

# Judicial Discretion to Find Abuse Under Section 707(b)(3)

*Eugene R. Wedoff\**

I. INTRODUCTION .....	1035
II. THE MEANS TEST AS A PRESUMPTION OF ABILITY TO REPAY DEBT.....	1037
III. ARGUMENTS FOR MEANS TEST EXCLUSIVITY. ....	1041
A. <i>The language of section 707(b): The specific governs the general?..</i>	1041
B. <i>Context of section 707(b): Consistency with Chapter 13?</i> .....	1042
C. <i>The legislative history: A need to remove judicial discretion in determining disposable income?</i> .....	1044
D. <i>Bankruptcy policy: A need to protect special interests?</i> .....	1045
IV. GUIDANCE FROM THE MEANS TEST ON NON-PRESUMPTIVE ABUSE.....	1046
A. <i>The abuse threshold</i> .....	1046
B. <i>“Current monthly income”</i> .....	1047
C. <i>Allowed deductions</i> .....	1048
D. <i>Exempt property</i> .....	1050
V. CONCLUSION .....	1051

## I. INTRODUCTION

[T]here is nothing wrong with the means test. People who make high incomes — lawyers, doctors and accountants are examples — and file bankruptcy, wiping out all their debts, who don’t care who got hurt by their failure to pay and they care only about themselves, this will crack down on those people . . . .<sup>1</sup>

Imagine a person with a high income — a corporate CEO, for example — whose company goes out of business and who finds himself temporarily unemployed. While waiting for his next opportunity, he maintains his lifestyle by depleting his personal savings and incurring substantial debt, both secured (his normal annual purchase of a new Jaguar and new home equity loans) and unsecured (cash advances and other charges on his credit card, which has a very high limit). After a few months, he gets new employment with even higher compensation than before, but he wonders if there isn’t some way that he could avoid repaying some of the debt he incurred. Chapter 7 of the Bankruptcy Code<sup>2</sup> seems a good possibility: it offers an immediate

---

\* United States Bankruptcy Judge, Northern District of Illinois.

1. 151 CONG. REC. S2216, S2219 (daily ed. Mar. 8, 2005) (statement of Sen. Sessions).

2. 11 U.S.C. §§ 701-784 (2000 & Supp. V 2005).

discharge of all unsecured debts in exchange for the debtor's non-exempt assets.<sup>3</sup> That's no problem for our executive because the remaining equity in his home is protected by a generous state exemption, his cash is gone (or in exempt retirement accounts), and his cars are encumbered by liens. There's nothing that a Chapter 7 trustee could sell for debt repayment.

Indeed, the only problem the executive might have is the means test that was added to section 707(b) of the Bankruptcy Code<sup>4</sup> by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA").<sup>5</sup> As reflected in the quotation from Senator Sessions set out above, the means test was designed to "crack down" on debtors with sufficient income to repay a substantial portion of their debt. It does this through a formula that determines how much income a debtor may have available for debt repayment. If this amount exceeds defined levels, the debtor is presumed to be abusing Chapter 7, and if the presumption is not rebutted, the debtor can be denied Chapter 7 relief. But as it turns out, the means test is no problem for our executive. The test measures a debtor's income during the six months before a bankruptcy filing, and he would have been unemployed during most of that period. Moreover, it allows a deduction from income in the amount of whatever secured debt payments the debtor is obligated to make, even debts secured by luxury vehicles or other unnecessary items. So although the executive has plenty of income to pay his debts, he passes the means test. There is no presumption of abuse.

To discharge all of his unsecured debt in Chapter 7, the executive needs to leap just one more hurdle. Section 707(b)(3) of the Bankruptcy Code, added by BAPCPA, governs situations in which the means test presumption does not arise.<sup>6</sup> It allows a court to find abuse in such situations by considering "the totality of the circumstances . . . of the debtor's financial situation."<sup>7</sup> One might think that this provision would let judges look at how much money a debtor actually has available to pay debts and "crack down" on genuinely wealthy debtors who pass the means test.<sup>8</sup> But according to a re-

---

3. See 11 U.S.C. § 541 (defining property of the debtor's estate and allowed exemptions); *id.* § 704(a)(1) (requiring a Chapter 7 trustee to "collect and reduce to money the property of the estate"); *id.* § 727(a) (providing for the Chapter 7 discharge); FED. R. BANKR. P. 4004(c) (providing for prompt entry of Chapter 7 discharge).

4. 11 U.S.C. § 707(b) (Supp. V 2005).

5. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.).

6. 11 U.S.C. § 707(b)(3).

7. *Id.* § 707(b)(3)(B).

8. See Eugene R. Wedoff, *Means Testing in the New § 707(b)*, 79 AM. BANKR. L.J. 231, 236 (2005) (reading § 707(b)(3) to allow judicial determination of debt paying ability).

cent article by Professors Culhane and White, that is not the case.<sup>9</sup> Once a debtor passes the means test, the article contends, the debtor's financial situation is irrelevant to a finding of "abuse"; relief can be denied only for dishonesty or similar "serious debtor misconduct."<sup>10</sup> Our executive, then, having told no lies and having made no lifestyle changes to facilitate bankruptcy, can both keep his income and discharge his unsecured debts in Chapter 7.

This article suggests the contrary — that if a section 707(b) motion properly raises the question, a bankruptcy judge has a duty to consider the actual financial situation of a debtor who is not subject to a means test presumption; that the judge should find abuse where the debtor can repay a sufficient amount of unsecured debt; and that the means test serves to guide, rather than foreclose, such determinations of abuse. Part I discusses the language of BAPCPA that requires this result, focusing on the nature of the means test as a presumption. Part II examines (and finds wanting) the contrary arguments asserted in the Culhane & White article. Part III explores the extent to which statutory provisions associated with the means test may guide judicial determinations of debt-paying ability.

## II. THE MEANS TEST AS A PRESUMPTION OF ABILITY TO REPAY DEBT

The key to understanding the proper role of the means test in Chapter 7 is to recognize that it is simply a mechanism for generating a presumption; it does not result in any final determination. Although the means test itself is complex, its function as a presumption is clear from the interaction of five provisions of section 707(b):

- Paragraph (b)(1) provides that a court may deny Chapter 7 relief "if it finds that the granting of relief would be an abuse of the provisions of this chapter."<sup>11</sup>

- Subparagraph (b)(2)(A) sets out the means test, which calculates an amount of income that a debtor may have available to pay debts that are neither secured by liens on the debtor's property nor given a special priority by the Bankruptcy Code.<sup>12</sup> This available-for-ordinary-debt-payment amount can be called "disposable" income, because it is the income not needed for living expenses and payment of secured and priority debts.<sup>13</sup> Put another way, disposable income equates to "ability to pay" unsecured debt. The means test calculates disposable income by subtracting specified allowances for living

---

9. Marianne B. Culhane & Michaela M. White, *Catching Can-Pay Debtors: Is the Means Test the Only Way?*, 13 AM. BANKR. INST. L. REV. 665 (2005).

10. *Id.* at 666, 687.

11. 11 U.S.C. § 707(b)(1).

12. *Id.* § 707(b)(2)(A).

13. *Cf. id.* § 1325(b)(2) (providing a similar definition of "disposable income" for use in Chapter 13).

expenses and payments of secured and priority claims from the debtor's defined "current monthly income."<sup>14</sup>

- Clause (b)(2)(A)(i) provides that "the court shall presume abuse exists" if the debtor's monthly disposable income calculated under the means test is either (1) greater than \$166.66 or (2) at least \$100 and sufficient to pay 25% of the debtor's nonpriority unsecured claims in 60 months.<sup>15</sup> These amounts of monthly disposable income can be referred to as the "abuse threshold," since a debtor who has disposable income at or above these amounts is presumed to be abusing Chapter 7.

- Subparagraph (b)(2)(B) provides for the only possible rebuttal of the means test's presumption of abuse: the debtor must show "special circumstances that justify additional expenses or adjustments of current monthly income" that would cause the debtor's monthly disposable income to fall below the abuse threshold.<sup>16</sup>

- Paragraph (b)(3) provides in full:

In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter in a case in which the presumption in subparagraph (A)(i) of such paragraph does not arise or is rebutted, the court shall consider —

(A) whether the debtor filed the petition in bad faith; or

(B) the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse.<sup>17</sup>

From these provisions, it is evident that the means test operates as a classic presumption, that is, a rule providing that proof of one fact (the "foundational" fact) is effective to establish another fact (the "presumed" fact).<sup>18</sup> For example, in one common presumption, the foundational fact that a child is born to a woman while she is married gives rise to a presumed fact that her husband is the biological father.<sup>19</sup> In the means test presumption, the founda-

---

14. *See id.* § 101(10A) (defining "current monthly income" as the monthly average of income that the debtor receives from all sources, derived in the six calendar months prior to filing bankruptcy).

15. *Id.* § 707(b)(2)(A)(i)(I)-(II).

16. *Id.* § 707(b)(2)(B)(i).

17. *Id.* § 707(b)(3).

18. ROGER C. PARK, DAVID P. LEONARD & STEVEN H. GOLDBERG, EVIDENCE LAW § 4.08, at 106-07 (2004); *see also* JOHN W. STRONG, MCCORMICK ON EVIDENCE § 342 (5th ed. 2003) (providing a similar explanation of presumptions).

19. *See* STRONG, *supra* note 18, at § 343; *see, e.g.*, 750 ILL. COMP. STAT. 45/5(a)(1) (2005).

tional fact is the amount of monthly disposable income calculated under the means test; the presumed fact is that the debtor actually has disposable income in the calculated amount.

Just as husbands can rebut a presumption of paternity by introducing evidence (such as a genetic test) demonstrating that they did not father children born during their marriages,<sup>20</sup> so Chapter 7 debtors can rebut the amount of disposable income calculated under the means test. This rebuttal requires a demonstration that their actual disposable income is less than that amount either because the means test measured income at a level inaccurately high or because it measured deductions for living expenses and payments of secured and priority debt at levels inaccurately low.

And as with the presumption of paternity, the means test is not infallible. As noted above, the means test measures income by averaging the debtor's income during the six months before the debtor filed bankruptcy.<sup>21</sup> Therefore, if a debtor's income has been permanently reduced shortly before filing, the six-month average income will be higher than what the debtor actually has available.<sup>22</sup> And whenever the means test has a fixed allowance for a given expense, that allowance has the potential to be lower than what the debtor actually needs for reasonable support.

Thus, the provision for rebutting the means test calculation in section 707(b)(2)(B) addresses the very real possibility that this calculation may not accurately measure the debtor's disposable income. It also brings into play Rule 301 of the Federal Rules of Evidence, which provides that in the absence of some contrary statute or rule:

a presumption imposes on the party against whom it is directed the burden of going forward with evidence to rebut or meet the presumption, but does not shift to such party the burden of proof in the sense of the risk of nonpersuasion, which remains throughout the trial upon the party on whom it was originally cast.<sup>23</sup>

Under this rule, if a debtor contests a means test presumption of disposable income by introducing the type of evidence required by section 707(b)(2)(B), showing lower total income or higher necessary deductions, the burden of going forward shifts to the party moving for relief under section 707(b)(1). The burdened party must show actual disposable income at or above the abuse threshold. In such a situation, the judge hearing the contested motion, independent of the means test measurements, determines the total

---

20. *See, e.g.*, 750 ILL. COMP. STAT. 45/5(b) (providing for rebuttal of the marital paternity presumption by clear and convincing evidence).

21. *See* 11 U.S.C. § 101(10A).

22. *See* Wedoff, *supra* note 8, at 248-51 (giving examples of situations in which the defined "current monthly income" differs greatly from actually available income).

23. FED. R. EVID. 301.

income actually available to the debtor as well as the expenditures the debtor must actually make to provide for reasonable support and pay secured and priority debts.

The function of the means test as a presumption has one final critical feature. A presumption is merely one method of establishing a fact. Where a presumption does not arise, a party may prove the necessary fact directly, using the same type of evidence that could be used to rebut the presumption. Returning to the prior example, an unmarried mother without a presumption as to the paternity of her child may still establish paternity with the results of a genetic test or other probative evidence. Similarly, a party asserting abuse under section 707(b)(1) may prove that the debtor's actual disposable income is at or above the abuse threshold, even if the means test presumption does not arise, using the same type of evidence that would be presented if the debtor sought to show that the means test presumption was inaccurate.

So, for example, a debtor subject to a means test presumption might try to rebut it by showing housing expenses higher than the means test allows: special assessments on a condominium, perhaps, or unusually high property taxes.<sup>24</sup> Conversely, a movant seeking to establish that the debtor's actual disposable income exceeds the abuse threshold might introduce evidence that the debtor owned a home in a community with very low property taxes, so that the debtor's actual home ownership expense was less than the means test allowance. In either situation, the court would determine the debtor's actual housing expenses, using the same kind of evidence under the same judicially determined standards.

Far from rejecting this conclusion, the language of section 707(b) compels it. There is no provision in section 707(b) stating that the means test is the only way to establish the debtor's disposable income. To the contrary, section 707(b)(3) explicitly states that in the absence of the means test presumption, "the court shall consider . . . whether . . . the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse."<sup>25</sup> Given that the means test is directed at measuring debt-paying ability as a presumption, this direction confirms that where the presumption does not arise, the debtor's actual debt-paying ability must be assessed in ruling on a motion under section 707(b)(1).

---

24. The means test uses housing allowances specified by the Internal Revenue Service as part of its Collection Financial Standards for collecting delinquent taxes. The housing allowance is based on a county-wide average and does not take into consideration the fact that costs in individual communities (or condominium developments) may vary greatly from the county average. *See* Wedoff, *supra* note 8, at 259-60 (discussing anomalies caused by county-wide averaging).

25. 11 U.S.C. § 707(b)(3).

### III. ARGUMENTS FOR MEANS TEST EXCLUSIVITY

The Culhane & White article makes four arguments in support of its conclusion that the means test is the only way by which debt-paying ability can lead to a denial of Chapter 7 relief under section 707(b). None of these arguments detracts from the principles set out above.

#### *A. The language of section 707(b): The specific governs the general?*

Culhane & White's first argument focuses on section 707(b) itself, asserting that if "judges are free under section 707(b)(3) to substitute their own can-pay standards for Congress'[s] means test," the means test would be rendered "superfluous."<sup>26</sup> This, the argument proposes, would violate the principle of statutory construction that "the specific governs the general."<sup>27</sup> Similarly, the article proposes that the means test is a "rule" that Congress used to replace a former "standard" regarding ability to pay.<sup>28</sup>

These arguments ignore the role of the means test as a presumption. Specific statutory provisions only replace general ones if the two are in conflict,<sup>29</sup> but there is no conflict between the means test's calculation of presumptive disposable income and a judicial calculation of actual disposable income. To the contrary, section 707(b)(2)(B) requires such a determination if the debtor seeks to rebut the means test presumption, and section 707(b)(3) requires a judicial review of "the totality of the circumstances" of the debtor's financial situation in cases where the presumption does not arise.

The actual language of section 707(b)(3) is particularly instructive. As the Culhane & White article recognizes, this language is drawn from case law interpreting pre-BAPCPA section 707(b), which allowed dismissal of a Chapter 7 case for undefined "substantial abuse."<sup>30</sup> The article also acknowledges that when this case law examined the "totality of the circumstances" to determine substantial abuse, the debtor's ability to repay debt from disposable income was very important, if not dispositive.<sup>31</sup> Accordingly, the phrase "to-

---

26. Culhane & White, *supra* note 9, at 680.

27. *Id.*

28. *Id.* at 679.

29. *See* Dorr, Cooper & Hays v. Wyle (*In re* Pacific Far East Line, Inc.), 644 F.2d 1290, 1293 (9th Cir. 1981) ("The construction principle that specific provisions prevail over general gains a foothold only when there is some kind of conflict between the general and specific statutory provisions.") (citation omitted).

30. Culhane & White, *supra* note 9, at 686-87.

31. *Id.* at 686 & n.101. *See, e.g.*, Kornfeld v. Schwartz (*In re* Kornfeld), 164 F.3d 778, 781 (2d Cir. 1999):

The Code does not define substantial abuse, and our decisions have not elaborated on its meaning. Other courts have generally adopted a "totality of circumstances test" that seeks to ascertain whether the debtor is attempting to obtain an inequitable discharge at the expense of his or her

tality of the circumstances . . . of the debtor's financial situation" in section 707(b)(3) necessarily includes the extent of the debtor's disposable income, one of the most significant aspects of any individual's financial situation and one on which the relevant case law had particularly focused.<sup>32</sup>

The means test, then, does not replace judicial assessment of disposable income. Rather, it sets out a rule for determining disposable income that is only presumptively applicable. When the results of that rule are challenged, either by a debtor under section 707(b)(2) or a creditor under section 707(b)(3), the court is required to make a determination of actual disposable income under judicially defined standards.

### *B. Context of Section 707(b): Consistency with Chapter 13?*

As noted above, disposable income is a concept used in Chapter 13 as well as in the means test.<sup>33</sup> Section 1325(b)(1)(B) allows a party with standing to demand that a Chapter 13 debtor propose a plan that applies all of the debtor's "projected disposable income" received in an "applicable commitment period" to unsecured debts.<sup>34</sup> For this purpose, "disposable income" is defined as "current monthly income" adjusted for deductions in "amounts reasonably necessary to be expended" for support, charitable contributions, and business expenses.<sup>35</sup> Finally, section 1325(b)(3) provides that for debtors whose current monthly income exceeds defined state medians, "[a]mounts

---

creditors. However, a division among courts exists over the degree of emphasis to be placed upon the ability of the debtor to repay debts out of future income. Some courts view this factor as dispositive. Others use a broader, multi-factored test in conducting the substantial abuse inquiry but still consider ability to pay an important factor.

(citations omitted).

32. The Culhane & White article does not appear to propose any alternative definition of "totality of the circumstances . . . of the debtor's financial situation." At one point, it states that the phrase "must be read as limited to serious debtor misconduct." Culhane & White, *supra* note 9, at 666. At another, it suggests that the phrase "should encompass debtor actions . . . not illegal or necessarily dishonest [but] nonetheless manifestly unreasonable under the debtor's circumstances." *Id.* at 687. Neither of these suggestions is supported by any textual analysis, and — wholly apart from the contrary case law — it is difficult to see how the broad language of the "totality of the circumstances" bearing on a debtor's financial situation can be read as addressing only certain debtor misconduct. Indeed, because § 707(b)(3) sets out "bad faith" as a ground for finding abuse separate from the "totality of the [debtor's financial] circumstances," it strongly suggests that debtor misconduct of any kind should be treated under the "bad faith" rubric, leaving the "totality of the circumstances" to address the debtor's financial status — most prominently including disposable income. 11 U.S.C. § 707(b)(3) (Supp. V 2005).

33. See Culhane & White, *supra* note 9, at 666.

34. See 11 U.S.C. § 1325(b)(1)(B).

35. *Id.* § 1325(b)(2).

reasonably necessary to be expended under paragraph (2) shall be determined in accordance with subparagraphs (A) and (B) of section 707(b)(2)” — that is, the means test, without the provision for judicial determination of abuse in consideration of the totality of the debtor’s financial circumstances.<sup>36</sup>

The Culhane & White article sees these Chapter 13 provisions as an indication that the means test is the sole method for determining disposable income:

[E]ven if judge-made ability-to-pay tests were used to push debtors identified as “can-pays” into chapter 13, those with higher incomes would not have to pay more into the plan than the means test mandates. . . . Once again, Congress demonstrated a determination to replace judicial discretion under general standards with precise rules-based calculations.<sup>37</sup>

Even as to Chapter 13 debtors whose current monthly income exceeds the applicable median, this argument has difficulties. First, many of these debtors may be ineligible for Chapter 13, under the debt limits imposed by section 109(e).<sup>38</sup> Second, as the Culhane & White article acknowledges, there is at least some possibility that judges might use the “good faith” requirement of section 1325(a)(3) to require debtors to contribute their actual disposable income to plan payments, even when a lower disposable income is calculated under the means test.<sup>39</sup> Third, Chapter 13 allows parties in interest to seek post-confirmation modification of a debtor’s plan to increase plan payments.<sup>40</sup> Motions for modification would likely be based on the disposable income that the debtor actually has available for plan contributions, determined under judicially defined standards.<sup>41</sup>

But there is a more fundamental reason why section 1325(b)(3) cannot be seen as evidence of a “Congressional determination to replace judicial discretion” with the means test. Section 1325(b)(3) only determines dispos-

---

36. *Id.* § 1325(b)(3).

37. Culhane & White, *supra* note 9, at 682.

38. 11 U.S.C. § 109(e) (2000) (currently setting an unsecured debt limit of \$307,675 and a secured debt limit of \$922,975 for Chapter 13 eligibility).

39. Culhane and White, *supra* note 9, at 682.

40. *See* 11 U.S.C. § 1329(a)(1).

41. *See* Powers v. Savage (*In re* Powers), 202 B.R. 618, 622 (B.A.P. 9th Cir. 1996) (affirming modification of plan to increase payments, and holding that under § 1329(a)(1), “the circumstances of the debtor’s changed financial situation can . . . be considered in exercise of the court’s discretion”). Modification based on increases in debtors’ income is facilitated by the requirement that debtors file annual budgets and tax return information throughout the “applicable commitment period” — five years for debtor whose current monthly income exceeds the minimum. *See* 11 U.S.C. § 521(f) (Supp. V 2005) (filing of postpetition tax returns); *id.* § 1325(b)(4)(A)(ii) (five year commitment period).

able income for Chapter 13 debtors whose current monthly income is above the median. For all others — likely the substantial majority — section 1325(b)(2) continues to require determination of “amounts reasonably necessary to be expended” under judicial standards; the means test deductions are not employed.<sup>42</sup> Individual Chapter 11 cases have a similar “disposable income” requirement under BAPCPA,<sup>43</sup> but again there is no provision in Chapter 11 for use of means test deductions in determining disposable income.<sup>44</sup>

Section 1325(b)(3), then, is no indication of any general Congressional intent to use the means test as a replacement for the determination of disposable income under judicially determined standards.

*C. The legislative history: A need to remove judicial discretion in determining disposable income?*

The Culhane & White article asserts that “legislative history” supports “the view that the means test is now the exclusive ‘ability to pay’ test.”<sup>45</sup> The only actual legislative history cited in the article, however, is the House Report on BAPCPA.<sup>46</sup> That report, as quoted in the article, complains of the “inherently vague” standard of “substantial abuse” contained in the pre-BAPCPA version of section 707(b).<sup>47</sup> The report does not contend that this vagueness led courts to make unreasonable determinations of disposable income (debt-paying ability), but rather that it led to uncertainty as to whether debt-paying ability was even a basis for dismissal:

The standard for dismissal — substantial abuse — is inherently vague, which has led to its disparate interpretation and application

---

42. See 11 U.S.C. § 1325(b)(2). Data showing that most Chapter 13 debtors will have incomes below the median is set out in Scott F. Norberg, *Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13*, 7 AM. BANKR. INST. L. REV. 415, 461 (1999) (reporting that in a studied sample of Chapter 13 cases, the debtors “generally had incomes that were much lower than the national and regional populations”).

43. See 11 U.S.C. § 1129(a)(15) (providing a five-year period for disposable income contributions to an individual Chapter 11 plan).

44. See Henry J. Sommer, *Trying to Make Sense Out of Nonsense: Representing Consumers Under the “Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,”* 79 AM. BANKR. L.J. 191, 224 n.179 (2005) (“[B]ecause new § 1129(a)(15) incorporates only § 1325(b)(2) and not § 1325(b)(3), it does not appear that § 1325(b)(3) would be applicable in Chapter 11 cases, even though most individual Chapter 11 debtors will have incomes above the applicable state median income.”).

45. Culhane & White, *supra* note 9, at 667, 678.

46. *Id.* at 678.

47. H.R. REP. NO. 109-31, pt. 1, at 12 (2005), as reprinted in 2005 U.S.C.C.A.N. 88, 98.

by the bankruptcy bench. Some courts, for example, hold that a debtor's ability to repay a significant portion of his or her debts out of future income constitutes substantial abuse and therefore is cause for dismissal; others do not.<sup>48</sup>

The Culhane & White article otherwise cites only scholarly articles dealing with section 707(b) or means-testing and a transcribed debate involving George Wallace, an attorney for the American Financial Services Association, an organization that lobbied for BAPCPA.<sup>49</sup> Mr. Wallace's statements are not legislative history.<sup>50</sup> Ironically, his remarks about means testing recognized a need for "something that is both a bright-line test and something that provides sufficient flexibility for the hard case."<sup>51</sup> This is an apt description of a means test that operates as a presumption, but allows for individualized judicial determinations of abuse when the presumption is inaccurate.

Certainly, no legislative history indicates that BAPCPA was intended to employ judicial determination of abuse under section 707(b) as a sort of pro-debtor ratchet, loosening the means test when its calculation of disposable income is inaccurately high but unable to tighten it when the calculation is too low.

#### D. *Bankruptcy policy: A need to protect special interests?*

The Culhane & White article lists a number of aspects of the means test that can be seen as advancing the goals of particular interest groups. For example, benefits under the Social Security Act are omitted from calculations of "current monthly income."<sup>52</sup> The article attributes this omission to a Congressional policy of "protect[ing] retirement benefits at the expense of creditors."<sup>53</sup> Similarly, the article characterizes the means test's deduction for all postpetition payments on secured debt, with no reasonableness limitation, as a feature that "bought the support of home mortgage lenders."<sup>54</sup> And the article sets out a list of additional deductions — for health savings accounts, care of invalid relatives, and private school tuition — that it contends "advance policies far different from maximum repayment of unsecured creditors."<sup>55</sup> The

---

48. *Id.* (footnotes omitted).

49. *Resolved: The Time Has Come for Means Testing Consumer Bankruptcy — A Debate (Excerpts)*, 17 AM. BANKR. INST. J. 6 (Apr. 1998) [hereinafter *Resolved*].

50. *Cf. In re Virtual Network Servs. Corp.*, 98 B.R. 343, 346 (N.D. Ill. 1989) (cautioning against any use of legislative history that might encourage "lobbyists to smuggle their views into the extrinsic materials in the hope that one day a court will elevate them to the status of law").

51. *Resolved*, *supra* note 49, at 46 (comment of George Wallace).

52. Culhane & White, *supra* note 9, at 674.

53. *Id.* (omission in original) (footnote omitted).

54. *Id.* at 676.

55. *Id.* at 676-77.

article argues that these perceived policy decisions require that the means test be the only measure of disposable income in Chapter 7: “On these points, the mostly mechanical means test overrules prior ability to pay and disposable income case law. Congress surely did not intend to let each bankruptcy judge’s idiosyncratic views on whether a given debtor could ‘easily . . . repay his debts’ undo these decisions.”<sup>56</sup>

The means test may indeed imply Congressional policy decisions about disposable income but any such implication simply requires judges to take the implied policy decisions into consideration when they are relevant. This is true both in determining disposable income for Chapter 11 debtors and Chapter 13 debtors whose current monthly income is not above the median and in determining whether debtors who avoid the means test presumption are nevertheless abusing Chapter 7. The next part of this article considers the implications of the means test for such determinations. Judges can certainly honor any Congressional policy implicit in the means test without making the test a conclusive measure of disposable income below the abuse threshold.

#### IV. GUIDANCE FROM THE MEANS TEST ON NON-PRESUMPTIVE ABUSE

When judges assess the totality of a debtor’s financial circumstances under section 707(b)(3) for the purpose of determining whether the debtor is abusing Chapter 7, they will not be exploring a wilderness. As noted above, “totality of the circumstances” is itself a judicial construct for determining “substantial abuse” under pre-BAPCPA section 707(b), and the case law applying that construct lays out the general scope of the abuse to be determined.<sup>57</sup> The case law interpreting “disposable income” in Chapter 13 — an issue since 1984 — provides another source of helpful precedent.<sup>58</sup> But the detailed provisions of the means test also provide guidance in assessing the ability to pay that BAPCPA treats as abuse. Each element of the means test — its threshold of abuse, its assessment of “current monthly income,” its allowed deductions, and even its treatment of exempt property — can be examined for potential policy indications.

##### *A. The abuse threshold*

The clearest guidance concerns how much disposable income should lead to a finding of abuse. The abuse threshold set out in section 707(b)(2)(A)(i) is irrebuttable. Section 707(b)(2)(B) only allows a debtor to rebut the means test’s calculation of disposable income in an amount above

---

56. *Id.* at 667.

57. See *supra* note 32 and accompanying text.

58. The relevant case law is collected and discussed in KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY §§ 163.1-167.1 (3d ed. 2004).

the abuse threshold; it does not allow any argument that the threshold itself is too low.<sup>59</sup> Disposable income of more than \$166.66 per month, or disposable income of at least \$100 per month, sufficient to pay 25% of the debtor's non-priority unsecured debt in 5 years, is always an abuse requiring a denial of Chapter 7 relief.<sup>60</sup> Since the abuse threshold cannot be challenged through the means test, there is a clear policy judgment that the threshold fixes the level at which debt-paying ability becomes abusive of Chapter 7. When judges are required to make determinations of abuse under section 707(b)(3), they should accordingly use the means test threshold: if a debtor's actual disposable income, as determined by the court, falls below that threshold, there should be no finding of abuse based on debt-paying ability; if disposable income meets or exceeds the threshold, abuse should be found.

### B. "Current monthly income"

Just as the abuse threshold is the feature of the means test presumption that most clearly should be incorporated into judicial determinations of non-presumptive abuse, "current monthly income" is the feature that most clearly should not be. When the court is determining the income that a debtor actually has available to pay nonpriority unsecured debt, it would be absurd to start with a total income figure that does not reflect the debtor's actual total income. Although an average of the debtor's income during the six months before bankruptcy can serve as a rough approximation of actual monthly income for purposes of the means test presumption, plainly it will not be accurate in many situations.<sup>61</sup> Under section 707(b)(2)(B) debtors can rebut the presumption of an inaccurately high "current monthly income" by showing their actual monthly income during the bankruptcy case.<sup>62</sup> Judges assessing actual debt-paying ability under section 707(b)(3) should likewise begin with an assessment of the debtor's actual monthly income. So, for example, when a debtor obtains new permanent employment shortly before filing bankruptcy, the salary of the new job — not average earnings during the prior six months — will be the relevant consideration.

A separate consideration is whether income items excluded from the definition of current monthly income in section 101(10A) — most notably benefits under the Social Security Act — should be omitted from the actual income assessed under section 707(b)(3). It can be argued that the exclusion of Social Security Act benefits reflects a policy of protecting retirement in-

---

59. 11 U.S.C. § 707(b)(2)(B) (Supp. V 2005).

60. *See id.* § 707(b). However, the dollar amounts in § 707(b) are subject to periodic adjustment for inflation under 11 U.S.C. § 104(b)(1); therefore, the abuse threshold will likely rise over time. *See id.* § 104(b)(1).

61. *See supra*, note 22.

62. 11 U.S.C. § 707(b)(2)(B).

come from creditors.<sup>63</sup> On the other hand, when a court makes a determination of actual disposable income, the special needs of retired persons can be dealt with appropriately by allowing increased deductions from income for food, health care, housing, transportation and other items potentially affected by age or disability. The means test's exclusion of Social Security Act benefits may well have served as a proxy for this sort of individualized determination of the needs of retirees, and be inappropriate in a determination of actual disposable income. Social Security Act benefits are certainly part of the "totality" of the debtor's financial circumstances, and these benefits are available for paying expenses (and unsecured nonpriority debt) just as much as other income. The plain meaning of section 707(b)(3), thus, should be applied, requiring that Social Security Act benefits be considered in gauging non-presumptive abuse.

### *C. Allowed deductions*

Turning from income to deductions, it is notable that most of the living expense deductions specified by the means test are limited to amounts "reasonable and necessary." These include expenses in the "other necessary expense" categories listed by the Internal Revenue Service, allowed as deductions by section 707(b)(2)(A)(ii)(I),<sup>64</sup> as well as the special statutory deductions allowed by section 707(b)(2)(A)(ii)(I)-(V) in addition to the IRS deductions.<sup>65</sup> The "reasonable and necessary" limitation on these allowances permits the exercise of judicial discretion even when the allowances are used in the means test. This discretion would apply similarly in determining abuse under section 707(b)(3) when the calculations resulting from the means test analysis do not invoke a presumption of abuse. Nevertheless, the inclusion of expenses in these categories as allowable deductions in the means test does have at least one effect on the non-presumptive determination: expenses in each of the categories must be recognized as at least potentially reasonable. Thus, a court could not conclude that contributions to health savings accounts are never necessary expenses, since "reasonably necessary" expenses of this kind are specifically allowed as deductions in section 707(b)(2)(A)(ii)(I). On the other hand, where the statute limits the amount of the deduction for purposes of the means test — as in the annual limit of \$1,500 per minor child for private elementary or secondary school — a court could find that a higher expenditure was reasonably necessary, both in determining actual disposable income under section 707(b)(3) or in rebutting a means test presumption under section 707(b)(2)(B).

A more significant issue arises in connection with deductions for living expenses that the means test allows in fixed amounts. Under sec-

---

63. See Culhane & White, *supra* note 9, at 674.

64. See Wedoff, *supra* note 8, at 261-64.

65. See *id.* at 264-71.

tion 707(b)(2)(A)(ii)(I), the means test allows deductions for food, clothing, housekeeping supplies, personal care, and miscellaneous expenses in a lump sum fixed by the “National Standards” of the IRS.<sup>66</sup> Deductions for housing and transportation are similarly allowed in amounts fixed by the IRS’s “Local Standards.”<sup>67</sup> Because these amounts do not vary with the debtor’s actual needs, the means test’s allowances for these expenses may well be inaccurate as applied in a given case.<sup>68</sup> Judges would not be bound to accept them, either in means test rebuttals or non-presumptive determinations of abuse.

Perhaps the most debatable aspect of the means test deductions is the unlimited deduction for current secured debt payments. As set out in section 707(b)(2)(A)(iii)(I), the means test provides a deduction for 1/60th of “the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition.”<sup>69</sup> This allowance is not subject to any “reasonable and necessary” limitation, and so, for purposes of the means test, debtors may deduct debt secured by vacation homes, pleasure boats, and other items manifestly not necessary for support. Debtors may even deduct the entire amount of a balloon mortgage, divided by 60, as long as the mortgage becomes due in the five years following bankruptcy.

As with the exclusion of Social Security Act benefits from current monthly income, it can be argued that this secured debt deduction reflects a general policy of BAPCPA — here, a policy favoring secured creditors over unsecured — so that in assessing the totality of the debtor’s financial circumstances, a court should allow the full deduction for secured debt payments that the means test specifies.<sup>70</sup> However, as with its treatment of Social Security Act benefits, the means test’s secured debt deduction is better understood as a proxy for more individualized determinations. Certainly, the means test evidences no policy that all secured obligations be repaid rather than enforced through repossession or foreclosure. To the contrary, if a debtor is in default, the means test allows a deduction for cure payments needed to retain the collateral only if the collateral is reasonably necessary for support of the debtor or the debtor’s dependents.<sup>71</sup> Thus, the means test appears to use current payment status as a rough measure of the debtor’s need for particular collateral, reflecting a judgment that debtors are less likely to default on loans secured by collateral necessary for their support. When an individualized determination of the totality of a debtor’s financial circumstances is conducted,

---

66. *See id.* at 253-55.

67. *See id.* at 255-61.

68. *See, e.g., supra* note 24 and accompanying text (discussing the potential variances in housing costs).

69. 11 U.S.C. § 707(b)(2)(A)(iii)(I) (Supp. V 2005).

70. *See Culhane & White, supra* note 9, at 674.

71. *See* 11 U.S.C. § 707(b)(2)(A)(iii)(II).

such presumptions are not appropriate, and the debtor's real need for collateral—whether or not the loan is in default—can properly be considered.

#### *D. Exempt property*

The means test says nothing about the extent of a debtor's property, exempt or non-exempt. In determining presumptive disposable income, however, the means test's starting point, current monthly income, includes income "from all sources . . . without regard to whether such income is taxable."<sup>72</sup> Thus, the means test requires inclusion of income received from any number of exempt sources, such as retirement accounts and life insurance proceeds.<sup>73</sup> This is in keeping with pre-BAPCPA case law, which considered exempt income in determining "substantial abuse."<sup>74</sup>

Consistent with the means test, a court determining actual disposable income based on the "totality of the circumstances" may take into account the extent of a debtor's exempt property in determining the actual expenses that the debtor is required to incur. For example, the expenses a debtor incurs for transportation can vary depending on the extent to which the debtor's automobile is exempt. If a debtor owns a valuable, lien-free automobile that can be fully exempted in bankruptcy, it is unlikely that the debtor will need to incur any vehicle acquisition costs for the period after a bankruptcy filing, eliminating an expense allowed in the means test.<sup>75</sup> However, if the automobile cannot be exempted, it will likely be sold by a Chapter 7 trustee, thus avoiding any concern that the debtor's ownership of the vehicle is an abuse of Chapter 7 and justifying a deduction for vehicle acquisition expenses in calculating actual disposable income. Pre-BAPCPA case law recognized the reality that the extent of the debtors' exempt property can bear on their debt-

---

72. 11 U.S.C. § 101(10A)(A).

73. Tax-exempt retirement funds are generally exempted from a debtor's bankruptcy estate. *Id.* § 522(a)(3)(C). A debtor's right to receive life insurance proceeds from a former supporter of the debtor is part of a debtor's federal bankruptcy exemptions. *See id.* § 522(d)(11)(C). Section 541(b)(7)(B) provides that contributions made by debtors to certain retirement plans will not constitute current monthly income for purposes of Chapter 13, but this limitation does not apply in Chapter 7, and would not affect distributions from the retirement account in any event. The Culhane & White article appears to misconstrue § 541(b)(7)(B) on this point. *See Culhane & White, supra* note 9, at 690 n.111.

74. *See, e.g., Taylor v. United States (In re Taylor)*, 212 F.3d 395, 397 (8th Cir. 2000) ("The question of whether income from a pension is exempt from creditors is a wholly independent inquiry from the question of whether the pension income is reasonably necessary to support the debtor."); *In re Shields*, 322 B.R. 894, 898 (Bankr. M.D. Fla. 2005) ("Social security benefits, disability benefits, and retirement benefits should be treated as 'income' for purposes of determining whether a debtor has 'disposable income' . . . even though such benefits are exempt from the claims of the debtor's creditors.").

75. *See Wedoff, supra* note 8, at 257-58.

paying ability.<sup>76</sup> There is no policy inherent in the means test that prevents a court from considering the extent of exempt property in making a non-presumptive determination of abuse under section 707(b)(3).

## V. CONCLUSION

Despite his new salary, huge home, and ample retirement accounts, the recently re-employed CEO, hypothesized at the beginning of this article, will pass the means test. However, under section 707(b)(3), he does not thereby evade consideration of his actual disposable income in a determination of his debt-paying ability. If, as is highly likely, his actual disposable income meets or exceeds the abuse threshold, the CEO will either have to pay his debts outside of bankruptcy or obtain a discharge through a payment plan under Chapter 11 or Chapter 13.

In this hypothetical, the means test itself fails to accomplish the goal of its sponsors — requiring debtors who have the means to repay a defined amount of debt to do so. And situations like this hypothetical will arise frequently in actual practice because the means test is not an efficient way to identify likely abuse of Chapter 7. However, BAPCPA did not exacerbate this flaw by making the means test the conclusive means of determining a debtor's debt-paying ability. Rather, the means test is only the starting point in such a determination. When an abuse is asserted under section 707(b)(3) judges are required to determine the debtor's actual financial condition, including debt-paying ability. And so, even when the means test does not presume abuse, genuinely wealthy debtors may be denied Chapter 7 relief.

---

76. See, e.g., *Kornfeld v. Schwartz (In re Kornfeld)*, 164 F.3d 778, 781 (2d Cir. 1999) (“A totality of the circumstances inquiry is equitable in nature and the existence of an asset, even if exempt from creditors, is relevant to a debtor's ability to pay his or her debts.”).