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Loopholes for the Affluent Bankrupt

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LOOPHOLES FOR THE AFFLUENT BANKRUPT

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[The] rich get richer [until] the poor get educated.[1]
— *Sage Francis*

INTRODUCTION

Recent bankruptcy cases are exposing a problem. Affluent individuals filing for bankruptcy are treated more favorably under the Bankruptcy Code than those debtors with little to no means of financial sustenance or income. Did Congress intend this result? The legislative history is unclear. But one thing seems certain: The United States Bankruptcy Code contains a set of loopholes that appear to be designed for the well-to-do segment of society. Courts throughout the United States are either overlooking these provisions or simply condoning their utilization under the defensible conviction that the Bankruptcy Code permits it.

In this Article, I argue that the Bankruptcy Code unfairly discriminates against individuals of lower-class economic status. Specifically, I identify two loopholes—one found in Chapter 7 and one located in Chapter 11—that are arguably intended to benefit those with high incomes and significant assets. Courts need to consider whether the use of these loopholes is permitted under the Code, and if so, how they should be addressed in individual bankruptcy cases. The Bankruptcy Code should create a level playing field for debtors—not an oasis for the affluent.

Two scenarios demonstrate that the United States Bankruptcy Code favors those with higher incomes living lavish lifestyles.

Imagine Bob, a successful businessman, owes you $50,000 on an unsecured personal loan. Bob has a substantial amount of assets, but the majority of those assets are exempt. Bob makes a good living, bringing in over $200,000 a year. Bob also has a fair

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1 SAGE FRANCIS, *Slow Down Gandhi*, *on* A HEALTHY DISTRUST (Epitaph Records 2005).

amount of disposable income after his monthly expenses are taken care of. But most of this excess income has been used by Bob to put a pool and a tennis court on the grounds of his extravagant home. A substantial amount of Bob's debt derives from a personal guaranty he signed years ago so that his friend could open up a small coffee shop. In addition, he also has some student loan debt, which he accumulated while pursuing his MBA.

Bob has some other unsecured debt, too, but he is refusing to pay. Creditors are stacking up. Bob decides to file for Chapter 7 bankruptcy, where a trustee will be appointed to sell all of Bob's nonexempt assets and then distribute the proceeds to Bob's creditors, after which Bob will receive a discharge of his debt—or what lawyers refer to as "straight liquidation."[2]

Chapter 7 bankruptcy is very appealing to Bob. All of Bob's assets are exempt, so he can basically receive a discharge for free. "Wait!" a friend tells you. "Bob makes too much money to qualify for Chapter 7 bankruptcy.[3] He should be relegated to Chapter 13, where he will be required to pay you, and his other creditors, his hefty disposable income for the next three to five years."[4] In fact, your friend tells you she knows of a few people who tried to file for Chapter 7 bankruptcy, but failed to qualify because their incomes were too high.

In Bob's case, he will likely be able to stiff his creditors in Chapter 7 bankruptcy without having any of his valuable assets touched by the trustee. In most cases, in order to qualify for Chapter 7 bankruptcy, a debtor must pass what is commonly referred to as a qualifying "Means Test." The Means Test is a formula designed to keep bankruptcy filers with higher incomes from filing for bankruptcy under Chapter 7 of the United States Bankruptcy Code.[5] Interestingly, only filers with "primarily consumer debts" need to satisfy this test.[6] Section 707(b) of the Bankruptcy Code provides "the court . . . may dismiss a case filed by an individual debtor under [Chapter 7] whose debts are primarily consumer debts . . . if it finds that the granting of relief would be an abuse of the provisions of [Chapter 7]."[7] Thus, it is a prerequisite that the

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[2] *See* 11 U.S.C. § 704(a)(1) (2018); 1 ALLISON SJOBERG ET AL., ASSET PROTECTION: DOMESTIC AND INTERNATIONAL LAW AND TACTICS § 3:8 (2019).

[3] *See* 11 U.S.C. § 707(b)(2)(A)(i).

[4] *See id.* § 1325(a)(4).

[5] *See id.* § 707(b)(2)(A)(i); ALLISON SJOBERG ET AL., *supra* note 2.

[6] 11 U.S.C. § 707(b)(1).

[7] *Id.*

debts in a Chapter 7 bankruptcy case be "primarily consumer debts" before dismissal can occur pursuant to section 707(b).[8]

Under section 101(8) of the Bankruptcy Code, a "consumer debt" is defined as a "debt incurred by an individual primarily for a personal, family, or household purpose."[9] In determining whether debt is for a "personal, family, or household purpose,"[10] courts generally look to the purpose for which the debt was incurred. Debt incurred for a business venture or with a profit motive does not fall into the category of debt incurred for "personal, family, or household purpose[s]." Most courts conclude that the ratio of the dollar amount of consumer debt to non-consumer debt should control in determining whether the indebtedness is primarily consumer debt for purposes of 707(b).[11]

Consequently, if over 50 percent of Bob's total debt arises out of a personal guaranty agreement, for example, which was executed for a business venture or profit motive, section 707(b) would not apply, and he could file for Chapter 7 protection.[12] In other words, because Bob qualifies as a "businessman," he can take advantage of Chapter 7 liquidation and receive a full discharge of his debts within a few months after filing for bankruptcy.[13]

By contrast, imagine your friend Gabe is injured in a horrific motorcycle accident. He makes approximately $70,000 a year as a plumber. As a result of the accident and a financially draining divorce, he is left with hundreds of thousands of dollars of debt. Gabe's situation seems a lot worse than Bob's, but nonetheless, Gabe likely will not be able to file for bankruptcy under Chapter 7. Oddly, despite Gabe's income being $130,000 less than Bob's, his income is still too high to pass Chapter 7's qualifying means test—a factor that now matters since the majority of Gabe's debt is "consumer debt[ ]."[14]

Imagine another scenario. You represent a bank. The bank has lent $1.5 million to a wealthy individual, who has been living a lavish lifestyle. The majority of her income has come from a wealthy father and a trust fund. The individual does not have sufficient "business" debt, so the Means Test of Chapter 7 would prevent her

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[8] *Id.*
[9] *Id.* § 101(8).
[10] *Id.*
[11] *See* discussion *infra* Section II.C.
[12] *See* 11 U.S.C. § 707(b)(1).
[13] *See* discussion *infra* Section II.C.
[14] 11 U.S.C. § 707(b)(1). *See* discussion *infra* Section II.A.

from filing under Chapter 7.[15] She also does not want to be relegated to Chapter 13, where a trustee would basically babysit her for the next three to five years and require that she turn over her monthly disposable income.[16] Instead, the spoiled child is told she can liquidate her nonexempt assets in order to fund a Chapter 11 plan, rather than pay future disposable income to creditors under Chapter 13. Under Chapter 11, the individual would basically give her assets to a liquidating trust, which would then complete distribution of funds to creditors, after which the individual would receive a discharge of debt and then go back to living her lavish lifestyle.

Do these scenarios seem fair? It seems peculiar, and unfair, that both Chapter 7 and Chapter 11 of the Bankruptcy Code have provisions in which individuals with significant incomes, or assets, or who are labeled as a "businessman," are treated more favorably than the typical struggling debtor.

In this Article, I first analyze whether Chapter 7 allows individuals with primarily business debts to avoid the so-called "Means" Test altogether and successfully receive a discharge. In doing so, I discuss ways in which individuals with higher incomes have manipulated this provision to avoid paying their financial obligations. I also discuss whether good faith plays a role in the Means Test analysis.

After discussing the Means Test manipulation under Chapter 7, I analyze a second issue under the Bankruptcy Code which benefits the affluent: Whether individuals with a high net worth, but no current cash flow, can liquidate their nonexempt assets to fund a Chapter 11 plan, rather than contribute future disposable income per Chapter 13.[17] In conjunction, this Article then determines whether "completion of payments" occurs once the debtor gives all of her assets to a liquidating trust, who then completes distribution to the creditors.

Under Chapter 13, a debtor's plan must extend for three years, and in some cases five years, unless the plan provides for payment in full of all unsecured claims sooner.[18] Chapter 11 is different. Section 1129(a)(15), which applies only to Chapter 11 plans, does not specify a minimum period or a commitment period.[19]

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[15] *See* 11 U.S.C. § 707(b)(1).
[16] *See id.* § 1325(b)(1)(B), (b)(4)(A)(i)–(ii).
[17] *See id.* § 1322(a)(4).
[18] *See id.* § 1325(b)(4).
[19] *See id.* § 1129(a)(15).

Rather, section 1129(a)(15) requires either that the debtor pay all unsecured claims in full *or* that the debtor's plan devote an amount equal to five years' worth of the debtor's "projected disposable income."[20] In other words, the requirement in section 1129(a)(15) is that "the value of the property" distributed be equal to the "disposable income."[21]

In a case where a debtor has assets that can be liquidated to fund a plan, if the value of those assets equals the projected disposable income, then section 1129(a)(15) would arguably be satisfied even if no disposable income is contributed.[22] Furthermore, under section 1141(d), the general rule in Chapter 11 bankruptcy cases involving individuals is that the discharge will not be entered until the debtor has completed all payments under the plan.[23]

Does this reading of the Bankruptcy Code mean that a debtor could simply set up a liquidating trust, deliver all of her assets to that trust, and then experience a discharge because there has been a "completion of payments"? And as long as those delivered assets equals the five-year "projected disposable income," then is section 1129(a)(15) satisfied even if no disposable income is contributed? Is this fair to creditors and is this what Congress intended?

I argue that such a literal interpretation allows a debtor to distort her "projected disposable income," receive a discharge, and abuse the bankruptcy process by living a lavish lifestyle, all while paying creditors a fraction of their claims. To bolster this argument, I also examine section 1129(a)(3)'s good faith requirement.

I. BANKRUPTCY BASICS FOR INDIVIDUALS

A. Chapter 7

To fully understand the abuse that occurs under the Bankruptcy Code, one must grasp the concepts of Chapters 7, 11, and 13. Chapter 7 of the Bankruptcy Code is entitled "liquidation" and is sometimes referred to as "straight bankruptcy."[24] Chapter 7 is the most common chapter used by debtors because its purpose is

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[20] *See id.*
[21] *Id.*
[22] *See id.*
[23] *See id.* § 1141(d).
[24] David Haynes, *What is Chapter 7 Bankruptcy?*, THE BALANCE (July 9, 2019), https://www.thebalance.com/what-is-bankruptcy-316202 [https://perma.cc/PZC2-TUGW].

to provide debtors with a "fresh start."[25] In a Chapter 7 bankruptcy case, a trustee is appointed and her duty is to collect the nonexempt property of the debtor, convert that property to cash, and distribute that cash to creditors in accordance with the distribution scheme of the Bankruptcy Code.[26] Essentially, the debtor gives up all nonexempt property owned at the time of the filing of the bankruptcy petition in exchange for a discharge of all incurred debt.[27]

In a very simplified overview, a Chapter 7 case contains the following basic stages: (1) a Chapter 7 petition is filed; (2) the filing of the petition results in the stay of creditor collection activity[28] and the appointment of a trustee to administer the case;[29] (3) the debtor exercises exemption rights with respect to owned property;[30] (4) the trustee collects and sells or liquidates any property available for distribution to the creditors;[31] (5) the proceeds from the sale of the property are used to pay administrative expenses and the claims of the creditors according to the Bankruptcy Code's priority scheme;[32] and (6) the debtor *may* be discharged from any remaining prepetition debts[33] that are not exempted from discharge.[34]

B. Chapter 13

Two basic goals of bankruptcy are oft-stated: The first and "principal purpose of the Bankruptcy Code is to grant a 'fresh start' to the 'honest but unfortunate debtor.' "[35] However, the fresh start must be balanced with the subsequent goal of ensuring "the

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[25] *Id.*

[26] 11 U.S.C. § 704(a).

[27] The right to a discharge is not absolute, and some types of debt are not discharged. For example, if the debtor has committed some bad act enumerated in section 727 of the Bankruptcy Code, the debtor may not be entitled to any discharge. *Id.* § 727(a). Moreover, certain enumerated debts set forth in section 523(a) are not dischargeable. *Id.* § 523(a). Additionally, bankruptcy discharge does not extinguish consensual liens on the debtor's property. Young v. Wells Fargo Bank, N.A. (*In re* Young), No. 04-32102, 2007 WL 1159952, at *2 (Bankr. S.D. Tex. Apr. 16, 2007).

[28] 11 U.S.C. § 362(a).

[29] *Id.* § 701(a).

[30] *See id.* § 522(b).

[31] *See id.* § 704(a).

[32] *See id.* § 726(a).

[33] *See id.* § 727(b).

[34] *See id.* § 523(a).

[35] Marrama v. Citizens Bank of Mass., 549 U.S. 365, 367 (2007) (quoting Grogan v. Garner, 498 U.S. 279, 286–87 (1991)).

fair and equitable treatment of the creditors of a debtor in bankruptcy."[36] As the United States Supreme Court stated, "a central purpose of the Code is to provide a procedure by which certain insolvent debtors can reorder their affairs, make peace with their creditors, and enjoy 'a new opportunity in life with a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.' "[37]

Although the goals of Chapters 7 and 13 of the Bankruptcy Code are the same, the Chapter 13 process differs significantly from the Chapter 7 process. "Chapter 13 authorizes an individual with regular income to obtain a discharge after the successful completion of a payment plan approved by the bankruptcy court."[38] Unlike a Chapter 7 bankruptcy case, in a Chapter 13 case, "the debtor retains assets, often his home, . . . subject to [the] court-approved plan."[39] The repayment plan in a Chapter 13 bankruptcy case has a duration of three to five years—the applicable "commitment period"—depending on whether the Chapter 13 debtor has monthly income below or above the national median.[40] Further, plan payments are made from a debtor's calculated "future earnings or other future income."[41] Notably:

> That three to five year commitment period, while onerous in the sense that the debtor is continuously under the jurisdiction of the bankruptcy court, provides some relief for the debtor regarding his nondischargeable unsecured debt. For example, collection of unsecured taxes and student loans are stayed during the pendency of the Chapter 13 case due to the bankruptcy automatic stay, whereas those creditors could commence collection against the Chapter 7 debtor immediately after discharge is entered in the comparatively much shorter Chapter 7 case.[42]

In addition, debtors are not allowed to incur debt without authorization, which means they "must learn to live within a budget during the time they are under the [bankruptcy] Court's jurisdiction."[43]

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[36] *In re* Westby, 473 B.R. 392, 401 (Bankr. D. Kan. 2012).

[37] Grogan v. Garner, 498 U.S. 279, 286 (1991) (quoting Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934)).

[38] *Marrama*, 549 U.S. at 367.

[39] Harris v. Viegelahn, 135 S. Ct. 1829, 1834 (2015).

[40] *See* Hamilton v. Lanning (*In re* Lanning), 545 F.3d 1269, 1275 (10th Cir. 2008) (discussing the applicable commitment period for below-median and above-median debtors), *aff'd*, 560 U.S. 505 (2010).

[41] *Harris*, 135 S. Ct. at 1835 (quoting 11 U.S.C. § 1322(a)(1) (2018)).

[42] *In re* Wark, 542 B.R. 522, 530 (Bankr. D. Kan. 2015).

[43] *Id.*

Although the Chapter 7 process is much faster, it is also a much more demanding process. As set forth above, in a Chapter 7 bankruptcy proceeding, "the debtor's assets are immediately liquidated and the proceeds [are] distributed to creditors."[44] In *Harris*, the Supreme Court explained that "Chapter 7 allows a debtor to make a clean break from his financial past, but at a steep price: prompt liquidation of the debtor's assets."[45]

There are also significant differences in who is eligible to file a petition under each Chapter of the Bankruptcy Code. While the Chapter 13 process is "wholly voluntary,"[46] Chapter 13 relief is only available to "an individual with regular income" who owes debts that are less than a specified sum set forth in the Code.[47] Further, and as discussed in detail below, in order to file a Chapter 7 petition, the debtor must pass a Means Test, which basically provides that if a debtor's "current monthly income" is less than or equal to the median income for her governing state, then she is presumed to be eligible for Chapter 7 bankruptcy.[48]

Lastly, and relevant to this Article, postpetition wages are treated differently by Chapter 7 and Chapter 13. For example, with "a Chapter 13 proceeding, postpetition wages are '[p]roperty of the estate' and may be collected by the Chapter 13 trustee for distribution to creditors. In a Chapter 7 proceeding, those earnings are not estate property; instead, they belong to the debtor."[49] Consequently, because of this differing treatment, the Supreme Court has stated:

> Proceedings under Chapter 13 can benefit debtors and creditors alike. Debtors are allowed to retain their assets, commonly their home or car. And creditors, entitled to a Chapter 13 debtor's "disposable" postpetition income, usually collect more under a Chapter 13 plan than they would have received under a Chapter 7 liquidation.[50]

C. Chapter 11

Every debtor that commences a voluntary case under Chapter 11—including an individual—is presumed to intend to bring about

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[44] *Harris,* 135 S. Ct. at 1834.

[45] *Id.* at 1835.

[46] *Id.*

[47] 11 U.S.C. § 109(e) (2018).

[48] *See* Hamilton v. Lanning (*In re* Lanning)*,* 545 F.3d 1269, 1272 n.2 (10th Cir. 2008) (discussing the Means Test), *aff'd*, 560 U.S. 505 (2010).

[49] *Harris*, 135 S. Ct. at 1834 (alteration in original) (citations omitted).

[50] *Id.* at 1835 (citation omitted).

consensual acceptance and court approval of what is called a "plan of reorganization." The word "plan" appears in several places in the Bankruptcy Code. Section 1103(c)(3), for example, states that one of the important duties of a creditor's committee is to "participate in the formulation of a plan."[51] Moreover, section 1106(a)(5) mandates the debtor in possession file "a plan" "as soon as practicable" after the commencement of a case.[52] And sections 1112(b)(4)(J)–(M) authorize dismissal or conversion of a Chapter 11 case for failure to propose, confirm, or carry out the provisions of "a plan."[53] The confirmation of a plan is the prime objective of a Chapter 11 case.[54] Nonetheless, the idea of "a plan" and "confirmation" of a plan can be a nebulous concept for those unfamiliar with bankruptcy law.

At its core, "[a] plan of reorganization is a contract which binds a debtor and its creditors."[55] A plan tells the creditors what they will receive on account of their claims and when and how they will receive it. As the Second Circuit observed, "[t]he plan of reorganization determines how much and in what form creditors will be paid, whether stockholders will continue to retain any interests, and in what form the business will continue."[56] Generally, a plan must be accepted by creditors and confirmed by the court in order to become effective. "Once a plan is confirmed, the preconfirmation debt is 'replaced' with a new indebtedness as provided in the confirmed plan. The new indebtedness is in essence a new and binding contract between the debtor and the creditors."[57]

Some individual debtors may not be able to obtain meaningful relief under Chapters 7 or 13 of the Bankruptcy Code.[58] Indeed, Chapter 7 may not afford meaningful relief to some individuals because it does not allow them to retain nonexempt assets, which may be necessary for a fresh start. And while Chapter 13 provides for a restructuring of a debtor's debt and the retention of property,

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[51] 11 U.S.C. § 1103(c)(3).

[52] *Id.* § 1106(a)(5).

[53] *Id.* § 1112(b)(4)(J)–(M).

[54] *See id.* § 1112(b)(4)(J).

[55] *In re* Pettibone Corp., 134 B.R. 349, 351–52 (Bankr. N.D. Ill. 1991).

[56] Comm. of Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063, 1070 (2d Cir. 1983).

[57] Fed. Land Bank of Jackson v. Herron (*In re* Herron), 60 B.R. 82, 84 (Bankr. W.D. La. 1986); *see also In re* Ernst, 45 B.R. 700, 702 (Bankr. D. Minn. 1985) ("The plan is essentially a new and binding contract, sanctioned by the Court, between a debtor and his preconfirmation creditors.").

[58] *See* Andrew G. Balbus, *Does the Absolute Priority Rule Apply to Individuals in Chapter 11?*, 20 NORTON J. BANKR. L. & PRAC. 79, 82 (2011).

certain debtors do not qualify for Chapter 13 bankruptcy because of the debt limits it imposes.[59] As a result, individual debtors with higher net worth seek relief in Chapter 11 bankruptcy.[60]

When individuals file for Chapter 11 bankruptcy, a few unique provisions of the Bankruptcy Code come into play. One of those provisions is section 1123(a)(8), which ensures that a debtor devotes income to plan implementation and creditor claims.[61] This provision requires the individual Chapter 11 debtor's plan to provide "all or such portion of earnings from personal services . . . or other future income . . . as is necessary for the execution of the plan."[62] Another provision, section 1129(a)(15), requires individual Chapter 11 debtors to either pay all allowed unsecured claims in full—which is highly unlikely—or devote an amount equal to five years' worth of the debtor's "projected disposable income" to property to be distributed under the plan.[63] Finally, section 1141(d)(5) provides a discharge date for individuals in a Chapter 11 bankruptcy process, which occurs "on completion of all payments under the plan."[64]

II. DID CONGRESS REALLY "MEAN" THIS?

A. *What is the Means Test?*

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005—referred to by most practitioners and judges as "BAPCPA"—became effective on October 17, 2005.[65] When enacted, the goal of BAPCPA was "to address what Congress perceived to be certain abuses of the bankruptcy process. Among the abuses identified by Congress was the easy access to [C]hapter 7 liquidation proceedings by consumer debtors who, if required to

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[59] 11 U.S.C. § 109(e).

[60] *See* Balbus, *supra* note 58 ("[M]any individuals have no alternative to filing in Chapter 11. Individuals with household incomes over the median income for similar sized households in their state may not qualify for Chapter 7 under § 707(b). Individuals with large amounts of debt or without regular income may not qualify for Chapter 13 under § 109(e).").

[61] *See* 11 U.S.C. § 1123(a)(8).

[62] *Id.*

[63] *See id.* § 1129(a)(15).

[64] *Id.* § 1141(d)(5).

[65] Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, § 1501, 119 Stat. 23, 216 (2005) (codified at 11 U.S.C. § 101 note (Effective Date of 2005 Amendment)).

file under [C]hapter 13, could afford to pay some dividend to their unsecured creditors."[66]

To steer more debtors capable of paying their unsecured creditors away from Chapter 7 and into a repayment plan under Chapter 13, Congress retooled section 707(b) of the Bankruptcy Code.

Section 707(b)(1) provides that the court, after notice and a hearing, may dismiss a Chapter 7 bankruptcy case "or, with the debtor's consent, convert such a case to [one] under [C]hapter 11 or 13, of this title, if [the court] finds that the granting of relief [under Chapter 7] would be an abuse of the provisions" enumerated within the chapter.[67] BAPCPA, however, changed the circumstances under which a Chapter 7 bankruptcy case may be dismissed by removing the "substantial" qualifier and providing for "abuse," to be determined pursuant to the provisions of section 707(b).[68] When a debtor's disposable income exceeds fixed amounts—that is, when the debtor fails the Means Test—section 707(b)(2) creates a presumption of abuse.[69] If the presumption of abuse does not arise—that is, when the debtor passes the Means Test—section 707(b)(3) looks to "whether the debtor filed the petition in bad faith" or whether the "totality of the circumstances . . . of the debtor's financial situation demonstrates abuse."[70]

The Means Test provides a formula which calculates a debtor's average monthly disposable income over a sixty-month period. By deducting statutorily specified expenses, secured debt payments, and priority debt payments from "current monthly income," the Means Test is able to calculate the debtor's approximate disposable income. The Bankruptcy Code defines the "current monthly income" of a debtor to include "all sources" in the six-month period prior to commencement of the bankruptcy case.[71] Sections 707(b)(2)(A)(ii)–(iv) specify the authorized deductions from current monthly income.[72] If the resulting income figure exceeds certain mathematical threshold amounts, the Chapter 7

[66] *In re* Hardacre, 338 B.R. 718, 720 (Bankr. N.D. Tex. 2006) (citing 151 CONG. REC. S2,469–70 (daily ed. Mar. 10, 2005) (statements of Sens. Grassley & Nelson)).

[67] 11 U.S.C. § 707(b)(1).

[68] *In re* Hardacre, 338 B.R. at 720–21.

[69] *See* 11 U.S.C. § 707(b)(2)(a)(i).

[70] *Id.* § 707(b)(3).

[71] *Id.* § 101(10A).

[72] *See id.* § 707(b)(2)(A)(ii)–(iv).

bankruptcy filing is presumptively abusive.[73] Specifically, the Bankruptcy Code provides that the court "*shall presume*" that the debtor's case is an abuse of Chapter 7 "if the debtor's current monthly income," less the amounts deductible under sections 707(b)(2)(A)(ii)–(iv), "and multiplied by 60[,] is not less than the lesser of" (A) "25 percent of the debtor's nonpriority unsecured claims in the case, or $6,000, whichever is greater; or" (B) "$10,000."[74]

The presumption of abuse that arises from having a high income may only be rebutted by establishing special circumstances, "such as a serious medical condition" or proof of an "order to [be on] active duty in the Armed Forces."[75] Further, the Means Test does not apply to disabled veterans if the debt was accrued primarily while they were on active duty[76] or "performing a homeland defense activity."[77]

In short, the Means Test is nothing more than a "screening mechanism" set forth in the Bankruptcy Code to determine whether a Chapter 7 bankruptcy filing is appropriate or would result in debtor abuse.[78] If a debtor's disposable income is above the amounts listed within the Code, then the debtor is capable of reimbursing creditors and will not be able to liquidate all nonexempt assets under a Chapter 7 bankruptcy case. The goal of the statute is clear: to keep debtors from abusing the provisions of the Bankruptcy Code.[79]

B. What Did Congress "Mean"?

In 1978, Congress drafted the United States Bankruptcy Code. This was Congress's first attempt to structure and unify bankruptcy procedures in the United States since 1898.[80] The 1978 code provided, in section 707, limited language with respect to the dismissal of consumer bankruptcy filings. The provision in its

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[73] *See id.* § 707(b)(2)(A)(i).

[74] *Id.* § 707(b)(2)(A)(i) (emphasis added).

[75] *Id.* § 707(b)(2)(B)(i).

[76] 10 U.S.C. § 101(d)(1) (2018) (defining active duty as "full-time training duty, annual training duty, and attendance, while in the active military service, at a school designated as a service school by law or by the Secretary of the military department concerned").

[77] 11 U.S.C. § 707(b)(2)(D)(i).

[78] *In re* Rivers, 466 B.R. 558, 560 (Bankr. M.D. Fla. 2012) (quoting Ransom v. FIA Card Servs., N.A., 562 U.S. 61, 65 n.1 (2011)).

[79] Zolg v. Kelly (*In re* Kelly), 841 F.2d 908, 914 (9th Cir. 1988) (finding that the rule adopted by a majority of the courts is "that a debtor's ability to pay his debts will, standing alone, justify a section 707(b) dismissal").

[80] *See* Act of July 1, 1898, ch. 541 (1898).

entirety states: "The court may dismiss a case under this chapter only after notice and a hearing and only for cause including—(1) unreasonable delay by the debtor that is prejudicial to creditors; and (2) nonpayment of any fees and charges required under chapter 123 of title 28."[81]

The provision granted bankruptcy judges the sole discretion to dismiss a case after a debtor or creditor made the petition for dismissal.[82] The vague language of section 707 also granted judges the sole power to interpret the "for cause" requirement of the section.[83] This led to variances in the administration and application of consumer bankruptcy dismissals as well as a staggering increase in the number of individuals filing for bankruptcy under section 707. In the four years after the enactment of the 1978 Bankruptcy Code, the number of annual individual "bankruptcy filings more than doubled . . . from 172,423 to 449,839."[84]

In 1984, in response to the increase in bankruptcy filings, Congress passed several amendments to the Bankruptcy Code that were aimed at stymieing the number of consumer filings that could be handled by partial repayment under Chapter 13. Some of the provisions adopted by the 1984 amendments included dismissing a filing for "failure . . . to abide by orders of the court" or, if "the debtor requested and obtained [a] voluntary dismissal of the case[,] following the filing of a request for relief from [an] automatic stay."[85] Additionally, the 1984 amendments permitted a bankruptcy court to "dismiss a case filed by an individual debtor . . . whose debts [were] primarily consumer debts."[86] If the court found that the granting of bankruptcy relief would be a "substantial abuse" of the bankruptcy provisions based on the type of debt incurred by the debtor, the court had complete discretion to dismiss the case.[87] By and large, however, the amendments were weak and did little to slow the increasing number of consumer filings they were intended to stifle.[88]

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[81] Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 707, 92 Stat. 2549, 2606 (codified as amended at 11 U.S.C. § 707).

[82] *See In re* Blackmon, 3 B.R. 167, 169 (Bankr. S.D. Ohio 1980); *see also In re* Lang, 5 B.R. 371, 375 (Bankr. S.D.N.Y. 1980).

[83] *See Blackmon*, 3 B.R. at 169.

[84] Wayne R. Wells et al., *The Implementation of Bankruptcy Code Section 707(b): The Law and the Reality*, 39 CLEV. STATE L. REV. 15, 17 (1991).

[85] *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 301, 98 Stat. 333, 352 (codified as amended at 11 U.S.C. § 109(g)).

[86] *Id.* § 312, 98 Stat. at 355 (codified as amended at 11 U.S.C. § 707(b)).

[87] *Id*

[88] *See* Wells et al., *supra* note 84, at 17–18.

Attempts to amend and better define when a consumer bankruptcy filing could and should be dismissed were made in the two decades following the enactment of the 1984 amendments, but they all ultimately failed.[89] In 2005, Congress successfully passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) and created the Means Test, which requires individuals filing for bankruptcy under Chapter 7 of the Bankruptcy Code to rebut the presumption that a filing is abusive by demonstrating a financial need created by an inability to pay off their debt.[90]

The Means Test is "[t]he heart" of BAPCPA given Congress's desire to prevent apparent abuse of the bankruptcy system.[91] With the Means Test, the legislature intended to maximize the amount debtors are repaying, or will repay, to their creditors.[92] There has been much debate over the true intent of Congress in the enactment of BAPCPA.[93] However, the Supreme Court has stated:

> The starting point in discerning congressional intent is the existing statutory text and not the predecessor statutes. It is well established that "when the statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it according to its terms."[94]

A plain reading of the statute provides that Congress intended to ensure that those who do not qualify for straight liquidation under Chapter 7 of the Bankruptcy Code will have their plans converted to Chapter 11 or 13 because those who have the resources to pay creditors should do so.[95] As stated above, the Means Test determines whether a debtor has the capability of affording reasonable and necessary expenses while leaving enough

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[89] *See* Sara Sternberg Greene, *The Failed Reform: Congressional Crackdown on Repeat Chapter 13 Bankruptcy Filers*, 89 AM. BANKR. L.J. 241, 248 (2015).

[90] *See* Milavetz, Gallop & Milavetz, P.A. v. United States, 559 U.S. 229, 231–32, 244, 250 (2010) (finding that disclosure requirements in the Code "are reasonably related to the [government's] interest in preventing deception of consumers" (quoting Zauderer v. Off. of Disciplinary Couns., 471 U.S. 626, 651 (1985)).

[91] Ransom v. FIA Card Servs., N.A., 562 U.S. 61, 64 (2011) (alteration in original) (quoting H.R. REP. NO. 109-31, pt. 1, at 2 (2005)).

[92] *See id.*

[93] *See In re* Woodman, 287 B.R. 589, 592 (Bankr. D. Me. 2003) (discussing whether Congress intended to differentiate between pre-existing definitions and existing definitions in the Act), *aff'd sub nom.* Evergreen Credit Union v. Woodman (*In re* Woodman), 379 F.3d 1 (1st Cir. 2004).

[94] Lamie v. U.S. Tr., 540 U.S. 526, 534 (2004) (quoting Hartford Underwriters Ins. Co. v. Union Planters Bank, N.A., 530 U.S. 1, 6 (2000)) (reiterating the proper standard in which to analyze Congressional intent).

[95] *See* H.R. REP. NO. 109-31, pt. 1, at 2 (2005).

disposable income to pay back creditors.[96] A debtor can only claim "applicable" expenses when calculating his or her disposable income.[97] Hence, if Congress did not want to distinguish between those who qualify for the allowance and those who do not, it would "have omitted the term 'applicable' altogether."[98] If the word "applicable" were omitted from the statute, any debtor could qualify for any monthly expense in an effort to achieve a desired result. The Code defines a debtor's disposable income as her "current monthly income . . . less amounts reasonably necessary to be expended."[99] Because these amounts will be deducted from the current monthly income, a debtor should be required to qualify for the allowance by incurring an expense in the authorized category. BAPCPA's objectives are then achieved by requiring a debtor to qualify for the kind of expense for which she claims a deduction for the Means Test.

Pre-BAPCPA, the method for determining a debtors' reasonable expenses led to inconsistent determinations.[100] The previous "test required judges to make significant value judgments" that led to diverse rulings, particularly regarding whether certain expenses "were justifiable."[101] Some courts read this to mean only expenses that are a basic need are justifiable.[102] This interpretation of the text led different courts to disagree about the actual definition of basic needs.[103] Courts found the determination as to whether most needs were basic to be within their discretion.[104] The standard used to reach these inconsistent results considered an expenditure

[96] *See* 11 U.S.C. § 707(b)(2)(A)(ii)–(iv) (2018).

[97] *See Ransom*, 562 U.S. at 69–70.

[98] *Id.*

[99] 11 U.S.C. § 1325(b)(2).

[100] *In re* Slusher, 359 B.R. 290, 294 (Bankr. D. Nev. 2007) ("Before BAPCPA, courts and the relevant statute defined 'projected disposable income' as income not reasonably necessary for maintaining or supporting the debtor or a dependent, with that determination being made on an estimated basis at plan confirmation." (citation omitted)).

[101] *Id. See also In re* Woodman, 287 B.R. 589, 592–93 (Bankr. D. Me. 2003) (finding that a tobacco expense of $240 each month was reasonable and necessary), *aff'd sub nom.* Evergreen Credit Union v. Woodman (*In re* Woodman), 379 F.3d 1 (1st Cir. 2004); Univest-Coppell Vill., Ltd. v. Nelson, 204 B.R. 497, 500 (E.D. Tex. 1996) (finding that $395 each month for private school tuition was not reasonably necessary).

[102] *See In re* Jones, 55 B.R. 462, 466–67 (Bankr. D. Minn. 1985) (holding that private education is not a basic need because the debtor's daughter could alternatively attend a local public school).

[103] *Cf.* 11 U.S.C. § 707(b) (outlining the basic needs and what they entail under the Code as opposed to how the courts interpret them).

[104] *See, e.g.*, *In re* Gonzales, 157 B.R. 604, 607–08 (E.D. Mich. 1993).

to be "reasonably necessary" if most reasonable persons could agree as to whether the expenditure is reasonably necessary.[105] However, the "reasonable person" standard cannot be reliably applied to individual monthly incomes because there is little to no evidence on which a judge can rely upon to determine whether "most people" would consider a monthly expenditure as reasonably necessary.[106]

According to the House Judiciary Committee Report on the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, "[t]he purpose of the bill [was] to improve bankruptcy law and practice by restoring personal responsibility and integrity in the bankruptcy system and ensure that the system is fair for both debtors and creditors."[107] The bill garnered bipartisan support, as well as "support from the business community, banking and financial services industries [and] other groups such as family farmers and child support enforcement agencies."[108]

Congressman Todd Tiahrt, when speaking in support of the passage of the bill before the United States House of Representatives, stated: "The bill we are voting on today will help foster greater personal responsibility and make it more difficult for those who use bankruptcy as a tool for fraud to cheat their way out of debt."[109] Congressman Tiahrt further explained that the country cannot continue to routinely direct "high consumer debt" to bankruptcy as a first resort.[110] Although Tiahrt was "pleased [the bill] addresse[d] common bankruptcy abuses while continuing to offer Americans who need to file for bankruptcy the means to do so," he recognized this should be "a last resort."[111] In an opinion issued by the United States Attorney's Office about BAPCPA, bankruptcy abuse is defined as the "discharging [of] debts which debtors theoretically could afford, at least in part, to pay."[112] This illustrates the growing concern of individual debt liquidation and the need for a mechanism that requires individuals to enroll in a repayment plan.

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[105] *Id.* at 607.

[106] *Id.*

[107] H.R. REP. NO. 109-31, pt. 1, at 2 (2005).

[108] *See id.* at 6.

[109] 109 CONG. REC. E737 (daily ed. Apr. 22, 2005) (statement of Rep. Todd Tiahrt).

[110] *Id.*

[111] *Id.*

[112] Judith Benderson, *Introduction: A History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, U.S. ATT'YS' BULL. (Exec. Off. for U.S. Att'ys, Washington, D.C.) July 2006, at 1, 1.

The House Judiciary Committee enumerated the four factors that prompted Congress to draft and ultimately pass BAPCPA:

1. "[T]he recent escalation of consumer bankruptcy filings does not appear to be just a temporary event, but part of a generally consistent upward trend."[113]

As support, the Committee cited the increase in the total number of annual bankruptcy filings: "Over the past decade, the number of bankruptcy filings has nearly doubled to more than 1.6 million cases filed in fiscal year 2004. As a result, there is a growing perception that bankruptcy relief may be too readily available . . . ."[114]

2. "[T]here are significant losses asserted to be associated with bankruptcy filings."[115]

> [I]n 1997 alone, more than $44 billion of debt was discharged by debtors who filed for bankruptcy relief, a figure when amortized on a yearly basis amounts to a loss of at least $110 million every day. These losses, according to one estimate, translate into a $400 annual "tax" on every household in our nation.[116]

3. "[T]he present bankruptcy system has loopholes and incentives that allow and—sometimes—even encourage opportunistic personal filings and abuse."[117]

According to the United States Trustee Program, a component of the Justice Department charged with administrative oversight of bankruptcy cases, " '[a]buse of the system is more widespread than many would have estimated.' Such abuse ultimately hurts consumers as well as creditors."[118]

4. "[S]ome bankruptcy debtors are able to repay a significant portion of their debts, according to several studies."[119]

Prior to the passage of BAPCPA, there was "no clear mandate requiring debtors to repay their debts."[120] Instead, many individuals chose to file under Chapter 7 even if they had the means to

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[113] H.R. REP. NO. 109-31, pt. 1, at 3 (2005).
[114] *Id.* at 4 (emphasis omitted) (footnote omitted).
[115] *Id.*
[116] *Id.* (emphasis omitted) (footnotes omitted).
[117] *Id.* at 5.
[118] *Id.* (quoting J. Christopher Marshall, *Civil Enforcement: An Early Report*, J. NAT'L ASS'N BANKR. TRS. (NABTALK), Fall 2002, at 39).
[119] *Id.*
[120] *Id.*

set up a repayment plan under Chapter 13.[121] The 1984 amendments set up the Means Test for dismissing a filing under Chapter 7 for "substantial abuse," but the courts differed in their determination of what qualified as "substantial abuse."[122]

Since the passage of the 1978 Bankruptcy Code, the number of individuals filing for bankruptcy under Chapter 7 has steadily increased.[123] Congress identified many of these filings as abusive because the filers had the capacity to repay at least some of their debts, making a Chapter 13 bankruptcy filing more appropriate.[124] In short, the Means Test acts as a filtering process to ensure that those who are capable of paying their debts, in fact do so. Congress's enactment of BAPCPA and the Means Test was a response to the systematic abuse of bankruptcy. This is clear from the language in the statute and the previous measures in the Code that led to a wide range of results. By creating particular categories of expenditures that qualify as allowances, Congress narrowed the definition of "reasonably necessary," as well as who can qualify for such allowances.

C. The Non-Consumer Debt Exception

As set forth above, only Chapter 7 cases "filed by an individual debtor whose debts are *primarily consumer debts*" may be subject to dismissal for abuse.[125] Accordingly, a threshold issue in many Chapter 7 cases is whether the debtor's debts are primarily consumer debts. If they are not, section 707(b) does not apply, ending the inquiry. If more than half of a debtor's total debt is consumer debt, the "primarily consumer debts" standard found in seciton 707(b)(1) is implicated and the Means Test or a totality analysis[126] may proceed.

Section 101(8) of the Bankruptcy Code defines "consumer debt" as "debt incurred by an individual primarily for a personal, family, or household purpose."[127]

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[121] *Id.* at 5 & n.18.

[122] *Id.*

[123] *See id.* at 3 & n.5.

[124] *See id.* at 12.

[125] *Id.* at 12–13 (emphasis added).

[126] The totality of circumstances test is used by bankruptcy courts to determine if a debtor has engaged in substantial abuse of the bankruptcy process by filing under Chapter 7 when they are able to repay their debts under a Chapter 13 payment schedule.

[127] 11 U.S.C. § 101(8) (2018).

The Fourth Circuit explained the following method for making this determination:

> In determining whether debt is for "personal, family, or household purposes" under [section] 101(8), courts look to the purpose for which the debt was incurred. And, courts have concluded uniformly that debt incurred for a business venture or with a profit motive does not fall into the category of debt incurred for "personal, family, or household purposes." In short, debt incurred for a business venture is not "consumer debt" . . . .[128]

A similar position has been adopted in the Eighth and Fifth Circuits, where courts have looked at the debtor's purpose in incurring the debt to determine whether an obligation is classified as consumer debt.[129] "If the credit transaction involves a profit motive, then it is not a consumer debt. On the other hand, if a debt does not involve a business transaction or potential profit motive, then the debt is ordinarily considered a consumer debt."[130]

As shown by the examples discussed above, some debtors originally incur debt for a business purpose and later use the credit to fund personal expenses.[131] Therefore, it is reasonable to interpret Congress's enactment of section 707(b) and its exceptions as a counter to Chapter 7 abuse by consumers who incur debt through "easy-credit practices," consume the items purchased, and then seek discharge of their debt even if they have the ability to pay off their creditors.[132]

Further, the Bankruptcy Code does not explain how to categorize debts as "primarily" consumer debts, and courts are divided as to whether to only consider the overall dollar amount or include the relative number of claims in the consideration.[133] Most courts, however, have held that "a debtor is considered to have primarily

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[128] Cypher Chiropractic Ctr. v. Runski (*In re* Runski), 102 F.3d 744, 747 (4th Cir. 1996) (first citing Zolg v. Kelly (*In re* Kelly), 841 F.2d 908, 913 (9th Cir. 1988); and then citing *In re* Bell, 65 B.R. 575, 577 (Bankr. E.D. Mich. 1986)).

[129] *See* Lapke v. Mut. of Omaha Bank (*In re* Lapke), 428 B.R. 839, 843 (B.A.P. 8th Cir. 2010) (citing Cox v. Fokkena (*In re* Cox), 315 B.R. 850, 855 (B.A.P. 8th Cir. 2004)).

[130] *In re* Palmer, 117 B.R. 443, 446 (Bankr. N.D. Iowa 1990) (citing *In re* Booth, 858 F.2d 1051, 1054–1055 (5th Cir. 1988)).

[131] *See* Stewart v. U.S. Tr. (*In re* Stewart), 175 F.3d 796, 806–07 (10th Cir. 1999) (holding that loans incurred for educational expenses were not considered "non-consumer" debt because the debtor used the money to support his family).

[132] *See id.* at 812–13.

[133] *In re* Jones, No. 08-05676-8, 2009 WL 102442, at *2 (Bankr. E.D.N.C. Jan. 12, 2009).

consumer debts when more than one half of the dollar amount of the debt owed is consumer in nature."[134]

In a recent 2017 case, *In re Grillot*, a creditor moved to dismiss a debtor's Chapter 7 case for substantial abuse, arguing, among other things, that the debtor's financial situation implicated the Means Test, that he otherwise failed it, and consequently, his case should be dismissed.[135] The debtor, on the other hand, argued that section 707(b)(1) of the Bankruptcy Code did not apply because his debts were not primarily consumer debts.[136] The main issue in *Grillot* was whether a guaranty of the debtor's wife's business debt was a consumer debt.[137]

In *Grillot*, when the debtor filed for Chapter 7 bankruptcy, he stated that his debts were primarily business debts and not primarily consumer debts.[138] "He did not complete [the bankruptcy form] to determine whether the [M]eans [T]est applie[d], claiming to be exempt from a presumption of abuse."[139]

The debtor was a doctor, likely making a very healthy living.[140] In fact, when he and his wife divorced, he "voluntarily provided support to [her] of $8,500–$10,000 per month during their separation."[141] As of the petition, the debtor owed almost $446,000 in back taxes, comprising roughly 34 percent of his $1.3 million debt.[142] The guaranty debt was approximately $642,000.[143]

The guaranty of the debt arose after the debtor and his wife were separated.[144] Without consulting with a lawyer, the debtor simply signed a guaranty in the amount of $613,800 to help with his wife's business.[145] He believed that, if he signed the guaranty, it would reduce spousal maintenance and would have a positive economic trickle-down effect with regard to another business in which he maintained a minority interest.[146] The business failed and the lender sued the debtor, "obtaining a $613,000 judgment

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[134] U.S. Tr. v. Mohr, 436 B.R. 504, 510 (S.D. Ohio 2010) (citing *In re* Martens, 171 B.R. 43, 45 (Bankr. N.D. Ohio 1994)).
[135] *In re* Grillot, 578 B.R. 651, 656 (Bankr. D. Kan. 2017).
[136] *See id.* at 652.
[137] *See id.* at 656–57.
[138] *See id.* at 652.
[139] *Id.*
[140] *See id.* at 652–53.
[141] *Id.* at 654.
[142] *See id.* at 653.
[143] *See id.*
[144] *See id.* at 654–55.
[145] *See id.*
[146] *See id.* at 655.

(plus pre-and post-judgment interest) against [the debtor]" prior to the bankruptcy filing.[147]

Once in bankruptcy, the lender argued that the debtor "should be subjected to [section] 707(b)(1)'s dismissal" based on the "abuse provision," claiming that debtor's case was "either presumptively abusive because it fail[ed] the [M]eans [T]est or that granting [him] chapter 7 relief constitute[d] an abuse based upon the totality of the circumstances of his financial situation."[148]

The court correctly noted that "[section] 707(b)(1) provides that *only* [C]hapter 7 cases 'filed by an individual debtor . . . whose debts are primarily consumer debts' may be subject to dismissal for abuse."[149] The threshold issue in *Grillot*, therefore, was whether the debtor's debts were primarily consumer debts. If they were not, as the court noted, section 707(b) simply would not apply, ending the inquiry.[150] But "[i]f more than half of [the] debtor's total debt [was] 'consumer debt,' the 'primarily consumer debts' standard in [section] 707(b)(1) [would be] met and the [M]eans [T]est or totality analysis [would] proceed."[151]

The entire analysis as to whether the debtor's debts were "primarily consumer debts" revolved around the guaranty debt.[152] The guaranty debt was the debtor's "largest debt, constituting 49% of his . . . total indebtedness."[153] If the guaranty debt and home mortgage debt were considered consumer debts, his consumer debt would "exceed 50% of the total debt."[154]

The lender in *Grillot* argued that the debtor and his ex-wife "entered into a 'quid pro quo' whereby [his wife] would waive any further support in their divorce proceeding in exchange for [the debtor's] [g]uaranty."[155] The lender claimed "that trading the [g]uaranty for the support release ma[de] [the guaranty] a consumer debt as a support obligation would be."[156] The debtor disagreed and so did the court, despite the fact that the debtor did

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[147] *Id.* at 656.
[148] *Id.* (footnotes omitted).
[149] *Id.* (third alteration in original) (emphasis added) (quoting 11 U.S.C. § 707(b)(1) (2018)).
[150] *See id.* at 656–67.
[151] *Id.* at 656.
[152] *See id.* at 656–57.
[153] *Id.* at 656.
[154] *Id.*
[155] *Id.* at 657.
[156] *Id.*

not guarantee the debt for a business he owned or controlled and had no financial interest in the business.[157]

The court recognized that "[a]n individual's guaranty of a business or commercial debt is generally a non-consumer debt," while "[a] support obligation is generally a consumer debt."[158] But it held that the debtor had more of a "profit motive" in signing the guaranty agreement because he stood to possibly gain financially from the success of the business.[159] As such, the court concluded that the guaranty was "predominantly a business debt that should not be counted as a consumer debt in the 'primarily consumer debt' calculation," and therefore, section 707(b) was not applicable.[160]

In re West provides another example.[161] A debtor, Sharon West, signed a real estate purchase contract, making an offer to buy a family home on twenty-four acres in Missouri for the purchase price of $999,500.[162] The sale was going to be a cash deal.[163] The sale of the home did not close and the buyers sued the debtor.[164] The buyers received a judgment by default in the amount of approximately $1.2 million.[165] Thereafter, the debtor filed for Chapter 7 bankruptcy.[166] Believing her debts were "business debt[s]," she did not complete the Means Test.[167] If she had, it would have shown that her monthly disposable income was approximately $2,000, which would have triggered a presumption of abuse—i.e., the debtor's current monthly income would have been more than sufficient to fund a Chapter 13 plan over a sixty-month period.[168] The presumption, then, is that she was capable of paying creditors the money they were owed.[169]

The sellers filed a motion to dismiss or convert the case under section 707(b).[170] Thus, the issue before the court was whether the sellers' judgment against the debtor was a "consumer debt."[171]

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[157] *Id.* at 658.
[158] *Id.* at 657 (footnotes omitted).
[159] *Id.* at 658.
[160] *Id.* at 660.
[161] James v. West (*In re* West), No. 16-40358, 2017 WL 746250 (Bankr. W.D. Mo. Feb. 24, 2017).
[162] *Id.* at *1.
[163] *Id.* at *2.
[164] *Id.*
[165] *Id.*
[166] *Id.* at *3.
[167] *Id.* at *5–6, *7.
[168] *See id.* at *6.
[169] *See id.*
[170] *Id.* at *3.
[171] *Id.* at *6.

This, the court held, turned on "whether the [d]ebtor incurred the debt 'primarily for a personal, family, or household purpose.' "[172] The court stated that "primarily" in the context of section 707(b) "means more than half by total dollar amount of all debt."[173] The " 'primarily' component" was not at issue in the *West* case because "it [was] undisputed that the [sellers'] debt [was] much more than half of the [d]ebtor's total debts."[174]

To determine whether the debtor's debt was a consumer debt—a clear question of fact—the court looked to "the debtor's purpose or intent in incurring the debt."[175] The court found that a debt "incurred for business ventures or other profit-seeking activities" squarely falls within the meaning of a business debt—i.e., a non-consumer debt.[176]

The debtor, of course, had every incentive to argue that the debt was a business debt so that she would not be forced to use her $2,000 disposable income to pay creditors through a payment plan. She argued that she bought the home "to turn it into a bed and breakfast . . . , a profit motive that would render the debt a business debt."[177] The court bought her argument and the debtor was able to avail herself of Chapter 7 relief.[178]

In re Cherrett provides yet another example of an affluent debtor taking advantage of Chapter 7.[179] In *Cherrett*, the debtor was offered a $300,000 salary to take a job in Aspen, Colorado, but he did not want to relocate his daughter to a new school.[180] Thus, in addition to his substantial salary, his potential employer—Aspen Skiing Company—offered him "a $500,000 housing loan," which "was interest-only for the first ten years[,] . . . coupled with a bonus plan providing [the debtor] a guaranteed annual bonus of up to $33,750 to cover the interest payments on the loan."[181]

The debtor accepted the position and left his current job and family in Jackson Hole.[182] Subsequently, the debtor purchased a condo for approximately $1 million.[183] When the economy crashed,

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[172] *Id.*
[173] *Id.*
[174] *Id.*
[175] *Id.*
[176] *Id.*
[177] *Id.* at *7.
[178] *Id.*
[179] Aspen Skiing Co. v. Cherrett (*In re* Cherrett), 873 F.3d 1060 (9th Cir. 2017).
[180] *Id.* at 1063.
[181] *Id.*
[182] *Id.*
[183] *Id.*

the debtor and his wife filed for Chapter 7 bankruptcy.[184] One of the debtor's debts was the $550,000 he owed to Aspen under the housing loan.[185] Aspen filed a motion to dismiss the Chapter 7 petition for abuse under section 707(b)(1), arguing "that because the [debtors] incurred the [h]ousing [l]oan to purchase a personal residence, the debt was a consumer debt, and [the debtors] were not entitled to Chapter 7 relief in light of their ability to pay their creditors [through] a . . . Chapter 13 plan."[186]

The Ninth Circuit affirmed the bankruptcy court's denial of the motion. It held that "[e]vidence that a debtor incurred a debt 'purely or primarily as a business investment, albeit an investment in herself or himself, much like a loan incurred for a new business,' can serve as an important factor in determining the debtor's purpose."[187] It also agreed with the bankruptcy court's finding that the debtor incurred the debt " 'so he could work at a very prestigious, top of the line, equal to the Four Seasons, equal to the best hotels in the world,' resort."[188]

There is no question that the debtor in *Cherrett*, like the debtors in the other cases mentioned, benefited from Chapter 7 bankruptcy because he was affluent. The debtor received a phenomenal compensation package, purchased a $1 million condo—in addition to the home he owned in Jackson Hole, Wyoming—and then, when he could not service his debt load, turned to Chapter 7 and received a discharge of his debt. If this were the ordinary situation where a person takes out a small loan to purchase a home, even with a modest annual salary of approximately $60,000, that person would likely be relegated to a Chapter 13 plan and forced to pay creditors over a three- to-five-year period. Cases like this illustrate clear loopholes favoring only the affluent bankrupt.

Like Chapter 7, Chapter 11 also provides a mechanism whereby those with substantial assets and income can avoid paying creditors over time despite their high earning potential.

III. THE LIQUIDATING LOOPHOLE

Several interesting issues arise when an individual contemplates filing a Chapter 11 plan, but with no intention of actually

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[184] *Id.* at 1063–64.

[185] *Id.* at 1064.

[186] *Id.*

[187] *Id.* at 1067 (quoting Stewart v. U.S. Tr. (*In re* Stewart), 215 B.R. 456, 465 (B.A.P. 10th Cir. 1997), *aff'd*, 175 F.3d 796 (10th Cir. 1999)).

[188] *Id.* at 1068.

paying creditors over a period of time. This section explores some of the differences between Chapter 11 and Chapter 13 plans and whether Chapter 11 provides an avenue for the affluent to avoid payment plans. Specifically, the main issue this section addresses is whether Chapter 11 allows a debtor to liquidate his assets to fund a plan, rather than contributing disposable income, and whether that contribution of assets results in an immediate discharge. This analysis centers on section 1129(a)(15) of the Bankruptcy Code.

A. *Section 1129(a)(15) and Individual Plan Confirmation*

Section 1129(a)(15) of the Bankcruptcy Code, added in 2005, provides that—"in a case in which the debtor is an individual and [where] the holder of any allowed unsecured claim objects"—a plan may only be confirmed if:

> (A) the value, as of the effective date of the plan, 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 value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in section 1325(b)(2)) to be received during the 5-year period beginning on the date that the first payment is due under the plan, or during the period for which the plan provides payments, whichever is longer.[189]

1. The Mandate of Section 1129(a)(15)(B)

Under subsection (B), the confirmation requirement is that the debtor's plan distribute property equal in value to the debtor's projected disposable income over the five-year period commencing with the date that the first payment is due under the plan. Although based on Chapter 13 practice, the confirmation requirement differs.

Generally, Chapter 13 requires that projected disposable income be paid to holders of allowed unsecured claims.[190] "In contrast, [section] 1129(a)(15) provides only that the amount to be distributed under the [C]hapter 11 plan be not less than the projected disposable income for the required period. Significantly, it does not require that the payments be made to holders of unsecured

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[189] 11 U.S.C. § 1129(a)(15) (2018).
[190] *See id.* § 1325(b)(1)(B).

claims."[191] "There is no reason to read into [section] 1129(a)(15)(B) the requirement that an individual debtor must pay *unsecured creditors* his or her projected disposable income, and there is every reason not to do so."[192]

In fact, courts that have considered this issue have uniformly held that section 1129(a)(15)(B) does not require an individual debtor to pay an amount at least equal to her projected disposable income to unsecured creditors.[193] All that section requires is that the total value of *all* property distributed in a plan must be equal to or greater than the debtor's projected disposable income.

2. Calculating Projected Disposable Income

Disposable income is not defined in Chapter 11 of the Bankruptcy Code. It is, however, defined under section 1325(b)(2), which defines it, in pertinent part, as "current monthly income received by the debtor" minus various expenses and with certain exclusions.[194] The Supreme Court held, in *Hamilton v. Lanning*, that in calculating "projected disposable income" in a Chapter 13 case, courts should employ a "forward-looking approach," first calculating disposable income, and then in unusual cases taking into account other known or virtually certain information about the debtor's future income or expenses.[195] But Chapter 11 is different and likely more attractive for individuals with wealth.

Unlike Chapter 13, in Chapter 11, an individual debtor is allowed to have expenses that exceed those of an above-median income Chapter 13 debtor. In *In re Johnson*, the debtor's living expenses were estimated at $831,151.50, which is vastly greater

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[191] Paul W. Bonapfel, *Individual Chapter 11 Cases Under BAPCPA,* 25 AM. BANKR. INST. J. 1, 57 (2006).

[192] *In re* Pfeifer, No. 12-13852, 2013 WL 5687512, at *3 (Bankr. S.D.N.Y. Oct. 18, 2013).

[193] *See In re* Gbadebo, 431 B.R. 222, 226 (Bankr. N.D. Cal. 2010) ("The Debtor correctly notes that [section 1129(a)(15)(B)'s] requirement goes to the amount paid to all creditors under the Plan, not just to the . . . creditor who objects to the plan."); Proudfoot Consulting Co. v. Gordon (*In re* Gordon), 465 B.R. 683, 693 n.8 (Bankr. N.D. Ga. 2012) ("[Section] 1129(a)(15) only requires the amount of projected disposable income equal the 'value of property to be transferred under the plan' to all creditors, not just unsecured creditors."); *In re* Ekstrom, No. 08-07750, 2010 WL 1254893, at *7, *18 (Bankr. D. Ariz. Mar. 23, 2010) (holding that an individual debtor satisfied section 1129(a)(15) because "the value of the property to be distributed under the plan [was] not less than the projected disposable income of the Debtor during the period for which the plan provides payments," even though most of the debtor's plan payments went toward reducing his substantial tax obligations).

[194] 11 U.S.C. § 1325(b)(2).

[195] *See* Hamilton v. Lanning, 560 U.S. 505, 509 (2010).

than what would be allowed in Chapter 13.[196] Nonetheless, the plan was confirmed.[197] The court's reasoning in *Johnson*—which is correct—was that the term "projected disposable income" means "current monthly income received by the debtor . . . less amounts reasonably necessary to be expended."[198] Section 1129(a)(15)(B) references only section 1325(b)(2), but not section 1325(b)(3).[199] This means the plain meaning of the Bankruptcy Code itself would lead to the conclusion that section 1325(b)(3) does not apply when the "amounts reasonably necessary to be expended" are being determined under section 1129(a)(15)(B). Albeit section 1129(a)(15) uses the disposable income definition found in Chapter 13, the section is silent regarding what reasonable expenses in relation to the calculation of disposable income should be.[200] Further, section 1325(b)(3) can be incorporated into section 1325(b)(2) as a laundry list of permissible expenses. However, this is not included in section 1129(a)(15).[201]

> The omission [in section 1129(a)(15)] appears intentional, as noted in a leading bankruptcy treatise:
>
> > [T]he reference in section 1129(a)(15) is explicitly to, and only to, paragraph (2) of section 1325(b). Congress had it within its power to draft the cross-reference more broadly, but did not. It presumably took into account the business orientation of most [C]hapter 11s, as well as the increased levels of creditor involvement in a [C]hapter 11 case[ ]. These factors, together with the requirement that the debtor obtain the consent of all unsecured creditor classes under section 1129(a)(8), would tend to indicate that individual creditor insistence on the artificial expenses standards found in [C]hapter 7 are neither necessary nor appropriate in [C]hapter 11 cases.[202]

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196 *See In re* Johnson, No. 14-57104, 2016 WL 8853601, at *16 (Bankr. S.D. Ohio Nov. 10, 2016).

197 *Id.*

198 11 U.S.C. § 1325(b)(2).

199 *Id.* § 1129(a)(15)(B).

200 *See id.* § 1129(a)(15).

201 *In re* Woodward, No. BK11-40936, 2014 WL 1682847, at *4 (Bankr. D. Neb. Apr. 29, 2014).

202 *Id.* at *4–5 (quoting 7 COLLIER ON BANKRUPTCY ¶ 1129.02[15][a] (Alan N. Resnick & Henry J. Sommers eds., 16th ed. rev. 2014)).

3. The Temporal Component in Chapter 11

Section 1129(a)(15) also differs from Chapter 13 in regard to the time component. Under Chapter 13, a debtor's plan *must* extend for three years, and in some cases five years, unless the plan provides for payment in full of all unsecured claims sooner.[203] Section 1129(a)(15) does not specify a minimum period. In contrast, section 1129(a)(15) requires either that the debtor pay all unsecured claims in full or that the debtor's plan devote an amount equal to five years' worth of the debtor's projected disposable income.[204] Thus, if property from any other source is used to supplement the payments, the plan may be shorter. As noted in a recent Norton Annual Survey:

> The requirement in section 1129(a)(15) is that "the value of property" distributed be equal to the disposable income. The requirement is not that "the disposable income" be contributed directly. Thus, in a case where a debtor has substantial assets that can be liquidated to fund a plan, it could be argued that if the value of those assets equals the projected disposable income, then Bankruptcy Code section 1129(a)(15)(B) would be satisfied even if no disposable income is contributed.[205]

In reading section 1129(a)(15),

> Congress made clear that a Chapter 11 plan of any length may be confirmed as long as the value of the property to be distributed is not less than the projected disposable income of the debtor to be received over five years (or the length of the plan, whichever is longer).[206]

Indeed, Chapter 11

> provides that if creditors are not paid in full and someone objects, then the plan must distribute at least the amount of the annualized disposable income to be received in five years or during the term of the plan, whichever is longer. This process yields a dollar amount, and nothing else. . . . All of [section] 1129(a)(15) is only about the value of the property to be distributed under the plan, and this is entirely consistent with

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[203] 11 U.S.C. § 1325(b)(4)(B). In fact, there is no minimum payment that must be made to unsecured creditors unless the plan is rejected by a more senior class, which would invoke the absolute priority rule under the Bankruptcy Code.

[204] *Id.* § 1129(a)(15)(B).

[205] Debra Grassgreen, *Individual Chapter 11 Cases After BAPCPA: What Happened to the "Fresh Start?",* 2006 NORTON ANN. SURV. BANKR. L. 12.

[206] Baud v. Carroll, 634 F.3d 327, 340 (6th Cir. 2011).

> pre-BAPCPA Chapter 11 practice, which never imposed a minimum plan duration.[207]

This means that a Chapter 11 plan of less than one year could conceivably be confirmed, so long as the plan provided for distribution of an amount that is not less than the debtor's projected disposable income over five years.

Theoretically, a debtor wanting to take advantage of this provision would have to use something other than his disposable income during the five-year period. For the affluent bankrupt, this would not be difficult given that most are able to tap into third-party financial resources—for example, trust income, family wealth, unencumbered assets, and so forth. This is because an individual Chapter 11 creditor must distribute property under the agreed plan that is in conformity only with the projected disposable income requirement calculated based on section 1129(a)(15)(B).[208]

B. Completion of Payments Under the Plan; The Discharge Loophole; and Plan Modification

There are two sections under Chapter 11 that discuss the concept of "completion of payments" under the plan, both of which are relevant to whether a debtor can avoid payment plans: First, section 1127(e), which deals with post-confirmation modification before the "completion of payments under the plan;"[209] and second, section 1141(d)(5)(A), which deals with discharge following "completion of all payments under the plan."[210] If "completion of all payments under the plan" in a Chapter 11 case is as simple as liquidating a debtor's assets and turning them over to a liquidation trustee for immediate or eventual distribution to creditors, a Chapter 11 debtor could presumably receive an immediate discharge; there would be no possible way to modify the debtor's plan if his financial situation improves or turns out to be a misrepresentation. Accordingly, the first issue to explore is whether "completion of payments" means (1) completion of payments by the debtor to a liquidating trustee only; or (2) completion of payments both by the debtor to the trustee and then by the trustee to the creditors.

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[207] Randolph J. Haines, *Chapter 11 May Resolve Some Chapter 13 Issues,* 2007 NORTON BANKR. L. ADVISER 1.

[208] Sally S. Neely, *How BAPCPA Changes Chapter 11 Cases for Individuals*, SS029 ALI-ABA 625, 674 (2011).

[209] 11 U.S.C. § 1127(e).

[210] *Id.* § 1141(d)(5)(A).

Unfortunately, section 1127(e)—dealing with post-modification—and section 1141(d)(5)(A)—dealing with debtor discharge—provide little guidance on this issue, and no reported case discusses the impact of these sections on the "completion of payments" of an individual debtor's Chapter 11 plan. A leading treatise, however, notes that section 1127(e) is substantially similar to section 1329 of the Bankruptcy Code.[211] And one commentator opines that Chapter 13 cases dealing with post-confirmation modification "will presumably provide guidance for interpretation of the identical language that BAPCPA added for chapter 11 cases."[212] Further, section 1141(d)(5)(A) is substantially similar to section 1328. As such, Chapter 13 cases dealing with this subject will also provide interpretational guidance.

1. Individual Discharge

Interpretations of the language "completion of payments under the plan" focus on discharge under section 1141(d)(5)(A) and section 1328(a) of the Bankruptcy Code. Per section 1141(d)(5)(A), the general rule in Chapter 11 cases involving individuals is that the discharge will not be entered until the debtor has completed all payments under the plan.[213] Similarly, in Chapter 13, pursuant to section 1328(a), an individual debtor will receive a discharge as soon as practicable after completion by the debtor of all payments under the plan.[214] But again, there is a dramatic difference when it comes to discharge of an individual in Chapter 13 versus an individual in Chapter 11. Cases interpreting Chapter 13 discharge hold that prepaying a Chapter 13 plan does *not* constitute "completion . . . of all payments under the plan" for purposes of discharge since there is an implied temporal component that would prevent a debtor from escaping the thirty-six-month minimum plan period.[215]

Chapter 11 differs, as unlike section 1325(b), which requires a "commitment period," section 1129(a)(15)(B) does not specify a minimum period and does not contain an implied temporal component. Rather, the requirement in section 1129(a)(15) is that

[211] *See* COLLIER ON BANKRUPTCY, *supra* note 202, ¶¶1127.04, 1127.LH[2].

[212] Bonapfel, *supra* note 191.

[213] 11 U.S.C. § 1141(d)(5)(A).

[214] *Id.* § 1325(b).

[215] *See, e.g.*, Fridley v. Forsythe (*In re* Fridley), 380 B.R. 538, 546 (B.A.P. 9th Cir. 2007) (holding that section 1325(b)'s "applicable commitment period" is a temporal requirement of thirty-six months and the debtors' lump sum prepayment of the Chapter 13 plan's proposed payment did not entitle debtors to a discharge).

"the value of the property" distributed be equal to the disposable income.[216] The requirement is not that the disposable income be contributed directly. Accordingly, under Chapter 11, if the debtor liquidates his assets to fund the plan and the value of those assets equals the debtor's five-year projected disposable income, then section 1129(a)(15)(B) is satisfied even if no disposable income is contributed. And, once the debtor gives these assets to a liquidating trust, for example, "completion of payments" has occurred pursuant to section 1127(e) and section 1141(d)(5)(A), even if the trust has not completed distribution to the creditors.[217]

Understanding how these provisions work makes Chapter 11 extremely attractive to the affluent bankrupt—especially those who can tap into outside financial sources. Hypothetically, the plan could be a straightforward liquidation plan. On the effective date of the plan, the debtor could sell assets, or borrow or receive money from family, and simply turn over the proceeds to a liquidating trustee. Assuming that the debtor proves compliance with the requirements of section 1129, including that the "value of the property" she is distributing under the plan is greater than her projected disposable income for the next five years, the debtor will be granted a discharge on the effective date of the plan because she has completed her payments under the plan.

When Congress enacted BAPCPA, it provided that until "completion of all payments under the plan" an individual debtor was ordinarily not entitled to a discharge and that before "completion of payments under the plan" an individual debtor's plan could be modified even if substantially consummated.[218] But as mentioned, nowhere did Congress provide that "payments under the plan" must be made for at least five years for individual Chapter 11 debtors. It is flawed to equate the five year period in section 1129(a)(15)(B) used for measuring an individual debtor's "projected disposable income," and thus how many dollars a plan must distribute, to be a requirement that "payments under the plan" be at least five years in duration. The Bankruptcy Code says no such thing and Congress did not manifest any intention for that to be the law.

Again, this means that the first and only payment under a hypothetical Chapter 11 plan for an affluent bankrupt could be due on the effective date of the plan. For instance, assume the debtor

[216] 11 U.S.C. § 1129(a)(15)(B).
[217] *Id.* §§ 1127(e), 1141(d)(5)(A).
[218] *Id.*

receives $50,000 a month in income and that his lavish expenses are $40,000 a month. Based upon these amounts, the debtor's projected disposable income is $600,000 (($50,000 – $40,000) x 60). All the debtor has to do to confirm a plan is come up with $600,000.01 on the effective date of the plan and distribute it to a liquidating trustee. It does not matter what the debtor's support expenses are determined to be. This simply would not be a viable option in a Chapter 13 case, since the debtor would be required to devote that income for three to five years, and the monthly expenses would clearly be challenged and reduced for being excessive and lavish.[219]

In this hypothetical, the debtor would also be entitled to discharge pursuant to section 1141(d)(5)(A) if the bankruptcy court agreed that the debtor "completed payments" under the plan. As stated, section 1141(d)(5)(A) provides that debts are discharged in individual cases upon "completion of all payments under the plan."[220] A creditor challenging this maneuver would, more than likely, lose based on a simple reading of the Chapter 13 requirements that are not found in Chapter 11.

Section 1325(b)(1)(B) permits confirmation of a Chapter 13 plan if, "as of the effective date of the plan,"

> the plan provides that all of the debtor's projected disposable income to be received in the applicable commitment period beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan.[221]

BAPCPA replaced the term "applicable commitment period" with the term "three-year period" to limit objections by any trustee or holder of an unsecured claim to those whose disposable income to be received will be applied to unsecured creditor payments.[222] Each of these terms—"applicable commmitment period" before BAPCPA and "three-year period" after it—"operated as a temporal requirement."[223] The "applicable commitment period" is meant to influence "debtors to have [C]hapter 13 plans that are longer than three years."[224] However, under Chapter 13 the debtors would also

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[219] *See, e.g.*, *In re* Roedemeier, 374 B.R. 264, 273 (Bankr. D. Kan. 2007) ("Since the Debtor's plan proposes to distribute property worth more than [his projected disposable income], the plan satisfies this new confirmation requirement.").

[220] 11 U.S.C. § 1141(d)(5)(A).

[221] *Id.* § 1325(b)(1).

[222] Fridley v. Forsythe (*In re* Fridley), 380 B.R. 538, 543–44 (B.A.P. 9th Cir. 2007).

[223] *Id.*

[224] *Id.* at 544.

be exposed to trustees or creditors requesting to increase payments for the duration of the plan.[225] Thus, "[a] debtor desiring to prepay a [C]hapter 13 plan and obtain an early discharge without paying allowed unsecured claims in full must follow the [section] 1329 modification procedure . . . ."[226]

Chapter 11 does not impose this temporal requirement and there is no "run[ning] of the gauntlet" for modification purposes, as discussed below.[227] Rather, section 1129(a)(15)(B) provides a method in which a debtor's plan can be confirmed over the objection of an unsecured creditor if the plan does nothing more than distribute "property" with a "value" that is at least as much as the debtor's "projected disposable income" for a five-year period.[228]

Further, unlike a Chapter 13 creditor, a Chapter 11 creditor would be hard pressed to argue that the transfer of estate property to a liquidating trust is not a "completion of payments under the plan" for purposes of a section 1141(d)(5)(A) discharge. Under Chapter 13, creditors can successfully argue that the phrase "completion of payments under the plan" requires evidence that claims are paid as proposed by the plan, including all payments being actually distributed to creditors and not just conveyed to a liquidating trust of some sort. Simply put, that is not what the Bankruptcy Code says. Section 1141(d)(5)(A) provides that ordinarily, a discharge cannot be granted to an individual debtor until "completion of all payments under the plan."[229] But section 1141 does not say a discharge cannot be granted until all claims are paid. Using Chapter 13 cases, in contrast, would not be to the benefit of the creditor because it has generally been held that a Chapter 13 plan is "complete" when the debtor makes all payments to the trustee, not when the trustee distributes the payments to the creditors.[230] Thus, under a literal reading of the

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[225] *Id.*

[226] *Id.*

[227] *Id.*

[228] 11 U.S.C. § 1129(a)(15)(B) (2018).

[229] *Id.* § 1141(d)(5)(A).

[230] *In re* Phelps, 149 B.R. 534, 538–39 (Bankr. N.D. Ill. 1993) ("[T]he court cannot conclude that Congress intended the phrase 'completion of payments' in [section] 1329(a) to refer to the completion of payments by the trustee to creditors" and should only be construed to mean the "completion of payments by the debtor to the trustee."); *In re* Moss, 91 B.R. 563, 565 (Bankr. C.D. Cal. 1988) ("While section 1328(a) does not specify whether 'payments' as used therein refers to the payments the debtor makes to the trustee or to the payments that the trustee or debtor makes to creditors, it is reasonable to construe the language to apply to the payments made by the debtor to the trustee. Under this interpretation, the debtor will have an incentive to make all

Bankruptcy Code, when a debtor completes her obligations as provided for in the plan, that debtor has effected a completion of payments under such plan.

In the hypothetical discussed above, the debtor would likely be entitled to a discharge on the effective date of the plan because, at that point, she will have distributed property ($600,000.01) to the liquidating trustee, the value of which is greater than her projected disposable income for the five-year period. This satisfies the only confirmation requirement set forth in section 1129(a)(15) and constitutes a completion of all payments under the plan for purposes of section 1141(d)(5)(A).

2. Post-Confirmation Modification

What if, in the above-discussed hypothetical, the debtor, just one year later, begins amassing great wealth? Or, what if prior to bankruptcy, the debtor intentionally stopped receiving income to reduce her projected disposable income, and then shortly after the plan is confirmed and the debtor has turned over the property to the liquidating trustee, she begins making a substantial amount of money? Could the plan be modified? Could distributions to creditors become greater? The answer—if a "completion of payments under the [Chapter 11] plan" has occurred—is no. Under Chapter 13, the answer would be yes.

In a Chapter 11 case in which the debtor is an individual, the 2005 Amendments have altered the rules regarding post-confirmation modification. Section 1127(e) provides:

> If the debtor is an individual, the plan may be modified at any time after confirmation of the plan but before the completion of payments under the plan, whether or not the plan has been substantially consummated, upon request of the debtor, the trustee, the United States 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 period of 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 made other than under the plan.[231]

required payments as promptly as possible because the debtor will be assured of receiving a discharge when the debtor's payments are completed.").

[231] 11 U.S.C. § 1127(e).

There is no doubt that section 1127(e) was created to give unsecured creditors the ability to propose post-confirmation amendments to an individual debtor's plan in situations in which there has been a substantial change in the debtor's income or expenses that was not anticipated at the time of the confirmation hearing. A similar provision exists in Chapter 13. The problem, however, is that this provision dissolves the second the debtor completes payments under the plan, which, as discussed above, can happen on the effective date by turning over the assets to a liquidating trustee. In other words, section 1127(e) is truly meaningless in Chapter 11 liquidating plans.

IV. CREATING A LEVEL PLAYING FIELD

There are a few ways to approach the affluent debtor issue. First, one can take the "leave-it-alone" approach. Under this approach, one would argue that the Bankruptcy Code says what it says and that there are no "loopholes" for the affluent. One would point out that the Bankruptcy Code is clear on its face and Congress meant what it said. If this thought process is followed, nothing will change. Those individuals who want to take advantage of Chapter 7 liquidation without dealing with the Means Test can simply accumulate more business debt than personal debt by signing guaranty agreements, purchasing investment properties, buying expensive homes in order to take a new job, and so on. Those who want to avoid Chapter 7 and 13, but do not want to be relegated to a five-year payment plan and potential post-modification motions when their lifestyles improve, can reduce their monthly income prior to filing, incur a substantial amount of lavish expenses, and then find assets that are greater than five years' worth of disposable income.

A second approach would be to modify or amend the Bankruptcy Code, which is highly difficult and unlikely. To be effective, this would entail abolishing the "primarily consumer debt" language under Chapter 7 and forcing all individuals with higher incomes into Chapter 13 or 11. In addition, Congress would have to modify Chapter 11 to add a temporal component to individual Chapter 11 plans—for example, debtors would not be able to complete payments on the effective date of the plan. Instead, similar to a Chapter 13 case, debtors would be relegated to a longer period in which to pay creditors. This would give creditors the opportunity to move for modifications to the plan when, and if, the debtor's financial situation dramatically improves.

The third approach—and what this Article suggests—is that when these concerns arise, the issue of bad faith should be heavily addressed. In non-consumer Chapter 7 cases, this Article argues that bad faith can constitute a cause for dismissal under section 707(a). Specifically, when evidence suggests that debtors have manipulated their income to avoid the Means Test, dismissal may be appropriate. Similarly, in individual Chapter 11 cases, this Article argues that section 1129(a)(3) places a burden upon the debtor to prove that her plan is being executed in good faith. When evidence suggests that the debtor has manipulated her income prior to filing to reduce income and increase expenses, and when the debtor is proposing to complete all payments under the plan on the effective date, a presumption of bad faith should arise.

A. Bad Faith Under Chapter 7

Congress, yet again, is looking after the best interests of the well-to-do by making their cases in Chapter 7 more difficult to dismiss than those cases with primarily consumer debts. Dismissing cases pursuant to sections 707(b)(1) to (3) is permissible if: (1) there is a presumption of abuse based on the debtor's monthly net income being higher than the Means Test standard; or (2) if the circumstances surrounding the debtor's financial situation show abuse or that the filing was done in bad faith.[232] Section 707(b)(1) states, in pertinent part that a court may *sua sponte* or after a motion by any party in interest, "[a]fter notice and a hearing," dismiss a filed case if the individual debtor's "debts are primarily consumer debts" and the court finds "the granting of relief would be an abuse" of Chapter 7 provisions.[233]

Of course, before even dismissing a case under section 707(b), a court would be required to determine that the debtor has "primarily consumer debts," and this determination, as discussed in this Article, hinges upon the reasons why the debts were incurred. If the debts were incurred primarily for personal, family, or household purposes, this section would apply. But if they are incurred for a profit motive, the entirety of section 707(b) would be inapplicable because a section 707(b) dismissal is only available when a Chapter 7 debtor has primarily consumer debts.

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[232] *In re* Piazza, 451 B.R. 608, 611–12 (Bankr. S.D. Fla. 2011), *aff'd sub nom.* Piazza v. Nueterra Healthcare Physical Therapy, LLC (*In re* Piazza), 719 F.3d 1253 (11th Cir. 2013).

[233] 11 U.S.C. § 707(b)(1).

Notwithstanding, this Article contends that section 707(a) warrants dismissal for the affluent debtor attempting to avoid Chapters 13 and 11 by living a lavish lifestyle and incurring a substantial amount of business debt. In other words, this Article asserts that bad faith constitutes a case for dismissal of a Chapter 7 case under section 707(a), despite several cases holding that there is no "good faith" filing requirement in Chapter 7 cases.

Section 707(a) states:

> The court may dismiss a case under this chapter only after notice and a hearing and *only for cause*, including—
> (1) unreasonable delay by the debtor that is prejudicial to creditors;
> (2) nonpayment of any fees or charges required under [C]hapter 123 of title 28; and
> (3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521(a), but only on a motion by the United States trustee.[234]

Courts seem to agree that the three examples of "cause" found in section 707(a) "are illustrative, not exhaustive."[235] Thus, no court should be limited to the three examples found in section 707(a) in determining whether there is cause to dismiss a Chapter 7 case.

But the unanimity of opinions on the application of section 707(a) stops there. Courts have wrestled with the question of what constitutes "for cause," whether the "good faith" or "bad faith" of the debtor matters and, if it does matter, what conduct encompasses "bad faith."[236]

A few questions, therefore, arise that appear to be troubling bankruptcy courts. First, whether section 707(a) imposes a duty of "good faith" on debtor, and second, what exactly constitutes bad faith pursuant to section 707(a).

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[234] *Id.* § 707(a) (emphasis added).

[235] *See In re Piazza*, 719 F.3d at 1261; Smith v. Geltzer (*In re* Smith), 507 F.3d 64, 72 (2d Cir. 2007); Neary v. Padilla (*In re* Padilla), 222 F.3d 1184, 1191 (9th Cir. 2000); Huckfeldt v. Huckfeldt (*In re* Huckfeldt), 39 F.3d 829, 831 (8th Cir. 1994); Indus. Ins. Servs., Inc. v. Zick (*In re* Zick), 931 F.2d 1124, 1126 (6th Cir. 1991).

[236] 11 U.S.C. § 707(a); Shangraw v. Etcheverry (*In re* Etcheverry), 242 B.R. 503, 505 (Bankr. D. Colo. 1999).

1. Does Section 707(a) Impose a Duty of "Good Faith" on Debtors?

At one end of the spectrum, courts have answered this question with a flat "no," stating that section 707(a) "does not include an implicit good faith requirement in the context of the dismissal of Chapter 7 bankruptcy liquidation proceedings."[237] On the other end of the spectrum, courts have held that a debtor's prepetition bad faith in the bankruptcy process may serve as the basis for dismissal under section 707(a). The Fifth Circuit, for example, in holding so, reasoned: "This is no more than acknowledgment in the [C]hapter 7 context of what has long been recognized: 'Every bankruptcy statute since 1898 has incorporated literally, or by judicial interpretation, a standard of good faith for the commencement, prosecution, and confirmation of bankruptcy proceedings.' "[238]

Other decisions seem to fall somewhere in between. On the restrictive and more limited end, the Ninth Circuit, for example, has concluded that "bad faith per se can properly constitute 'cause' for dismissal of a Chapter 11 or Chapter 13 petition" but cannot be cause for dismissal under section 707(a).[239] Consequently, the court "discarded the 'bad faith' label in favor of simply examining the actions of the debtor" to assess whether his prepetition conduct—which included, among other things, running up credit card debt in advance of filing his bankruptcy petition—"provide[d] 'cause' for dismissal under [section] 707(a)."[240] The Ninth Circuit concluded it did not.[241]

Similarly, the Eighth Circuit has held that while "some conduct constituting cause to dismiss a Chapter 7 petition may readily be characterized as bad faith[,] . . . framing the issue in terms of bad faith may tend to misdirect the inquiry away from the fundamental principles and purposes of Chapter 7."[242] In citing a case out of the district of Minnesota, the Eighth Circuit adopted a "narrow, cautious approach to bad faith," concluding

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[237] *In re Etcheverry*, 242 B.R. at 504; *see also In re* Landes, 195 B.R. 855, 862 (Bankr. E.D. Pa. 1996) (holding there is no good faith filing requirement in Chapter 7 cases).

[238] Krueger v. Torres (*In re* Krueger), 812 F.3d 365, 370 (5th Cir. 2016) (quoting Little Creek Dev. Co. v. Commonwealth Mortg. Corp. (*In re* Little Creek Dev. Co.), 779 F.2d 1068, 1071 (5th Cir. 1986)).

[239] *In re Padilla*, 222 F.3d at 1193.

[240] *Id.*

[241] *Id.* at 1194.

[242] Huckfeldt v. Huckfeldt (*In re* Huckfeldt), 39 F.3d 829, 832 (8th Cir. 1994).

that bad faith under section 707(a) should "be limited to extreme misconduct falling outside the purview of more specific Code provisions, such as using bankruptcy as a 'scorched earth' tactic against a diligent creditor, or using bankruptcy as a refuge from another court's jurisdiction."[243]

Other circuits, including the Eleventh Circuit, have taken a less restrictive approach to a section 707(a) dismissal. In a 2013 case, the Eleventh Circuit examined both legal and non-legal definitions of the word "cause" and held that "the ordinary meaning of 'cause' is adequate or sufficient reason."[244] Applying this definition, the court held that "prepetition bad faith" is a "sufficient reason" for dismissal under section 707(a).[245] It reasoned that "[b]ad-faith bankruptcy filings significantly burden the legal system in general and bankruptcy courts in particular."[246] The court further held that bankruptcy courts can, and should, sanction litigants for "any improper purpose" under Rule 9011(b)(1) of the Federal Rules of Bankruptcy Procedure and can also "tak[e] any action . . . necessary or appropriate . . . to prevent an abuse of process" under section 105(a).[247] It stated: "[W]e see no reason why prepetition bad faith should not constitute an adequate or sufficient reason for dismissal. To hold otherwise would 'create[ ] the appearance that such an abusive practice is implicitly condoned by the [Bankruptcy] Code.' "[248]

The Sixth Circuit has stated that "[a] lack of good faith . . . has been recognized in a number of bankruptcy cases as a valid cause of dismissal under [section] 707(a)."[249]

The Fifth Circuit has held that "[c]ourts have broad authority to determine what [constitutes] cause for dismissal under [section] 707(a)."[250] It stated: "[C]ause is any reason cognizable to the equity power and conscience of the court as constituting an abuse of the bankruptcy process," including "prepetition bad-faith conduct,

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[243] *Id.* (citing *In re* Khan, 172 B.R. 613, 624–26 (Bankr. D. Minn. 1994)).
[244] Piazza v. Nueterra Healthcare Physical Therapy, LLC (*In re* Piazza), 719 F.3d 1253, 1261–62 (11th Cir. 2013).
[245] *Id.* at 1262.
[246] *Id.*
[247] *Id.* (alterations in original).
[248] *Id.* (second and third alterations in original) (quoting Dinova v. Harris (*In re* Dinova), 212 B.R. 437, 441 (B.A.P. 2d Cir. 1997)).
[249] Indus. Ins. Servs. v. Zick (*In re* Zick), 931 F.2d 1124, 1126–27 (6th Cir. 1991).
[250] Krueger v. Torres (*In re* Krueger), 812 F.3d 365, 370 (5th Cir. 2016).

postpetition bad faith conduct, or petitions that simply serve no legitimate bankruptcy purpose."[251]

In short, recent case law confirms that "most courts accept the proposition that a debtor's bad faith can constitute 'cause' for the dismissal of a case under [section] 707(a)."[252]

2. What Constitutes Bad Faith or Cause Under Section 707(a)?

"Recognizing that bad faith may justify the dismissal of a Chapter 7 case is one thing, trying to identify or articulate what bad faith actually is in the context of a Chapter 7 filing is a much more problematic endeavor."[253] "Not surprisingly, courts disagree sharply about the proper standard."[254]

On one end of the spectrum, there are cases in which courts have concluded that the debtor's ability to pay should not be considered in the good faith analysis. These cases focus on the history of section 707 and conclude that "noneconomic factors" are not appropriate for consideration in the good faith analysis. As one court noted:

> In a Chapter 7 case . . . the potential bases for dismissal on grounds of bad faith are narrow. "The ultimate question [is] whether the petition was filed with the intent and desire to obtain the relief that is available under a particular chapter of the Bankruptcy Code, through the means that Congress has specified, or whether the debtor is pursuing some other goal." In Chapter 7, a case should be dismissed on account of bad faith *only where the debtor has taken advantage of the court's jurisdiction in a manner abhorrent to the purposes of Chapter 7*.[255]

Another court traced the legislative history of section 707 and found that "[i]n passing on a motion for dismissal under [section] 707(a) . . . the Bankruptcy Court should exclude any consideration that goes to the debtor's financial means."[256] It also criticized decisions basing dismissal on the debtor's ability to pay, concluding, "[t]hese decisions are fundamentally flawed in their analysis . . . because the question of whether a Chapter 7 debtor could

[251] *Id.* (alteration in original) (citations omitted).
[252] *In re* Tallman, 397 B.R. 451, 454 (Bankr. N.D. Ind. 2008) (cataloging cases).
[253] *Id.*
[254] *In re* Bushyhead, No. 15-CV-89, 2016 WL 11263627, at *5 (N.D. Okla. May 25, 2016).
[255] *In re* Kane & Kane, 406 B.R. 163, 168 (Bankr. S.D. Fla. 2009) (second alteration in original) (emphasis added) (quoting *In re Tallman*, 397 B.R. at 456).
[256] *In re* Khan, 172 B.R 613, 624 (Bankr. D. Minn. 1994).

meet dischargeable debt obligations in whole or [in] part from future resources is irrelevant to a motion under [section] 707(a)."[257]

The court pronounced what it believed to be the correct "good faith" inquiry as one that primarily focuses on the debtor's "manifested attitude" in relation to the bankruptcy process.[258] The court emphasized that the proper question to ask is whether the debtor is filing for bankruptcy for the relief that Congress intended to make available and whether the debtor is willing to comply, "responsibly," with the imposed duties and costs for receiving the intended relief.[259]

Thus, a presumption of "bad faith" would arise if a debtor is filing to receive the benefits of a bankruptcy filing and simultaneously evade, either "intentionally or fraudulently," all of the duties or detriments that accompany the relief sought.[260] A filing with the intention to intervene with an automatic stay of section 362(a) of the Bankruptcy Code or a motivation to use bankruptcy as a "tactic against a pressing creditor or opponent in litigation" without any adherence to the duties will also rise to the determination of a bad faith filing.[261]

The Eighth Circuit agreed with the narrow approach to bad faith adopted in *Khan*. It stated that a finding of bad faith may be supported when the debtor has a "frivolous, non[-]economic motive for filing a bankruptcy petition, when there is a sinister or unworthy purpose, or when there is an abuse of the judicial process."[262] However, the court specified that taking advantage of legal rights, on its own, will not suffice to find for a bad faith filing on behalf of the debtor.[263]

In *Huckfeldt*, the court affirmed the bankruptcy court's dismissal of the debtor's Chapter 7 filing, concluding that: (1) the debtor filed the petition for the purposes of frustrating a divorce order and forcing his ex-wife into bankruptcy; and (2) the debtor had manipulated his earnings "to ensure that the Chapter 7 proceeding would achieve these non-economic motives."[264]

Some courts, on the other hand—and this Article supports this conclusion—have expressly held that the debtor's income

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[257] *Id.* at 622.
[258] *Id.* at 625.
[259] *Id.*
[260] *Id.*
[261] *Id.*
[262] Huckfeldt v. Huckfeldt (*In re* Huckfeldt), 39 F.3d 829, 832 n.4 (8th Cir. 1994).
[263] *Id.*
[264] *Id.* at 832.

may, and should, be considered as a factor in the "for cause" analysis. For example, the Third Circuit in *Perlin* stated:

> While the legislative history makes clear that a debtor's ability to repay his debts is inadequate cause for dismissal, we do not read the history as prohibiting a bankruptcy court from considering a debtor's substantial income and expenses in determining whether the debtor filed his bankruptcy petition in good faith. The legislative history establishes only that a debtor's ability to repay is an invalid cause for dismissal. It does not indicate that a bankruptcy court must ignore the economic reality of a debtor's financial situation in determining whether a valid cause for dismissal exists.[265]

The Fifth Circuit has adopted an even broader view, stating that "[c]ourts have broad authority to determine what is cause for dismissal under [section] 707(a): '[C]ause is any reason cognizable to the equity power and conscience of the court as constituting an abuse of the bankruptcy process.' "[266]

The most expansive view—for which this Article advocates—is set forth in *In re Piazza*, where the Eleventh Circuit adopted "the ordinary meaning of 'cause,' as authorizing dismissal when adequate or sufficient reason exists for such an action."[267] Stating that "[b]ad faith does not lend itself to a strict formula," the court accepted a "totality of the circumstances" approach that included inquiry into whether the debtor "failed to repay his creditors or 'make life-style adjustments' despite his debts."[268] The Eleventh Circuit found that:

> The totality-of-the-circumstances inquiry looks for "atypical" conduct that falls short of the "honest and forthright invocation of the [Bankruptcy] Code's protections." In making that determination, bankruptcy courts must, as they so often do, "sift the circumstances surrounding [a] claim to see that injustice or unfairness is not done." Under this inquiry, bad faith is ultimately "evidenced by the debtor's deliberate acts or omissions that

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[265] Perlin v. Hitachi Cap. Am. Corp. (*In re* Perlin), 497 F.3d 364, 372 (3d Cir. 2007); *see also In re* Woodburn, No. 07-00927-5, 2008 WL 2777352, at *5 (Bankr. E.D.N.C. July 17, 2008) ("The court may consider the debtor's ability to repay debts, but ability to repay debts alone is not sufficient grounds to dismiss a case under [section] 707(a).").

[266] Krueger v. Torres (*In re* Krueger), 812 F.3d 365, 370 (5th Cir. 2016) (third alteration in original) (quoting Little Creek Dev. Co. v. Commonwealth Mortg. Corp. (*In re* Little Creek Dev. Co.), 779 F.2d 1068, 1072 (5th Cir. 1986)).

[267] Piazza v. Nueterra Healthcare Physical Therapy, LLC (*In re* Piazza), 719 F.3d 1253, 1262 (11th Cir. 2013).

[268] *Id.* at 1271, 1273–74.

constitute a misuse or abuse of provisions, purpose, or spirit of the Bankruptcy Code."[269]

Piazza directly addresses the affluent-debtor problem and provides a potential solution to handling these issues. The debtor, Piazza, filed his Chapter 7 bankruptcy petition on October 8, 2010, "a day before [the] deadline to produce documents relevant to a state court final judgment."[270] The judgment was the result of the debtor's failure to pay a business guarantee to Nueterra Healthcare Physical Therapy, which became a creditor in the bankruptcy case.[271] At the time he filed for bankruptcy, the debtor made about $8,000 a month and so did his wife.[272] As such, at the time the debtor filed for bankruptcy, he and his wife, together, earned almost $200,000 a year.

When the debtor filed for bankruptcy under Chapter 7, the creditor filed a motion explicitly asking the court to dismiss the case pursuant to sections 707(b)(1), (b)(2), and (b)(3).[273] But all of the creditor's section 707(b) arguments "hinge[d] on the assumption that the [d]ebtor improperly declared . . . the majority of his debt [as] non-consumer (business) debt."[274] This was an important point in the creditor's motion because if the debtor was, instead, primarily a consumer debtor, the case would be dismissed for failure to satisfy the Means Test—i.e., the debtor would have sufficient money to fund a Chapter 13 plan or not need bankruptcy to deal with his debt obligations.[275] Unfortunately for the creditor, the court concluded that the debtor's non-consumer business debt was at least 55 percent of the total debt.[276] This meant that the creditor could not pursue a section 707(b) motion for dismissal as it is only available when a Chapter 7 debtor has primarily consumer debts. Nonetheless, at the hearing on the motion, the creditor moved to dismiss the case under section 707(a), alleging that it was a bad-faith bankruptcy filing.[277]

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[269] *Id.* at 1271–72 (alterations in original) (citations omitted).
[270] *In re* Piazza, 451 B.R. 608, 610 (Bankr. S.D. Fla. 2011), *aff'd sub nom*. Piazza v. Nueterra Healthcare Physical Therapy, LLC (*In re* Piazza), 719 F.3d 1253 (11th Cir. 2013).
[271] *Id.*
[272] *See id.*
[273] *See id.* at 611.
[274] *Id.*
[275] *See id.*
[276] *See id.* at 613.
[277] *See id.*

At the time the bankruptcy court in *Piazza* was deciding the section 707(a) issue, the Eleventh Circuit had not addressed whether bad faith constituted cause for dismissal of a Chapter 7 case. The court in *Piazza* observed that several districts had reached conflicting decisions, acknowledging some found there was no good faith filing requirement in a Chapter 7 case.[278]

The *Piazza* court rejected this approach and, in doing so, stated that "one of the primary policy aims of bankruptcy[is] to give the honest yet unfortunate debtor a fresh start—not the dishonest business person a head start."[279] It further concluded that "[w]hether a debtor is a consumer or non-consumer debtor is . . . irrelevant to whether a Chapter 7 case may be dismissed for bad faith."[280] And "[b]ecause there is no reason to exempt business debtors from the good faith requirement imposed by BAPCPA upon consumer debtors, . . . that bad faith can constitute cause for dismissal of a Chapter 7 case under [section] 707(a)."[281]

What makes *Piazza* useful for judges and attorneys representing creditors who believe affluent debtors are taking advantage of Chapter 7 bankruptcy is that it sets forth various factors that help shed light on a debtor's intentions and assists in determining whether the debtor is truly an honest, but unfortunate, debtor entitled to a fresh start. This Article contends that the factors identified by the court in *Piazza* should be heavily employed and analyzed in cases where individual debtors are avoiding the Means Test by asserting non-consumer debt as their primary source of debt. The factors that this Article would like to see courts adopt are as follows:

(i) the debtor reduced his creditors to a single creditor shortly before the petition date;
(ii) the debtor made no life-style adjustments or continued living a lavish life-style;
(iii) the debtor filed the case in response to a judgment, pending litigation, or collection action;
(iv) there is an intent to avoid a large, single debt;
(v) the debtor made no effort to repay his debts;
(vi) the unfairness of the use of Chapter 7;
(vii) the debtor has sufficient resources to pay his debts;
(viii) the debtor is paying debts of insiders;

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[278] *Id.*
[279] *Id.*
[280] *Id.*
[281] *Id.* at 614.

(ix) the schedules inflate expenses to disguise financial well-being;
(x) the debtor transferred assets;
(xi) the debtor is over-utilizing the protections of the Bankruptcy Code to the unconscionable detriment of creditors;
(xii) the debtor employed a deliberate and persistent pattern of evading a single major creditor;
(xiii) the debtor failed to make candid and full disclosure;
(xiv) the debtor's debts are modest in relation to his assets and income; and
(xv) there are multiple bankruptcy filings or other procedural "gymnastics."[282]

Most of the time, the three statutorily listed grounds for dismissal in section 707(a)'s non-exclusive list will not be present. As such, the foregoing factors become extremely useful to bankruptcy courts and practitioners when combating affluent-debtor abuse. In the *Piazza* case, for example, the evidence suggested that:

> (1) the Debtor filed his petition to avoid a final judgment; (2) the Debtor failed to disclose the amount of debt owed to [another creditor]; (3) the Debtor had the ability to repay his debts or a portion of his debts; and (4) the Debtor continue[d] to maintain high expenditures . . . and a lavish lifestyle . . . .[283]

As part of his "lavish lifestyle," the debtor continued making payments in the amount of $2,000 a month to his wife's 401k account, "continued to pay high credit card expenses, and continued to lease a luxury vehicle."[284]

Without adopting these factors, the court would have likely lost its avenue to dismiss the debtor's case because of his "non-consumer" status. Further, the court noted, "[t]here was no sudden financial disaster, the Debtor and his spouse still maintained their jobs, no medical crisis occurred, [and] the petition was timed perfectly to stay the Creditor's collection efforts . . . ."[285] The court also found that it was uncontroverted that the debtor had "not made any material lifestyle adjustments, and continue[d] to contribute significant amounts to his wife's retirement fund *at the expense of his creditors*."[286]

When it came to analyzing whether the debtor had sufficient resources to pay his debts, the court considered: (1) the $2,000

[282] *Id.* at 614–15.
[283] *Id.* at 616.
[284] *Id.*
[285] *Id.*
[286] *Id.* at 617 (emphasis added).

monthly contribution by the debtor to his wife's 401(k); (2) a luxury vehicle leased by the debtor; (3) the transfer of "thousands of dollars to his wife" only one month prior to the petition; (4) the wife's "successful career"; and (5) the ability of the debtor to repay "a portion of his debts to creditors."[287]

Based upon the foregoing, the court properly concluded that, based on the articulated factors, the debtor had acted in bad faith and therefore granted the creditor's motion to dismiss.[288]

Because amendments to the Bankruptcy Code do not appear to be forthcoming—especially with respect to the issues identified herein—it seems that a reasonable means to combat the abuse is to take the approach identified in this Article. Individual debtors who avoid the Means Test by claiming they have more business debt than consumer debt should be forced to go through the "good faith gauntlet." What most of these debtors have in common is the failure to make lifestyle adjustments prior to a bankruptcy filing, the desire to continue a lavish lifestyle, the idea that they do not have to make an effort to repay their debts, the means and resources to pay debts, and the avoidance of candid and full disclosures in their filings. The factors identified above will surely disqualify the affluent bankrupt from filing under Chapter 7.

Another issue, however, is how the courts and practitioners should handle an affluent debtor in Chapter 11 seeking to receive an immediate discharge on the effective date of her plan by contributing assets to a liquidating trust and paying creditors a fraction of their claims. The answer is parallel to the solution for Chapter 7: bad faith must be scrutinized heavily in Chapter 11 cases.

B. *Bad Faith Under Chapter 11*

Pursuant to section 1129(a)(3), the party seeking confirmation must show that "[t]he plan has been proposed in good faith and not by any means forbidden by law."[289] However, as explained by the Seventh Circuit, good faith can be seen as a "reasonable likelihood that the plan will achieve a result consistent with the objectives and purposes of the Bankruptcy Code."[290] Thus, despite

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[287] *Id.*

[288] *See id.*

[289] 11 U.S.C. § 1129(a)(3) (2018).

[290] *In re* Madison Hotel Assocs., 749 F.2d 410, 424–25 (7th Cir. 1984) (quoting *In re* Nite Lite Inns, 17 B.R. 367, 370 (Bankr. S.D. Cal. 1982)); *see also* Kane v. Johns-Manville Corp., 843 F.2d 636, 649 (2d Cir. 1988) ("The good[ ]faith test means that

the lack of a definition under section 1129(a)(3), the focus should be on whether the plan will yield results that are in accord with the purpose of the Bankruptcy Code.

The good faith standard found in section 1129(a)(3) "speaks more to the process of plan development than to the content of the plan."[291] And it must be viewed in light of the totality of the circumstances surrounding the establishment of a Chapter 11 plan, including the debtor's pre-filing conduct.[292] In assessing the totality of circumstances, a court has " 'considerable judicial discretion' in finding good faith."[293] Moreover, the bankruptcy courts are "in the best position to assess the good faith of the parties' proposals."[294] Notwithstanding, "the fact that a debtor proposes a plan in which it avails itself of an applicable Code provision does not constitute evidence of bad faith."[295]

In short, the "touchstone" of the good faith inquiry is "the plan itself and whether it will achieve a result consistent with the objectives and purposes of the Bankruptcy Code."[296] Factors that courts have considered in determining a debtor's good faith include if the plan: "(1) fosters a result consistent with the [Bankruptcy] Code's objectives, (2) the plan has been proposed with honesty and good intentions and with a basis for expecting that reorganization can be effected, and (3) [the plan exhibited a] fundamental fairness in dealing with the creditors."[297]

Regarding the first factor, the United States Supreme Court has specifically identified two purposes of Chapter 11: "preserving

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'the plan was proposed with "honesty and good intentions" and with "a basis for expecting that a reorganization can be effected." ' ") (quoting Koelbl v. Glessing (*In re* Koelbl), 751 F.2d 137, 139 (2d Cir. 1984)).

[291] *In re* Bush Indus., Inc., 315 B.R. 292, 304 (Bankr. W.D.N.Y. 2004).

[292] *See In re* Madison Hotel Assocs., 749 F.2d at 425; *see also* Jasik v. Conrad (*In re* Jasik), 727 F.2d 1379, 1383 (5th Cir. 1984); *In re* WorldCom, Inc., No. 02-13533, 2003 WL 23861928, at *51 (Bankr. S.D.N.Y. Oct. 31, 2003); *In re* Leslie Fay Cos., 207 B.R. 764, 781 (Bankr. S.D.N.Y. 1997); *In re* Resorts Int'l, Inc., 145 B.R. 412, 469 (Bankr. D.N.J. 1990); *In re* Toy & Sports Warehouse, Inc., 37 B.R. 141, 149 (Bankr. S.D.N.Y. 1984).

[293] *In re* Coram Healthcare Corp., 271 B.R. 228, 234 (Bankr. D. Del. 2001) (quoting *In re* Am. Family Enters., 256 B.R. 377, 401 (D.N.J. 2000)).

[294] *In re* Sound Radio, Inc., 93 B.R. 849, 853 (Bankr. D.N.J. 1988), *aff'd in part, remanded in part*, 103 B.R. 521 (D.N.J. 1989).

[295] *In re* PPI Enters. (U.S.), Inc., 228 B.R. 339, 347 (Bankr. D. Del. 1998), *aff'd*, 324 F.3d 197 (3d Cir. 2003).

[296] *In re* Frascella Enters., Inc., 360 B.R. 435, 446 (Bankr. E.D. Pa. 2007) (quoting *In re* PWS Holding Corp., 228 F.3d 224, 242 (3d Cir. 2000)).

[297] *In re* Genesis Health Ventures, Inc., 266 B.R. 591, 609 (Bankr. D. Del. 2001) (citations omitted).

going concerns and maximizing property available to satisfy creditors."[298]

The second factor requires that the plan has been proposed with honesty and good intentions, and that it "has a reasonable hope of success."[299] The Third Circuit has provided guidance on this point, stating that, "[a]t its most fundamental level, the good faith requirement ensures that the Bankruptcy Code's careful balancing of interests is not undermined by petitioners whose aims are antithetical to the basic purposes of bankruptcy."[300] In analyzing whether a debtor's plan has been proposed for honest and good faith reasons, courts regularly consider "whether the debtor intended to abuse the judicial process," whether the plan was proposed for ulterior motives, or if "no realistic probability of an effective reorganization exists."[301]

The third and final factor courts consider in determining good faith is whether the debtor exhibited a fundamental unfairness when dealing with its creditors. To comply with this requirement, the plan must treat all parties fairly and ensure its confirmation comports with due process.[302]

Like section 707(a)'s dismissal authority for the Chapter 7 cases, this Article contends that section 1129(a)(3) provides the best approach for challenging affluent debtors who are using Chapter 11 as an abusive tactic. However, the factors discussed above for Chapter 7 cases should also be employed in this analysis. To understand how simple it is for an individual to abuse Chapter 11, consider the following hypothetical:

For the last ten years, Daryl has received $10 million a year from a trust fund. He has no job and has over-expended in every way possible. He now has approximately $50 million of debt. He cannot qualify for Chapter 7 because his debts—for example, a Lamborghini, a penthouse, gambling debt, and more—are considered consumer goods and his "income" of $10 million a year would disqualify him under the Means Test. But Daryl does not want to be under the control of a trustee, so he must figure out a way to

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[298] Bank of Am. Nat'l Tr. & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 526 U.S. 434, 453 (1999).

[299] Brite v. Sun Country Dev., Inc. (*In re* Sun Country Dev., Inc.), 764 F.2d 406, 408 (5th Cir. 1985).

[300] NMSBPCSLDHB, L.P. v. Integrated Telecom Express, Inc. (*In re* Integrated Telecom Express, Inc.), 384 F.3d 108, 119 (3d Cir. 2004).

[301] *In re* Sound Radio, Inc., 93 B.R. 849, 853 (Bankr. D.N.J. 1988), *aff'd in part, remanded in part*, 103 B.R. 521 (D.N.J. 1989).

[302] *In re* Mount Carbon Metro. Dist., 242 B.R. 18, 39, 41 (Bankr. D. Colo. 1999).

avoid Chapter 13. Also, Daryl does not want the $10 million figure to be used in his disposable income calculation, so a year before bankruptcy, the trustee of his trust, at Daryl's request, reduces his income to $200,000 a year—that is, $16,666 a month. Assume Daryl has reduced his expenses to $15,000 a month. Based on these amounts, Daryl's projected disposable income is $99,960 ((16,666 – $15,000) x 60). All that Daryl has to do to confirm a plan is come up with $99,961 on the effective date of the plan and transfer it to a liquidating trustee. The $99,961 could likely be gifted to him via the trust or his wealthy father.[303] Daryl would then be entitled to a discharge pursuant to section 1141(d)(5)(A) because he would have "completed payments" under the plan. Further, creditors could not seek to modify the plan because payments were already "completed" under the plan. A few months after the effective date of the plan, Daryl could enhance his trust payments to $10 million a year again, acquire more assets, and move on as if nothing happened, all while receiving a substantial discharge of unsecured debt. Further, depending on the state, Daryl could have accomplished all of this while living in a $20 million home with a substantial amount of equity.

Should Daryl's plan be confirmed? Technically, it has satisfied section 1129(a)(15). Thus, the only chance a creditor would have to dismantle the plan would be to challenge his case as a violation of section 1129(a)(3)'s good faith requirement. In turning to the good faith analyses adopted by the courts in Chapter 11 cases, Daryl's plan might survive, although there is a question as to whether it was proposed with honesty and good intentions and whether he exhibited a fundamental fairness in dealing with his creditors. If courts, however, were to also adopt the factors articulated above from the *Piazza* court, creditors would be more effective in combating the affluent Chapter 11 debtor. In analyzing those factors, the following would likely be present in a case where the debtor transfers assets to the liquidating trustee in return for an immediate discharge. In Daryl's case: (1) Daryl made no lifestyle adjustments or continued living a lavish lifestyle; (2) Daryl made no *real* effort to repay his debts; (3) Daryl has sufficient resources to pay his debts; (4) Daryl's schedules likely

[303] Clearly, the "best interest of creditors test" would come up with respect to the debtor's assets and whether creditors would receive more under a hypothetical liquidation, but this Article assumes that the majority of a debtor's assets are encumbered by perfected security interests, leaving unsecured creditors with nothing in a Chapter 7 case.

inflate expenses to disguise financial well-being; (5) Daryl is over-utilizing the protections of the Bankruptcy Code to the unconscionable detriment of creditors; and (6) Daryl likely failed to make candid and full disclosures.

CONCLUSION

The affluent debtor problem is significant. There is no doubt that those with money and assets are treated more favorably under the Bankruptcy Code than the honest, yet unfortunate, debtor. Whether Congress intended this result is a mystery. The provisions that benefit the affluent will likely stand for years to come. Amending the Bankruptcy Code or repealing these provisions seem unlikely. Instead, the simplest way to combat this abuse is by making sure that no debtor is exempt from the good faith requirement found in Chapters 7 and 11 and that bad faith can, and should, constitute cause for dismissal. When the Chapter 7 debtor is avoiding the Means Test by making a "non-consumer" debt claim, or when the Chapter 11 debtor is proposing a plan that avoids repayment over a period of time, but instead an immediate discharge upon the transferring of assets to a liquidating trustee, the good faith analysis should be highly prevalent and scrutinized in every case.