable" altogether. Without that word, all debtors would be eligible to claim a deduction for each category listed in the Standards. Interpreting the statute to require a threshold eligibility determination thus ensures that "applicable" carries meaning, as each word in a statute should.

This reading draws support from the statute's context and purpose. The Code initially defines a debtor's disposable income as his "current monthly income ... less amounts reasonably necessary to be expended." § 1325(b)(2). It then instructs that such reasonably necessary amounts "shall be determined in accordance with" the means test. § 1325(b)(3). Because Congress intended the means test to approximate the debtor's reasonable expenditures on essential items, a debtor should be required to qualify for a deduction by actually incurring an expense in the relevant category. Further, the statute's purpose-to ensure that debtors pay creditors the maximum they can afford-is best achieved by interpreting the means test, consistent with the statutory text, to reflect a debtor's ability to afford repayment. Pp. 723 - 725.

(b) The vehicle-ownership category covers only the costs of a car loan or lease. The expense amount listed ($471) is the average monthly payment for loans and leases nationwide; it is not intended to estimate other conceivable expenses associated with maintaining a car. Maintenance expenses are the province of the separate "Operating Costs" deduction. A person who owns a car free and clear is entitled to the "Operating Costs" deduction for all driving-related expenses. But such a person may not claim the "Ownership Costs" deduction, because that allowance is for the separate costs of a car loan or lease. The IRS' Collection Financial Standards reinforce this conclusion by making clear that individuals who have a car but make no loan or lease payments may take only the operating-costs deduction. Because Ransom owns his vehicle outright, he incurs no expense in the "Ownership Costs" category, and that expense amount is therefore not "applicable" to him. Pp. 725 - 726.

(c) Ransom's arguments to the contrary-an alternative interpretation of the key word "applicable," an objection to the Court's view of the scope of the "Ownership Costs"

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category, and a criticism of the policy implications of the Court's approach-are unpersuasive. Pp. 726 - 730.

577 F.3d 1026, affirmed.

KAGAN, J., delivered the opinion of the Court, in which ROBERTS, C.J., and KENNEDY, THOMAS, GINSBURG, BREYER, ALITO, and SOTOMAYOR, JJ., joined. SCALIA, J., filed a dissenting opinion.
Christopher P. Burke, Las Vegas, NV, Daniel Lucid, Santa Monica, CA, for Petitioner.

Deanne E. Maynard, Seth M. Galanter, Marc A. Hearron, Morrison & Foerster LLP, Washington, DC, Mark P. Ladner, Larren M. Nashelsky, Morrison & Foerster LLP, New York City, ***721**Gilbert B. Weisman. John D. Sheehan, William Andrew McNeal, Becket & Lee LLP, Malvern, PA, for Respondent.

Nicole A. Saharsky, Washington, DC, for United States as amicus curiae, by special leave of the Court, supporting the respondent.

For U.S. Supreme Court Briefs, see:2010 WL 3167315 (Resp.Brief)2010 WL 3518666 (Reply.Brief)

Justice KAGAN delivered the opinion of the Court.

Chapter 13 of the Bankruptcy Code enables an individual to obtain a discharge of his debts if he pays his creditors a portion of his monthly income in accordance with a court-approved plan. 11 U.S.C. § 1301 *et seq.* To determine how much income the debtor is capable of paying, Chapter 13 uses a statutory formula known as the "means test." §§ 707(b)(2) (2006 ed. and Supp. III), 1325(b)(3)(A) (2006 ed.). The means test instructs a debtor to deduct specified expenses from his current monthly income. The result is his "disposable income"-the amount he has available to reimburse creditors. § 1325(b)(2).

This case concerns the specified expense for vehicle-ownership costs. We must determine whether a debtor like petitioner Jason Ransom who owns his car outright, and so does not make loan or lease payments, may claim an allowance for car-ownership costs (thereby reducing the amount he will repay creditors). We hold that the text, context, and purpose of the statutory provision at issue preclude this result. A debtor who does not make loan or lease payments may not take the car-ownership deduction.

I

A

[1][2] "Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA or Act) to correct perceived abuses of the bankruptcy system." *Milavetz, Gallop & Milavetz, P.A. v. United States,* 559 U.S. ----, ----, 130 S.Ct. 1324, 1329, 176 L.Ed.2d 79 (2010). In particular, Congress adopted the means test-"[t]he heart of [BAPCPA's] consumer bankruptcy reforms," H.R.Rep. No. 109-31, pt. 1, p. 2 (2005) (hereinafter H.R. Rep.), and the home of the statutory language at issue here-to help ensure that debtors who *can* pay creditors *do* pay them. See, *e.g., ibid.* (under BAPCPA, "debtors [will] repay creditors the maximum they can afford").

[3][4][5][6][7][8] In Chapter 13 proceedings, the means test provides a formula to calculate a debtor's disposable income, which the debtor must devote to reimbursing creditors under a court-approved plan generally lasting from three to five years. §§ 1325(b)(1)(B) and (b)(4).[FN1] The statute defines "disposable income" as "current monthly income" less "amounts reasonably necessary to be expended" for "maintenance or support," business expenditures, and certain charitable contributions. §§ 1325(b)(2)(A)(i) and (ii). For a debtor whose income is above the median for his State, the means test identifies which expenses***722** qualify as "amounts reasonably necessary to be expended." The test supplants the pre-BAPCPA practice of calculating debtors' reasonable expenses on a case-by-case basis, which led to varying and often inconsistent determinations. See, *e.g., In re Slusher,* 359 B.R. 290, 294 (Bkrtcy.Ct.Nev.2007).

FN1. Chapter 13 borrows the means test from Chapter 7, where it is used as a screening mechanism to determine whether a Chapter 7 proceeding is appropriate. Individuals who file for bankruptcy relief under Chapter 7 liquidate their nonexempt assets, rather than dedicate their future income, to repay creditors. See 11 U.S.C. §§ 704(a)(1), 726. If the debtor's Chapter 7 petition discloses that his disposable income as calculated by the means test exceeds a certain threshold, the petition is presumptively abusive. § 707(b)(2)(A)(i). If the debtor cannot rebut the presumption, the court may dismiss the case or, with the debtor's consent, convert it into a Chapter 13 proceeding. § 707(b)(1).

[9] Under the means test, a debtor calculating his "reasonably necessary" expenses is directed to claim al-

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lowances for defined living expenses, as well as for secured and priority debt. §§ 707(b)(2)(A)(ii)-(iv). As relevant here, the statute provides:

> "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 [IRS] for the area in which the debtor resides." § 707(b)(2)(A)(ii)(I).

These are the principal amounts that the debtor can claim as his reasonable living expenses and thereby shield from creditors.

The National and Local Standards referenced in this provision are tables that the IRS prepares listing standardized expense amounts for basic necessities. [FN2] The IRS uses the Standards to help calculate taxpayers' ability to pay overdue taxes. See 26 U.S.C. § 7122(d)(2). The IRS also prepares supplemental guidelines known as the Collection Financial Standards, which describe how to use the tables and what the amounts listed in them mean.

FN2. The National Standards designate allowances for six categories of expenses: (1) food; (2) housekeeping supplies; (3) apparel and services; (4) personal care products and services; (5) out-of-pocket health care costs; and (6) miscellaneous expenses. Internal Revenue Manual § 5.15.1.8 (Oct. 2, 2009), http:// www. irs. gov/ irm/ part 5/ irm_ 05- 015- 001. html# d0e1012 (all Internet materials as visited Jan. 7, 2011, and available in Clerk of Court's case file). The Local Standards authorize deductions for two kinds of expenses: (1) housing and utilities; and (2) transportation. *Id.*, § 5.15.1.9.

The Local Standards include an allowance for transportation expenses, divided into vehicle "Ownership Costs" and vehicle "Operating Costs." [FN3] At the time Ransom filed for bankruptcy, the "Ownership Costs" table appeared as follows:

FN3. Although both components of the transportation allowance are listed in the Local Standards, only the operating-cost expense amounts vary by geography; in contrast, the IRS provides a nationwide figure for ownership costs.

	Ownership Costs	
	First Car	**Second Car**
National	$471	$332

App. to Brief for Respondent 5a. The Collection Financial Standards explain that these ownership costs represent "nationwide figures for monthly loan or lease payments," *id.*, at 2a; the numerical amounts listed are "base[d] ... on the five-year average of new and used car financing data compiled by the Federal Reserve Board," *id.*, at 3a. The Collection Financial Standards further instruct that, in the tax-collection context, "[i]f a taxpayer has no car payment, ... only the operating costs portion of the transportation standard is used to come up with the allowable transportation expense." *Ibid.*

B

Ransom filed for Chapter 13 bankruptcy relief in July 2006. App. 1, 54. Among his liabilities, **Ransom** itemized over $82,500 in unsecured debt, including a claim held by respondent FIA Card Services,* N.A. (FIA). *Id.*, at 41. Among his assets, **Ransom** listed a 2004 Toyota Camry, valued at $14,000, which he owns free of any debt. *Id.*, at 38, 49, 52.

For purposes of the means test, **Ransom** reported income of $4,248.56 per month. *Id.*, at 46. He also listed monthly expenses totaling $4,038.01. *Id.*, at 53. In determining those expenses, **Ransom** claimed a car-ownership deduction of $471 for the Camry, the full amount specified in the IRS's "Ownership Costs" table. *Id.*, at 49. **Ransom** listed a separate deduction of $338 for car-operating costs. *Ibid.* Based on these figures, **Ransom** had disposable income of $210.55 per month. *Id.*, at 53.

Ransom proposed a 5-year plan that would result in repayment of approximately 25% of his unsecured debt. *Id.*, at 55. FIA objected to confirmation of the plan on the ground that it did not direct all of **Ransom's** disposable income to unsecured creditors. *Id.*, at 64. In particular, FIA argued that **Ransom** should not have claimed the car-ownership allowance because he does not make loan or lease payments on his car. *Id.*, at 67. FIA noted that without

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this allowance, **Ransom's** disposable income would be $681.55-the $210.55 he reported plus the $471 he deducted for vehicle ownership. *Id.*, at 71. The difference over the 60 months of the plan amounts to about $28,000.

C

The Bankruptcy Court denied confirmation of **Ransom's** plan. App. to Pet. for Cert. 48. The court held that **Ransom** could deduct a vehicle-ownership expense only "if he is currently making loan or lease payments on that vehicle." *Id.*, at 41.

Ransom appealed to the Ninth Circuit Bankruptcy Appellate Panel, which affirmed. *In re Ransom*, 380 B.R. 799, 808-809 (2007). The panel reasoned that an "expense [amount] becomes relevant to the debtor (i.e., appropriate or applicable to the debtor) when he or she in fact has such an expense." *Id.*, at 807. "[W]hat is important," the panel noted, "is the payments that debtors actually make, not how many cars they own, because [those] payments ... are what actually affect their ability to" reimburse unsecured creditors. *Ibid.*

The United States Court of Appeals for the Ninth Circuit affirmed. *In re Ransom*, 577 F.3d 1026, 1027 (2009). The plain language of the statute, the court held, "does not allow a debtor to deduct an 'ownership cost' ... that the debtor does not have." *Id.*, at 1030. The court observed that "[a]n 'ownership cost' is not an 'expense'-either actual or applicable-if it does not exist, period." *Ibid.*

We granted a writ of certiorari to resolve a split of authority over whether a debtor who does not make loan or lease payments on his car may claim the deduction for vehicle-ownership costs. 559 U.S. ----, 130 S.Ct. 2097, 176 L.Ed.2d 721 (2010).[FN4] We now affirm the Ninth Circuit's judgment.

FN4. Compare *In re Ransom*, 577 F.3d 1026, 1027 (C.A.9 2009) (case below), with *In re Washburn*, 579 F.3d 934, 935 (C.A.8 2009) (permitting the allowance), *In re Tate*, 571 F.3d 423, 424 (C.A.5 2009) (same), and *In re Ross-Tousey*, 549 F.3d 1148, 1162 (C.A.7 2008) (same). The question has also divided bankruptcy courts. See, *e.g.*, *In re Canales*, 377 B.R. 658, 662 (Bkrtcy.Ct.C.D.Cal.2007) (citing dozens of cases reaching opposing results).

II

[10][11] Our interpretation of the Bankruptcy Code starts "where all such inquiries must begin: with the language of the statute itself." ***724***United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241, 109 S.Ct. 1026, 103 L.Ed.2d 290 (1989). As noted, the provision of the Code central to the decision of this case 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 [IRS] for the area in which the debtor resides." § 707(b)(2)(A)(ii)(I).

The key word in this provision is "applicable": A debtor may claim not all, but only "applicable" expense amounts listed in the Standards. Whether Ransom may claim the $471 car-ownership deduction accordingly turns on whether that expense amount is "applicable" to him.

[12][13] Because the Code does not define "applicable," we look to the ordinary meaning of the term. See, *e.g.*, *Hamilton v. Lanning*, 560 U.S. ----, ----, 130 S.Ct. 2464, 2471, 177 L.Ed.2d 23 (2010). "Applicable" means "capable of being applied: having relevance" or "fit, suitable, or right to be applied: appropriate." Webster's Third New International Dictionary 105 (2002). See also New Oxford American Dictionary 74 (2d ed.2005) ("relevant or appropriate"); 1 Oxford English Dictionary 575 (2d ed.1989) ("[c]apable of being applied" or "[f]it or suitable for its purpose, appropriate"). So an expense amount is "applicable" within the plain meaning of the statute when it is appropriate, relevant, suitable, or fit.

What makes an expense amount "applicable" in this sense (appropriate, relevant, suitable, or fit) is most naturally understood to be its correspondence to an individual debtor's financial circumstances. Rather than authorizing all debtors to take deductions in all listed categories, Congress established a filter: A debtor may claim a deduction from a National or Local Standard table (like "[Car] Ownership Costs") if but only if that deduction is appropriate for him. And a deduction is so appropriate only if the debtor has costs corresponding to the category covered by the table-that is, only if the debtor will incur that kind of expense during the life of the plan. The statute underscores the necessity of making such an individualized determination by referring to "*the debtor's* applicable monthly expense amounts," § 707(b)(2)(A)(ii)(I) (emphasis added)-in other words, the expense amounts applicable (appropriate, etc.) to each particular debtor. Identifying

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these amounts requires looking at the financial situation of the debtor and asking whether a National or Local Standard table is relevant to him.

[14] If Congress had not wanted to separate in this way debtors who qualify for an allowance from those who do not, it could have omitted the term "applicable" altogether. Without that word, all debtors would be eligible to claim a deduction for each category listed in the Standards. Congress presumably included "applicable" to achieve a different result. See *Leocal v. Ashcroft*, 543 U.S. 1, 12, 125 S.Ct. 377, 160 L.Ed.2d 271 (2004) ("[W]e must give effect to every word of a statute wherever possible"). Interpreting the statute to require a threshold determination of eligibility ensures that the term "applicable" carries meaning, as each word in a statute should.

[15][16] This reading of "applicable" also draws support from the statutory context. The Code initially defines a debtor's disposable income as his "current monthly income ... less amounts *reasonably necessary to be expended*." § 1325(b)(2) (emphasis added). The statute then instructs that "[a]mounts reasonably necessary to be expended ... shall be determined in accordance***725** with" the means test. § 1325(b)(3). Because Congress intended the means test to approximate the debtor's reasonable expenditures on essential items, a debtor should be required to qualify for a deduction by actually incurring an expense in the relevant category. If a debtor will not have a particular kind of expense during his plan, an allowance to cover that cost is not "reasonably necessary" within the meaning of the statute.[FN5]

> FN5. This interpretation also avoids the anomalous result of granting preferential treatment to individuals with above-median income. Because the means test does not apply to Chapter 13 debtors whose incomes are below the median, those debtors must prove on a case-by-case basis that each claimed expense is reasonably necessary. See §§ 1325(b)(2) and (3). If a below-median-income debtor cannot take a deduction for a nonexistent expense, we doubt Congress meant to provide such an allowance to an above-median-income debtor-the very kind of debtor whose perceived abuse of the bankruptcy system inspired Congress to enact the means test.

[17] Finally, consideration of BAPCPA's purpose strengthens our reading of the term "applicable." Congress designed the means test to measure debtors' disposable income and, in that way, "to ensure that [they] repay creditors the maximum they can afford." H.R. Rep., at 2. This purpose is best achieved by interpreting the means test, consistent with the statutory text, to reflect a debtor's ability to afford repayment. Cf. *Hamilton*, 560 U.S., at ----, 130 S.Ct., at 2475-2476 (rejecting an interpretation of the Bankruptcy Code that "would produce [the] senseless resul[t]" of "deny[ing] creditors payments that the debtor could easily make"). Requiring a debtor to incur the kind of expenses for which he claims a means-test deduction thus advances BAPCPA's objectives.

Because we conclude that a person cannot claim an allowance for vehicle-ownership costs unless he has some expense falling within that category, the question in this case becomes: What expenses does the vehicle-ownership category cover? If it covers loan and lease payments alone, Ransom does not qualify, because he has no such expense. Only if that category also covers other costs associated with having a car would Ransom be entitled to this deduction.

[18][19][20][21] The less inclusive understanding is the right one: The ownership category encompasses the costs of a car loan or lease and nothing more. As noted earlier, the numerical amounts listed in the "Ownership Costs" table are "base[d] ... on the five-year average of new and used car financing data compiled by the Federal Reserve Board." App. to Brief for Respondent 3a. In other words, the sum $471 is the average monthly payment for loans and leases nationwide; it is not intended to estimate other conceivable expenses associated with maintaining a car. The Standards do account for those additional expenses, but in a different way: They are mainly the province of the separate deduction for vehicle "Operating Costs," which include payments for "[v]ehicle insurance, ... maintenance, fuel, state and local registration, required inspection, parking fees, tolls, [and] driver's license." Internal Revenue Manual §§ 5.15.1.7 and 5.15.1.8 (May 1, 2004), reprinted in App. to Brief for Respondent 16a, 20a; see also IRS, Collection Financial Standards (Feb. 19, 2010), http:// www. irs. gov/ individuals/ article/ 0,, id= 96543, 00. html. [FN6] A person who owns a car free and clear is entitled to ***726** claim the "Operating Costs" deduction for all these expenses of driving-and Ransom in fact did so, to the tune of $338. But such a person is not entitled to claim the "Ownership Costs" deduction, because that allowance is for the separate costs of a car loan or lease.

> FN6. In addition, the IRS has categorized taxes,

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including those associated with car ownership, as an "Other Necessary Expens[e]," for which a debtor may take a deduction. See App. to Brief for Respondent 26a; Brief for United States as *Amicus Curiae* 16, n. 4.

[22] The Collection Financial Standards-the IRS's explanatory guidelines to the National and Local Standards-explicitly recognize this distinction between ownership and operating costs, making clear that individuals who have a car but make no loan or lease payments may claim only the operating allowance. App. to Brief for Respondent 3a; see *supra,* at 722. Although the statute does not incorporate the IRS's guidelines, courts may consult this material in interpreting the National and Local Standards; after all, the IRS uses those tables for a similar purpose-to determine how much money a delinquent taxpayer can afford to pay the Government. The guidelines of course cannot control if they are at odds with the statutory language. But here, the Collection Financial Standards' treatment of the car-ownership deduction reinforces our conclusion that, under the statute, a debtor seeking to claim this deduction must make some loan or lease payments.[FN7]

FN7. Because the dissent appears to misunderstand our use of the Collection Financial Standards, and because it may be important for future cases to be clear on this point, we emphasize again that the statute does not "incorporat[e]" or otherwise "impor[t]" the IRS's guidance. *Post,* at 730, 732 (opinion of SCALIA, J.). The dissent questions what possible basis except incorporation could justify our consulting the IRS's view, *post,* at 732, n., but we think that basis obvious: The IRS *creates* the National and Local Standards referenced in the statute, revises them as it deems necessary, and uses them every day. The agency might, therefore, have something insightful and persuasive (albeit not controlling) to say about them.

Because Ransom owns his vehicle free and clear of any encumbrance, he incurs no expense in the "Ownership Costs" category of the Local Standards. Accordingly, the car-ownership expense amount is not "applicable" to him, and the Ninth Circuit correctly denied that deduction.

III

Ransom's argument to the contrary relies on a different interpretation of the key word "applicable," an objection to our view of the scope of the "Ownership Costs" category, and a criticism of the policy implications of our approach. We do not think these claims persuasive.

A

Ransom first offers another understanding of the term "applicable." A debtor, he says, determines his "applicable" deductions by locating the box in each National or Local Standard table that corresponds to his geographic location, income, family size, or number of cars. Under this approach, a debtor "consult [s] the table[s] alone" to determine his appropriate expense amounts. Reply Brief for Petitioner 16. Because he has one car, Ransom argues that his "applicable" allowance is the sum listed in the first column of the "Ownership Costs" table ($471); if he had a second vehicle, the amount in the second column ($332) would also be "applicable." On this approach, the word "applicable" serves a function wholly internal to the tables; rather than filtering out debtors for whom a deduction is not at all suitable, the term merely directs each debtor to the correct box (and associated dollar amount of deduction) within every table.

This alternative reading of "applicable" fails to comport with the statute's text, context, or purpose. As intimated earlier, ***727** *supra,* at 724 - 725, Ransom's interpretation would render the term "applicable" superfluous. Assume Congress had omitted that word and simply authorized a deduction of "the debtor's monthly expense amounts" specified in the Standards. That language, most naturally read, would direct each debtor to locate the box in every table corresponding to his location, income, family size, or number of cars and to deduct the amount stated. In other words, the language would instruct the debtor to use the exact approach Ransom urges. The word "applicable" is not necessary to accomplish that result; it is necessary only for the different purpose of dividing debtors eligible to make use of the tables from those who are not. Further, Ransom's reading of "applicable" would sever the connection between the means test and the statutory provision it is meant to implement-the authorization of an allowance for (but only for) "reasonably necessary" expenses. Expenses that are wholly fictional are not easily thought of as reasonably necessary. And finally, Ransom's interpretation would run counter to the statute's overall purpose of ensuring that debtors repay creditors to the extent they can-here, by shielding some $28,000 that he does not in fact need for loan or lease payments.

As against all this, Ransom argues that his reading is necessary to account for the means test's distinction between "applicable" and "actual" expenses-more fully

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stated, between the phrase "*applicable* monthly expense amounts" specified in the Standards and the phrase "*actual* monthly expenses for ... Other Necessary Expenses." § 707(b)(2)(A)(ii)(I) (emphasis added). The latter phrase enables a debtor to deduct his actual expenses in particular categories that the IRS designates relating mainly to taxpayers' health and welfare. Internal Revenue Manual § 5.15.1.10(1), http:// www. irs. gov/ irm/ part 5/ irm_05-015-001.html# d0e1381. According to Ransom, "applicable" cannot mean the same thing as "actual." Brief for Petitioner 40. He thus concludes that "an 'applicable' expense can be claimed [under the means test] even if no 'actual' expense was incurred." *Ibid.*

[23] Our interpretation of the statute, however, equally avoids conflating "applicable" with "actual" costs. Although the expense amounts in the Standards apply only if the debtor incurs the relevant expense, the debtor's out-of-pocket cost may well not control the amount of the deduction. If a debtor's actual expenses exceed the amounts listed in the tables, for example, the debtor may claim an allowance only for the specified sum, rather than for his real expenditures.[FN8] For the Other Necessary Expense categories, by contrast, the debtor may deduct his actual expenses, no matter how high they are.[FN9] ***728** Our reading of the means test thus gives full effect to "the distinction between 'applicable' and 'actual' without taking a further step to conclude that 'applicable' means 'nonexistent.' " *In re Ross-Tousey,* 368 B.R. 762, 765 (Bkrtcy.Ct.E.D.Wis.2007), rev'd, 549 F.3d 1148 (C.A.7 2008).

FN8. The parties and the Solicitor General as *amicus curiae* dispute the proper deduction for a debtor who has expenses that are *lower* than the amounts listed in the Local Standards. Ransom argues that a debtor may claim the specified expense amount in full regardless of his out-of-pocket costs. Brief for Petitioner 24-27. The Government concurs with this view, provided (as we require) that a debtor has *some* expense relating to the deduction. See Brief for United States as *Amicus Curiae* 19-21. FIA, relying on the IRS's practice, contends to the contrary that a debtor may claim only his actual expenditures in this circumstance. Brief for Respondent 12, 45-46 (arguing that the Local Standards function as caps). We decline to resolve this issue. Because Ransom incurs no ownership expense at all, the car-ownership allowance is not applicable to him in the first instance. Ransom is therefore not entitled to a deduction under either approach.

FN9. For the same reason, the allowance for "applicable monthly expense amounts" at issue here differs from the additional allowances that the dissent cites for the deduction of actual expenditures. See *post,* at 731 - 732 (noting allowances for "actual expenses" for care of an elderly or chronically ill household member, § 707(b)(2)(A)(ii)(II), and for home energy costs, § 707(b)(2)(A)(ii)(V)).

Finally, Ransom's reading of "applicable" may not even answer the essential question: whether a debtor may claim a deduction. "[C]onsult[ing] the table[s] alone" to determine a debtor's deduction, as Ransom urges us to do, Reply Brief for Petitioner 16, often will not be sufficient because the tables are not self-defining. This case provides a prime example. The "Ownership Costs" table features two columns labeled "First Car" and "Second Car." See *supra,* at 722. Standing alone, the table does not specify whether it refers to the first and second cars *owned* (as Ransom avers), or the first and second cars for which the debtor incurs *ownership costs* (as FIA maintains)-and so the table does not resolve the issue in dispute.[FN10] See *In re Kimbro,* 389 B.R. 518, 533 (6th Cir. BAP 2008) (Fulton, J., dissenting) ("[O]ne cannot really 'just look up' dollar amounts in the tables without either referring to IRS guidelines for using the tables or imposing pre-existing assumptions about how [they] are to be navigated" (footnote omitted)). Some amount of interpretation is necessary to decide what the deduction is for and whether it is applicable to Ransom; and so we are brought back full circle to our prior analysis.

FN10. The interpretive problem is not, as the dissent suggests, "whether to claim a deduction for one car or for two," *post,* at 731, but rather whether to claim a deduction for *any* car that is owned if the debtor has no ownership costs. Indeed, if we had to decide this question on the basis of the table alone, we might well decide that a debtor who does not make loan or lease payments cannot claim an allowance. The table, after all, is titled "Ownership *Costs* "-suggesting that it applies to those debtors who incur such costs. And as noted earlier, the dollar amounts in the table represent average automobile loan and lease payments nationwide (with all other car-related expenses approximated in the separate "Operat-

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ing Costs" table). See *supra,* at 725 - 726. Ransom himself concedes that not every debtor falls within the terms of this table; he would exclude, and thus prohibit from taking a deduction, a person who does not own a car. Brief for Petitioner 33. In like manner, the four corners of the table appear to exclude an additional group-debtors like Ransom who own their cars free and clear and so do not make the loan or lease payments that constitute "Ownership Costs."

B

Ransom next argues that viewing the car-ownership deduction as covering no more than loan and lease payments is inconsistent with a separate sentence of the means test that provides: "Notwithstanding any other provision of this clause, the monthly expenses of the debtor shall not include any payments for debts." § 707(b)(2)(A)(ii)(I). The car-ownership deduction cannot comprise *only* loan and lease payments, Ransom contends, because those payments are *always* debts. See Brief for Petitioner 28, 44-45.

Ransom ignores that the "notwithstanding" sentence governs the full panoply of deductions under the National and Local Standards and the Other Necessary Expense categories. We hesitate to rely on that general provision to interpret the content of the car-ownership deduction because Congress did not draft the former with the latter specially in mind; any friction between the two likely reflects only a ***729** lack of attention to how an across-the-board exclusion of debt payments would correspond to a particular IRS allowance.[FN11] Further, the "notwithstanding" sentence by its terms functions only to exclude, and not to authorize, deductions. It cannot establish an allowance for non-loan or -lease ownership costs that no National or Local Standard covers. Accordingly, the "notwithstanding" sentence does nothing to alter our conclusion that the "Ownership Costs" table does not apply to a debtor whose car is not encumbered.

FN11. Because Ransom does not make payments on his car, we need not and do not resolve how the "notwithstanding" sentence affects the vehicle-ownership deduction when a debtor has a loan or lease expense. See Brief for United States as *Amicus Curiae* 23, n. 5 (offering alternative views on this question); Tr. of Oral Arg. 51-52.

C

Ransom finally contends that his view of the means test is necessary to avoid senseless results not intended by Congress. At the outset, we note that the policy concerns Ransom emphasizes pale beside one his reading creates: His interpretation, as we have explained, would frustrate BAPCPA's core purpose of ensuring that debtors devote their full disposable income to repaying creditors. See *supra,* at 724 - 725. We nonetheless address each of **Ransom's** policy arguments in turn.

Ransom first points out a troubling anomaly: Under our interpretation, "[d]ebtors can time their bankruptcy filing to take place while they still have a few car payments left, thus retaining an ownership deduction which they would lose if they filed just after making their last payment." Brief for Petitioner 54. Indeed, a debtor with only a single car payment remaining, Ransom notes, is eligible to claim a monthly ownership deduction. *Id.,* at 15, 52.

[24] But this kind of oddity is the inevitable result of a standardized formula like the means test, even more under Ransom's reading than under ours. Such formulas are by their nature over- and under-inclusive. In eliminating the pre-BAPCPA case-by-case adjudication of above-median-income debtors' expenses, on the ground that it leant itself to abuse, Congress chose to tolerate the occasional peculiarity that a brighter-line test produces. And Ransom's alternative reading of the statute would spawn its own anomalies-even placing to one side the fundamental strangeness of giving a debtor an allowance for loan or lease payments when he has not a penny of loan or lease costs. On Ransom's view, for example, a debtor entering bankruptcy might purchase for a song a junkyard car-"an old, rusted pile of scrap metal [that would] si[t] on cinder blocks in his backyard," *In re Brown,* 376 B.R. 601, 607 (Bkrtcy.Ct.S.D.Tex.2007)-in order to deduct the $471 car-ownership expense and reduce his payment to creditors by that amount. We do not see why Congress would have preferred that result to the one that worries Ransom. That is especially so because creditors may well be able to remedy Ransom's "one payment left" problem. If car payments cease during the life of the plan, just as if other financial circumstances change, an unsecured creditor may move to modify the plan to increase the amount the debtor must repay. See 11 U.S.C. § 1329(a)(1).

[25] Ransom next contends that denying the ownership allowance to debtors in his position "sends entirely the wrong message, namely, that it is advantageous to be deeply in debt on motor vehicle loans, rather than to pay them off." Brief for Petitioner 55. But the choice here is not between thrifty savers and profligate borrowers, as **Ransom** would have it. Money is fungible: The $14,000 that

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Ransom ***730** spent to purchase his Camry outright was money he did not devote to paying down his credit card debt, and Congress did not express a preference for one use of these funds over the other. Further, **Ransom's** argument mistakes what the deductions in the means test are meant to accomplish. Rather than effecting any broad federal policy as to saving or borrowing, the deductions serve merely to ensure that debtors in bankruptcy can afford essential items. The car-ownership allowance thus safeguards a debtor's ability to retain a car throughout the plan period. If the debtor already owns a car outright, he has no need for this protection.

Ransom finally argues that a debtor who owns his car free and clear may need to replace it during the life of the plan; "[g]ranting the ownership cost deduction to a vehicle that is owned outright," he states, "accords best with economic reality." *Id.,* at 52. In essence, Ransom seeks an emergency cushion for car owners. But nothing in the statute authorizes such a cushion, which all debtors presumably would like in the event some unexpected need arises. And a person who enters bankruptcy without any car at all may also have to buy one during the plan period; yet Ransom concedes that a person in this position cannot claim the ownership deduction. Tr. of Oral Arg. 20. The appropriate way to account for unanticipated expenses like a new vehicle purchase is not to distort the scope of a deduction, but to use the method that the Code provides for all Chapter 13 debtors (and their creditors): modification of the plan in light of changed circumstances. See § 1329(a)(1); see also *supra,* at 729.

IV

Based on BAPCPA's text, context, and purpose, we hold that the Local Standard expense amount for transportation "Ownership Costs" is not "applicable" to a debtor who will not incur any such costs during his bankruptcy plan. Because the "Ownership Costs" category covers only loan and lease payments and because Ransom owns his car free from any debt or obligation, he may not claim the allowance. In short, Ransom may not deduct loan or lease expenses when he does not have any. We therefore affirm the judgment of the Ninth Circuit.

It is so ordered.

Justice SCALIA, dissenting.

I would reverse the judgment of the Ninth Circuit. I agree with the conclusion of the three other Courts of Appeals to address the question: that a debtor who owns a car free and clear is entitled to the car-ownership allowance. See *In re Washburn,* 579 F.3d 934 (C.A.8 2009); *In re Tate,* 571 F.3d 423 (C.A.5 2009); *In re Ross-Tousey,* 549 F.3d 1148 (C.A.7 2008).

The statutory text at issue is the phrase enacted in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), "applicable monthly expense amounts specified under the National Standards and Local Standards," 11 U.S.C. § 707(b)(2)(A)(ii)(I). The Court holds that the word "applicable" in this provision imports into the Local Standards a directive in the Internal Revenue Service's Collection Financial Standards, which have as their stated purpose "to help determine a taxpayer's ability to pay a delinquent tax liability," App. to Brief for Respondent 1a. That directive says that "[i]f a taxpayer has no car payment," the Ownership Cost provisions of the Local Standards will not apply. *Id.,* at 3a.

That directive forms no part of the Local Standards to which the statute refers; and the fact that portions of the Local Standards are to be disregarded for revenue-collection purposes says nothing about ***731** whether they are to be disregarded for purposes of Chapter 13 of the Bankruptcy Code. The Court believes, however, that unless the IRS's Collection Financial Standards are imported into the Local Standards, the word "applicable" would do no work, violating the principle that " 'we must give effect to every word of a statute wherever possible.' " *Ante,* at 724 (quoting *Leocal v. Ashcroft,* 543 U.S. 1, 12, 125 S.Ct. 377, 160 L.Ed.2d 271 (2004)). I disagree. The canon against superfluity is not a canon against verbosity. When a thought could have been expressed more concisely, one does not always have to cast about for some additional meaning to the word or phrase that could have been dispensed with. This has always been understood. A House of Lords opinion holds, for example, that in the phrase " 'in addition to and not in derogation of' " the last part adds nothing but emphasis. *Davies v. Powell Duffryn Associated Collieries, Ltd.,* [1942] A.C. 601, 607.

It seems to me that is the situation here. To be sure, one can say "according to the attached table"; but it is acceptable (and indeed I think more common) to say "according to the applicable provisions of the attached table." That seems to me the fairest reading of "applicable monthly expense amounts specified under the National Standards and Local Standards." That is especially so for the Ownership Costs portion of the Local Standards, which had no column titled "No Car." Here the expense amount would be that shown for one car (which is all the debtor here owned) rather than that shown for two cars; and it

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would be no expense amount if the debtor owned no car, since there is no "applicable" provision for that on the table. For operating and public transportation costs, the "applicable" amount would similarly be the amount provided by the Local Standards for the geographic region in which the debtor resides. (The debtor would not first be required to prove that he actually operates the cars that he owns, or, if does not own a car, that he actually uses public transportation.) The Court claims that the tables "are not self-defining," and that "[s]ome amount of interpretation" is necessary in choosing whether to claim a deduction at all, for one car, or for two. *Ante,* at 728. But this problem seems to me more metaphysical than practical. The point of the statutory language is to entitle debtors who own cars to an ownership deduction, and I have little doubt that debtors will be able to choose correctly whether to claim a deduction for one car or for two.

If the meaning attributed to the word by the Court were intended, it would have been most precise to say "monthly expense amounts specified under the National Standards and Local Standards, if applicable for IRS collection purposes." And even if utter precision was too much to expect, it would at least have been more natural to say "monthly expense amounts specified under the National Standards and Local Standards, *if applicable.*" That would make it clear that amounts specified under those Standards may nonetheless not be applicable, justifying (perhaps) resort to some source other than the Standards themselves to give meaning to the condition. The very next paragraph of the Bankruptcy Code uses that formulation ("if applicable") to limit to actual expenses the deduction for care of an elderly or chronically ill household member: "[T]he debtor's monthly expenses may include, *if applicable,* the continuation of actual expenses paid by the debtor that are reasonable and necessary" for that purpose. 11 U.S.C. § 707(b)(2)(A)(ii)(II) (emphasis added).

Elsewhere as well, the Code makes it very clear when prescribed deductions are limited to actual expenditures. ***732**Section 707(b)(2)(A)(ii)(I) itself authorizes deductions for a host of expenses-health and disability insurance, for example-only to the extent that they are "actual ... expenses" that are "reasonably necessary." Additional deductions for energy are allowed, but again only if they are "actual expenses" that are "reasonable and necessary." § 707(b)(2)(A)(ii)(V). Given the clarity of those limitations to actual outlays, it seems strange for Congress to limit the car-ownership deduction to the somewhat peculiar category "cars subject to any amount whatever of outstanding indebtedness" by the mere word "applicable," meant as incorporation of a limitation that appears in instructions to IRS agents.[FN*]

FN* The Court protests that I misunderstand its use of the Collection Financial Standards. Its opinion does not, it says, find them to be incorporated by the Bankruptcy Code; they simply "reinforc[e] our conclusion that ... a debtor seeking to claim this deduction must make some loan or lease payments." *Ante,* at 726. True enough, the opinion says that the Bankruptcy Code "does not incorporate the IRS's guidelines," but it immediately continues that "courts may consult this material in interpreting the National and Local Standards" so long as it is not "at odds with the statutory language." *Ibid.* In the present context, the real-world difference between finding the guidelines incorporated and finding it appropriate to consult them escapes me, since I can imagine no basis for consulting them unless Congress meant them to be consulted, which would mean they are incorporated. And without incorporation, they *are* at odds with the statutory language, which otherwise contains no hint that eligibility for a Car Ownership deduction requires anything other than ownership of a car.

I do not find the normal meaning of the text undermined by the fact that it produces a situation in which a debtor who owes no payments on his car nonetheless gets the operating-expense allowance. For the Court's more strained interpretation still produces a situation in which a debtor who owes only a single remaining payment on his car gets the full allowance. As for the Court's imagined horrible in which "a debtor entering bankruptcy might purchase for a song a junkyard car," *ante,* at 729: That is fairly matched by the imagined horrible that, under the Court's scheme, a debtor entering bankruptcy might purchase a junkyard car for a song plus a $10 promissory note payable over several years. He would get the full ownership expense deduction.

Thus, the Court's interpretation does not, as promised, maintain "the connection between the means test and the statutory provision it is meant to implement-the authorization of an allowance for (but only for) 'reasonably necessary' expenses," *ante,* at 727. Nor do I think this difficulty is eliminated by the *deus ex machina* of 11 U.S.C. § 1329(a)(1), which according to the Court would allow an unsecured creditor to "move to modify the plan to increase the amount the debtor must repay," *ante,* at 729. Apart

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from the fact that, as a practical matter, the sums involved would hardly make this worth the legal costs, allowing such ongoing revisions of matters specifically covered by the rigid means test would return us to "the pre-BAPCPA case-by-case adjudication of above-median-income debtors' expenses," *ante,* at 729. If the BAPCPA had thought such adjustments necessary, surely it would have taken the much simpler and more logical step of providing going in that the ownership expense allowance would apply only so long as monthly payments were due.

The reality is, to describe it in the Court's own terms, that occasional overallowance (or, for that matter, underallowance) "is the inevitable result of a standardized formula like the means test.... Congress chose to tolerate the occasional peculiarity that a brighter-line test produces."***733** *Ibid.* Our job, it seems to me, is not to eliminate or reduce those "oddit [ies]," *ibid.,* but to give the formula Congress adopted its fairest meaning. In my judgment the "applicable monthly expense amounts" for operating costs "specified under the ... Local Standards," are the amounts specified in those Standards for either one car or two cars, whichever of those is applicable.

U.S.,2011.
Ransom v. FIA Card Services, N.A.
131 S.Ct. 716, 79 USLW 4020, Bankr. L. Rep. P 81,914, 11 Cal. Daily Op. Serv. 459, 2011 Daily Journal D.A.R. 509, 22 Fla. L. Weekly Fed. S 737

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pend only on the size of the event and the nature of the facilities involved in it (a bandstand, stage, tents, and so forth)"), *aff'd on other grounds*, 534 U.S. 316, 122 S.Ct. 775, 151 L.Ed.2d 783 (2002). Instead, the ordinance requires the purchase of insurance even if, as could well be the case, the insurance premium reflects the insurer's assessment of the connection between the risk of loss and the content of the insured's expressive activity. For that reason, were I free to do so, I would follow the substantial case law holding such an insurance requirement unconstitutional as a violation of the First Amendment. *See Santa Monica Food Not Bombs v. City of Santa Monica* ("*Food Not Bombs*"), 450 F.3d 1022, 1049–52 (9th Cir.2006) (Berzon, J., dissenting in part); *id.* (citing cases invalidating insurance requirements for public forum permits as content-based).

I fully expressed this view, however, in *Food Not Bombs*, but did not prevail. The *Food Not Bombs* majority did not acknowledge the substantial case law supporting my conclusion, and did not consider the likelihood that insurance premiums would, like the fees set in *Forsyth County v. Nationalist Movement*, 505 U.S. 123, 134, 112 S.Ct. 2395, 120 L.Ed.2d 101 (1992), reflect the content of the permittee's expression and the likely reaction of bystanders to that content. Still, I am bound by *Food Not Bombs* as precedent, and so concur.

I note that the discussion in this opinion of the indemnification provision supports my view that setting an unrestricted insurance requirement as a condition for issuing a permit for expressive activity is unconstitutional. We explain today why the indemnity provision is not narrowly tailored. Insurance companies typically set premiums by first determining the risk of loss. Nothing in the Long Beach ordinance would prevent any issuer from taking into account, in assessing the risk of loss and then setting the premium for event insurance accordingly, the very considerations we conclude make the indemnity provision insufficiently narrowly tailored. Moreover, an insurance requirement demands up front payment even if the insured risk never eventuates, making it even *less* narrowly tailored, and *more* likely to discourage communicative activities in public fora than an indemnity requirement.

I nonetheless concur, as I agree with Judges Fletcher and Pregerson that there is no difference of principle between the insurance requirement in this case and the one in *Food Not Bombs*.

In re Scott Lee EGEBJERG, Debtor.

Scott Lee Egebjerg, Debtor-Appellant,

v.

Peter C. Anderson, United States Trustee, Trustee-Appellee.

No. 08-55301.

United States Court of Appeals, Ninth Circuit.

Argued and Submitted March 12, 2009.

Filed May 29, 2009.

Amended Aug. 3, 2009.

Background: United States Trustee (UST) moved to dismiss debtor's bankruptcy petition as an abuse of Chapter 7. The United States Bankruptcy Court for the Central District of California, Geraldine Mund, J., dismissed petition. Debtor appealed.

Holdings: After granting debtor's petition for direct appeal, the Court of Appeals, Michael Daly Hawkins, Circuit Judge, held that:

(1) as an issue of first impression, payments made on loan from debtor's re-

tirement account cannot be deducted in performing Chapter 7 means test;

(2) as an issue of first impression, payments made by debtor on loan taken from retirement account were not deductible under means test as "other necessary expense"; and

(3) debtor's repayment of loan taken from his retirement account did not establish "special circumstances" rebutting presumption of abuse.

Affirmed.

1. Bankruptcy ⚷3782

Court of Appeals reviews the bankruptcy court's legal conclusions de novo.

2. Bankruptcy ⚷2021.1, 2825

As used in Bankruptcy Code, terms "debt" and "claim" are coextensive. 11 U.S.C.A. § 101(5, 12).

3. Bankruptcy ⚷2021.1

Debtor's obligation to repay a loan from his or her retirement account is not a "debt" under the Bankruptcy Code. 11 U.S.C.A. § 101(12).

See publication Words and Phrases for other judicial constructions and definitions.

4. Bankruptcy ⚷2264(1)

Since debtor's obligation to repay loan from retirement account is not a "claim" or "debt" under the Bankruptcy Code, debtor may not deduct payments on such loans as monthly payment "on account of secured debts" in performing means test under Chapter 7 for determining whether presumption of abuse exists. 11 U.S.C.A. § 101(5, 12), 707(b)(2)(A)(iii).

See publication Words and Phrases for other judicial constructions and definitions.

5. Statutes ⚷212.1

Court presumes that when Congress legislates, it is aware of past judicial interpretations and practices.

6. Statutes ⚷195

Court presumes that if Congress includes particular language in one section of a statute but omits it in another, Congress acted intentionally in that exclusion.

7. Bankruptcy ⚷2264(1)

Payments made by Chapter 7 debtor on loan taken from his retirement plan were not deductible under means test for determining whether presumption of abuse exists as "other necessary expense," even though debtor contended that replenishment of his 401(k) plan was necessary to his long-term health and welfare, where payments did not fit within any Internal Revenue Service (IRS) category of expenses that might be considered necessary, payments were voluntary in that debtor could simply ask loan administrator to treat his outstanding loan balance as early withdrawal, and payments were not of same kind and character as those expenses allowed elsewhere under IRS list. 11 U.S.C.A. § 707(b)(2)(A)(ii).

8. Bankruptcy ⚷2264(1)

Debtor's repayment of loan taken from his retirement account did not establish "special circumstances" rebutting presumption of abuse of Chapter 7 arising in debtor's case under means test where debtor's only explanation for loan was that he was attempting to pay off bills in hope of avoiding bankruptcy. 11 U.S.C.A. § 707(b)(2)(B).

See publication Words and Phrases for other judicial constructions and definitions.

Michael R. Totaro, Totaro & Shanahan, Pacific Palisades, CA, for the debtor-appellant.

Kelsi Brown Corkran, Civil Division, Department of Justice, Washington, D.C., for the trustee-appellee.

Appeal from the United States Bankruptcy Court for the Central District of California, Geraldine Mund, Bankruptcy Judge, Presiding. BK No. SV 06–12592–GM.

Before: HAWKINS, MARSHA S. BERZON and RICHARD R. CLIFTON, Circuit Judges.

ORDER AND AMENDED OPINION

ORDER

The Opinion filed on May 29, 2009, and reported at 2009 WL 1492138 (9th Cir. May 29, 2009), is replaced by the Amended Opinion filed concurrently with this Order.

OPINION

MICHAEL DALY HAWKINS, Circuit Judge:

In this direct appeal from the bankruptcy court, Scott Lee Egebjerg ("Egebjerg") challenges the bankruptcy court's dismissal of his Chapter 7 petition for abuse under 11 U.S.C. § 707(b)(3). In an issue of first impression in this circuit under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), we consider whether a debtor's repayment of a 401(k) loan constitutes a "monthly payment on account of secured debts" or an "[o]ther [n]ecessary [e]xpense" that can be deducted from a debtor's monthly income for purposes of calculating the debtor's disposable monthly income under § 707(b)(2). Because we conclude it is not, the debtor's filing in this case was presumptively abusive under the "means test" of § 707(b)(2). We therefore affirm the bankruptcy court's dismissal of his Chapter 7 petition.

FACTS AND PROCEDURAL HISTORY

Egebjerg filed a voluntary Chapter 7 bankruptcy petition on December 31, 2006. At the time, he had been employed by Ralph's grocery store for twenty-seven years and earned a gross income of $6,115.56 per month. Egebjerg was single with no assets. His only secured property was an automobile he used for work and a timeshare. He had unsecured consumer debt of about $31,000.

Approximately two years before he filed for bankruptcy, Egebjerg had taken a loan from his 401(k) plan. The plan automatically deducted $733.90 from his paycheck each month to repay this loan, which was scheduled to be fully repaid by September 2008. According to Egebjerg's amended schedule of necessary expenses (in which he included the 401(k) repayment), he was left with a monthly disposable income of $15.31.[1]

The U.S. Trustee moved to dismiss Egebjerg's Chapter 7 petition, arguing that Egebjerg had improperly included the 401(k) repayment in his necessary expenses. If, the Trustee urged, this amount were not subtracted from income as a necessary expense, Egebjerg's filing was presumptively abusive under the "means test" of § 707(b)(2). The Trustee further argued that even if the presumption of abuse did not arise under § 707(b)(2), the court should still dismiss the case because, under the totality of the

1. Egebjerg's estimated monthly disposable income on the amended schedule was $170.31, less a $155 deduction for the difference between his actual rent and the applicable monthly rent expense specified in the IRS's Housing and Utility Standards, which debtors are required to use for means test purposes. Egebjerg listed this rent differential as a necessary "Other Expense[ ]" on line 56 of his amended means test form. The government does not challenge this deduction and we express no opinion on its propriety. Instead, we assume, without deciding, that the deduction was proper.

circumstances, Egebjerg had sufficient means to repay a meaningful portion of his debts, especially once his 401(k) loan was repaid.

The bankruptcy court rejected the Trustee's first argument, concluding that the 401(k) loan was a "secured debt" and could be deducted from income for purposes of the means test. By including this figure, no presumption of abuse arose under § 707(b)(2).

Still, agreeing with the Trustee on the totality of the circumstances ground, the bankruptcy court dismissed the Chapter 7 petition under § 707(b)(3), noting that, at the time of the court's order in June 2007, the 401(k) loan would be repaid in just over a year, leaving $525 a month to repay unsecured creditors. The court concluded that the debtor could therefore pay a significant amount of his debts in a Chapter 13 proceeding and that, because of his ability to pay, it would be an abuse to permit the case to continue as a Chapter 7 proceeding. The court ordered the case to be dismissed unless the debtor converted to a Chapter 13 within ten days, which Egebjerg did not do.

Egebjerg filed a notice of appeal and requested that the bankruptcy court enter an order certifying the decision for direct appeal pursuant to 28 U.S.C. § 158(d)(2). The bankruptcy court entered the certification, and a motions panel of this court granted Egebjerg's petition for direct appeal and stayed the district court appeal pending circuit review.

DISCUSSION

I. Statutory Background

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. *Id.* (emphasis added). Courts looked to the "totality of the circumstances" to make this substantial abuse determination. *In re Price*, 353 F.3d 1135, 1139–40 (9th Cir.2004).

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. BAPCPA introduced a mathematical formula, commonly referred to as the "means test," to determine whether a debtor's financial circumstances create a presumption against granting relief under Chapter 7. 11 U.S.C. § 707(b)(2) (2008). A presumption of abuse may be rebutted if the debtor demonstrates "special circumstances" such as "a serious medical condition or a call or order to active duty in the Armed Forces." § 707(b)(2)(B). Even 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. § 707(b)(3); *Blausey v. U.S. Trustee*, 552 F.3d 1124, 1127 n. 1 (9th Cir.2009).

[1] This case potentially implicates both § 707(b)(2) and § 707(b)(3). However, because the statute is framed to consider the presumptive abuse question first, and resorts to the totality of circumstances analysis only if the debtor survives the means test, we have chosen to address the proper interpretation of § 707(b)(2) first. We review the bankruptcy court's legal conclusions de novo. *In re Fowler*, 394 F.3d 1208, 1212 (9th Cir.2005).

II. Presumption of Abuse under § 707(b)(2)

A. Secured Debt

[2] In calculating the debtor's current monthly income, § 707(b)(2) permits the

debtor to deduct "the average monthly payments on account of *secured debts.*" § 707(b)(2)(A)(iii) (emphasis added). In the Bankruptcy Code, the term "debt" means "liability on a claim." § 101(12). "Claim" is defined very broadly within the Code to mean any "right to payment," whether fixed, contingent, matured, disputed, secured, and so on. § 101(5). The terms "debt" and "claim" are coextensive, "flip sides to the same coin." *In re Rifkin*, 124 B.R. 626, 628 (Bankr.E.D.N.Y.1991); S.Rep. No. 989, 95th Cong.2d Sess., 23 (1978), *reprinted in* U.S.C.C.A.N. 5787, 5809. Therefore, Egebjerg's 401(k) loan constitutes a "debt" only if the plan administrator has a "claim" for repayment.

[3] We join the vast majority of courts in holding that the debtor's obligation to repay a loan from his or her retirement account is not a "debt" under the Bankruptcy Code. *See, e.g., In re Villarie*, 648 F.2d 810 (2d Cir.1981) (loan drawn on employee's contributions to retirement system not a "debt" because plan has no right to sue a member for the amount of the advance, it is simply offset against future benefits); *Bolen v. Adams*, 403 B.R. 396, 2009 WL 605270, *3 (N.D.Miss.2009) (vast majority of courts have held a debtor's obligation to repay retirement account loan is not a "debt" under the Code); *Eisen v. Thompson*, 370 B.R. 762, 769 (N.D.Ohio 2007) (majority view is that retirement plan loans are not secured debts); *In re Esquivel*, 239 B.R. 146, 152 (Bankr. E.D.Mich.1999) ("clear consensus" that borrowing from retirement account does not give rise to either secured or unsecured "claim" under the Bankruptcy Code); *see also McVay v. Otero*, 371 B.R. 190, 195 (W.D.Tex.2007); *In re Fulton*, 211 B.R. 247, 264 (Bankr.S.D.Ohio 1997); *In re Scott*, 142 B.R. 126, 131–32 (Bankr.E.D.Va. 1992); *In re Jones*, 138 B.R. 536, 537–38 (Bankr.S.D.Ohio 1991).

The reasoning behind these decisions is straightforward. Egebjerg's obligation is essentially a debt to himself—he has borrowed his own money. *In re Smith*, 388 B.R. 885, 887 (Bankr.C.D.Ill.2008); *see also McVay*, 371 B.R. at 197 (collecting cases). Egebjerg contributed the money to the account in the first place; should he fail to repay himself, the administrator has no personal recourse against him. *In re Villarie*, 648 F.2d at 812. Instead, the plan will deem the outstanding loan balance to be a distribution of funds, thereby reducing the amount available to Egebjerg from his account in the future. *See In re Mowris*, 384 B.R. 235, 238 (Bankr.W.D.Mo. 2008); *see also Mullen v. United States*, 696 F.2d 470, 472 (6th Cir.1983). This deemed distribution will have tax consequences to Egebjerg, but it does not create a debtor-creditor relationship. *In re Smith*, 388 B.R. at 888 ("Nonpayment comes with liability for income taxes and penalties, but non-payment is a valid, lawful alternative.").

As succinctly explained by one district court:

> Retirement plan loans are qualitatively different than secured debts such as home mortgages and car loans. The retirement plan administrator does not loan the plan participant the administrator's money. It simply deducts the requested loan amount from the participant's own account, and credits the loan payments and interest back to the participant's account. If the participant defaults on the loan, the plan administrator deducts the amount owed from the vested account balance, and repays the loan with this deduction. The participant must treat this deduction as a distribution which is taxable as income to the participant in the default year. The participant may also be subject to an early withdrawal penalty. But, the plan

administrator has no right to payment under the Bankruptcy Code.

Thompson, 370 B.R. at 768 n. 10.

[4] Because the debtor's loan repayment obligation is not a "claim" or "debt" under the Bankruptcy Code, the debtor may not include payments on such loans as a deduction for purposes of the means test under § 707(b)(2). *See, e.g., In re Smith*, 388 B.R. at 888; *In re Mowris*, 384 B.R. at 237–38; *McVay*, 371 B.R. at 203; *Thompson*, 370 B.R. at 768–72. This conclusion under BAPCPA is not only supported by the definitions of "claim" and "debt" within the Code, but also by two basic canons of statutory construction.

[5] First, we presume that when Congress legislates, it is aware of past judicial interpretations and practices. *See Dewsnup v. Timm*, 502 U.S. 410, 419, 112 S.Ct. 773, 116 L.Ed.2d 903 (1992). ("When Congress amends the Bankruptcy laws, it does not write on a clean slate.") (internal quotation marks omitted). "Because overwhelming case law preceding [BAPCPA] held that 401(k) loans were not 'debts' under the Code, and because Congress has not expressly said otherwise, the Court must presume that 'debt' retains its pre-2005 Act meaning." *Thompson*, 370 B.R. at 771; *see also In re Mowris*, 384 B.R. at 238 ("The overwhelming majority of pre-BAPCPA opinions held that a debtor's obligation to make payments on a loan taken from a qualified retirement account was not a claim or debt under the Code, and the court must assume that Congress was aware of this judicial interpretation when it enacted BAPCPA.").

[6] Second, we also presume that if Congress includes particular language in one section of a statute but omits it in another, Congress acted intentionally in that exclusion. *KP Permanent Make-Up, Inc. v. Lasting Impression I, Inc.*, 543 U.S. 111, 118, 125 S.Ct. 542, 160 L.Ed.2d 440 (2004). Here, in BAPCPA, Congress expressly gave Chapter 13 debtors the ability to deduct 401(k) payments from their disposable income calculation, § 1322(f), but did not include any similar exemption for Chapter 7 debtors. Congress also added a section which provides that the automatic stay does not apply to automatic deductions to repay a retirement plan loan, but expressly stated that the provision shall not be construed to provide that such a loan constitutes a "claim" or "debt." § 362(b)(19). "In light of the amendments sprinkled throughout the Code [addressing 401(k) loans]—especially section 1322(f)—the lack of a 401(k) provision in section 707 is a glaring indication that Congress did not intend 401(k) loan repayments to be deducted in Chapter 7." *In re Turner*, 376 B.R. 370, 376 (Bankr.D.N.H.2007).

Although Egebjerg contends that this construction creates anomalous results, "[t]he explanation for the lack of such a provision in section 707 is that Congress intended to steer many would-be Chapter 7 debtors toward Chapter 13." *Id.* As one court explained:

> First, 401(k) loan repayments are finite; a loan will eventually be paid off. Second, a Chapter 13 case is prospective, *i.e.*, it encompasses a debtor's current and future financial circumstances for a period of three to five years .... Excluding 401(k) loans from the means test evidences a "wait and see" approach that would channel debtors with such expenses into the longer period of bankruptcy supervision of Chapter 13 rather than the relatively short tenure of a Chapter 7 case, notwithstanding that doing so might result in a zero payment plan. However, because, as here, 401(k) loans might be paid off within the commitment period of a Chapter 13 case, the ability to increase the monthly plan payment would direct newly available funds to creditors. Such an approach serves

both the Congressional intent to protect retirement contributions and "ensure that debtors repay creditors the maximum they can afford," a primary goal of BAPCPA.

In re Lenton, 358 B.R. 651, 660 (Bankr. E.D.Penn.2006).

B. Other Necessary Expense

[7] In addition to maintaining that his 401(k) loan to himself is a "secured debt," Egebjerg also contends that his loan repayments are an "other necessary expense" for the purposes of applying the means test. We reject that argument as well.

Under the statutory provisions governing the means test, debtors may deduct, in addition to payments on secured debt, their "actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service." 11 U.S.C. § 707(b)(2)(A)(ii). In turn, the Internal Revenue Manual ("IRM") lists fifteen categories of expenses which may be considered necessary under certain circumstances, such as child care, education and court-ordered payments such as alimony and child support. IRM § 5.15.1.10.

The IRM list of categories appears to be nonexhaustive. *See* IRM § 5.15.1.10(1) (noting that other expenses may be considered if they meet the necessary expense test—i.e., if they "provide for the health and welfare of the taxpayer and/or his or her family or [provide] for the production of income."). However, some bankruptcy courts have held that this list *is* exhaustive for purposes of the bright-line means test, because, by the plain language of § 707(b)(2)(A)(ii)(I), Congress expressly limited a debtor's deductions for other expenses to "the *categories specified*" by the Internal Revenue Service. *See In re Turner*, 376 B.R. at 375; *In re Lara*, 347 B.R. 198, 204 (Bankr.N.D.Tex.2006); *In re Mordis*, 2007 WL 2962903, *2 (Bankr. E.D.Mo.2007); *In re Whitaker*, 2007 WL 2156397, *4 (Bankr.N.D.Ohio 2007). Other courts have looked beyond the enumerated categories and considered the applicability of IRM § 5.15.1.10(1)'s "necessary expense test" on a case-by-case basis. *See In re Mowris*, 384 B.R. at 238–39; *In re Lenton*, 358 B.R. at 658.

We need not resolve this debate in this case, however, because we conclude that under either interpretation, Egebjerg's repayment of his 401(k) loan does not qualify as an "Other Necessary Expense." Such payments do not fit within any of the IRM's listed categories. *See, e.g., In re Barraza*, 346 B.R. 724, 730 (Bankr. N.D.Tex.2006) (rejecting argument that repayment could be considered an "involuntary deduction" because it is not a condition of the debtor's employment); *see also In re Lenton*, 358 B.R. at 657–58 (same). As discussed above, the 401(k) loan repayments themselves are voluntary in the sense that Egebjerg can simply ask the loan administrator to treat his outstanding loan balance as an early withdrawal from his 401(k) and thereby relieve himself of a future repayment obligation. Doing so would have tax consequences, but Egebjerg would retain the use of most of the money loaned.

According to Egebjerg, the replenishment of his 401(k) plan is necessary to his long-term "health and welfare," because he is approaching retirement and his 401(k) plan is his only significant asset.[2] But even if we were to look beyond the specified categories to consider the more general "necessary expense test" in the IRM,

2. Egebjerg does not actually provide his age. He states only that "[s]ince he has been employed with Kroger for 27 years he is not someone who is many years from retirement."

401(k) repayments are simply not of the same kind and character as those expenses allowed elsewhere under § 5.15.1.10. For example, dependent care expenses (for care of the elderly or handicapped) are permitted only if there is no alternative to paying the expense, and "[e]ducation" costs are necessary expenses only if they are "required for a physically or mentally challenged child and no public education providing similar services is available," or if they are "required as a condition of [the debtor's] employment." *Id.* We also note that the IRS guidelines themselves provide that "[c]ontributions to voluntary retirement plans are not a necessary expense." IRM § 5.15.1.23; *see also In re Lenton*, 358 B.R. at 658 ("[i]f future voluntary contributions to the 401k plan are not necessary expenses, it is hard to argue that the replenishment of past voluntary contributions to the 401k account by repaying loans is a necessary expense.").[3]

Arguing to the contrary, Egebjerg cites *Hebbring v. United States Trustee*, 463 F.3d 902 (9th Cir.2006), *In re Hill*, 328 B.R. 490 (Bankr.S.D.Tex.2005), and *In re Vansickel*, 309 B.R. 189 (Bankr.E.D.Va. 2004), for the proposition that voluntary 401(k) contributions are not *per se* unnecessary expenses for the purposes of calculating a debtor's disposable income under § 707(b)(2). What Egebjerg fails to note is that each of these cases either pre-dates the BAPCPA (and therefore pre-dates the means test) or applies pre-BAPCPA law. *See, e.g., Hebbring*, 463 F.3d at 904 n. 1. This point is critical because the pre-BAPCPA § 707(b)(2) "totality of circumstances" test for abuse, which now appears (as modified by BAPCPA) as part of § 707(b)(3), is distinct from the current § 707(b)(2) means test. When it introduced the means test, Congress provided, by reference to the IRS guidelines, specific guidance as to what qualifies as a necessary expense for the purposes of applying that test. Our holding in *Hebbring*, which concerns only the former "totality of circumstances" test, is simply not applicable.[4]

For all the foregoing reasons, the bankruptcy court erred by allowing Egebjerg to deduct his 401(k) repayment from disposable income for purposes of the means test. If the amount of his loan repayment is included in Egebjerg's income, then a presumption of abuse arises under § 707(b)(2).

III. Special Circumstances

[8] The bankruptcy court also held, in the alternative, that even if the amount of Egebjerg's loan repayment obligation should not be included as a secured debt or necessary expense, it could be properly included as a "special circumstance" which could rebut the presumption of abuse, citing *In re Thompson*, 350 B.R. 770 (Bankr. N.D.Ohio 2006). However, *Thompson* was

3. We do not hold that § 5.15.1.23 is controlling, but that it is useful and persuasive in the context of this case—defining the parameters of § 5.15.1.10(1) and what was considered to provide for "health and welfare" at the time Congress cross-referenced the IRM's "Other Necessary Expenses" provisions. We recognize that the extent of the manual's "incorporation" and/or usefulness in interpreting § 707(b)(2)(A)(ii)(I) is a subject of extensive debate, particularly with respect to interpreting the "applicable monthly expense amounts specified under the National Standards and Local Standards." *See In re Ross-Tousey*, 549 F.3d 1148, 1156-57 (7th Cir.2008) (discussing split in authority). By our narrow decision today, we do not mean to imply that the IRS standards have been incorporated wholesale into the Bankruptcy Code or that they control outcomes on other issues.

4. Egebjerg also argues that our failure to recognize his 401(k) repayments as a "necessary expense" would create a conflict with the Bankruptcy Code's automatic stay provisions. We reject this argument for the reasons already stated in Part II.A.

reversed by the district court on this very point on appeal, *Thompson*, 370 B.R. at 772–73, and the majority of courts agree that the mere obligation to repay a 401(k) loan is not itself a special circumstance. *See, e.g., Smith*, 388 B.R. at 888; *In re Mowris*, 384 B.R. at 240; *In re Turner*, 376 B.R. at 378.

Section 707(b)(2)(B) provides:

> 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 ... justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative.

Thus, Congress did not provide an exhaustive list of "special circumstances," but did indicate examples of situations it would consider sufficient to rebut the presumption of abuse. As one court has noted, both examples given by Congress share "a commonality; they both constitute situations which not only put a strain on a debtor's household budget, but they arise from circumstances normally beyond the debtor's control." *In re Castle*, 362 B.R. 846, 851 (Bankr.N.D.Ohio 2006).

We need not explore the outside parameters of the special circumstance provision, however, for we agree that "retirement plan loans are neither extraordinary nor rare; many individuals take loans for many different reasons, and they are all required to repay the loans. Without more, a situation as common as the withdrawal of one's retirement funds cannot be a 'special circumstance' within the accepted definition of this term." *Thompson*, 370 B.R. at 773.

While there may be situations in which the debtor's underlying reason for taking out a 401(k) loan may constitute a special circumstance, *see In re Tauter*, 402 B.R. 903, 906–7 (Bankr.M.D.Fla.2009), Egebjerg's only explanation was that he was using the money to "pay off bills" in the hope of avoiding bankruptcy in the first instance. Although a commendable goal, "the fact that he borrowed from those retirement funds and now wishes to pay the loans back is not a life altering circumstance of the kind referenced in the statute. It is simply the consequence of a prior financial decision." *Smith*, 388 B.R. at 888.

It appears that borrowing from a 401(k) is not an uncommon approach for many debtors, usually stemming from their "longstanding general inability to keep up with their obligations to creditors." *Thompson*, 370 B.R. at 773; *see also In re Mowris*, 384 B.R. at 240; *In re Turner*, 376 B.R. at 378. Indeed, if the original unsecured consumer obligation could not be considered a special circumstance, it would seem problematic to find "special circumstances" for the 401(k) loan that merely replaced those debts. *See In re Jackson*, 2008 WL 5539790 at *3 n. 20 (Bankr.D.Kan.2008); *cf. Turner*, 376 B.R. at 378–79 (401(k) repayment may be special circumstance if taken out for a "special" reason other than general financial problems preceding almost every bankruptcy).

Thus, on this record, while we agree with the bankruptcy court's bottom line conclusion, it erred by concluding Egebjerg had demonstrated special circumstances under § 707(b)(2)(B). Because Egebjerg thus did not rebut the presumption of abuse under § 707(b)(2)(A), the bankruptcy court properly dismissed Egebjerg's Chapter 7 petition.

AFFIRMED.

KEY NUMBER SYSTEM

Panel 3

Pre-Planning for the Corporate or Single Asset Filing

Honorable Redfield T. Baum, Lori Winkelman, Fred Petersen, Janet Chubb (Reno, NV)

1. **Pre-Filing Considerations in Corporate Chapter 11 Cases – Lori Winkelman**
2. **Debtor's Corporate Bankruptcy Planning Checklist – Fred Petersen**
3. **Creditor's Bankruptcy Planning Considerations – Janet Chubb**

Pre-Filing Considerations In Corporate Chapter 11 Cases

Lori Winkelman, Quarles & Brady LLP

I. Disgorgement of Retainers and Fees.

Pursuant to the Bankruptcy Code, the Debtor must seek authorization to employ professionals such as attorneys and accountants. Prior to the filing, it is common for an attorney to receive a retainer, which may or may not come from the operations of the single-asset Debtor. If the retainer comes from the operations of the Debtor, it may be subject to disgorgement. In addition, a retainer may be subject to disgorgement if the attorney does not comply with the Bankruptcy Code, or a court finds the attorney acts in bad faith. The bankruptcy court has the authority to enter disgorgement orders pursuant to §105 (inherent sanction powers), §329(b) and §330(a) (power to review reasonableness of fees paid to debtor's counsel), and Rule 9011 (power to sanction bad faith filings). See Hale v. U.S. Trustee, 509 F.3d 1139 (9th Cir. 2007) (applying §105 and Rule 9011); In re Tran, 427 B.R. 805 (Bankr. N.D. Cal 2010) (applying §329(b) and Rule 9011).

The court may direct disgorgement to the bankruptcy estate, the entity that paid the retainer or fees, or to the trustee. See In re Monument Auto Detail, Inc., 226 B.R. 219 (BAP 9th Cir. 1998) (citing §329(b)). Disgorgement may be sought by the trustee or the debtor, and is available in Chapter 7, 11, and 13 cases.

The rationale for disgorgement is that it deters counsel's non-compliance with the Bankruptcy Code. See In re BOH! Ristorante, Inc., 99 B.R. 971, 973 (BAP 9th Cir. 1989). In addition, disgorgement facilitates the bankruptcy court's "duty to see that [estate] funds are administered in a manner consistent with the intent of the Bankruptcy Code." See id. Both are implicated when counsel for a debtor-in-possession seeks allowance of an administrative claim for services rendered in a Chapter 11 case.

A bankruptcy court may order disgorgement of a retainer where counsel fails to comply with the Code's employment and compensation provisions. See In re Monument, 226 B.R. at 224-25 (failure to apply for employment authorization); In re Fraga, 210 B.R. 812 (BAP 9th Cir. 1997) (failure to file Rule 2016 disclosure). It is immaterial whether the employment or compensation would have been approved or whether the failure to comply with the Code was the result of mere negligence. An attorney cannot avoid disgorgement by arguing that the estate or

the debtor would be unjustly enriched by disgorgement. See In re Weibel, Inc., 176 B.R. 209 (BAP 9th Cir. 1994). Because failure to comply with the Code is fatal and requires disgorgement of the entire retainer and all fees paid, counsel must determine and properly disclose the source of a retainer and future compensation.

A bankruptcy court may order disgorgement where counsel has provided inadequate representation or engaged in misconduct in the prosecution of the bankruptcy case. See In re Avon Townhomes Venture, 433 B.R. 269 (Bankr. N.D. Cal 2010). Under these circumstances, the court must find that the fees are unreasonable in light of counsel's conduct under §329(b) or §330(a).[1] Rule 9011 is implicated where the misconduct is the filing, signing, or submittal of papers in bad faith. See Hale, 509 F.3d at 1140-1142.

Bad faith exists where counsel files a Chapter 11 petition when reorganization is impossible under the circumstances. See, e.g., In re Kohl, 95 F.3d 713 (8th Cir. 1996) (denying compensation; finding that reorganization was impossible because individual debtor had $90,000 in liquidated tax debt and lacked sufficient disposable income to repay the tax debt within §1129(a)(9)(C)'s six-year time limitation). Thus, counsel must conduct a reasonable investigation into the debtor's ability to reorganize before filing the petition.

Disgorgement is not a proper sanction where the attorney is not retained pursuant to §327 *and* the source of the retainer is a third-party. See In re BOH!, 99 B.R. at 973-74 (explaining that under such circumstances deterrence and preservation of estate assets are not implicated); see also In re W.T. Mayfield Sons Trucking Co., Inc., 225 B.R. 818 (Bankr. N.D. Ga. 1998) (citing BOH! and explaining that whether disgorgement is proper turns on whether payment of fees has an "adverse effect on the estate").[2]

But, regardless of the source of the retainer, fees paid to counsel for a debtor-in-possession are always subject to total disgorgement. See In re Famous Restaurants, Inc., 205 B.R. 922 (Bankr. D. Ariz. 1996). Although there is no conceivable adversity to the estate when a third party pays the retainer, disgorgement is a proper sanction to deter non-compliance with the

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[1] §329(b) applies in Chapter 7 and 13 cases. §330(a) applies in Chapter 11 cases.

[2] Court authorization of employment and compensation is still necessary where the source of the retainer is a third-party.

Bankruptcy Code's provisions relating to authorization of employment and compensation. See id.; In re BOH!, 99 B.R. at 973-74.

Some courts have held that a retainer is subject to automatic disgorgement upon conversion of a Chapter 11 case to Chapter 7 pursuant to §726(b), which requires disgorgement of claims that have already been paid in the Chapter 11 case to ensure pro rata distribution among all similarly-situated Chapter 7 claimants. See Specker Motor Sales Co. v. Eisen, 393 F.3d 659 (6th Cir. 2004).

In the Ninth Circuit, however, security retainers are not subject to automatic disgorgement under §726(b). See Dick Cepek Inc. v. Yoo, 339 B.R. 730 (9th Cir. BAP 2006). In Cepek, the Bankruptcy Appellate Panel explained that before any pro rata distributions are made under §726(b), the estate must be fully administered, reduced to cash, and any liens satisfied from such cash. Thus, to the extent that counsel has a valid and enforceable security interest in the retainer, any indebtedness secured thereunder must be repaid first. [3]

Although a retainer may not be subject to automatic disgorgement, conversion to Chapter 7 may implicate disgorgement sanctions for counsel misconduct under §105 or Rule 9011 (e.g., where counsel should have known that Chapter 11 reorganization was impossible). Therefore, it is important to always conduct a reasonable pre-filing investigation to determine, among other things, the source of the funds used to pay the retainer and whether reorganization is viable.

II. Use of Cash Collateral to Fund Retainers.

The Bankruptcy Code prohibits the use of a creditor's cash collateral without the creditor's consent or the bankruptcy court's approval. See 11 U.S.C. §363(c)(2). Cash collateral is cash in which the debtor and another entity have a "legally cognizable interest," for example, rents or profits derived from the debtor's business operations in which a creditor has a security

[3] Under Arizona and California law, a security retainer exists when funds are paid by a client and held in a trust account until counsel performs services. See Scottsdale Medical Pavilion, 159 B.R. 295, 298 (B.A.P. 9th Cir. 1993); In re Goco Realty Fund I, 151 B.R. 241 (Bankr. N.D. Cal. 1993). In a Chapter 11 case, title to the funds passes to the attorney when the bankruptcy court approves compensation. Until such time, the fees are property of the estate subject to the attorney's lien.

interest.[4] See 11 USC §363. Whether a creditor has a legally cognizable interest is a question of state law. See Scottsdale Medical Pavilion, 159 B.R. 295, 298 (B.A.P. 9th Cir. 1993).

Cash collateral controversies are common in single asset real estate cases because, absent a loan from a third-party, rents and profits are the debtor's only source of funds to pay legal fees. This problem is exacerbated as to rents; unlike other forms of cash collateral, post-petition rents are subject to the creditor's security interest. See 11 U.S.C. §552(b)(2). In addition, the existence of a security interest in rents may not be easy to ascertain because the neat rules of UCC Article 9 do not apply. See A.R.S. §33-702(B) (perfection of a security interest in rents under Arizona law). Another source of confusion is the lack of uniformity across jurisdictions. Compare A.R.S. §33-702(B) (not requiring enforcement step to perfect security interest in rents) with Cal. Civil Code §2938(a) and (c) (requiring enforcement step).

Under Arizona law, whether a security interest in rents is perfected turns on the language of the instrument (the assignment of rents). See Scottsdale Medical, 159 B.R. at 298. In Scottsdale Medical, the court found that the creditor had an interest in the rents at issue because the terms of the assignment immediately assigned the rents to the creditor upon execution and permitted the debtor to use the rents only if there were no defaults (a "present absolute assignment").[5] See id.

The rents in Scottsdale Medical would not have been cash collateral if the assignment of rents had required the creditor to take some enforcement step, such as noticing the default and making a demand for rents (a "conditional absolute assignment"). See In re Goco Realty Fund I, 151 B.R. 241 (Bankr. N.D. Cal. 1993). Until such time, the creditor's security interest is conditional, and therefore, is not a "legally cognizable interest." In other jurisdictions, California for example, an enforcement step is always necessary. See Cal. Civil Code §2938(c) (requiring enforcement step for absolute and conditional absolute assignments).[6]

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[4] The definition of cash collateral is broad enough to encompass interests other than security interests, such as setoff rights. See COLLIER ON BANKRUPTCY ¶ 363.03[a][3].

[5] This mechanism is akin to a license. The creditor is entitled to collect the rents directly, but permits the debtor to collect the rents if the debtor is not in default of the agreements secured by the assignment.

[6] California's statute states:

Given the nature of rents, debtor's counsel must review the applicable non-bankruptcy law and the relevant agreements to determine whether they may constitute cash collateral.

III. Artificial Impairment.

Bankruptcy Code §1124 states that "a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan . . . leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest." See 11 U.S.C. §1124(1). The Ninth Circuit has interpreted this definition broadly such that "any alteration of the rights constitutes impairment even if the value of the rights is enhanced." See In re L&J Anaheim Assocs., 995 F.2d 940, 942 (9th Cir. 1993) (internal citations omitted).

Impairment of a claim does not require that a plan be altered to a particular degree, but merely that a creditor's rights are in fact altered. See In re Patrician St. Joseph Partners Ltd. Partnership, 169 B.R. 669, 678 (Bankr. D. Ariz. 1994). Arguments that a debtor could have avoided impairing a claim are unavailing. A court will not ask "whether alternative payment structures could produce a different scenario in regard to impairment of classes; nor does the Code require that a plan proponent use all efforts to create unimpaired classes." See id.

Objecting creditors, however, are not without recourse. A court may properly refuse to confirm a plan on the basis of a debtor manufacturing an impaired class merely for the purpose of garnering votes of such classes in favor of its plan. Although a court may avoid questioning a

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> *Upon default of the assignor* under the obligation secured by the assignment of leases, rents, issues, and profits, the assignee shall be entitled to enforce the assignment in accordance with this section. *On and after the date the assignee takes one or more of the enforcement steps described in this subdivision,* the assignee shall be entitled to collect and receive all rents, issues, and profits . . . .

Cal. Civil Code §2938(c) (emphasis added). Compare with Arizona's statute, which states:

> *A mortgage or trust deed may provide for an assignment* to the mortgagee or beneficiary of the interest of the mortgagor or trustor in leases, rents, issues, profits or income from the property covered thereby, *whether effective before, upon or after a default* under such mortgage or trust deed or any contract secured thereby . . . .

A.R.S. §33-702(B) (emphasis added).

debtor's motives in determining whether a class is impaired under Section 1129(a)(10), such motives are appropriately examined in deciding whether or not a plan was proposed in good faith under Section 1129(a)(3). See L&J Anaheim Assoc., 995 F.2d at 943 n.2; In re Hotel Assoc. Of Tucson, 165 B.R. 470, 474-75 (9th Cir. BAP 1994) (instructing the lower court to recognize that the act of impairment in an attempt to gerrymander a voting class of creditors is indicative of bad faith).

In In re L&J Anaheim Assoc., the court recognized that permitting debtors to manufacture an impaired class for the purpose of obtaining class acceptance for a plan should not be allowed. 995 F.2d at 943 n.2. Other courts have come to the same conclusion. See, e.g., In re Woolley's Parkway Center, Inc., 147 B.R. 996, 1003 (Bankr. M.D. Fla. 1992) ("To illustrate further the lack of good faith of the Debtor . . . , need only consider the crass . . . attempt to manipulate . . . by artificially creating an impaired class . . . ."); In re Meadow Glen, Ltd., 87 B.R. 421, 427 (Bankr. W.D. Tex. 1988) ("Where there is no need to impair, the act of impairment is an abuse.").

IV. Conclusion.

To avoid these common pitfalls, debtor's counsel must conduct a reasonable investigation before filing the Chapter 11 petition. It is important to determine and properly disclose the source of a retainer and funds that will be used to pay fees during the pendency of the case, analyze whether reorganization is viable, and whether confirmation of a plan turns on an artificial impaired class.

DEBTOR'S CORPORATE BANKRUPTY PLANNING CHECKLIST

By Frederick J. Petersen

Mesch, Clark & Rothschild, P.C.

March 7, 2011

1. CORPORATE AUTHORITY AND RESOLUTION

Authority to file a voluntary Chapter 11 petition is truly a benchmark issue that must be addressed before a filing is commenced. In most situations where a debtor is adverse to a secured lender or another group of creditors, corporate authority may not be a significant issue because the debtor is unified against those third parties. However, if the company has a dispute within ownership, or a secured creditor has obtained control over the voting rights related to any part of the entity, a Chapter 11 filing may not be possible. The debtor must follow the procedures articulated in its corporate documents, so that the act of a Chapter 11 filing is appropriately authorized, and an individual has authority to file the petition and sign all related documents on behalf of the entity.

NOTE: 11 U.S.C. §303(b)(3) provides that in order to file a voluntary petition for a partnership, there must be a consensus of all general partners. Without a consensus of all general partners, the petition must be filed as an involuntary case, and all of the objection provisions in 11 U.S.C. §303 to an involuntary petition are reserved for a general partner who did not join in the petition. *See In re Cloverleaf Properties*, 78 B.R. 242 (9th Cir. 1987).

2. CONTROL OF ESTATE PROPERTY

The filing of a reorganization petition typically results in the continued operation of the debtor's affairs, with all assets and control vested in the debtor in possession. However, in planning for a bankruptcy, a careful review needs to be completed so that estate property is not lost, and placed beyond the reach of the reorganization estate once a petition is filed. Important considerations include the filing of a petition before:

(a) foreclosures or repossessions are completed, *See In re Hoopai,* 581 F.3d 1090, (9th Cir. 2009), [non-judicial foreclosure auction conducted, but affidavit of sale not recorded, as required by Hawaiian law, to complete sale before bankruptcy filing—assets determined to be property of the estate] ;

(b) leases are terminated;

(c) A custodian or receiver remains in possession and control for more than 120 days (See 11 U.S.C. §543(c)).

Generally, debtors file bankruptcy petitions prior to foreclosures, lease terminations, or the appointment of receivers, when applicable, so that there is no dispute as to who controls estate property.

3. IS THIS A "SINGLE ASSET REAL ESTATE CASE?"

With the substantial creditor protections included in the 2005 changes to the bankruptcy code, whether a case is a "Single Asset Real Estate" case is important. The determination may make a difference on the timing of a plan and the duration of the automatic stay (See 11 U.S.C. 362(d)(3)). Such a determination does not make a successful reorganization impossible, but it is certainly more difficult to meet the 1129 requirements in the circumstance where a secured creditor has a lien on all assets, can object to the use of cash collateral, and holds what may be a control vote in the unsecured class of creditors. *See in re Fort Lowell Retail, LLC,* 2011 WL 609793 (Bankr.D.Ariz. 2011)

a. 11 U.S.C. 101(51B)—defines "Single Asset Real Estate" as:

"real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor who is not a family farmer and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental."

b. But the definition is not the entire story. Courts look to the nature the assets and carefully analyze whether the assets are assembled for a single project. Courts consider whether the separate parcels are contiguous, whether there are different development plans for different parcels, whether the intended uses will yield active or passive revenue, and whether as actually used, different plans and income are apparent. *See Sargent Ranch, LLC,* 2010 WL 3189714 (S.D.Cal 2010)*; See also Pioneer Austin East Development I, LLC,* 2010 WL 2671732 (Bankr.N.D.Tex. 2010) [Separate tracts of land assembled for claimed different purposes and development, but all part as one project. Notably, various tracts had different lenders, so as to create different classes of secured creditors—but determined to be a single asset real estate case]*; See also Kara Homes,* 363 BR 399 (Bankr.D.N.J. 2007)

4. GUARANTOR ISSUES

a. Who is the Client?

Once an entity is insolvent, principals and counsel are to act as fiduciaries for the benefit of the estate and its creditors. *See In re Southwest Supermarkets, LLC,* 325

B.R. 417 (Bankr.D.Ariz. 2005). The obligation can be difficult to maintain, when ultimately, minimizing the deficiency owed by a guarantor is the reason for a bankruptcy filing. Even more difficult, is the practical issue when the sole source for funding a plan, is the very guarantor being simultaneously sued by a creditor.

b. Bankruptcy Relief for Third Parties

i. *In re Regatta Bay, LLC*, 406 B.R. 875 (Bankr.D.Ariz. 2009) reversed by *In re Regatta Bay, LLC*, 2009 WL 5730501 (D.Ariz. 2009). (Judge Haines)

ii. *In re Linda Vista Cinemas,* 2010 WL 4882773 (Bankr.D.Ariz. 2010). (Judge Marlar)

iii. Several bankruptcy courts have issued injunctions in favor of non-debtors who agree to make financial contributions to a debtor's reorganization. *See In re Finley, Kumble, Wagner, Heiner, Underberg, Manley, Myerson & Casey*, 85 B.R. 13 (Bankr. S.D.N.Y. 1988); *In re Myerson & Kuhn*, 121 B.R. 145, 157 (Bankr. S.D.N.Y. 1990).

iv. Other Courts have determined injunctions are appropriate if seven factors are met: 1) there is an identity of parties such that a suit against the non-debtor is a suit against the Debtor and will deplete assets of the estate; 2) the non-debtor has and will contribute significant assets to the reorganization; 3) the injunction is essential to reorganization; 4) the classes have primarily voted to accept the plan; 5) the plan pays all or

substantially all of the classes affected by the injunction; 6) claimants who choose not to settle recover in full on their claims; and 7) the bankruptcy court makes a record of specific factual findings that support its conclusions. *In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002); *In re A.H. Robins Co.*, 880 F.2d 694 (4th Cir. 1989); *MacArthur v. Johns-Manville, Corp.*, 837 F.2d 89, 92-94 (2nd Cir. 1988).

v. *In re Airadigm Communications, Inc.* 519 F.3d 640, 656 (C.A.7 (Wis.) 2008)

vi. *In re Seatco, Inc.*, 257 B.R. 469, 475 *opinion modified on reconsideration*, 259 B.R. 279 (Bankr. N.D. Tex. 2001)

vii. *In re Acorn Hotels, LLC*, 251 B.R. 696, 702 (Bankr. W.D. Tex. 2000)

5. TIMING THE FILING

There are many factors that must be considered when timing the filing.

(a) Payment of employees.

Although courts and creditors regularly authorize the payment of prepetition wages to employees in circumstances where it makes sense to continue the operation of the business, the filing should be timed to minimize the impact on employees. To this end, there are a few considerations:

(i) To the extent you have handed out pay checks, but those pay checks have not been cashed, a bankruptcy filing is going to freeze all bank accounts and prevent people from cashing their pay checks. The bankruptcy should be timed, if possible, so employees have a reasonable time to cash their checks before the filing, so as to not get caught by the frozen bank accounts.

(ii) Authority needs to be obtained from the court before pre-petition wages can be paid. This mean the case needs to be filed, the first day motions noticed, a hearing set and conducted, and an order entered by the court before the next payroll can be made. A filing the day before a payroll is due is not practical in order to meet the payroll obligation.

(iii) Minimize pre-petition wages to the extent possible – various employers pay employees on different schedules, but most of the time pay to some extent in arrears. If the filing can be timed so as to minimize the arrearage that represents a pre-petition claim of the employees, it is beneficial to employee relations, and to reduce the stress and uncertainty of your employees.

(b) Preferences, Fraudulent Conveyances.

Payments on antecedent debts made within the 90 days before a bankruptcy is filed, or fraudulent conveyances made within a year before the petition, are susceptible to being set aside post bankruptcy.

See In re Circuit City Stores, 2010 WL 4956022 (Bankr.E.D.Va. 2010) [Creditor may only claim payment one time, and cannot use credit from pre-petition deliveries as a 547(c)(4) new value defense to preference claims, while also asserting an 11 U.S.C. 503(b)(9) claim for the same monies.]; *TI Acquisition LLC v. Southern Polymer, Inc.*, 429 B.R. 377 (Bankr.N.D.Ga 2010) [Once creditor has allowed admin claim for delivery of goods, creditor may not assert a new value defense for delivery of the same goods.].

See In re Tousa, Inc., 422 BR 783 (S.D.Fla 2009), Overturned on Appeal, *In re Tousa, Inc.* 2011 WL 522008 (S.D.Fla 2011).

6. PROFESSIONAL RETAINERS

The Bankruptcy Code prevents the payment of professional persons (attorneys, accountants) after the filing of the bankruptcy petition from estate resources, except upon court authorization and after a notice to creditors. To the extent all of the assets of a debtor are encumbered, the secured lender will need to agree to a carve out or be compelled to a surcharge, in order to pay the professional persons. In order to avoid these problems, pre-petition retainers are typically paid to avoid the restrictions upon transfer of estate property to professionals. Court approval is still necessary before the retainers can be drawn down, but it avoids an issue of the fight about the transfer of estate property.

See In re Renfrew Center of Florida, Inc., 195 B.R. 335 (E.D.Pa. 1996) [Receipt of prepetition retainers did not disqualify law firm from representing two co-debtors, despite fact that retainers were paid entirely from funds consisting of receipts from debtors' accounts receivable, in which objecting bank had prior secured interest via a blanket lien against all of debtors' assets.]

See In re Jeep Eagle 17, Inc. 2009 WL 2132428 (D.N.J. 2009) [Retainer payment made to counsel for one entity, from cash collateral of a different entity (a co-debtor), creates a conflict that may prevent counsel from representing both entities. If disqualified, retainer may be subject to disgorgement.]

7. PAYMENTS TO NECESSARY SUPPLIERS

When the debtor's business is dependent upon provisions from particular suppliers, arrangements should be made pre-petition for the orderly access to such necessary ingredients, notwithstanding the bankruptcy. Frequently, key suppliers require that an account be brought current, will change an account to cash on delivery for all goods provided post bankruptcy, or will require the posting of a deposit, often depending on the frequency of the deliveries. Regardless of the particular arrangements, the lines of supply need to be examined and preserved before a petition is filed.

NOTE: Such payments may trigger a preference issue for the vendors if the case does not repay creditors in full.

8. PAYMENT OF UTILITIES

A business cannot operate without all necessary utilities remaining on. 11 U.S.C. §366 authorizes the utilities to demand and requires the debtor to provide "adequate assurance of payment" as defined in the statute. If such adequate assurance of payment cannot be provided within 20 days from the filing, the statute allows the utility to alter, refuse, or discontinue service. In order to avoid these problems, utilities should be paid current, so they are not creditors of the bankruptcy estate. To the extent utility companies have some claim for a stub period, request should be made to authorize and allow those pre-petition payments, in exchange for the requirement to post cash deposit or letter of credit required as an assurance of payment.

9. HOLD ONTO CASH

While the Bankruptcy Code allows the debtor powers to do many things, the Bankruptcy Code cannot be used to force a creditor to continue lending money or make credit available post bankruptcy. A filing virtually automatically triggers increased cash flow needs to pay cash in advance of deliveries, post security deposits to vendors and utilities, and to compensate for slowed collection of accounts receivable. A bankruptcy also leads to other incumbent expenses such as ordering new check stock and locating new, and sometimes more expensive vendors. To anticipate such cash needs, a debtor should hold onto its cash prior to a bankruptcy filing sufficient that the debtor can get through the first few months of the bankruptcy case, with the cash on hand. Such cash may be cash collateral of the secured creditor, and appropriate adequate protection must be provided for using such monies. However, to the extent any cash is not encumbered and would not constitute cash collateral, it should be segregated so it can be used as needed, without the objection of the secured creditor.

10. MAKING SURE THERE ARE IMPARIED CREDITORS

(a) Reviewing classes of creditors.

In a single asset real estate case, the secured creditor typically has a lien on the principal asset of the debtor, and possibly a deficiency, that may control the voting of the unsecured class of creditors. In order for a case to emerge from bankruptcy, there has to be an impaired, consenting class of creditors that vote in favor of the reorganization plan, before a cramdown over the objection of the secured creditor is possible.

See in re Fort Lowell Retail, LLC, 2011 WL 609793 (Bankr.D.Ariz. 2011) [More favorable treatment to administrative convenience class of creditors proved the debtor unable to meet 1129 requirements for objecting secured creditor who controlled unsecured class.]

See In re Loop 76, LLC, 2010 WL 5544491 (Bankr.D.Ariz. 2010) [Holding a debt, for which there is another, non-debtor source of repayment, is not "substantially similar" to other unsecured creditors, and may be separately classified.]; *See also Steelcase, Inc. v. Johnston,* 21 F.3d 323 (9th Cir. 1994); *In re Barakat*, 99 F.3d 1520 (9th Cir. 1996).

(b) Other secured creditors.

Customer deposits, secured vendor claims based upon vendor deposits, other secured creditors (auto or equipment loans),

(c) Accountants, architects, consultants, landscapers, janitorial supply

(d) Priority creditors. Real estate taxes, priority taxes, withholding taxes, impact fees, . . .

(e) Anticipate Possibility of the Secured Creditor Buying Claims

See In re DBSD North America, Inc., 419 B.R. 179, (Bankr.S.D.N.Y. 2009); *affirmed in part, reversed in part,* 2010 WL 1223109 (S.D.N.Y. 2010); *affirmed in part, reversed in part, 627* F.3d 496 (2nd Cir. 2010). [Discussion of basis for designating votes of creditors for "not in good faith."]

11. SETOFFS

The Bankruptcy Code specifically provides that bankruptcy law will not affect state setoff law. 11 U.S.C. 553. However, the automatic stay may prevent a creditor from unilaterally accomplishing this. In any case, before filing a petition, a debtor and his counsel should examine the potential for setoffs and make necessary arrangements with creditors, to the extent appropriate.

12. BANK ACCOUNTS

A bankruptcy debtor, for strategic purposes, may want to establish accounts at a new bank, other than one of its lenders that will be a creditor in the bankruptcy estate. Based on the requirements of the U.S. Trustee, the list of approved depositories should be reviewed.

13. FINANCING THE EXIT STRATEGY

(a) Money for initial creditor distributions.

Impaired classes of creditors must be incentivized to read the plan and disclosure statement, and return their ballot. Without some initial payment, experience shows it unlikely that creditors will spend their time supporting a Plan. A source of funds must be available to fund an initial distribution.

(b) PACA Trust issues.

By definition, PACA trust monies are not property of the bankruptcy estate. However, in order to prevent PACA creditors from seizing assets and accounts with PACA trust characteristics (the automatic stay does not stop them), PACA claims must be dealt with and repaid. Typically, payment of such claims takes priority over a secured creditor with a blanket lien on accounts and accounts receivable, but paying such amounts may critically injure the estate's reorganization prospects.

(c) Trade debt/reclamations/§503(b)(9) administrative claims

11 U.S.C. 503(b)(9) grants an administrative priority claim to vendors who sell goods to the debtor in the ordinary course of the debtor's business, and to the extent such goods are delivered within the 20 days prior to the commencement of the case. This administrative burden can be substantial, and must be anticipated for an exit strategy to be crafted.

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CREDITOR'S BANKRUPTCY PLANNING CONSIDERATIONS

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The role of a creditor in a pre-bankruptcy setting will be most influenced by whether the creditor is secured or unsecured. In a typical bankruptcy, individual unsecured creditors have very little leverage to influence proceedings once the debtor has filed. Trade creditors, who are usually unsecured, are generally advised to stop extending credit to help ensure payment and prevent or limit the risk of preference liability. Secured creditors, on the other hand, may have many more options to protect their interests depending on the nature of the collateral and their priority with respect to other creditors.

I. TRADE DEBT AND CRITICAL VENDORS

Trade creditors typically extend credit on an unsecured basis, expecting payment within 30 to 60 days of having shipped product. Creditors with an ongoing relationship with the debtor may quickly build a substantial debt if product continues to ship while the debtor's payments either slow in frequency or stop altogether. Even worse, the trade creditor may be subject to preference liability and be forced to essentially refund some or all payments received from the

debtor during the 90-day period before the debtor's bankruptcy filing, if such payments are not protected by any of the preference defenses set forth in 11 U.S.C. § 547. Because the bankruptcy trustee has two years to bring such actions, the creditor may find itself paying such preference liability years after parting ways with the defunct debtor.[1] Despite these challenges, trade creditors may take certain pre-filing actions to limit or reduce the adverse impact from a debtor's filing.

A. Reducing Preference Risk

The Bankruptcy Code[2] permits the trustee of the bankruptcy estate to avoid any transfer of an interest of the debtor in property made on antecedent debt while the debtor was insolvent on or within the 90 days before the debtor's bankruptcy filing.[3] To avoid the risk that the bankruptcy trustee will avoid payments made to satisfy antecedent debt, the creditor may require an insolvent debtor to prepay for goods and services or pay contemporaneously with delivery. Eliminating trade debt altogether provides the creditor certainty that future payments will not be subject to preference liability, but the creditor is still potentially liable for all payments received in the 90 days prior to the change in payment terms and will not be totally insulated from risk until 90 days after such change.

Demanding prepayment is not always practical, especially in light of the debtor's financial trouble. Preference law strives to reward trade creditors who continue to extend credit to debtors during the prepetition period by providing the defenses in 11 U.S.C. § 547. By modeling their behavior to match these defenses, knowledgeable trade creditors may improve their chances of retaining payments received during the preference period. Still, creditors should not forgo opportunities to get paid simply because they are concerned about preference liability.

[1] 11 U.S.C. § 546(a)(1)
[2] 11 U.S.C. § 101 et seq.
[3] 11 U.S.C. § 547(b)

The creditor is almost always better off accepting a payment prepetition and defending its retention rather than trying to get paid post-petition.

1. Ordinary Course of Business Defense[4]

A trustee may not avoid a payment on a debt that was incurred in the ordinary course of business or financial affairs of the debtor and the creditor and was either (i) paid in the ordinary course of business between the debtor and the creditor, or (ii) paid according to ordinary business terms.[5] A creditor who seeks the protection of this defense will benefit from maintaining consistent dealings with the debtor during the potentially turbulent pre-filing period. A creditor who engages in special collection practices during the 90-day preference period will probably have a weaker ordinary course of business defense.[6] Again, creditors should not abstain from collection efforts, or forgo getting paid, merely because of preference risk. Ideally, a creditor will establish a policy for collection of overdue debts and maintain conformance with that policy both before and after the preference period to establish a strong ordinary course of business defense.

The creditor should also be aware of any credit terms that differ substantially from credit terms typically used in the creditor's industry. Granting a struggling debtor longer credit terms than the creditor uses with other customers or that include other special accommodations will decrease the likelihood that payments meet the ordinary course of business defense. Creditors who desire protection from the ordinary course of business defense should maintain consistent dealings with struggling debtors regardless of their financial condition.

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[4] 11 U.S.C. § 547(c)(2)
[5] *Id.*
[6] *In re Stratosphere Gaming Corp.*, 23 Fed.Appx. 749, 750 (9th Cir. 2001).

2. Subsequent New Value Defense[7]

A transfer received by a trade creditor during the 90-day preference period may not be recovered by the trustee to the extent that, after such transfer, the creditor gave new value to the debtor.[8] To maximize the benefit of this defense, the creditor should attempt to continue shipping product to the debtor on an unsecured credit basis. The value of shipments made on an unsecured basis will offset the payments received prior to that shipment. Creditors should be wary that slowing shipments while the debtor is still paying may reduce the benefit of this defense. The creditor receives an offset only for value given subsequent to receipt of a preferential payment, so a creditor who refuses to make further shipments until a debtor's balance is current runs the risk of receiving substantial payments that will have no new value offset.

B. Critical Vendors

Bankruptcy courts are courts of equity, and they have used their equitable powers to permit payments to "critical vendors" that might not otherwise be permitted under the Bankruptcy Code.[9] Because payments to critical vendors are not clearly allowed under the Bankruptcy Code, courts fashion such payments on a case-by-case basis with the underlying goal of preserving the debtor's business as a going concern and enhancing value to the bankruptcy estate.[10] To be considered a critical vendor, the goods and services provided by the creditor to the debtor must be so important that the debtor's business would likely collapse if such

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[7] 11 U.S.C. § 547(c)(4)

[8] *Id.* The new value provided by the creditor only offsets liability to the extent the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor on account of such new value. *Id.*

[9] 11 U.S.C. § 105(a) ("the court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.") *See, e.g. In re Just for Feet, Inc.*, 242 B.R. 821, 824 (D. Del. 1999); *In re Lehigh & New England Ry. Co.*, 657 F.2d 570, 581 (3rd Cir. 1981); *In re Ionosphere Clubs, Inc.*, 98 B.R. 174, 175 (Bankr. S.D.N.Y. 1989).

[10] *In re Berry Good, LLC*, 400 B.R. 741, 747 (Bankr. D. Ariz. 2008).

shipments were to cease. In *In re A&A Dairy*, a case filed by a dairy farm in the District of Nevada, the court awarded critical vendor status to a supplier of cattle feed because the feed was necessary to keep the cattle alive.[11] Not only did the court permit the cattle feed supplier to be paid, it also allowed the supplier to retain a second deed of trust granted prepetition during the preference period. Similarly, courts have permitted a debtor consisting of a chain of movie theaters to pay suppliers of film and have permitted a shoe retailer to pay shoe suppliers for shipments needed for the holiday season.[12] Thus, during the pre-bankruptcy period, a trade creditor should consider whether the goods and services it provides to the potential debtor are so critical that the creditor could be granted "critical vendor" status. It is important for such creditors to negotiate their treatment as a critical vendor prepetition because many debtors move for authority to pay critical vendors on the first day of filing.

II. SECURED CREDITORS AND CONTROL OF ESTATE PROPERTY

One of the primary reasons debtors file bankruptcy cases is to obtain the protection of the automatic stay imposed on creditors upon filing, which prevents creditors from initiating or continuing collection proceedings.[13] The secured creditor has several tools at its disposal that may help avoid a bankruptcy altogether if the secured creditor can exercise its remedies before the debtor is able to file.

A. Foreclosure – Real and Personal Property

Foreclosure on real and personal property is dictated by state law. The uniform commercial code, which has been adopted in generally similar fashion in all 50 states, sets forth the procedure for foreclosure on personal property. So long as the secured creditor does not

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[11] Case No. 10-52539 (Order filed Jan. 4, 2011).
[12] *In re Wehrenberg, Inc.*, 260 B.R. 468 (Bankr. E.D. Mo. 2001); *In re Just for Feet, Inc.*, 242 B.R. at 824.
[13] 11 U.S.C. § 362

breach the peace, upon default the secured creditor may repossess collateral secured under Article 9 of the UCC and sell the collateral at public auction or private sale on ten days notice to the owner.[14] Thus, personal property may be recovered and sold quickly and inexpensively.

In circumstances where it is not practical to recover the personal property without a breach of the peace, the secured creditor may have to institute a replevin action under state law. This option is less favorable due to the cost of litigation and the time associated with obtaining a court order. Filing the suit will put the debtor on notice, who may have sufficient time to file a bankruptcy and obtain the protections of the automatic stay.[15]

Foreclosure of real property is not controlled by a uniform code, but is unique to the statutory law of the state where the real property is located. Many states allow for non-judicial foreclosure pursuant to publication of the sale and public auction. Again, a debtor who desires to avoid loss of valuable real property will often have time once notice is given to file a bankruptcy to obtain the protection of the automatic stay. Thus, a secured creditor who has not yet committed to foreclosure of real property must evaluate whether the debtor is likely to file a bankruptcy to save the property. Some factors to consider are the value of the property relative to the debtor's total assets, whether the property is critical to the debtor's business, whether the value of the collateral justifies the risk of debtor's possible filing, and whether the debtor has other assets with which to satisfy the debt. At a minimum, secured creditors should file their notice of default immediately. Once a secured creditor has concluded foreclosure is necessary, it should move forward as quickly as the foreclosure process will allow.

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[14] U.C.C. 9-612
[15] 11 U.S.C. § 362

B. Receivership

Another remedy available to the secured creditor in a pre-bankruptcy setting is the appointment of a receiver. Appointment of a receiver is generally appropriate when the secured creditor has a lien on assets that might otherwise be dissipated, wasted, misappropriated, or unlawfully diverted by current management.[16] The advantage of a receivership is that it can often be obtained quickly to preserve assets when dealing with a difficult debtor. State courts will often appoint a receiver on an expedited basis, which prevents giving the debtor time to file a bankruptcy petition before the order is granted. The practical effect of wresting control of the business or its critical assets from the debtor is that it may discourage filing of bankruptcy. Further, appointment of a receiver prepetition may yield helpful findings of fact from the state court that can be offered in a subsequent bankruptcy case to support a motion to appoint an examiner, trustee, or other responsible person.

Note, however, that if a debtor elects to file a bankruptcy after a receiver has been appointed, the receiver will be required to turn over the debtor's property to the bankruptcy estate.[17] To prevent the receiver's turnover of property, the creditors must show either (i) that the creditor's interests are best served by retaining the receiver, or (ii) the receiver has been in possession for more than 120 days.[18]

C. Assignment of Leases and Rents

Most mortgages and deeds of trust include an assignment of leases and rents granted by the debtor in favor of the secured lender. In virtually every case, rents generated by the debtor's real property are a valuable asset for repayment of debt. In some jurisdictions it is important for

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[16] John D. Ayer & Michael L. Bernstein, *American Bankruptcy Institute: Bankruptcy in Practice*, § 6.27 (4th ed. 2007)
[17] 11 U.S.C. § 543.
[18] 11 U.S.C. § 543(d)

the secured creditor to "activate" its rights under the mortgage before the debtor files for bankruptcy. This often is as simple as sending a notice letter declaring the default under the debt and demanding all rents be paid to the lender. Some jurisdictions also require that the secured lender send demand letters to tenants stating that all future rent payments should be made directly to the lender. Regardless of what may be required, it is good practice for a secured lender to begin collecting rents as early as possible. The automatic stay will prevent the secured lender from collecting rents post-petition until the stay is lifted. The secured lender will receive some protection from the fact that the rents constitute the secured creditor's cash-collateral post-petition, which the debtor cannot use without leave from the bankruptcy court or consent of the secured creditor.[19]

D. Termination of Leases

The Bankruptcy Code grants debtors the right to elect to assume or reject executory contracts and unexpired leases.[20] If the debtor's rights under an unexpired lease are valuable, the debtor will probably execute its right to assume such contract and assign it to a third party thereby capturing the value of the leasehold interest for itself. A landlord in such a position should seek to terminate the lease, if possible, before the debtor files. Termination will allow the landlord to remove the debtor from the property and lease the property to a new tenant, capturing the benefit of the valuable leasehold for itself rather than allowing the debtor to acquire it.

III. USE OF CASH AND RIGHT OF SETOFF

Some of the biggest battles in bankruptcy court erupt over the use of cash collateral. A debtor cannot use cash that constitutes a secured lender's collateral without approval from the

[19] 11 U.S.C. § 363(c)(2).
[20] 11 U.S.C. § 365

bankruptcy court or consent from the secured lender.[21] Due to such restrictions, the debtor is likely to manipulate its cash position to try to make cash available for use post-petition. The secured lender should take all efforts prepetition to secure as much cash as possible. The secured lender is most often a bank, and the lender should ensure that the debtor's cash is held in accounts at the bank and not in accounts with another institution. Even if the debtor is granted the right to use cash by court order, the secured lender can better police such use when the withdrawals and deposits are made on accounts with the secured lender.

A bank holding cash in accounts owned by the debtor may set off its obligation to pay those funds to the debtor by the amount of the bank's own claim. The right of setoff under state law is recognized in the Bankruptcy Code.[22] There are some key issues, however, that a creditor should note. First, both the claim of the creditor, and the obligation owed to the debtor must have arisen prepetition.[23] The creditor cannot set off a prepetition claim against funds acquired by the debtor post-petition.[24] Second, a creditor may only set off against an allowable claim.[25] If the creditor's claim is later disallowed, any setoff against such claim is recoverable by the trustee. A creditor must also be careful when applying setoff rights within the 90 days prior to the bankruptcy filing. To the extent that the creditor was able to set off a greater amount during that 90-day period than it would have been able to set off on the day the period commenced, the trustee may avoid the incremental improvement in the creditor's position.[26] Thus, while setoff

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[21] 11 U.S.C. § 363(c).
[22] 11 U.S.C. § 553.
[23] *Id.*
[24] *e.g. Hood v. Brownlee*, 62 F.2d 675 (4th Cir. 1933); *In re Kleather*, 208 B.R. 406 (Bankr. S.D. Ohio 1997).
[25] 11 U.S.C. § 553(a)(1).
[26] 11 U.S.C. § 553(b)

rights are generally recognized under the Bankruptcy Code, a creditor with such rights should be aware that such rights have certain limitations in a bankruptcy context.

IV. ARTIFICIAL IMPAIRMENT

The Bankruptcy Code requires that at least one impaired class accept a chapter 11 plan to permit the other provisions of the plan to be crammed down on the remaining impaired classes.[27] If an impaired class has accepted the plan, the court may approve the plan over the refusal of other impaired classes to accept the plan if the plan does not discriminate unfairly, and is fair and equitable with respect to each class of claims that is impaired and has not accepted the plan.[28] Creditors should be wary, however, of efforts by debtors to artificially impair a class of friendly creditors in an effort to cram down unfavorable treatment on other impaired creditors. The minor impairment of an unsecured class of creditors solely to create an accepting impaired class may be contested as unimpaired.[29] Such an effort by the debtor may be deemed to violate good faith requirements under the Bankruptcy Code.[30]

V. PREPACKAGED BANKRUPTCY PROVISIONS

Within the course of a workout negotiation before a debtor files bankruptcy, a creditor may attempt to obtain favorable bankruptcy treatment. Negotiations can include an agreement not to contest the secured creditor's motion for relief from stay, a stipulated budget for use of cash collateral, and even the sale of substantially all the debtor's assets with either the proceeds going to pay down the secured debt or the lender credit-bidding its interest.[31]

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[27] 11 U.S.C. § 1129(a)(10)
[28] 11 U.S.C. § 1129(b)(1)
[29] *In re Windsor on the River Assoc., Ltd.*, 7 F.3d 127 (8th Cir. 1993).
[30] *In re Dunes Hotel Assoc.*, 188 B.R. 174 (Bankr. D.S.C. 1995).
[31] 11 U.S.C. § 363.

VI. PARTICIPATION AGREEMENTS AND SYNDICATED LOANS

Many secured loans are either participated or syndicated loans. A secured lender acting as a lead bank in a participated loan must consider its rights and obligations under the participation agreement among the banks. It is important in a pre-bankruptcy setting to communicate with the other banks in the participation agreement to set a uniform strategy. A lead bank in a participated or syndicated loan should also be aware of potential litigation from participant banks who may become dissatisfied with the lead bank's actions on behalf of the group and may bring actions alleging violations of the participation or syndication agreement and any duty of care the lead bank may have therein.[32]

VII. CONCLUSION

The primary rule a creditor should remember is that it is always easier to get paid prepetition and defend keeping money than to forgo payment and attempt to collect after the debtor has filed. For that reason, creditors should aggressively seek to recover payment by all legal means before a debtor files a bankruptcy case. A creditor can almost always develop enough of a defense to its prepetition collection actions to retain some of the money it was paid. Once a creditor has concluded that foreclosure is necessary, it should move as quickly as the law will allow to give the debtor as little time as possible to react with a bankruptcy filing.

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[32] *First Citizens Federal Savings and Loan Assoc. v. Worthen Bank & Trust Co.*, 919 F.2d 510 (9th Cir. 1990).

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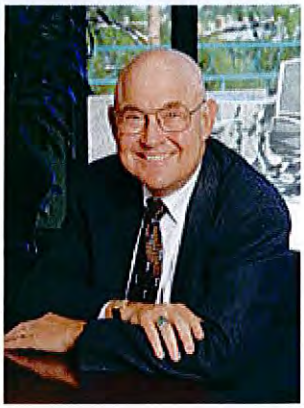

Lawrence D. Hirsch is a Shareholder practicing in both the Phoenix and Flagstaff offices. He has practiced in Phoenix for 30 years and has a broad range of experience in all aspects of Bankruptcy practice and debtor/creditor practice, including loan workouts.

Mr. Hirsch's practice includes:

• **Debtor representation**: representation of debtors in Chapters 7, 11 and 13. Mr. Hirsch has extensive experience in representing families and small businesses. This area of practice includes pre-bankruptcy workout negotiations.

• **Creditor representation**: representation of creditors in Chapters 7, 11 and 13.

• **Bankruptcy litigation**: representation of both debtors and creditors in all aspects of bankruptcy litigation including stay lift litigation, non-dischargeability litigation, claims litigation, exemptions, bad faith, and all other forms of bankruptcy litigation

• **Bankruptcy appeals**: representation of Appellees and Appellants in bankruptcy appeals to the Bankruptcy Appellate Panel, United States District Court, Ninth Circuit Court of Appeals, and the United States Supreme Court.

Mr. Hirsch received his undergraduate degree from Kenyon College with a degree in History and graduated cum laude from Gonzaga University School of Law. Mr. Hirsch was admitted to the Arizona Bar in 1977, the United States District Court in 1977, the Ninth Circuit Court of Appeals in 1995, and the United States Supreme Court in 1996. Mr. Hirsch was the recipient of the American Jurisprudence Award in Constitutional Law in 1976. He is the co-author of "Til Debts Due Us Part" Arizona Bar Journal, November 1987 and is a frequent lecturer for the State Bar of Arizona, the Maricopa County Bar Association, and PESI. He is a certified specialist in Bankruptcy Law by the State Bar of Arizona and is AV rated by Martindale Hubbell.

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Wayne Mortensen Bio

Wayne received his Bachelor of Arts Degree in Political Science from Brigham Young University in 1994. While at Brigham Young he had the opportunity to live in Washington D.C. and complete an internship for Congressman John Rhodes.

After completing work at Brigham Young, Wayne received his Juris Doctorate from California Western School of Law. It was at Cal Western where Wayne became interested in Bankruptcy Law. During his final semester at law school he was accepted to an externship with Judge Charles Case (U.S. Bankruptcy Judge District of Arizona).

Wayne's practice is limited to consumer law with a strong focus on Chapter 7 and Chapter 13 bankruptcy. During his 13 years of practice he has helped thousands of individuals and small businesses successfully navigate the convoluted area of bankruptcy law.

He is a frequent speaker at various State Bar professional education seminars.

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Retail & Consumer Products

Richard M. Lorenzen | Partner

Richard Lorenzen, a partner in the firm's Business practice, focuses on bankruptcy, creditors' rights and commercial litigation.

Professional Recognition

- Peer Review Rated AV in *Martindale-Hubbell* (AV®, BV® and CV® are registered certification marks of Reed Elsevier Properties Inc., used in accordance with the Martindale-Hubbell certification procedures, standards and policies.)
- Listed in *The Best Lawyers in America*

Professional Leadership

- American Bar Association
- State Bar of Arizona
- Maricopa County Bar Association

Community Involvement

- American Bankruptcy Institute, Committee on Health Care Insolvency, Founding Member
- Arizona State University College of Law Alumni Association, Past President

Related Employment

- O'Connor, Cavanagh, Anderson, Killingsworth & Beshears, P.A., Phoenix, Associate, 1982 - 1989; Partner, 1989 - 1999

Education

- London School of Economics, LL.M., 1981
- Arizona State University, Sandra Day O'Connor College of Law, J.D., 1980 Editor, *Arizona State Law Review*
- Occidental College, B.A., 1977

Bar Admissions

- Arizona

Court Admissions

- U.S. Supreme Court
- U.S. Court of Appeals for the Sixth Circuit
- U.S. Court of Appeals for the Ninth Circuit
- U.S. District Court for the District of Arizona

Highlights

Perkins Coie's Retail Group Ranked #1 Nationally by *Chambers USA*

Perkins Coie's Bankruptcy &

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Workouts Practice Listed Band 1
in *Chambers USA: America's Leading Lawyers for Business*

EDWARD K. BERNATAVICIUS is a trial attorney with the Office of the United States Trustee. He concentrates on a full spectrum of bankruptcy issues concerning consumer and commercial bankruptcy law. Upon arriving in Arizona, Mr. Bernatavicius worked with the Phoenix Law Firm of Allen, Sala & Bayne PLC where he assisted with representation of Chapter 7 trustees and corporate chapter 11 cases. Prior to arriving in Arizona, Mr. Bernatavicius lived in Southern New Jersey and worked for six years for the Law Office of John R. Morton, Jr. where he concentrated his practice on creditors rights in consumer bankruptcy proceedings throughout New Jersey and Pennsylvania. Mr. Bernatavicius was the Managing attorney for the firm=s creditors rights practice in Pennsylvania. While in New Jersey, Mr. Bernatavicius, was a Barrister in the New Jersey, Bankruptcy Inns of the Court, and was the only attorney selected by the New Jersey Bankruptcy Clerk of the Court=s Office to participate in their pilot program regarding court appearances by use of video technology.

Mr. Bernatavicius earned his bachelor of science from Lynchburg College in Lynchburg, VA in Political Science and Public Speaking. He was President of the Student Body his senior year and graduated cum laude. He earned his juris doctorate from the University of Villanova, School of Law and was elected commencement speaker by his graduating class.

Mr. Bernatavicius is the United States Trustee liaison to the Bankruptcy Section Executive Council and is currently serving his second term as Co- Chair of the Bankruptcy Section Day for the 2010 State Bar Convention.

Warren Stapleton is a member of Osborn Maledon. He was admitted to the bar in 1997 and clerked for a year with the Honorable Michael D. Ryan on the Arizona Court of Appeals. Warren has practiced bankruptcy law since 1998, with a primary focus on corporate reorganizations under Chapter 11. Warren has represented debtors (including individual Chapter 11 debtors), creditors, and creditors' committees. Warren also has experience in a variety of non-bankruptcy litigation related to the judgments and judgment collection.

Steven D. Jerome

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Steve Jerome's practice focuses upon bankruptcy and related state and federal court proceedings. He has significant experience in representing debtors, secured creditors and unsecured creditors in a variety of forums, including bankruptcy administrative proceedings, bankruptcy adversary proceedings, and state court receivership proceedings. In addition, Steve has significant experience in providing bankruptcy advice on transactional matters, including non-consolidation, true sale, perfection and preference bankruptcy opinion.

Representative Cases

- Lead attorney for numerous financial institutions with respect to bankruptcy, receivership and creditor's rights litigation (2000-present)
- Lead bankruptcy attorney for officer/minority shareholder in Dexter Distributing, contested Chapter 11 proceedings, resulting in confirmation of successful acquisition Chapter 11 Plan, which resulted in acquisition of operating company (2007-present)
- Lead debtor's attorney Prosoft Learning Corporation, successful Chapter 11 reorganization of public company (2006)
- Lead attorney for Washington Glass, secured and principal creditor in Empire Glass Companies Chapter 11 bankruptcy (2004-2005)
- Lead attorney for State Court appointed receiver of Mandall Armor Design & Manufacturing, Inc. (2004-2005)
- Lead attorney for Broadcast Development, LLC secured creditor on principal asset (KFNX radio station) in North American Broadcast Chapter 11 bankruptcy (2001-2005)
- Counsel for debtor in $6.2 billion revenue MicroAge, Inc. bankruptcies (2000-2004), including primary responsibility for litigating claim objections and in excess of 300 avoidance actions, which resulted in excess of 100% distribution to creditors
- Counsel for creditor the Arab Monetary Fund in international fraud and insolvency cases (1998-present)

Professional Recognition & Awards

Southwest Super Lawyers® (2010)
Super Lawyers® - Corporate Counsel Edition (2010)

Education

Creighton University School of Law (J.D., *cum laude*, 1997)
Leavy School of Business Santa Clara University (B.S., 1994)

Court Admissions

Supreme Court of Arizona
United States District Court, District of Arizona
United States Court of Appeals, Ninth Circuit
United States Court of Appeals, Third Circuit

Professional Memberships & Activities

State Bar of Arizona, Chair, Bankruptcy Section (2006-2007)
Chair-Elect, Bankruptcy Section (2005-2006)
Co-Chair, Legislative Committee, Bankruptcy Section (2004-2005)
Member, Local Rules Committee and Commercial Rules Sub-Committee
American Bankruptcy Institute

American Bar Association

Other Professional Experience

United States Bankruptcy Court, District of Nebraska, Judicial Law Clerk to Hon. Timothy J. Mahoney (1997-1998)

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A member of the firm's Financial Restructuring, Reorganization and Bankruptcy practice group, Jann Chubb guides clients throughout the U.S. in virtually all types of corporate recovery, bankruptcy and insolvency matters. She is one of only two lawyers in the state of Nevada to be inducted into the American College of Bankruptcy, an organization of approximately 600 bankruptcy professionals worldwide.

Well regarded in her field, Jann has written articles on various bankruptcy issues and speaks before a variety of professional groups and local, state and national legal associations.

Jann earned her J.D. from Loyola University of Los Angeles School of Law and her B.A. from Loma Linda University at La Sierra College. She is admitted to practice before the state and federal courts of Nevada, California and the U.S. Supreme Court and is a member of the Washoe County and American Bar Associations. She currently serves on the Ninth Circuit Advisory Board for the College and on the Advisory Board for the Ninth Circuit Judicial Conference.

Active within civic organizations, Jann is a board member and chairs the Driving Force Committee for the National Auto Museum (The Harrah's Collection) and is a board member and general counsel to the Commercial Real Estate Women (CREW) of Northern Nevada.

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My bio:

Professional Experience

Lori Winkelman is a partner in Quarles & Brady's Bankruptcy/Creditors' Rights Group. Ms. Winkelman represents secured creditors, unsecured creditors, debtors, and other parties in all aspects of bankruptcy, foreclosure and state court receivership. Her experience includes:

- ☐ Representing secured creditors and other parties in all types of Chapter 11 cases, including cash collateral negotiation and litigation, stay relief litigation, claims litigation, lease negotiation and plan litigation.
- ☐ Significant representation of lenders in single-asset bankruptcy cases.
- ☐ Representing creditors in nondischargeability litigation in all types of bankruptcy.
- ☐ Representing creditors in preference defense and fraudulent conveyance negotiation and litigation.
- ☐ Representing Native American housing authorities as a party-in-interest in complex plan financing and negotiating, involving understanding of complex NAHASDA regulations and other regulations.

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Frederick J. Petersen
Short bio

Frederick J. Petersen has been a partner at Mesch, Clark & Rothschild since 2005. His practice focuses on Bankruptcy, Business Reorganization, Commercial Litigation and Real Estate law. Petersen is the Chief Operating Officer of the firm and serves on the firm's management committee. Petersen represents a wide variety of clients including debtors, creditors, creditors committees and Chapter 11 Trustees in complex bankruptcy cases, and in providing financial and legal business advice. Petersen also represents individuals and companies in commercial litigation and real estate matters. He is an active volunteer for several organizations in the Tucson community and was selected in 2006 as one of the top "40 under 40" business leaders. fpetersen@mcrazlaw.com

Hon. Charles G. Case II was appointed a United States Bankruptcy Judge for the District of Arizona on January 5, 1994 and reappointed January 5, 2008. Previously, he was a member of the Phoenix law firm of Meyer, Hendricks, Victor, Osborn & Maledon, P.A., where he concentrated in bankruptcy, Chapter 11 reorganizations, secured transactions and commercial litigation. From 1975 to 1988, he practiced with the law firm of Lewis and Roca in Phoenix. He graduated *cum laude* from Harvard University and *magna cum laude* from Arizona State University College of Law. Judge Case is a fellow of the American College of Bankruptcy and a member of the American Law Institute, the International Exchange of Experience in Insolvency, and the American Bankruptcy Institute. He is a member of the International Insolvency Institute and co-chair of its Judicial Committee. He is a past President of the National Conference of Bankruptcy Judges and a former member of the Board of the Harvard Alumni Association.

Hon. Randolph J. Haines
U.S. Bankruptcy Court

THE HON. RANDOLPH J. HAINES, U.S. Bankruptcy Judge, received his B.A. with honors from the University of Wisconsin in 1970, a Ph.D. in philosophy from Yale University in 1975, and a J.D. from Stanford Law School, with Order of the Coif, in 1978. He joined the Phoenix law firm of Lewis and Roca upon graduation and practiced there for 22 years, primarily in the areas of bankruptcy and commercial litigation, until his appointment as a United States Bankruptcy Judge for the District of Arizona in March 2000. He has written extensively on bankruptcy law, is a contributing editor to the Norton Bankruptcy Law and practice 2d treatise and managing editor of the Norton Bankruptcy Law Adviser, a monthly newsletter and is a frequent speaker at bankruptcy conferences such as the Norton Institutes and the National Conference of Bankruptcy Judges. He has served for six years on the Arizona State Bar's Committee on the Rules of Professional Conduct, the committee that issues formal and informal advisory opinions on lawyer ethics.

Hon. Redfield T. Baum, Sr. has been a United States bankruptcy Judge for the District of Arizona since 1990. He was the Chief Judge of the Arizona Bankruptcy Court from 2005 to 2009. Judge Baum has been an active member of the National Conference of Bankruptcy Judges serving on the Board of Governors, the finance, elections, site selection and legislative committees, and he runs its annual golf tournament. He has served multiple times as a Judge pro tem on the Ninth Circuit Bankruptcy Judge's Appellate Panel, and has served on the Ninth Circuit Bankruptcy Judge's education and local rules committees. He was also a member of the Arizona State Federal Judicial Council. He has served as a visiting Judge and settlement judge in other districts in the Ninth Circuit. He helped create and implement the Alternative Dispute Resolution program adopted by the Arizona Bankruptcy Court.

Prior to his appointment, Judge Baum was a partner and director at the O'Connor, Cavanagh, Anderson, Westover, Killingsworth & Beshears law firm, one of the largest law firms in Arizona, where he concentrated in commercial law, creditor's rights, bankruptcy, chapter 11 reorganizations, and litigation. From 1973 to 1980, he practiced with and became a partner at the Arizona law firm of Rawlins, Ellis, Burris & Kiewit. He graduated with honors from Arizona State University [B.A. History] in 1970 and from Arizona State University College of Law in 1973. Judge Baum was commissioned as a second lieutenant in the United States Army in 1970 and became a captain prior to his discharge. He has been on the board of directors of the Sandra Day O'Connor College of Law at Arizona State University Alumni Association for many years.