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# THE DEBTOR'S DILEMMA: DISPOSABLE INCOME AS THE COST OF CHAPTER 13 DISCHARGE IN CONSUMER BANKRUPTCY

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## I. INTRODUCTION

The Bankruptcy Amendments and Federal Judgeship Act of 1984 ("BAFJA") reformed, or at any rate revised, a number of key provisions in the Bankruptcy Code.<sup>2</sup> While phenomenal attention has been paid to the restrictions it placed on the unilateral rejection of union contracts by debtors, and a good deal to the revision of the Bankruptcy Courts' jurisdictional grant, only a few studies have dealt in any detail with the major changes BAFJA made to the law of consumer bankruptcy.<sup>3</sup> This is perhaps surprising, because those changes have far broader impact (if rather less glamour).

Many of the consumer bankruptcy amendments were designed to rein in what some creditors saw as an excessive liberality toward debtors

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1. Pub. L. No. 98-353, 98 Stat. 333 (1984) (amending 11 U.S.C. §§ 101-151326 (1982 & Supp. 1986)).

2. In this article, "Code" or "Bankruptcy Code" refers to Title 11 of the United States Code, 11 U.S.C. §§ 101-151326 (1982 & Supp. 1986). "Act" or "Bankruptcy Act" refers to former Title 11, 11 U.S.C. §§ 1-1103 (1976) (repealed 1979).

3. Some of the more extensive treatments of the changes made by BAFJA are: Black & Herbert, *Bankcard's Revenge: A Critique of the 1984 Consumer Credit Amendments to the Bankruptcy Code*, 19 U. Rich. L. Rev. 845 (1985); Breitowitz, *New Developments in Consumer Bankruptcies: Chapter 7 Dismissal on the Basis of "Substantial Abuse,"* (pts. 1 & 2) 59 Am. Bankr. L.J. 327 (1985), 60 Am. Bankr. L.J. 33 (1986); and Morris, *Substantive Consumer Bankruptcy Reform in the Bankruptcy Amendments Act of 1984*, 27 Wm. & Mary L. Rev. 91 (1985).

in the original Bankruptcy Code.<sup>4</sup> One of their targets was Chapter 13.<sup>5</sup> Chapter 13 is roughly comparable to Chapter 11,<sup>6</sup> in that both govern "reorganization" bankruptcy proceedings, in which the debtor is allowed to retain assets in exchange for payments to be made to creditors from the debtor's future income. As such, both differ from Chapter 7<sup>7</sup> "liquidation" bankruptcies, in which the debtor loses non-exempt assets but is generally freed from any further obligation to pay.<sup>8</sup> Chapter 13 is designed primarily, but not exclusively, for consumer reorganizations;<sup>9</sup> Chapter 11 is designed for business reorganizations but can probably be used by at least some consumers.<sup>10</sup>

Traditionally, unsecured creditors have favored reorganization bankruptcies<sup>11</sup> because such proceedings hold out the promise (if not always the reality) of higher payment.<sup>12</sup> Indeed, what little systematic evidence there is suggests that successful consumer reorganizations produce, or at least propose, strikingly greater returns to creditors than do liquidations.<sup>13</sup> Creditors, however, were not delighted by the Code's

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4. See, e.g., Breitowitz, *supra* note 3, at 327-44; Black & Herbert, *supra* note 3, at 845-51.

5. 11 U.S.C. §§ 1301-1330 (1982 & Supp. 1986). This article will also, from time to time, refer to the cognate provisions of the prior Bankruptcy Act, Chapter XIII—Bankruptcy Act §§ 601-686, 11 U.S.C. §§ 1001-1086 (1976) (repealed 1979).

6. 11 U.S.C. §§ 1101-1174 (1982 & Supp. 1986).

7. *Id.* §§ 701-766.

8. This is not entirely true, since some debts are not dischargeable in Chapter 7 proceedings. *Id.* § 523.

9. Chapter 13 can be used to reorganize the financial affairs of some small proprietorships. See generally, Herbert, *Business Reorganizations Under Chapter 13: Some Second Thoughts*, 10 Okla. City U. L. Rev. 603 (1985); Moller, *It Isn't Only for Wage Earners Anymore: The Individual in Business and Chapter 13 of the Bankruptcy Code*, 17 Hous. L. Rev. 331 (1980).

10. With regard to the eligibility of consumer debtors for Chapter 11 proceedings, see generally, Herbert, *Consumer Chapter 11 Proceedings: Abuse or Alternative?*, 91 Com. L.J. 234 (1986).

11. So much so that some creditor organizations supported a proposal to make Chapter 13 proceedings mandatory for some consumer debtors. See *infra* note 41 and accompanying text.

12. The actual payment, of course, depends in large measure upon whether the plan succeeds or fails. Although little systematic data exists with regard to the success rate of Chapter 13 plans, it is said to be 50% or less. Countryman, *Legal Relief: Straight Bankruptcy and Wage Earner Plans*, 26 Bus. Law. 933, 939 (1971) (Chapter XIII plans); Girth, *The Bankruptcy Reform Process: Maximizing Judicial Control in Wage Earners' Plans*, 11 U. Mich. J.L. Ref. 51, 58-60 (1977) (Chapter XIII plans).

13. The General Accounting Office's study of consumer bankruptcy under the Code found that, on average, Chapter 13 plans promised payment of 57 percent of the amount of unsecured claims. U. S. General Accounting Office, *Report to the Chairman, Committee on the Judiciary, House of Representatives, Bankruptcy Reform Act of 1978—A Before and After Look* 45 (1983) [hereinafter GAO Report] (Figures on the actual payments

original version of Chapter 13. There were at least two reasons for this dissatisfaction.

First, it was not clear that Chapter 13 required the debtor to pay creditors more than they would get in liquidation. A large number of courts ruled that a so-called zero-payment or nominal-payment Chapter 13 plan was permissible.<sup>14</sup> This meant that the debtor was permitted to retain his assets for little or nothing, and to stretch whatever payments he did happen to make over a three-year period.<sup>15</sup> Second, the discharge awarded a Chapter 13 debtor is usually much broader than that given a Chapter 7 or individual Chapter 11 debtor.<sup>16</sup> Debts arising out of fraudulent conduct, for example, can be discharged only in Chapter 13 proceedings. Those courts that permitted nominal payment plans thus permitted a debtor to discharge an otherwise non-dischargeable debt for no additional cost.

These problems, if problems they were,<sup>17</sup> might have been resolved without legislative action. Chapter 13 plans must be confirmed by the

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made by debtors are not given in the GAO Report.). Chapter 7 cases rarely provide any money at all; according to the GAO Report, in 97 percent of such cases there are no assets available for distribution to creditors. *Id.* at 56-57. See also, D. Stanley & M. Girth, *Bankruptcy: Problems, Process, Reform 87-88* (1971) (84% of liquidation cases under the Bankruptcy Act provided for no distribution to creditors.); cf. Girth, *supra* note 12, at 55-61 (case study of Chapter XIII plans in Buffalo, New York, during 1971-75).

14. Prior to BAFJA, Chapter 13's minimum payout requirement was found in § 1325(a)(4), which required, as a condition of confirmation, that

the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date.

11 U.S.C. § 1325(a)(4) (1982).

Many of the numerous cases on this issue are collected and critiqued in 5 *Collier on Bankruptcy* ¶1325.04[2] (L. King 15th ed. 1986).

15. The normal duration of a Chapter 13 plan is three years. 11 U.S.C. § 1322(c) (1982).

16. Under 11 U.S.C. § 523(a) (1982 & Supp. 1986), individual debtors under Chapters 7 and 11 remain obligated on a laundry list of nondischargeable debts ranging from certain tax obligations to certain student loans to money judgments deriving from injuries caused by drunk driving. In Chapter 13, by contrast, the debtor is normally discharged from all obligations except certain long-term debts and those arising from alimony, maintenance or support. *Id.* § 1328(a). Cf. the narrower "hardship discharge" of *id.* § 1328(b),(c), which peculiarly leaves the economically less fit debtor subject to the full weight of § 523(a).

17. The magnitude of the problems was subject to much dispute. For example, the only comprehensive "before and after" study of the Code found that the debtors using Chapter XIII of the old Bankruptcy Act proposed payments averaging 92 percent of their unsecured debts, while debtors using Chapter 13 of the Code proposed payments averaging 57 percent of their unsecured debts. GAO Report, *supra* note 13, at 46. Both before and after debtors proposed to pay far more than would have been paid in the typical liquidation. See *supra* note 13.

bankruptcy court; accordingly, a number of courts refused to confirm nominal payment plans on the ingenious, if perhaps dubious, ground that they were not proposed in "good faith."<sup>18</sup> Many other bankruptcy courts permitted such plans. The risk of deforestation caused by publication of the seemingly innumerable cases and articles that carried on this debate was largely ended by BAFJA.<sup>19</sup>

The amended version of Section 1325 of the Code, which sets out the prerequisites for plan confirmation, imposes on the debtor the requirement that either he pay any unsecured creditor who objects to confirmation of the plan the allowed amount of her claim, or that he devote all of his projected disposable income for the succeeding three years to making payments under the plan.<sup>20</sup> It is this new cost of discharge which is the subject of this article. What is disposable income? What effect does the requirement have on the utility of Chapter 13 to consumer debtors?<sup>21</sup> Does Section 1325 still permit nominal payment

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18. Confirmation of a Chapter 13 plan is possible only if the plan was "proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1325(a)(3) (1982). Most of the better reasoned cases held that this requirement was limited to an investigation of the fairness of the plan creation process rather than a measure of the plan payments. 5 Collier on Bankruptcy, *supra* note 14.

19. But see *infra* notes 143-51 and accompanying text.

20. The relevant provision reads in full:

(1) If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan—

(A) the value of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or  
(B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

(2) For purposes of this subsection, "disposable income" means income which is received by the debtor and which is not reasonably necessary to be expended—

(A) for the maintenance or support of the debtor or a dependent of the debtor; or  
(B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

11 U.S.C. § 1325(b) (West Supp. 1986). Note that the Code's penchant for inane English is well evidenced by the wording of § 1325(b)(2)(B).

21. Because reported cases concerning business Chapter 13 proceedings are quite rare (indeed, those discussing the measure of disposable income in such proceedings seem to be non-existent), and because the potential special problems of the disposable income standard in such proceedings have been speculatively discussed elsewhere (Herbert, *supra* note 9, at 611-26), this article is solely concerned with the disposable income standard in consumer Chapter 13 proceedings. It is worth noting, however, that in the twelve months ending June 30, 1985, there were 7,124 "business" Chapter 13 filings. Report of the Judicial Conference of the United States 464 (1985).

plans? The answers to these questions will determine whether BAFJA eliminated debtor abuses—or merely discouraged consumer debtor reorganization.

## II. THE MEANING OF "DISPOSABLE INCOME"

### A. Background

Modern American bankruptcy law is somewhat paradoxical in nature. It attempts, on the one hand, to provide debtors with a financial "fresh start";<sup>22</sup> on the other, to provide an orderly and equitable method of asset collection and distribution. The bankruptcy system is asked simultaneously to serve as a kind of welfare program for the chronically or suddenly impoverished and as a low-fee collection agency for those whom the debtor cannot pay.<sup>23</sup>

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22. The classic articulation of the fresh start concept is usually said to be that contained in *Local Loan Co. v. Hunt*, 292 U.S. 234, 54 S. Ct. 695 (1934):

One of the primary purposes of the Bankruptcy Act is to "relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes."

....  
... The power of the individual to earn a living for himself and those dependent upon him is in the nature of a personal liberty quite as much as, if not more than, it is a property right. To preserve its free exercise is of the utmost importance, not only because it is a fundamental private necessity, but because it is a matter of great public concern. From the viewpoint of the wage earner there is little difference between not earning at all and earning wholly for a creditor. Pauperism may be the necessary result of either. . . . The new opportunity in life and the clear field for future effort, which is the purpose of the bankruptcy act to afford the emancipated debtor, would be of little value to the wage earner if he were obliged to face the necessity of devoting the whole or a considerable portion of his earnings for an indefinite time in the future to the payment of indebtedness incurred prior to his bankruptcy.

*Id.* at 244-45, 54 S. Ct. at 699 (citation omitted).

23. There are many thoughtful studies of this problem and of the complex historical evolution of bankruptcy from a more pure collection system to the present hybrid; serious scholarly interest in the subject extends at least as far back as 1918. See F. Noel, *A History of the Bankruptcy Clause of the Constitution of the United States of America* (1918) (unpublished dissertation) (available at the Virginia State Library, Richmond, Virginia) and C. Warren, *Bankruptcy in United States History* (1935). An excellent primer on the subject is Kennedy, *Reflections on the Bankruptcy Laws of the United States: The Debtor's Fresh Start*, 76 *West Va. L. Rev.* 427 (1974). A somewhat more recent and extremely brief study, largely derived from Noel and Warren, can be found in Sullivan, Warren & Westbrook, *Limiting Access to Bankruptcy Discharge: An Analysis of the Creditors' Data*, 1983 *Wis. L. Rev.* 1091, 1098-1101. For a more complex recent examination of the problem, see Boshkoff, *Limited, Conditional, and Suspended Discharges in Anglo-American Bankruptcy Proceedings*, 131 *U. Pa. L. Rev.* 69 (1982).

This paradox manifests itself throughout the Bankruptcy Code. Provided certain requirements are met, the ordinary Chapter 7 debtor receives a discharge of all or virtually all his debts in exchange for payments that are nearly always far smaller than those debts; indeed, unsecured creditors in liquidation proceedings typically receive nothing at all.<sup>24</sup> This is the "discharge" aspect of bankruptcy. On the other hand, if the debtor has any non-exempt assets, some part of those assets, or of the debtor's future income, or both are distributed to creditors—the "collection" aspect of bankruptcy. Moreover, since some debts are felt to be more important than others (or their incurrence more heinous), they are given special status. One form of special status is "priority" in the collection aspect, which requires the payment by the trustee of those debts in preference to others.<sup>25</sup> Another is "non-dischargeability," which has no direct effect on the collection aspect of bankruptcy but limits the scope of its discharge aspect by refusing to release the debtor from certain obligations.<sup>26</sup>

Straddling one of the fault lines between these two aspects of bankruptcy are the two types of bankruptcy created by the code—liquidation bankruptcy and reorganization bankruptcy. Chapter 7<sup>27</sup> of the Code exemplifies the former;<sup>28</sup> Chapters 11,<sup>29</sup> and 13,<sup>30</sup> the latter. As indicated above, in the paradigmatic liquidation bankruptcy, the debtor's non-exempt assets are seized by the trustee and sold; the proceeds, if any, are distributed to creditors. In the paradigmatic reorganization bankruptcy, the debtor retains assets in exchange for an obligation to make payments out of future income. Historically, liquidation has been the norm and reorganization the exception; moreover, it has generally been true that no debtor can be forced to reorganize by his creditors.<sup>31</sup>

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24. See *supra* note 13. Indeed, the truth of the matter is that Chapter 7 is scarcely a system of distribution at all:

One who does nothing more than peruse the provisions of the Code, however, would be blissfully unaware of the economic realities of the typical consumer proceedings. . . . [F]or all practical purposes, the priority and distribution provisions of chapter 7 are virtually a dead letter since, in over 90% of all cases, there are no assets available for distribution after exemptions are claimed.

Breitowitz, *supra* note 3, at 335.

25. The major priorities are listed in 11 U.S.C. § 507 (1982).

26. The major non-dischargeable debts are listed in *id.* § 523.

27. But note that Chapter 7 proceedings can include a temporary continuation of the debtor's business so as to provide for an orderly liquidation of the estate. *Id.* § 721.

28. Liquidations may also be conducted under Chapter 11. *Id.* § 1123(5)(D).

29. *Id.* §§ 901-46. Chapter 9 provides for the reorganization of the debts of a municipality.

30. It should be noted, however, that nothing in Chapter 13 expressly prohibits liquidation of assets to fund the plan.

31. See generally, Black & Herbert, *supra* note 3, at 849-50. This principle was always

The perceived problem with the traditional treatment of reorganization is that some debtors have a combination of large debts, few current assets, and the prospect of greatly augmented income. Such debtors can undergo a cheap liquidation and thereby avoid paying debts that they could easily manage.<sup>32</sup> The problem of balancing the debtor's interest in discharge against the creditor's wish to get paid is not a new one,<sup>33</sup> and various Code provisions have long attempted to blunt the effect of "unnecessary" discharges.<sup>34</sup> In the view of some creditors,

followed with less rigor where corporations were concerned, *id.* at 850 n.22, and was considerably watered down by the Bankruptcy Code, which permits certain debtors to be placed involuntarily into Chapter 11. 11 U.S.C. § 303(a) (1982).

32. The most detailed treatment of this perceived problem was the so-called "Purdue Study," more formally, Credit Research Center, Krannert School of Management, Purdue University, Monograph Nos. 23 and 24, *Consumer Bankruptcy Study* (1982) [hereinafter *Purdue Study*] which asserted, among other things, that \$1,100,000 of debt was being "unnecessarily" discharged each year. 1 *Purdue Study* at 88-91.

33. Quite colorful Congressional debate on both sides of the discharge vs. collection issue can be found at least as early as the 1860's:

Of what advantage can it be to creditors or to the country that so many tens of thousands of the active men of this country should be held in thralldom?

.....

... The law formerly in force by which a creditor could keep his debtor in prison for an indefinite period, without relief, has been abolished in all Christian countries. But there may be a punishment of death without the knife, and an imprisonment without the bolts and bars of the jail.

.....

... What to [the debtors] are the guarantees of the Constitution? Why should they love the Government and yield it a hearty allegiance?

Cong. Globe, 38th Cong., 1st Sess. 2638 (1864) (remarks of Rep. Jenckes), and as late as the 1980's:

Mr. Chairman, for the last couple of years in going home, I have been getting many complaints from the owners of small businesses about the large number of persons taking bankruptcy. It was pointed out to me that a number of these persons taking bankruptcy had good jobs. They could pay their obligations, but it was the easier route to go chapter 7 and take bankruptcy and not worry about their debts.

.....

Well, something is wrong when the bankruptcy laws encourage people to take bankruptcy and then a small businessman goes before the courts and they tell him, "We can't help you at all."

130 Cong. Rec. H1812 (daily ed. March 21, 1984) (remarks of Rep. G. V. Montgomery).

34. To mention only a few examples: (1) Property received by the debtor within 180 days after the filing of the petition becomes part of the estate if it was received through bequest, devise, inheritance, as part of a property settlement with a spouse or as the beneficiary of life insurance (11 U.S.C. § 541(a)(5) (1982 & Supp. 1986); see also Bankruptcy Act § 70(a)(7), 11 U.S.C. § 110(a)(7) (1976) (repealed 1979)); (2) fraudulent transfers of property are avoidable (11 U.S.C. § 548 (1982 & Supp. 1986); see also Bankruptcy Act § 67(d), 11 U.S.C. § 107(d) (1976) (repealed 1979)); (3) most debtors eligible for Chapter 11 proceedings may be forced to reorganize (11 U.S.C. § 303(a) (1982); but see



however, the problem of the high-rolling debtor became much more acute with the passage of the Bankruptcy Reform Act<sup>35</sup> and the simultaneous erosion of social and moral inhibitions associated with declaring bankruptcy.<sup>36</sup>

Although many criticisms were leveled at the consumer bankruptcy provisions of the original Bankruptcy Code, two predominated. First, it was "too easy" to file for liquidation under Chapter 7; too many people who "could pay" were liquidating just to "shuck a couple of . . . debts."<sup>37</sup> Second, the Bankruptcy Reform Act, which actually tried to encourage consumers to reorganize under Chapter 13 rather than liquidate under Chapter 7 by making reorganization more attractive,<sup>38</sup> had made reorganization too cheap. On its face, Chapter 13 only obligated the debtor to pay what would have been paid in liquidation,<sup>39</sup> and gave creditors no vehicle to require payments in excess of that amount.<sup>40</sup> One response to these problems was a recommendation by the credit industry that, to obtain a discharge, all consumer debtors who had disposable income be required to pay their creditors all of their income in excess of a somewhat adjusted version of the federal poverty level for a period of several years.<sup>41</sup>

Although the validity of the data on which that proposal was based was derided,<sup>42</sup> and the feasibility and fairness of so-called bankruptcy

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Herbert, *supra* note 10, at 234, 248-251 (consumers should be permitted to file voluntary Chapter 11 proceedings because not prohibited by Code but should not be subject to involuntary Chapter 11 proceedings)). Each of these provisions gives creditors access to those non-current assets of the debtor that the debtor is presumed not to need for economic survival.

35. Pub. L. No. 95-598, 92 Stat. 2549 (1978) (which enacted, among other things, the Bankruptcy Code).

36. See generally, Black & Herbert, *supra* note 3, at 850-51; Breitowitz, *supra* note 3, at 327-41.

37. *In re Bryant*, 47 Bankr. 21, 24 (Bankr. W.D.N.C. 1984).

38. With regard to the structure and goals of the original version of Chapter 13 under the Code, see generally, Epstein, Chapter 13: Its Operation, Its Statutory Requirements as to Payment to and Classification of Unsecured Claims, and Its Advantages, 20 Washburn L.J. 1 (1980).

39. See *supra* note 14 and accompanying text.

40. See generally, Black & Herbert, *supra* note 3, at 847-48.

41. 1 Purdue Study, *supra* note 32, at 98-100. The income debtors would have been permitted to retain was adjusted for several, primarily geographical, factors from the federal poverty line. *Id.* at 42-56.

42. The most extensive critiques of the Purdue Study are Sullivan, Warren & Westbrook, *supra* note 23, and a follow-up study by the same authors, *Rejoinder: Limiting Access to Bankruptcy Discharge*, 1984 Wis. L. Rev. 1087. A number of other reports include data that contradict key aspects of the Purdue Study, including the GAO Report, *supra* note 13; Schuchman & Roper, *Personal Bankruptcy Data for Opt-Out Hearings and Other Purposes*, 56 Am. Bankr. L.J. 1 (1982); Schuchman, *The Average Bankruptcy:*

poverty vigorously contested,<sup>43</sup> variations of the basic proposal were strenuously urged in Congress.<sup>44</sup> In the end, the concepts of forced reorganization and mandatory payment standards were largely rejected. Two vestiges remain. The first is the requirement, noted above, that the Chapter 13 debtor pay his disposable income to his creditors under some circumstances. The second is set out in Section 707(b)<sup>45</sup> of the Code, which now permits the bankruptcy court, *sua sponte*, to dismiss consumer liquidation proceedings that are a "substantial abuse" of Chapter 7 of the Code.

### B. BAFJA and its Legislative History

The Consumer Credit Amendments of BAFJA and the legislative history accompanying those amendments are remarkable for their extreme reticence.<sup>46</sup> Congress felt neither the duty nor the desire to define the key provisions of those amendments in any useful way. "Disposable income" is no exception. We are told only that disposable income is

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A Description and Analysis of 753 Personal Bankruptcy Filings in Nine States, 88 Com. L.J. 288 (1983); and Woodward & Woodward, Exemptions as an Incentive to Voluntary Bankruptcy: An Empirical Study, 88 Com. L.J. 309 (1983).

43. See, e.g., Harris, A Reply to Theodore Eisenberg's Bankruptcy Law in Perspective, 30 UCLA L. Rev. 327, 352-55 (1982); LoPucki, "Encouraging" Repayment Under Chapter 13 of the Bankruptcy Code, 18 Harv. J. on Legis. 347, 369-72 (1981); Sullivan, Warren & Westbrook, *supra* note 23, at 1138-44; and Sullivan, Warren & Westbrook, *supra* note 42, at 1098-1101.

44. See generally, Ginsberg, The Proposed Bankruptcy Improvement Act: The Creditors Strike Back, 1982 N. Ill. U. L. Rev. 1 and Ginsberg, The Bankruptcy Improvements Act—An Update, 1983 N. Ill. U. L. Rev. 235.

45. The section reads in full:

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 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.

11 U.S.C. § 707(b) (West Supp. 1986).

46. In the apt words of one commentator:

The legislative history of the bill [BAFJA] as finally enacted is sparse. The so-called Conference Report contains nothing more than the text of the corrected bill that ultimately became law. The few remarks in the Congressional Record focus almost entirely on the restructuring of the court system, expressing dissatisfaction over the failure to establish an Article III judiciary and vesting the appointment of judges in courts of appeals, rather than in the President.

Breitowitz, *supra* note 3, at 336. Breitowitz goes on to note that there is a somewhat more substantial legislative history for some of the bankruptcy reform bills that were not passed. *Id.* The extent to which that legislative history should be relevant (given the refusal of Congress to enact the legislation upon which it commented) is a complex problem in its own right, unfortunately beyond the scope of this article.

income "not reasonably necessary to be expended . . . for the maintenance or support of the debtor or a dependent of the debtor"<sup>47</sup> and, if the debtor is in business, "not reasonably necessary to be expended . . . for the payment of expenditures necessary for the continuation, preservation, and operation of such business."<sup>48</sup>

A number of other Code provisions require similar income measuring determinations by the courts. The cases decided under these provisions may provide at least some precedential comfort for courts interpreting disposable income. It should be noted, however, that there is practically no legislative history regarding many of those provisions either; and, as will be discussed, only one group of parallel provisions creates a standard that is clearly identical to disposable income.

Several of the so-called "federal" exemptions<sup>49</sup> are limited to the amount "reasonably necessary for the support of the debtor and any dependent of the debtor."<sup>50</sup> These provisions articulate exactly the same standard used in Section 1325(b), and the courts should have no difficulty in applying cases decided under these exemptions to those under the disposable income standard. The exemption cases can obviously provide

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47. 11 U.S.C. § 1325(b)(2)(A) (West Supp. 1986).

48. *Id.* § 1325(b)(2)(B).

49. 11 U.S.C. § 522(b)(1),(d) (1982 & Supp. 1986). So-called because they are created by federal, rather than state, law.

50. These are:

The debtor's right to receive . . . alimony, support, or separate maintenance, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.

*Id.* § 522(d)(10)(D);

The debtor's right to receive . . . 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 . . . .

*Id.* § 522(d)(10)(E);

The debtor's right to receive, or property that is traceable to . . . a payment on account of the wrongful death of an individual of whom the debtor was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.

*Id.* § 522(d)(11)(B);

The debtor's right to receive, or property that is traceable to . . . a payment under a life insurance contract that insured the life of an individual of whom the debtor was a dependent on the date of such individual's death, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.

*Id.* § 522(d)(11)(C); and

The debtor's right to receive, or property that is traceable to . . . a payment in compensation of loss of future earnings of the debtor or an individual of whom the debtor is or was a dependent, to the extent reasonably necessary for the support of the debtor and any dependent of the debtor.

*Id.* § 522(d)(11)(E).

useful support for measuring a consumer's disposable income, but not that of a proprietor whose disposable income calculation also requires a determination of reasonably necessary business expenses.<sup>51</sup>

Similarly, Section 523(a)(8) makes certain student loan debts non-dischargeable unless excepting the debts from discharge would impose "undue hardship on the debtor and the debtor's dependents."<sup>52</sup> The courts should also look to this rule as a source of interpretive decisions.<sup>53</sup> The utility of Section 523(a)(8) may be more limited than that of the exemption provisions, because "undue hardship" could obviously be interpreted as imposing a greater or lesser standard than disposable income.<sup>54</sup>

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51. See supra note 20.

52. The section reads, in pertinent part:

A discharge under section 727, 1141, or 1328(b) of this title does not discharge an individual debtor from any debt . . . for an educational loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or a nonprofit institution, unless—

(A) such loan first became due before five years (exclusive of any applicable suspension of the repayment period) before the date of the filing of the petition; or

(B) excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents.

11 U.S.C. § 523(a)(8) (West Supp. 1986).

53. With some caution, however, since it appears that no court has considered the possibly significant difference in wording between the "debtor or dependents" formula used in §§ 522 and 1325 and "debtor and dependents" formula used in § 523. With regard to undue hardship generally, see Kosel, Running the Gauntlet of "Undue Hardship"—The Discharge of Student Loans in Bankruptcy, 11 Golden Gate L. Rev. 457 (1981).

54. Some indication of the meaning of undue hardship can be gleaned from the Report of the Bankruptcy Commission that ultimately led to the enactment of the Code:

In order to determine whether nondischargeability of the debt will impose an "undue hardship" on the debtor, the rate and amount of his future resources should be estimated reasonably in terms of ability to obtain, retain, and continue employment and the rate of pay that can be expected. Any unearned income or other wealth which the debtor can be expected to receive should also be taken into account. The total amount of income, its reliability, and the periodicity of its receipt should be adequate to maintain the debtor and his dependents, at a minimal standard of living within their management capability, as well as to pay the educational debt.

2 Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d Cong., 1st Sess. 140-41 n.17 (1973).

The great majority of bankruptcy courts have followed the analytical schemes provided in *Andrews v. South Dakota Student Loan Assistance Corp.*, 661 F.2d 702 (8th Cir. 1981) and *Pennsylvania Higher Educ. Assistance Corp. v. Johnson*, 5 Bankr. Ct. Dec. (CRR) 532 (Bankr. E.D. Pa. 1979), to determine when undue hardship is present and a discharge of student loans is proper.

*Johnson*, decided prior to the effective date of the Code under the cognate provision

There are also a number of valuable pre-BAFJA cases under the "good faith" requirement of Section 1325(a)(3).<sup>55</sup> As noted above, a number of courts sought to avoid Chapter 13 "abuse" by interpreting good faith to require the best efforts, or at least a substantial effort, of the debtor to pay his creditors. While it is not clear that the good faith-best efforts standard is identical to the disposable income standard, they are certainly aimed at the same perceived abuse and thus may be substantively indistinguishable.<sup>56</sup>

A new provision of the Code that provided some rhetorical comfort to the credit industry may also provide some help to consumer lawyers. One of the new provisions added by BAFJA creates a presumption that certain debts incurred in the acquisition of "luxury goods or services"<sup>57</sup> are nondischargeable.<sup>58</sup> Since "luxury goods or services" are negatively

of prior law (20 U.S.C. §§ 1087-93 (1976) (repealed 1978)) set out an elaborate three-part test which, in greatly simplified form, looks to three consecutive questions: (1) Could the debtor, during the period of the loan, both pay the loan and maintain himself and his dependents at a subsistence standard of living? (2) If so, has the debtor been negligent or irresponsible in his efforts to minimize expenses, maximize resources, or secure employment, and did this affect his ability to simultaneously pay the loan and maintain a subsistence standard of living? (3) If so, did the amount of the student loan, and the percentage of the debtor's total indebtedness represented by the student loan indicate that the dominant purpose of the bankruptcy was to discharge the student debt or that the debtor had definitely benefited financially from the education the loan helped to finance? 5 Bankr. Ct. Dec. (CCR) at 536-45.

It is unfortunate that Congress does not seem to have realized that all of these income-based provisions are interlocking. All relate to the creditors' ability to reach the debtor's future income against the will of the debtor and without any chance for the debtor to bargain over the amount of his income that will go to creditors. It would have been most helpful if a logically coherent and linguistically consistent basis for granting involuntary access to future income had been set out in the Code.

55. That section states, in pertinent part: "Except as provided in subsection (b), the court shall confirm a plan if . . . the plan has been proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1325 (a)(3) (1982).

56. Unless, of course, a debtor's best efforts are still required, or if the good faith standard otherwise obligates the debtor to provide more money to the plan than § 1325(b) requires. See *infra* notes 143-151 and accompanying text.

57. The quotation marks appear in the Code.

58. The section reads, in pertinent part:

A discharge under section 727, 1141 or 1328(b) of this title does not discharge an individual debtor from any debt—

.....  
(2) for money, property, services, or an extension, renewal, or re-financing of credit, to the extent obtained by—

(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;

.....  
(C) for purposes of subparagraph (A) of this paragraph,

defined as those that are not "reasonably acquired for the support or maintenance of the debtor or a dependent of the debtor,"<sup>59</sup> the terminology appears analogous to disposable income. Again, however, Congress has provided language susceptible of dissimilar interpretations without indicating how the potential distinction is to be properly drawn. Can something be "reasonably acquired" but not be "reasonably necessary"?

Finally, Section 707(b), under which a case can be dismissed for "substantial abuse" of the liquidation and discharge system of Chapter 7,<sup>60</sup> has occasionally been seen as parallel to Section 1325(b). Great caution must be used in comparing the two, however. It is quite clear that Section 707(b) should require something more than the presence of disposable income to permit dismissal of a bankruptcy case.

Although the legislative history of Section 707(b) is sparse, what little exists is as unequivocal as any in the Bankruptcy Code. Section 707(b) dismissal, if based on the amount distributed to creditors, is appropriate only if the amount the debtor could comfortably pay is greatly disproportionate to the amount the creditors will receive in liquidation.<sup>61</sup> Some cases suggest that, even if substantial payments could

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consumer debts owed to a single creditor and aggregating more than \$500 for "luxury goods or services" incurred by an individual debtor on or within forty days before the order for relief under this title . . . are presumed to be nondischargeable; "luxury goods or services" do not include goods or services reasonably acquired for the support or maintenance of the debtor or a dependent of the debtor . . . .

11 U.S.C. § 523(a)(2) (West Supp. 1986). Reasonably comprehensive catalogues of the problems created by this oddly worded and ill-considered provision can be found in Black & Herbert, *supra* note 3, at 870-74 and Morris, *supra* note 3, at 128-32.

59. 11 U.S.C. § 523(a)(2) (West Supp. 1986).

60. See *supra* note 45 and accompanying text.

61. § 202(c) of the unenacted Omnibus Bankruptcy Improvements Act of 1983 was identical to § 707(b). With regard to that provision, the Senate Report on the Omnibus Bankruptcy Improvements Act stated:

This provision represents a balancing of two interests. It preserves the fundamental concept embodied in our bankruptcy laws that debtors who cannot meet debts as they come due should be able to relinquish non-exempt property in exchange for a fresh start. At the same time, however, it upholds creditors' interests in obtaining repayment *where such repayment would not be a burden*.

Crushing debt burdens and severe financial problems place enormous strains on borrowers and their families. Family life, personal emotional health, or work productivity often suffers. By enabling individuals who cannot meet their debts to start a new life, unburdened with debts they cannot pay, the bankruptcy laws allow troubled borrowers to become productive members of their communities. Nothing in this bill denies such borrowers with unaffordable debt burdens bankruptcy relief under Chapter 7. However, 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) (emphasis added).

be made, there is no "substantial abuse" of bankruptcy if the debtor has made an economically justifiable decision and has acted in a forthright manner with his creditors.<sup>62</sup> In any event, the reduction of "substantial abuse" to the equivalent of "disposable income" would ignore Congress' decision not to make Chapter 13 mandatory for the typical consumer debtor.<sup>63</sup> By and large, the cases seem to have recognized this distinction.

Thus, Section 707(b) should not be viewed as an analogue of Section 1325(b), but as describing one end of a spectrum on which Section 1325(b) lies roughly in the middle. Some debtors have little or no income beyond that needed to pay minimal living expenses. They cannot reorganize because they have no income available to be contributed to a plan.<sup>64</sup> Some debtors can reorganize, and if they choose to do so may be required to pay all their disposable income as the price of reorganization. Still others must reorganize because there is no reason we consider valid for them not to pay their debts.<sup>65</sup> What can safely be said is that expenditures that evidence substantial abuse of the bankruptcy laws are by definition among those expenditures that are not reasonably necessary for the debtor or the debtor's dependents. In short, what Section 707(b) prohibits, Section 1325(b) prohibits; but what Section 1325(b) prohibits, Section 707(b) may allow.

Within the limitations indicated, this article does incorporate some unsystematic discussion of disposable income related cases, especially those decided since the disposable income standard was imposed. Nevertheless, these cases are used merely to strengthen discussion of partic-

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62. See, e.g., *In re Edwards*, 50 Bankr. 933 (Bankr. S.D.N.Y. 1985).

63. See *supra* notes 41-45 and accompanying text; see also Breitowitz, *supra* note 3, at 66-67:

[T]he underlying assumption of [§ 707(b)] as well as of its predecessors is that dismissal of the chapter [sic] 7 will result in substantial returns to creditors by their realizing on the debtor's future income. This ignores the basic psychological fact that if all of the debtor's disposable income must be applied to the repayment of debts, the amount of that disposable income is likely to diminish. As Professor Vern Countryman noted:

Voluntary composition and extension agreements have been successfully employed . . . but an involuntary composition or extension agreement forced upon a debtor seeking relief under Chapter 7 can be expected to work about as well as compulsory marriage counselling for a spouse bent on a separation or divorce . . . A debtor who is forced into Chapter 13 would not reasonably be expected to have the same incentive or to make the same effort to produce the earnings necessary successfully to perform the plan . . . [quoting S. Rep. No. 446, 97th Cong., 2d Sess. 62-63 (1982)].

64. 11 U.S.C. § 1325(a)(6) (1982) requires, as a condition of confirmation, that "the debtor will be able to make all payments under the plan . . . ."

65. Or more precisely, such debtors can choose to reorganize or not to file bankruptcy at all.

ularly important points as to which there are no cases yet under Section 1325(b), or to provide additional illustrations where case law does exist. No attempt is made to study comprehensively any payment standard other than disposable income.

### C. *The Cases*

#### 1. *In General*

In measuring disposable income and its kindred provisions, the courts can be neatly if simplistically divided into two groups—discharge oriented and collection oriented. The primary concern of the former group is the debtor's fresh start; it is more sensitive to the burdens of bankruptcy. The latter is more concerned with abuses, present or potential, and is more censorious of those whose financial habits have created problems for their creditors as well as themselves. The distinction between the two groups is not perhaps as great as their labels at first suggest. Both attempt to balance the unreconcilable—the desire of the creditor to extract payment from what the debtor claims to be a dry hole. Indeed, there are few if any radical differences in the total dollars that debtors are required to pay by courts in the two camps, although there are significant variations at the margin. The differences are more sharply drawn in the courts' rhetoric, a sample of which is given below:

From the discharge side:

[Chapter 13] was not intended to take the last so[u]. A cushion of money is necessary in Chapter 13 budgeting to guard against life's unexpectancies. It is not in the public interest to squeeze the last dollar from Chapter 13 debtors to fund a Chapter 13 plan.<sup>66</sup>

Collection's reply:

[T]his case was brought, not because of the Debtor's unemployment or an inability to pay on his part, but because he simply desired to shuck a couple of his debts.

....

... While Congress intended to give the Debtors relief in such cases, it was not the design of the Bankruptcy laws to allow

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66. In re Otero, 48 Bankr. 704, 708 (Bankr. E. D. Va. 1985). More controversially, the *Otero* court went on to hold that imposition of the disposable income standard is discretionary with the court. *Id.* at 708. To date, this position has not been adopted by any other court.



the Debtor to lead the life of Riley while his creditors suffer on his behalf.<sup>67</sup>

Still other courts have stressed the compromise nature of BAFJA's restrictions on consumer bankruptcy. "Code § 707(b) is an attempt to adjust the balance between the ease of discharge and respect for the sanctity of contract . . . ."<sup>68</sup> "[T]he purpose of chapter 13 is to provide the maximum recovery to creditors while at the same time leaving the debtor sufficient money to pay for his or her basic living expenses."<sup>69</sup> None of these general principles adds much to the initial definition.

## 2. *General Definition of Income*

Since disposable income is defined negatively—as the excess of income over reasonably necessary expenses—the first step is to determine what constitutes income. Several problems have arisen. First, how does one determine the amount of future income? Second, does the debtor's income include sources other than the debtor's income from earnings and investment? Third, to what extent must changes in the debtor's income be reflected in the plan? Finally, should disposable assets be counted in determining disposable income?

The first problem is perfectly familiar to a profession that attempts to project, e.g., lost future income in a wrongful death case. To date, however, the disposable income cases have been rather less than scientific in estimating future income. The one case explicitly dealing with this matter, *In re Foster*,<sup>70</sup> provides very little guidance.

The Fosters were farmers; their income was thus variable and uncertain.<sup>71</sup> The court made no significant effort to estimate what that income might be; it merely noted that "[t]he projected disposable income of a family like the Fosters can not be estimated with the degree of certainty it could be for a family with a fixed income."<sup>72</sup> The court

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67. *In re Bryant*, 47 Bankr. 21, 24, 26 (Bankr. W.D. N.C. 1984) (discussing § 707(b)). See also, *In re Campbell*, 63 Bankr. 702, 705 (Bankr. W.D. Mo. 1986) (§ 707(b) case): [T]his writer has been appalled at the number of cases where the disposable income (for 36 months) shown on the filed schedules exceeded the total indebtedness. . . . Such cases cause (hopefully well founded) queries in this Judge's mind as to the moral fiber of some debtors and the ethical standards of some counsel.

68. *In re Edwards*, 50 Bankr. 933, 938 n.3 (Bankr. S.D.N.Y. 1985).

69. *In re Jones*, 55 Bankr. 462, 466 (Bankr. D. Minn. 1985).

70. 61 Bankr. 492 (Bankr. N.D. Ind. 1986).

71. *Id.* at 494.

72. *Id.*

went on to suggest that any reasonable guesstimate of future income and expenses would be acceptable.<sup>73</sup>

The meager case law on the second question has appropriately read "income" quite broadly. It includes any income of any kind that is not exempt from seizure in bankruptcy.<sup>74</sup> Less obviously but perhaps more significantly, the calculation of disposable income may include income other than the debtor's.

The reasonably necessary expenses that are deducted from income are those relating to support of the debtor or the debtor's dependents.<sup>75</sup> Obviously, some debtors are themselves dependents (or at least share living expenses with others), and many debtors have dependents who are also dependents of other persons. In other words, many debtors have the benefit of someone else's income. At least one disposable income case has held that the income of a non-debtor spouse must be taken into account in determining the debtor spouse's disposable income, precisely because the debtor spouse has the benefit of that income and thus not all of his income is reasonably necessary for support of himself or his dependents.<sup>76</sup>

The treatment of these issues is not controversial. A difficult problem would arise, however, if a debtor enjoyed the benefit of income that was less assured than that of a spouse.<sup>77</sup> Support to an adult debtor from a parent or rich aunt might well cease, especially if all of that support would be used to pay creditors rather than to improve the debtor's style of life. The debtor might also be the beneficiary of a spendthrift trust. Can the debtor exploit the uncertainty of income from the trust to prevent inclusion of any income from it in the disposable income calculation? How should the court respond if the plan is confirmed on the assumption that the debtor will receive nothing from the trust, yet two weeks later, the trustees suddenly distribute \$100,000 to the debtor?

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73. This may be gleaned from the court's willingness to believe that Mr. Foster would be able to work 76-78 hours per week, and that the debtor's planned expenses, which the court found "very conservative" and even "not realistic," did not disqualify the plan from confirmation. *Id.* The plan, however, was denied confirmation on other grounds. *Id.* at 494-495.

74. *In re Red*, 60 Bankr. 113 (E.D. Tenn. 1986) (income tax refund).

75. See *supra* note 20.

76. *In re Saunders*, 60 Bankr. 187 (Bankr. N.D. Ohio 1986); cf. *In re Shands*, 63 Bankr. 121 (Bankr. E.D. Mich 1985) (§ 707(b) case). *Saunders* relied on several good-faith cases: *In re Kern*, 40 Bankr. 26 (Bankr. S.D.N.Y. 1984); *In re Sellers*, 33 Bankr. 854 (Bankr. D. Colo. 1983) and *In re Kull*, 12 Bankr. 654 (S.D. Ga. 1981).

77. The court in *Kern* skirted this issue. *Kern* argued that his wife's income should not be taken into account because she would divorce him if he required her to contribute to her own support. The court brushed this argument aside as "simply untenable," because "to do so would mean forcing Mr. Kern's creditors to subsidize part of her living expenses." 40 Bankr. at 29.

That problem is of course part of a larger difficulty directly related to the problem of projecting income. The debtor's income will almost certainly change during the course of the three year period. To what extent can and should the court permit or require adjustment of the debtor's payments?

If read literally, Section 1325(b)(1)(B) would not permit adjustment. The income that must be paid to creditors is "the debtor's *projected* disposable income *to be received in the three-year period beginning on the date that the first payment is due under the plan.*"<sup>78</sup> If the amount paid is increased or decreased after the beginning of the period, it no longer reflects the debtor's projected income for that period but rather his actual income.

Such a literal reading would impose an unusual rigidity on Chapter 13 proceedings. Congress made it almost as easy to modify a Chapter 13 plan as to propose one.<sup>79</sup> The apparent reason was that Congress wanted Chapter 13 debtors to be able to make justifiable changes in unsuccessful but salvageable plans; if such changes were prohibited, such plans would be abandoned entirely and liquidation would follow.

It should be obvious that a miscalculation of disposable income is the most serious risk to a Chapter 13 plan.<sup>80</sup> A debtor who estimates his disposable income at \$30,000 and proposes to pay creditors accordingly will not be able to do so if his disposable income proves to be only \$10,000.<sup>81</sup> If the plan cannot be modified to reduce the payments,

78. 11 U.S.C. § 1325(b)(1)(B) (West Supp. 1986) (emphasis added).

79. The relevant provision states, in pertinent part:

At any time after confirmation of the plan but before the completion of payments under such plan, the plan may be modified, upon request of the debtor, the trustee, or the holder of an allowed unsecured claim, to—

(1) increase or reduce the amount of payments on claims of a particular class provided for by the plan;

(2) extend or reduce the time for such payments;

or

(3) alter the amount of the distribution to a creditor whose claim is provided for by the plan, to the extent necessary to take account of any payment of such claim other than under the plan.

11 U.S.C. § 1329(a) (1982 & Supp. 1986). The prerequisites for confirmation of a modification are essentially identical to those for confirmation of the original plan. *Id.* § 1329(b); e.g., there is no requirement of approval by unsecured creditors. Moreover, the modified plan becomes the plan *unless* disapproved. *Id.* § 1329(b)(2).

80. Indeed, it may be almost the only risk other than the debtor's change of heart. What little data exists suggests that Chapter 13 plans fail for the obvious reasons—recognition of the difficulty of funding the plan, illness, layoff, or reduced income. Girth, *supra* note 12, at 59-60.

81. Or, more precisely, he will not be able to do so without the sale of the assets he hoped to preserve or devastating results to himself or his dependents.

the debtor will have to convert to Chapter 7.<sup>82</sup> The availability of modification also reduces the need to guess precisely the debtor's future income and expenses, and thus greatly simplifies the initial process of determining disposable income.

Prior to 1984 it was probably true that only the debtor could propose a modification of the plan.<sup>83</sup> However, since BAFJA the trustee and any holder of an unsecured claim have been able to do likewise.<sup>84</sup> There is nothing in the Code that supports any distinction between the modification rights of the debtor (who will of course seek to reduce payments when income falls) and those of the trustee and the creditors (who may similarly seek to increase payments when income rises).<sup>85</sup> It is thus reasonably certain that a modification increasing or decreasing plan payments to correspond with changes in income is permissible.<sup>86</sup>

A more subtle question is the extent to which the plan itself can or must provide in advance for possible future changes in the debtor's income. The court in *In re Akin*<sup>87</sup> refused to confirm a plan because there was "no statement in the plan that as the debtor's disposable income increases it will automatically be applied to the plan."<sup>88</sup> *In re Krul*<sup>89</sup> imposed a somewhat less demanding requirement. Noting that the debtor was likely to experience a rise in future income, it required the debtor to provide for payment to creditors of 50% of any increase in his income during the plan period.<sup>90</sup>

It is certainly difficult to justify either approach under the language of Section 1325(b), since both require payment plans that are clearly

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82. Which the debtor may do unilaterally at any time during the pendency of the proceeding. 11 U.S.C. § 1307(a) (1982).

83. *In re Boone*, 53 Bankr. 78 (Bankr. E.D. Va. 1985); contra, *In re Koonce*, 54 Bankr. 643 (Bankr. D. S.C. 1985).

84. 11 U.S.C. § 1329(a) (West Supp. 1986).

85. It is unlikely, however, that this right will be exercised very often. First, there is no normal vehicle for monitoring changes in the debtor's financial status. Second, the cost of monitoring the debtor will rarely be seen by creditors to be justified, given the small size of the typical Chapter 13 proceeding. Cf. Girth, *supra* note 12, at 60-63.

It should be noted, however, that, by giving these modification rights to the trustee and the creditors, Congress has watered down two Chapter 13 principles—voluntariness and simplicity. Since someone other than the debtor can now force the plan to be modified, the debtor is not solely in control of his reorganization. And the possibility of creditor modification may, in some large Chapter 13 cases, induce creditor monitoring and reintroduce (albeit on an informal basis) some of the negotiating process that was eliminated by the Code. See Herbert, *supra* note 9, at 635-36.

86. See *In re Koonce*, 54 Bankr. 643 (Bankr. D. S. C. 1985) (case filed prior to BAFJA). *Koonce* reads like a very bad law school hypothetical; after the debtor's Chapter 13 plan was confirmed he won \$1,300,000 in the Massachusetts State Lottery.

87. 54 Bankr. 700 (Bankr. D. Neb. 1985).

88. *Id.* at 703.

89. 54 Bankr. 375 (Bankr. D. Colo. 1985).

90. *Id.* at 377-78.

different from the provision of "projected" disposable income to creditors. Nevertheless, if modifications of disposable income are permissible during the plan period, it is hard to identify any *per se* reason why the plan itself could not call for automatic modification as disposable income fluctuates.<sup>91</sup> Arguably, the only difference is the advantage of avoiding the additional costs associated with piecemeal modification.

There are other problems, however. The *Akin* approach may be administratively unworkable. Who will monitor the debtor to determine his disposable income? This is a serious problem, because both income and reasonably necessary expenses will vary from time to time. Can the debtor unilaterally reduce payments whenever he believes his disposable income has dropped? If so, the *Akin* rule would make Chapter 13's modification provisions almost a nullity insofar as the debtor is concerned, since it would permit the debtor to change his payment level at will without going through the required (if admittedly simple) modification procedures.

The monitoring problem in *Krull* might be simpler, since only the amount of the debtor's gross income needs to be watched. *Krull*, however, imposed a payment standard that is radically different from that set out in Section 1325(b). The plan required the debtor to pay neither his projected disposable income nor his actual disposable income, but his projected disposable income plus 50% of the amount by which his actual disposable income exceeded his projected disposable income.<sup>92</sup> The court arrived at this calculation by superimposing the "good faith" standard on the disposable income standard, a matter which will be discussed below.

The final problem with the general definition of income has not yet arisen in any reported case. If the debtor has assets which he can sell to meet living expenses, does that mean that the amount of his income needed for living expenses is correspondingly reduced? The answer to this question should be no, because it would frustrate one of the key purposes of Chapter 13, that is, to permit the debtor to retain assets in exchange for future income. The requirement that the debtor provide creditors with at least the value of his assets means that the debtor will have to "pay" for any assets retained anyway; and to force the debtor to "pay" for those assets and then dispose of them would effectively impose a double discharge cost on the debtor.

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91. It should be noted that the logic of *Akin* is that, as both the debtor's income and the debtor's reasonably necessary expenses change, the amount payable to creditors should change.

92. *Krull*, 54 Bankr. at 378.

### 3. *Discretionary Decreases in Income*

To date, no court has had to deal directly with one potential problem: a debtor who deliberately reduces his income during the plan period. One of the policy concerns in the area of individual reorganization is the debtor's difficulty in maintaining the incentive to work if the fruits of his labor merely garnish the creditor's table. If all of a debtor's income above a very low level of expenditure is devoted to paying debts, why should the debtor bother to earn that extra money? Professionals especially have the opportunity to manipulate their incomes. A doctor, for example, might choose to spend his plan period working in Harlem for a fraction of the salary he could earn in Scarsdale. At least one disposable income case and a few other cases in related areas have indicated that the debtor's *ability* to earn, rather than his actual income, is crucial to determining the amount the creditors should receive.<sup>93</sup> If indeed that is the case, and if this principle were carried to its logical extreme, the debtor would be forced to earn as much as he possibly could. This would be, to say the least, an awkward rule to enforce.<sup>94</sup> If, however, the debtor has unfettered power to choose how much he will earn, the disposable income standard could be eviscerated.

The problem may be largely a chimera, for at least two reasons. First, even if the debtor pays everything he earns above his bare living expenses to creditors, the debtor, especially if he is a professional, may still obtain significant benefits from continuing his ordinary work. The greater experience and knowledge which the debtor will have at the end of the plan period is a marketable asset which, because it has not yet been converted into income, is retained by the debtor. Second, the courts' treatment of the disposable income standard virtually ensures that the debtor will be able to enjoy, during the plan period, a lifestyle roughly commensurate with his income. The simple truth is that the courts have not required high-income debtors to live as if they were earning minimum wage; they have only been obligated to live as if they

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93. See, e.g., *In re Kazzaz*, 62 Bankr. 308 (Bankr. E.D. Va. 1986) (debtor's inability to read or write English relevant in determining disposable income); *In re Sanabria*, 52 Bankr. 75 (N. D. Ill. 1985) (fact that debtor was a newly graduated medical doctor and thus would likely experience increased income relevant to whether Chapter 13 plan was filed in good faith). See also, *In re Bell*, 56 Bankr. 637 (Bankr. E.D. Mich. 1986) (potential income of former college president relevant in determining whether Chapter 7 petition was a substantial abuse under § 707(b)) and *In re Springer*, 54 Bankr. 910 (Bankr. D. Neb. 1985) (potential future income due to Harvard graduate degree relevant in determining whether student loans were dischargeable under undue hardship standard of § 523(a)(8)).

94. One example of this, perhaps only slightly tongue-in-cheek, asks whether, if such a standard were adopted and the debtor were a football player, "the bankruptcy judge, sweatshirted and bewhiskled, [would] decide if [the debtor] was 'dogging it.'" Sullivan, Warren & Westbrook, *supra* note 23, at 1136 n.283.

were moderately frugal recipients of their level of income.<sup>95</sup> While the fairness of this interpretation may be subject to debate, it is unlikely that the courts will or, given the background of the present statutory structure, should change it.<sup>96</sup>

The courts should, however, be conscious of the risk of reduced incentive to earn when evaluating disposable income; if allowable expenses are pared so low that the debtor sees no point in making any money, the goal of making Chapter 13 an alternative to Chapter 7 that is attractive to debtors and profitable to creditors will be frustrated. There may also be occasional cases in which the court must make very difficult decisions about the debtor's willingness to cooperate with the plan. The doctor who announces he is heading to Harlem for the duration, seeing in his forced income reduction the opportunity to fulfill an apparently sincere religious or ethical duty, would present the court with a hard choice between the interests of the creditors and the interests of those whom the doctor proposes to serve.

#### 4. *Savings and Contingency Reserves*

The division between the different philosophies regarding disposable income becomes clearly visible when the debtor seeks to continue any form of savings plan or reserves any of his income for contingencies. Some courts have permitted significant amounts to be held back "for a rainy day." Others have refused to allow the debtor to retain quite picayune sums.

The extremes are set out neatly in two cases, *In re Otero*<sup>97</sup> and *In re Red*.<sup>98</sup> In *Otero*, the debtor was permitted to retain \$117 per month as a "cushion . . . against life's unexpectancies."<sup>99</sup> In *Red*, the debtor was denied permission to continue a \$12.50 per week payroll transfer to her credit union savings account.<sup>100</sup> Other cases are about equally divided.<sup>101</sup>

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95. See *infra* notes 131-32 and accompanying text.

96. It should be obvious that this problem would have become much more acute if the Purdue Study recommendation that all debtors be forced to live at the adjusted poverty line had been accepted by Congress.

97. 48 Bankr. 704 (Bankr. E.D. Va. 1985).

98. 60 Bankr. 113 (Bankr. E.D. Tenn. 1986).

99. 48 Bankr. at 708.

100. 60 Bankr. at 116.

101. See, e.g., *In re Greer*, 60 Bankr. 547 (Bankr. C.D. Cal. 1986) (\$75 per month contingency reserve a "reasonably necessary" expense); *In re Festner*, 54 Bankr. 532 (Bankr. E.D. N.C. 1985) (\$47 per month for retirement plan and stock purchase plan part of disposable income); see also *In re Ali*, 33 Bankr. 890 (Bankr. D. Kan. 1983) (plan that permitted debtor to retain \$19 per month of his disposable income in good faith), and *In re Bell*, 56 Bankr. 637 (Bankr. E.D. Mich. 1986) (one reason for holding

The real issue is whether the money saved is likely to be needed by the debtor during the three year period or not. Obviously, a debtor should not be allowed to save for retirement, or even a mardi gras ending to his penitential three years. If the debtor can afford to shift current income to the post-plan period, that income was self-evidently not necessary for the support of the debtor or his dependents during the plan period.<sup>102</sup> Yet it is equally obvious that personal expenses do not arrive in tidy monthly lumps. The debtor should be allowed to retain during one part of the plan period those assets that may reasonably be needed by the debtor for necessary expenses during another part. If this were not permitted, the chance for successful completion of the plan would be sharply reduced. Moreover, to the extent that the court is concerned about the retention of excessive contingency reserves, it could require the debtor to account for any unspent and uncommitted reserves at the end of the plan, and to make a final dividend to creditors of whatever excess remained.

The principle that income can be shifted within but not beyond the plan period is implicitly recognized in a number of the disposable income cases. Many permissible periodic expenditures, such as clothing purchases, insurance premiums and medical bills, are presented in the schedule of expenses as if they were monthly payments.<sup>103</sup> In fact, such schedules could just as easily and much more accurately describe such "payments" as "savings reserve for insurance policy."<sup>104</sup> This in turn suggests that small savings plans, such as that in *Red*, would be permitted if appropriately relabeled.

### 5. Lifestyle Expenses

Since the paradigmatic bankruptcy abuser is the free-spending swinger who finances his sybaritic lifestyle at the expense of his creditors, it is

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that Chapter 7 proceeding was a substantial abuse of the Bankruptcy Code was that the debtor's schedules of income and expenses reflected investment of \$820 per month in an annuity).

102. Assuming, of course, that the debtor did not habitually deprive himself or his dependents of necessities for the purpose of saving money.

103. See, e.g., *In re Tinneberg*, 59 Bankr. 634 (Bankr. E.D.N.Y. 1986) (automobile insurance, clothing); *In re Greer*, 60 Bankr. 547 (Bankr. C.D. Cal. 1986) (automobile insurance, clothing); *In re Jones*, 55 Bankr. 462 (Bankr. D. Minn. 1985) (medical expenses, automobile insurance, health insurance, household insurance, real estate taxes, clothing); see also, *In re Ali*, 33 Bankr. 890 (Bankr. D. Kan. 1983) (medical expenses, automobile insurance, health insurance, clothing) (good faith standard).

104. There seem to be no disposable income cases that directly discuss the potential "savings" aspects of life insurance. Logically, the debtor should not be permitted to shift disposable income from the plan period to the post plan period by using plan period disposable income to increase the cash value of a life insurance policy; conversely, the debtor should be able to purchase a reasonable amount of term insurance to protect his dependents.



not surprising that the courts have examined the debtor's discretionary expenses with a close and often jaundiced eye. One of the earliest, and most cited, cases touching upon this issue is *In re Taff*.<sup>105</sup> That case concerned the Section 522(d)(10)(E) exemption for certain benefit payments made to the debtor "to the extent reasonably necessary for the support of the debtor and any dependent of the debtor."<sup>106</sup> *Taff* held that this standard was based on the amount that "ought to be sufficient to sustain basic needs" and was "not related to [the debtor's] former status in society or the lifestyle to which he is accustomed."<sup>107</sup>

The rhetoric of *Taff* has been strongly echoed in a number of disposable income cases. Courts have found objectionable the payment of private college tuition;<sup>108</sup> private secondary school tuition;<sup>109</sup> monthly food budgets of \$515,<sup>110</sup> \$500,<sup>111</sup> and \$480;<sup>112</sup> monthly telephone expenses of \$300;<sup>113</sup> and monthly transportation expenses of \$608<sup>114</sup> relating to the debtor's operation of a car that the court viewed as a "luxury automobile."<sup>115</sup>

On the other hand, the courts have rather freely permitted the debtor's budget to include modest expenses for recreational activities. *In re Tinneberg*<sup>116</sup> characterized a creditor's objection to the debtors' inclusion in their budget of \$12 per month for newspapers and periodicals as "not only spurious [but] downright heartless."<sup>117</sup> Section 707(b) cases have been even more generous. *In re Bell*,<sup>118</sup> which found the debtor's Chapter 7 filing to be abusive, apparently saw nothing wrong with the debtor expending \$100 per month for racquetball and movies.<sup>119</sup> *In re*

105. 10 Bankr. 101 (Bankr. D. Conn. 1981).

106. See supra note 50.

107. 10 Bankr. at 107.

108. *In re Jones*, 55 Bankr. 462, 466-67 (Bankr. D. Minn. 1985). See also, *In re Jolly*, 13 Bankr. 123, 125 (Bankr. E.D. Wis. 1981) (money saved for children's education properly available to creditors) (good faith standard).

109. *In re Jones*, 55 Bankr. at 466-67.

110. *Id.* at 467 (family of four).

111. *In re Kress*, 57 Bankr. 874, 876 (Bankr. D.N.D. 1985) (§ 707(b) case) (family of four).

112. *In re Bell*, 56 Bankr. 637, 642 (Bankr. E.D. Mich. 1986) (§ 707(b) case) (single individual).

113. *In re Kress*, 57 Bankr. at 876 (§ 707(b) case) (three telephone lines plus payment to wife to serve "as a sort of live-in answering service").

114. *In re Bell*, 56 Bankr. at 642 (§ 707(b) case).

115. *Id.* The luxury car in question turned out to be a 1984 Audi. *Id.* at 639.

116. 59 Bankr. 634 (Bankr. E.D.N.Y. 1986).

117. *Id.* at 635. Indeed, the court went on to encourage the debtors to submit a *less* austere budget to "increase the likelihood of the success of their plan." *Id.* at 635 n.1.

118. 56 Bankr. 637 (Bankr. E.D. Mich. 1986).

119. *Id.* at 639-42 (§ 707(b) case). See also *In re Edwards*, 50 Bankr. 933, 940 (Bankr. S.D.N.Y. 1985) (§ 707(b) case) (inclusion of \$100 per month for recreation for family

*Kress* seems to have found a \$200 per month recreation budget excessive,<sup>120</sup> but even that might have been allowed but for the debtor's penchant for flagrantly puffing up every item on his list of expenses.<sup>121</sup>

The courts have thus generally followed an unobjectionably commonsensical approach to lifestyle expenses, neither requiring asceticism nor condoning hedonism. Four problems have not yet been significantly explored. The first is the cost of reducing lifestyle expenses. The second is the treatment of discretionary increases in expenses. The third is the impact on the debtor's dependents. The fourth is the impact that the *Taff* approach may have on the high rollers whom we presumably want to coax into Chapter 13. These are discussed in order.

One disposable income case has held that the debtor's monthly \$989 mortgage payment was "well above the amount necessary to provide adequate housing for a family of four."<sup>122</sup> This decision is questionable on at least two grounds. First, the payment is not abnormal in the current housing market.<sup>123</sup> Of course, it is possible to find cheaper housing, and if the *Taff* rationale is followed to its extreme conclusion, the debtor should be obligated to find the cheapest apartment not condemned by the local housing authority. The second problem is that there are costs involved in reducing some expenses—housing is a good example. If the debtor's house payment is forcibly reduced to \$450 per month, the bank (which undoubtedly does not think that the original monthly payment was in any way excessive) is likely to insist that the house be sold or the mortgage foreclosed. Sale of the debtor's home under such circumstances may well bring a fire-sale price that will reduce the debtor's assets (and may thus reduce the amount his creditors ultimately receive). Moreover, the debtor may be unable to buy new housing and may be required to provide a hefty rent deposit, precisely because of his economic problems.

This is not to say that housing expenses should not be reviewed by the court. It would be difficult, to say the least, to justify ownership of a second home; and the cost of the debtor's primary home may be

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of five in budget did not make Chapter 7 filing a substantial abuse of the Bankruptcy Code).

120. 57 Bankr. at 876 (§ 707(b) case).

121. The actual comment concerning the recreation budget was: "The Court has serious questions about the appropriateness of a debtor in Chapter 7 to be paying his wife \$300.00 per month to answer the phone and be spending another \$200.00 per month on recreation." *Id.* at 876. (§ 707(b) case). *Kress* provides virtually a textbook case of the type of debtor at which § 707(b) was aimed; the debtor had an income between \$70,000 and \$90,000 per year; his total unsecured debts were only \$37,927. *Id.*

122. *In re Jones*, 55 Bankr. 462, 467 (Bankr. D. Minn. 1985).

123. *In re Greer*, 60 Bankr. 547, 549 (Bankr. C.D. Cal. 1986), *perhaps* reflecting its view of the California real estate market, did not blink at a house payment of \$1,255 per month.

so great that the costs of relocation would be justified. Those costs should be taken into account, however, before the debtor is forced to incur them.<sup>124</sup>

Just as the disposable income standard reduces the debtor's incentive to earn, so too it reduces the debtor's incentive to minimize expenses. To what extent can the debtor voluntarily increase his "reasonably necessary" expenses during the plan period? For example, the debtor's child might need orthodontic work, which the debtor has been delaying because he does not want to spend the money. Since that money will go to creditors if it is not used to fix the child's teeth, it literally costs the debtor nothing to have the work done during the plan period.

There is little indication in the cases that this has been much of a problem.<sup>125</sup> Potentially discretionary expenses have been measured by the same yardstick as other expenses—whether they are nebulously reasonable in light of the debtor's income and obligations.<sup>126</sup> One case, examining the substantial abuse standard, suggests that the court's examination of such issues should be very cautious, because of the interest in preserving personal autonomy and the constitutional right of privacy in family matters.<sup>127</sup> Lawyers for debtors filing Chapter 13 should, consequently, consider whether it might be appropriate to schedule reasonable discretionary expenditures for the plan period.

The third inadequately explored issue is the effect of the disposable income standard on the debtor's dependents. Whatever level of frugality the court imposes on the debtor is also imposed on the debtor's family. Should the *Taff* rule apply with equal force to, e.g., the debtor's children as it does to the debtor?

It is difficult to articulate any per se reason why the debtor's dependents should be treated the same as the debtor. Sometimes, of course, it is the dependents who will have induced the debtor to overspend and thus to suffer bankruptcy. In other circumstances, however, the debtor will have been as sparing with his children as with his creditors

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124. It should be noted that it is not at all clear that Jones was forced to move. The debtor's schedules claimed monthly expenditures of \$4,177.54, which included not only the mortgage payment but \$1,000 per month for private school tuition and \$515 per month for food, all of which the court found excessive. The court, however, only reduced the debtor's permissible monthly expenses to \$3,800, a reduction of a mere \$377.54. 55 Bankr. at 467. Obviously, this reduction could have been dealt with by reducing "excessive" expenses other than the mortgage payment. Other listed expenses, such as utilities, clothing, laundry, periodicals, and transportation could also have been adjusted downward, at least to some degree.

125. Perhaps because creditors probably have great difficulty in identifying such expenses.

126. See, e.g., *In re Edwards*, 50 Bankr. 933 (S.D.N.Y. 1985) (§ 707(b) case).

127. *Id.* at 940 n.9. (bankruptcy court should not intrude into debtors' decision to have a child, citing *Eisenstadt v. Baird*, 405 U.S. 438, 92 S. Ct. 1029 (1972)).

so as to indulge himself more fully. The difficulty with diminishing the dependents' expectations along with the debtor's is that children have needs unique to their age that, if left unmet, will impose severe hardship for years to come. Education is the clearest example of such a need.

Perhaps the obvious resolution of this problem is that the expenses we tend to view as "reasonably necessary" for children "just naturally" differ from those we think of as being equally necessary for an adult. In *In re Jones*,<sup>128</sup> for example, the court found private college tuition to be an unnecessary expense<sup>129</sup> on the basis that "[a]n expensive private school education is not a basic need of the Debtor's dependents, particularly in view of the high quality public education available in this country at both the collegiate and secondary school levels."<sup>130</sup> This language certainly suggests that state college tuition, which might not be a necessary expense for a forty year old debtor, would be a necessary expense for his eighteen year old dependent.

The final unaddressed problem with lifestyle expenses is the proper treatment of the type of debtor against whom the disposable income standard is aimed—the high income/low asset debtor. *Taff* says that the debtor's prior lifestyle is not relevant in determining the amount he has to pay creditors. This is not, in fact, an accurate description of the cases, nor is it clear whether it is the appropriate rule.

The disposable income cases have permitted the debtor to continue something resembling his prior lifestyle. The debtor has not been forced to live in bankruptcy poverty, or anywhere near bankruptcy poverty, unless he was already poor.<sup>131</sup> This may not be fair. It may well impose

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128. 55 Bankr. 462 (Bankr. D. Minn. 1985).

129. *Id.* at 466-67.

130. *Id.* at 467 (emphasis added).

131. This is evidenced by the income earned and expenses allowed in the (admittedly few) disposable income cases that reveal those figures: *In re Greer*, 60 Bankr. 547 (Bankr. C.D. Cal. 1986) (\$3,200.00 per month net-of-withholding-tax income; debtor permitted to expend \$2,492.57); *In re Rushton*, 58 Bankr. 36 (Bankr. M.D. Ala. 1986) (\$772.00 net income; debtor permitted to expend \$582.00); *In re Jones*, 55 Bankr. 462 (Bankr. D. Minn. 1985) (\$4,324.00 per month net income; debtor permitted to expend \$3,800.00); *In re Festner*, 54 Bankr. 532 (Bankr. E.D.N.C. 1985) (\$1,393.00 per net month income; expenses of \$1,130 found reasonable; confirmation denied for other reasons); *In re Krull*, 54 Bankr. 375 (Bankr. D. Colo. 1985) (\$1,987.00 per month income (unclear whether net or gross); expenses of \$1,502.00 found reasonable; confirmation denied for other reasons); see also, *In re Tinneberg*, 59 Bankr. 634 (Bankr. E.D.N.Y. 1986) (no income stated; court suggested that \$837 per month projected expenses could properly be increased). Cf. *In re Perkins*, 55 Bankr. 422 (Bankr. N.D. Okla. 1985) (\$2,387.00 per month income; use of \$1,977.00 per month by debtor did not mean plan was not in good faith); *In re Peterson*, 53 Bankr. 339 (Bankr. D. Or. 1985) (\$1449.00 per month income (unclear whether net or gross); debtor permitted to expend \$1,179.00; however, no creditor objected to the proposed budget).

a higher relative discharge cost on those who have the least.<sup>132</sup> While egalitarian sentiments seem unpopular today, the problem created by permitting Chapter 13 debtors to enjoy very different lifestyles based on their social and economic status should at least be addressed by the courts.

Obviously, those high income debtors would be discouraged from filing Chapter 13 if they were forced to trim their lifestyles too severely. If BAFJA were interpreted in a way that led to fewer reorganizations, rather than more, its purposes presumably would be frustrated. Of course, this problem could be alleviated by the vigorous use of Section 707(b) to force reorganization. Thus, if the courts do in time adopt a more stringent definition of permissible lifestyle expenses, they will also have to monitor petitions more closely for signs of substantial abuse.

### 6. Charitable Contributions

The courts have universally ruled that, if charity begins at home, it ends with bankruptcy. Charitable contributions of even very modest amounts have been forbidden.<sup>133</sup> As a general principle, this is obviously correct. It should be self-evident that such contributions do not fit the definition of permissible expenses, and thus this rule is not, in most cases, even remotely controversial.

Nevertheless, one aspect of the prohibition on charity does raise troubling questions. One disposable income case<sup>134</sup> and at least one good faith case<sup>135</sup> prohibit the debtor from tithing to his church during the plan period. Under some circumstances, at least, such a prohibition may come uncomfortably close to an interference with freedom of religion.

Suppose that a debtor earns \$2000 per month and believes it to be a fundamental religious duty to contribute \$200 of that to his church each month. A determination that the \$200 is part of the debtor's disposable income requires the debtor to choose between fulfilling the religious duty and obtaining Chapter 13 relief. Worse still, if the payment

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132. Compare *Jones* (discharge cost 12.1% of \$4,324.00 per month income), *Greer* (discharge cost 22% of \$3,200.00 per month income) and *Perkins* (discharge cost 17.2% of \$2,387.00 per month income) with *Rushton* (discharge cost 24.6% of \$772 per month income), *Festner* (discharge would have cost 18.9% of \$1,393.00 per month income) and *Krull* (discharge would have cost 24.4% of \$1,987.00 per month income). The extremely small size of the sample, of course, can only suggest a possible problem that may or may not be widespread.

133. *In re Red*, 60 Bankr. 113 (Bankr. E.D. Tenn. 1986) (weekly \$1.50 United Way contribution was part of disposable income).

134. *In re Sturgeon*, 51 Bankr. 82 (Bankr. S.D. Ind. 1985).

135. *In re Breckenridge*, 12 Bankr. 159 (Bankr. S.D. Ohio 1980); cf. *In re Cadogan*, 4 Bankr. 598 (Bankr. W.D. La. 1980) (debtor would have to reduce other expenses to be allowed to continue tithing to church).

of the tithe to his church rather than to his creditors means that a Chapter 7 liquidation would be a substantial abuse of the Bankruptcy Code, the debtor would be forced to choose between that duty and any form of bankruptcy relief.

The disposable income cases have not yet confronted this issue directly. *In re Sturgeon*, the only reported disposable income case that addresses tithing, involved an objection to confirmation by the estate of a person whom the debtor had killed while driving under the influence of alcohol. The court did not frame the issue in explicit religious freedom terms; it merely categorized tithing as "a matter of conscience" rather than a "church law" and held "that it would be more just and more noble a gesture to offer the \$140.00 per month to the Estate of Christopher Helmsing."<sup>136</sup> *Sturgeon* does leave open the possibility that a different result might be warranted in other circumstances, e.g., those in which the debtor's church mandated tithing as a condition of membership. A later Section 707(b) case, *In re Gaukler*, which involved debtors who belonged to a church that mandated tithing, held that the debtors' "tithing" of \$672.48 per month from a net income of \$1,802.56 per month did not render their Chapter 7 petition a substantial abuse.<sup>137</sup>

At least one other Section 707(b) case has reviewed the same issue. *In re Edwards*<sup>138</sup> held that the debtors were not substantially abusing Chapter 7 even though their proposed budget included a monthly contribution of \$100 to their church.<sup>139</sup> The court viewed this decision as a personal one comparable in constitutional significance to another decision the couple had made, to bear another child:

[I]t may be questioned whether church contributions of \$100 a month should come ahead of repayment to creditors. Having a fourth child may be a questionable luxury. At what point such inquiries and decisions by a bankruptcy court would become an affront to society's sensibilities or the U.S. Constitution remains uncertain.<sup>140</sup>

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136. 51 Bankr. at 83-84.

137. 63 Bankr. 224 (Bankr. N.D. 1986). The court did, however, comment (perhaps inappropriately) on the tithing, which it characterized as "smack[ing] of irresponsibility" and the product of "a quite stern and uncaring religion that . . . require[d] faithful adherence to such a level of giving when the persons being asked to give are jeopardizing the welfare of their family in the course of compliance." *Id.* at 226.

138. 50 Bankr. 933 (Bankr. S.D.N.Y. 1985) (§ 707(b) case).

139. *Id.* at 940.

140. *Id.* at 940 n.9. Cf. *In re Gaukler*, 63 Bankr. at 226:

This is ultimately, however, a matter between the debtors and God. This Court will not presume to know by what avenue one ought to seek salvation . . . . The debtors seem quite sincere in their conviction and this court is not so presumptuous as to inflict its personal views of religious and financial respon-

*Edwards* and *Gaukler* may reflect nothing more than the appropriate distinction between the substantial abuse standard of Section 707(b) and the disposable income standard of Section 1325(b).<sup>141</sup> The *Edwards* court itself suggested that Chapter 13 might not be an attractive alternative for the debtors because of the greater constraints the disposable income standard would impose upon them.<sup>142</sup>

### 7. Disposable Income and Good Faith

As noted, many pre-BAFJA courts read into the requirement that the Chapter 13 plan be proposed in good faith an obligation to pay creditors as much as was, in the court's view, fair or even as much as was feasible.<sup>143</sup> This was especially so if the debtor was obtaining a discharge of debts that would not be dischargeable in Chapter 7. To what extent, if any, do these precedents survive the enactment of the disposable income standard?

To date, it does not even appear to have occurred to most courts that this problem should be addressed. For example, in *In re Akin*,<sup>144</sup> in which the court declined confirmation of the debtor's plan because of its failure to meet the disposable income standard,<sup>145</sup> the court listed eleven factors to consider in evaluating whether the plan was proposed in good faith. At least four of these factors related directly or indirectly

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sibility upon them . . . . As noted by their counsel, no Court has suggested that a debtor must give up good faith religious beliefs and obligations in order to come within the ambit of Chapter 7.

141. See supra notes 60-65 and accompanying text.

142. 50 Bankr. at 940 n.9.

143. See supra note 18 and accompanying text.

144. 54 Bankr. 700 (Bankr. D. Neb. 1985). A number of other cases similarly indicate that the good faith requirement affects the amount the debtor must pay under the plan. See, e.g., *In re Kazzaz*, 62 Bankr. 308 (Bankr. E.D. Va. 1986); *In re Whitehead*, 61 Bankr. 397 (Bankr. D. Or. 1986); *In re Greer*, 60 Bankr. 547 (Bankr. C.D. Cal. 1986); *In re Rushton*, 58 Bankr. 36 (Bankr. M.D. Ala. 1986); *In re Perkins*, 55 Bankr. 422 (Bankr. N.D. Okla. 1985). Contra *In re Red*, 60 Bankr. 113, 116 (Bankr. E.D. Tenn. 1986): "Thus, where the requirements of the § 1325(b) 'ability-to-pay' provisions are met, this court need not further inquire into the degree of substantiality of repayment of unsecured debt under the plan as a factor in assessing the 'good faith' of a chapter 13 plan under § 1325(a)(3)." See also 5 *Collier on Bankruptcy* ¶ 1325.04[3], p. 1325-17 (L. King, 15th ed. 1986):

[T]he 1984 amendments to the Code finally resolve the issue of whether any particular amount must be paid to unsecured creditors above that required by the best interests of creditors test. Since Congress has not dealt with the issue quite specifically in the ability-to-pay provisions, there is no longer any reason for the amount of a debtor's payments to be considered as even a part of the good faith standard.

145. 54 Bankr. at 703.

to the amount of payments to be made under the plan.<sup>146</sup> Obviously, none of the payment-related factors would be relevant if the disposable income standard had displaced good faith as the measure of plan payments.

*In re Krull*<sup>147</sup> goes much further. In *Krull*, the likelihood that the debtor's income would increase led the court to require that he pay half of that increase to creditors under the plan.<sup>148</sup> It is reasonably clear that the court imposed this requirement under the good faith provision rather than the disposable income provision:

A review of the 11 factors [for determining good faith] analyzed in the context of the facts and circumstances surrounding this filing is essential for a resolution of the good faith issue. The factors are as follows:

.....

(2) The debtor's employment history, ability to earn and likelihood of future increases in income. It is apparent that the debtor has the potential to earn much more than his schedules currently reflect . . . yet the proposed plan makes no provision for future increases.<sup>149</sup>

There is simply nothing in the Code that supports the continued use of the good faith requirement to impose payment obligations on

146. These were:

- (1) the amount of the proposed payments and the amount of the debtor's surplus;
- (2) the debtor's employment history, ability to earn and likelihood of future increases in income;
- (3) the probable or expected duration of the plan;

.....

- (7) the type of debt sought to be discharged and whether any such debt is non-dischargeable in Chapter 7.

*Id.* at 702.

147. 54 Bankr. 375 (Bankr. D. Colo. 1985).

148. *Id.* at 378; see *supra* notes 89-90 and accompanying text.

149. *Id.* at 377. The *Krull* court also drew a clear distinction between the payment of projected income required by § 1325(b)(1)(B) and the additional obligation it was imposing:

Therefore, the amended plan should require the debtor to pay 50 percent of any net earnings, above and beyond the amount scheduled, into the plan for distribution to the creditors. This provision does not conflict with the requirement in Section 1325(b)(1)(B) that all of the debtor's projected disposable income be paid into the plan because, "as of the effective date of the plan," all the debtor's projected income is provided for. Earnings above and beyond the amount scheduled are too speculative at this point as to be regarded as "projected" income.

*Id.* at 378.



the debtor. That the good faith requirement was ever so used is controversial.<sup>150</sup> The potential for "abuse" of Chapter 13 prior to BAFJA was such that perhaps the expansive reading given to good faith was justifiable. Such is no longer the case, however, since the imposition of the disposable income standard and the ability of creditors to force modification if the debtor's income does indeed rise<sup>151</sup> now provide adequate safeguards.

### III. THE IMPACT OF THE DISPOSABLE INCOME REQUIREMENT

#### A. *In General*

At least one early study of the disposable income standard expressed concern that, by increasing the cost of a Chapter 13 discharge, Congress had discouraged consumer Chapter 13 proceedings.<sup>152</sup> Although the available statistics are rather spotty, this does not appear to be the case.<sup>153</sup> Chapter 13 proceedings appear to be about as popular now as they were before BAFJA. There may be several reasons for this.

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150. See *supra* note 18 and accompanying text. Of course, there is no question that good faith is still a relevant inquiry with regard to matters other than the amount to be paid; it is clearly a prerequisite to confirmation. 11 U.S.C. § 1325(a)(3) (1982).

151. See *supra* notes 83-86 and accompanying text.

152. Black & Herbert, *supra* note 3, at 868-70.

153. According to *In re Greer*, 60 Bankr. 547, 550 (Bankr. C.D. Cal. 1986) there were 108,059 Chapter 13 cases filed in calendar year 1985. This compares favorably, in numbers at least, with the 1979-82 filing rates shown in the GAO Report at 2, and the reported Chapter 13 filings for the years ending June 30, 1981 (86,778 of 360,329 bankruptcy cases were filed under Chapter 13, or 24% of the total cases); 1982 (98,705 of 367,866 cases (27%)); 1983 (102,201 of 374,734 cases (27%)) and 1984 (91,358 of 344,275 cases (27%)). U.S. Bureau of the Census, Statistical Abstract of the United States 522 (1986). Figures for the year ending June 30, 1985 also appear comparable to prior years' figures. They show a total of 98,452 Chapter 13 cases among 364,536 Bankruptcy cases—27% of the total filings. Report of the Judicial Conference of the United States 464 (1985). The June 30, 1985 numbers include both pre-BAFJA and post-BAFJA cases, since BAFJA went into effect on October 10, 1984. Pub. L. No. 98-353, 98 Stat. 392 § 553(a) (1984).

Even more striking, if less broadly based, are the unpublished monthly case summaries of the Norfolk and Newport News divisions of the United States Bankruptcy Court for the Eastern District of Virginia. (Available from Professor Michael J. Herbert, T. C. Williams School of Law, University of Richmond, Virginia). During calendar years 1982 and 1983, the last two full years before BAFJA, the Chapter 13 cases ranged between 7% and 21% of total filings each month. For the year 1982, Chapter 13 proceedings were 16% of all filings (380 of 2,337); for the year 1983, Chapter 13 proceedings were 14% of all filings (324 of 2,287). In 1985, the first full year after BAFJA, the Chapter 13 cases ranged between 13% and 18% of the total filings each month, and were 15% of all filings for the year (454 of 2,994). In the first eight months of 1986, Chapter 13 cases ranged between 15% and 20% of the total filings each month, and were 18% of all filings for that time period (470 of 2,616).

The first is that creditors do not seem to file many objections to Chapter 13 plans. It was hypothesized that objections would become routine.<sup>154</sup> This apparently has not happened.<sup>155</sup> Indeed, given the paucity of reported disposable income cases, there seem to be fewer objections now than there were before BAFJA (or at any rate, fewer meriting published opinions). This might be due to debtors' proposing plans that are more satisfactory to their creditors so as to avoid objections. It may also be due to the normal time lag between the creation of a legal standard and its utilization by litigants.<sup>156</sup> Or it may simply reflect the long-observed passivity of creditors in Chapter 13 proceedings.<sup>157</sup> The amounts of money involved in the typical Chapter 13 case discourage much creditor activity and have led to the present system in which creditor participation is reduced to a minimum.<sup>158</sup>

Curiously, it appears that no major creditor has attempted to mitigate this cost—and make objections economically feasible—by creating hypothetical “disposable income profiles” for debtors. It would be quite easy for a major lender to develop such profiles from their own credit scoring systems. Since those systems are used to measure ability to pay before the loan is made, they could also be used to measure ability to pay after Chapter 13 has been filed. The cost of making the projection (which would be slight) and the cost of filing that projection, with an accompanying objection, (which would also be slight) would be the only expenses the creditor would have to incur. Moreover, if courts came to accept such profiles as a baseline for measuring disposable income, the need for objections would diminish as debtors' lawyers learned to draft plans that initially conformed to the profiles.

It is also curious (and perhaps somewhat disturbing) that Chapter 13 trustees rarely file objections to Chapter 13 plans. In theory at least, the trustee should not be dissuaded from her duty to review the plan and, in proper circumstances, object to it by the small size of the estate. In any event, it is obvious that the trustee ought not to allow herself

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154. Black & Herbert, *supra* note 3, at 865.

155. Nevertheless, this possibility cannot be entirely discounted for the future, at least not while a creditor can be found who is willing to squabble over \$12.00 per month for magazines (see *supra* notes 116-17 and accompanying text) or \$1.50 per month for United Way (see *supra* note 133).

156. This hypothesis seems exceedingly improbable for one rather simple reason. The consumer credit industry was deeply involved in the revision process and thus must surely have been aware of the implications of the disposable income standard. On the other hand, the fact that a number of cases still seem to be reviewing the amount of payments under the good faith standard (see *supra* notes 143-151 and accompanying text), leads one to conclude that the implications of the disposable income standard may not have sunk in for some part of the lending community.

157. See Girth, *supra* note 12, at 60-63.

158. *Id.* at 60-61.

to be so dissuaded. *Perhaps* very few Chapter 13 plans are objectionable; perhaps some trustees do not take their obligations as seriously as they should.

The second major reason for the minimal impact of disposable income on Chapter 13's popularity is that there is a distinctive market for Chapter 13. Some debtors need its broader discharge provisions. As long as the cost of meeting the disposable income standard is less than the cost of not having the debts discharged, Chapter 13 remains attractive.<sup>159</sup> Other debtors have the desire to "square" things with their creditors, and Chapter 13 may be an efficient way of meeting this perceived moral obligation. Indeed, many such people may already be complying with the disposable income standard.<sup>160</sup>

The third reason for the continued popularity of Chapter 13 is that the disposable income standard may not have raised the cost of Chapter 13 proceedings in fact as much as it did in theory. As noted above, there is some history of debtors proposing generous Chapter 13 plans for moral reasons. Moreover, many plans have been subjected to variations of the good faith-best efforts-reasonable efforts requirement for years. Disposable income could conceivably require less from the debtor than any payment-based good faith standard and certainly less than would be produced by his best efforts.

The final reason, which is closely related to the third, is that the initial cases, at least, have shown the courts to be reluctant to trim severely the debtor's lifestyle. While the "collection" oriented courts are capable of quite harsh rhetoric, the bottom-line differences between acceptable and unacceptable plans are relatively modest, except with regard to savings.<sup>161</sup> Thus, the creditors' objections, even when sustained, do not generally produce large increases in the payments under the plan.

The simple truth is that, if the reported cases are indicative of the typical disposable income case, debtors are not actually being forced to pay their disposable income to their creditors, at least in the sense that the Purdue Study defined disposable income. Fears that Section 1325(b) would render Chapter 13 unpopular were based on the assumption that something approaching bankruptcy poverty would be enforced. The courts have not done this, and their restraint has simultaneously dampened creditor ardor and muted the disincentive for debtors to file Chapter 13.

If the courts alter their philosophy regarding disposable income, and creditor passivity ends, the bankruptcy courts could find themselves with

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159. See *supra* note 16 and accompanying text.

160. The proposal of an average 57% payment to creditors is strong evidence of some debtors' desire to pay as much as (or perhaps even more than) is feasible. See *supra* note 17.

161. See *supra* notes 131-32 and accompanying text.

a serious docket problem. An ad hoc standard like disposable income requires a degree of individual attention that might be difficult to provide if objections were filed in a substantial number of Chapter 13 cases. There is, however, little reason to believe that the pattern of the first two years after BAFJA will prove abnormal or that the amount of disposable income litigation will sharply increase.

### B. *High Income/Low Asset Debtors*

As suggested previously, it should be obvious that the debtors most likely to respond to the disposable income standard by avoiding Chapter 13 are those for whom that standard was designed—the high income/low asset debtor who has the wherewithal to pay a large portion of his debts but for whom an asset-based bankruptcy would be cheap and easy. His ability to evade the disposable income requirement has been sharply curtailed by Section 707(b). Such a debtor is now faced with a dilemma—if he files for liquidation, the court may find that his income disqualifies him from relief. If he files for reorganization under Chapter 13, his relief may be very expensive. This is precisely the dilemma the Congress intended to create by its adoption of Sections 1325(b) and 707(b). To what extent has its effort succeeded?

One obvious limitation is the severe procedural constraint placed on Section 707(b). Only the court can object to the petition on the grounds of substantial abuse.<sup>162</sup> Yet it is the creditors who are perhaps most sensitive to it.

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162. See *supra* note 45. This limitation, which imposes on the court the awkward obligation to become a semi-litigant in the proceeding, sits poorly with some judges—see, e.g., *In re Campbell*, 63 Bankr. 702 (Bankr. W.D. Mo. 1986). At least one bankruptcy judge has resorted to poetry:

If my motion, it was granted and an appeal came to be,  
 Who would be the appellee?  
 Surely, it would not be me.  
 Who would file, but pray tell me,  
 a learned brief for the appellee The District Judge would not do so  
 At least this much I do know.

*In re Love*, 61 Bankr. 558, 559 (Bankr. S.D. Fla. 1986).

With regard to the court's ability to consider a § 707(b) dismissal after a creditor has improperly moved for such dismissal, see *In re Campbell* (motion by creditor, although improper, does not prevent the court from making an independent investigation of substantial abuse question), and Black & Herbert, *supra* note 53, at 856-57 (court may dismiss if acting independently of creditor's motion). *Contra*, *In re Christian*, 51 Bankr. 118 (Bankr. D. N.J. 1985); see also, the statement of Sen. Metzenbaum regarding this matter:

I also am extremely pleased that this bill prohibits creditors from filing motions attempting to deny bankruptcy relief to individuals because of substantial abuse. If a creditor asks a court to dismiss a case claiming that there has been substantial abuse of the bankruptcy laws by the debtor, the court would not be allowed

There is another escape valve for such debtors—Chapter 11. There is no doubt that virtually any debtor who has business obligations, and almost no doubt that virtually all consumer debtors, are eligible for relief under that chapter.<sup>163</sup> The additional costs and complexity of Chapter 11 proceedings will discourage most debtors from pursuing that route, but the high rollers are surely not among them.

The reason why Chapter 11 will be increasingly attractive is that it can be cheaper to the debtor than a Chapter 13 proceeding.<sup>164</sup> The Chapter 11 debtor is not automatically required to pay his disposable income to creditors; he is only required to pay them as little in excess of the liquidation value of his assets as he can get them to accept.<sup>165</sup> If the debtor or the debtor's attorney is a sufficiently skilled negotiator, this may be considerably less than is required by a court reviewing the disposable income standard.

#### IV. CONCLUSION

Section 1325(b), coupled with Section 707(b), creates an uneasy and fluid compromise between the tradition of asset based bankruptcy and the desire of at least some creditors to force at least some debtors to devote their future income to their debts. This section somewhat reduces the impact of the Bankruptcy Reform Act's attempt to lure debtors into reorganization, because it requires a potentially substantial quid-pro-quo for the benefits of Chapter 13. Nevertheless, contrary to some early fears, it appears that the additional burden imposed has not greatly reduced the attractiveness of Chapter 13.

In part the popularity of Chapter 13 is due to the wide discretion which the courts have exercised in applying the standard; despite protestations to the contrary, this discretion has generally been exercised in favor of permitting the debtor to maintain some semblance of his prior lifestyle. This discretion raises two questions that to date have been of more philosophical than practical significance. At what point does the court's review of the minutiae of a debtor's financial life become an unwarranted intrusion into personal autonomy? And to what extent is it fair to permit a high-income debtor to retain an approximately upper-middle class lifestyle? Both of these problems could have been alleviated by the imposition of a more objective standard, e.g., the

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to do so.

130 Cong. Rec. S7624 (daily ed. June 19, 1984). Unfortunately, Senator Metzenbaum's remarks are those of only one senator, and can be read to say either that the judge cannot grant the creditor's motion or that he cannot grant dismissal at all.

163. See generally Herbert, *supra* note 10 and accompanying text.

164. *Id.*

165. See Herbert, *supra* note 9, at 615-18.

poverty line standard suggested by the Purdue Study. That, however, was a political impossibility. It would also have created ethical dilemmas at least as acute as those created by disposable income.

The reality of bankruptcy is that it is overwhelmingly a system of debt discharge. Only a relatively small fraction of the total number of bankruptcy cases filed each year involve any distribution of property to unsecured creditors. Of those cases, only a portion are filed under Chapter 13. Disposable income will be an issue in only a fraction of a fraction of a fraction. The disposable income provision thus raises the cost of discharge for only a handful of debtors; to date at least, the increased cost has been fairly modest. There is thus little reason to believe that Section 1325(b) has transformed either Chapter 13 or the Bankruptcy Code.

