

JUDICIAL DISCRETION AND THE BANKRUPTCY ABUSE PREVENTION ACT

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ABSTRACT

Generally, Chapter 7 bankruptcy is available to only the most desperate individual debtors who do not have the means to pay their creditors back over time. Before 2005, the Bankruptcy Code gave judges discretion to decide which debtors were eligible for Chapter 7. The Bankruptcy Abuse Prevention Act, however, curtails this discretion, mandating that judges use a rigid means test to determine when a debtor is allowed to file. This Note argues that it was a poor decision to foreclose judicial discretion with the means test. It then proposes a compromise between the means test approach and the old standard.

INTRODUCTION

Each year, over one million people file for Chapter 7¹ bankruptcy in hope of relief from outstanding debt.² Chapter 7 is the simplest form of bankruptcy: debtors relinquish their unnecessary assets, and in exchange, they are allowed to walk away from any remaining obligations.³ Most Chapter 7 cases feature down-and-out debtors, who, outside of bankruptcy, would probably never have been able to repay their creditors.⁴ In these typical situations, Chapter 7 works to

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1. 11 U.S.C. §§ 700–785 (2000).
2. H.R. REP. NO. 109-31, pt. 1, at 3–4 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 90.
3. ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE LAW OF DEBTORS AND CREDITORS* 149 (5th ed. 2006).
4. *Id.* at 119 (“[T]he great majority of the bankrupt debtors are overwhelmingly in debt.”).

the benefit of both debtors and creditors. Creditors who were unlikely to be repaid outside of bankruptcy receive at least a portion of their due, and debtors are left alone to get back on their feet. Sometimes, however, debtors ask for an immediate discharge under Chapter 7 even though, outside of bankruptcy, they could pay their creditors back over time.⁵ These situations are very different than the typical ones. Here, creditors lose out because debtors make a conscious choice not to pay what they owe.

Contrast, for instance, the examples of Shirley Nichols and Kim Basinger. Before she became ill, Shirley Nichols was a financially responsible woman who, if anything, worked “entirely too hard.”⁶ In her thirties, however, Shirley unexpectedly fell sick and could not work for fourteen months.⁷ While out of work, she charged medical bills to her credit cards, eventually building thirty thousand dollars of debt.⁸ Although Shirley ultimately recovered and found a new job, she was unable to pay off her debt.⁹ After “agoniz[ing] over [the decision] for a month,” she filed for bankruptcy.¹⁰ “I don’t have another option,” she told reporters.¹¹ While in bankruptcy, Shirley moved into a house with six roommates to cut costs.¹²

In contrast, Kim Basinger’s career began as a model.¹³ By the time she was twenty, she was making one thousand dollars per day.¹⁴ Kim later appeared in hundreds of ads, television shows, and movies.¹⁵ After making *Batman* in 1989 and *The Marrying Man* in 1991, she bought her hometown of Braselton, Georgia, for \$20 million.¹⁶ In 1993, however, Kim backed out of a movie contract with

5. *E.g., In re Lamanna*, 153 F.3d 1, 5 (1st Cir. 1998) (considering the Chapter 7 petition of a debtor with means to pay his creditors back over time).

6. *The News Hour with Jim Lehrer: Bankruptcy Law?* (PBS television broadcast June 8, 1998) (transcript available at http://www.pbs.org/newshour/bb/law/jan-june98/bankrupt_6-8.html).

7. *Id.*

8. *Id.*

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.*

13. The Internet Movie Database, Biography for Kim Basinger, <http://www.imdb.com/name/nm0000107/bio> (last visited Nov. 27, 2007).

14. *Id.*

15. *Id.*

16. *Id.*

her studio.¹⁷ The studio sued her, and a jury found her liable for \$8.9 million.¹⁸ After the judgment, Kim discharged her debt in bankruptcy.¹⁹ Although forced to sell Braselton,²⁰ Kim was soon back on her feet and made \$5 million in 2000 for her movie *I Dreamed of Africa*.²¹

Most agree that the Kim Basingers of the world should not be allowed to escape their debt through Chapter 7 bankruptcy.²² Such individuals do not need bankruptcy protection because they have the ability to pay off their debts over time. Chapter 7 should generally be reserved for debtors who, like Shirley Nichols, are unable to pay their debts outside of bankruptcy and therefore have no other option. The disagreements, then, are about how to decide which debtors are able to pay²³ and about whether there should be any exceptions to the general rule that debtors who can pay over time cannot use Chapter 7 to discharge their debt.²⁴

Before 2005, the Bankruptcy Code left these questions to individual bankruptcy judges.²⁵ Judges determined a debtor's ability to pay under the individual facts and circumstances of each case.²⁶ Even if a debtor was able to pay, judges had discretion to allow the bankruptcy filing if the debt was incurred because of an unexpected emergency, such as a medical tragedy.²⁷ Congress placed almost no

17. Matt Walsh, *Boxing Ameritech*, FORBES, Oct. 10, 1994, at 18.

18. *Id.*

19. *Id.*

20. Biography for Kim Basinger, *supra* note 13.

21. *Id.*

22. Before 2005, in every circuit but one that addressed the issue, ability to pay was the primary factor in deciding whether to dismiss a Chapter 7 petition. *See infra* notes 64–68 and accompanying text.

23. Compare 11 U.S.C. § 707(b) (Supp. V 2005) (measuring ability to pay with an objective means test), with 11 U.S.C. § 707(b) (2000) (leaving the ability to pay determination to the discretion of bankruptcy judges).

24. Compare *In re Green*, 934 F.2d 568, 572 (4th Cir. 1991) (stipulating that although ability to pay is a primary factor, the totality of the circumstances must be considered), with 11 U.S.C. 707(b) (Supp. V 2005) (disallowing any exceptions to the general rule that debtors who can pay over time cannot use Chapter 7).

25. *See generally* Bankruptcy Amendments and Federal Judgeship Act, Pub. L. No. 98-353, 98 Stat. 333 (1984) (codified as amended in scattered sections of 11 and 28 U.S.C.) (leaving discretion to judges).

26. *E.g., In re Kornfield*, 164 F.3d 778, 783 (2d Cir. 1999).

27. *See In re Green*, 934 F.2d at 572 (including sudden injury, illness, and disability as factors to be considered as part of the totality of circumstances for a case).

restrictions on these judicial determinations.²⁸ Although judges generally exercised their discretion in accord with common sense,²⁹ the lack of congressional guidance occasionally allowed for outlier cases like that of Kim Basinger.

Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA)³⁰ in part out of dissatisfaction with bankruptcy judges and in reaction to cases like Basinger's.³¹ The BAPCPA almost completely curtails the discretion judges had under the previous regime. It mandates that judges measure ability to pay using a mechanized objective formula known as the means test³² and severely limits judicial discretion to adjust means test results.³³

This Note argues that it was a poor decision to completely foreclose judicial discretion with the means test. Although judges do need more guidelines than they had prior to 2005, the BAPCPA is too rigid. The situation demands a compromise between the BAPCPA's approach and the old standard. Part I of this Note describes who can file for Chapter 7, noting both what the law used to be and what it is under the BAPCPA. Part II points out the flaws in the new statute and argues that the BAPCPA's means test was a policy mistake. Finally, Part III offers suggestions for change, proposing a compromise between the BAPCPA's formulaic means test and the previous regime. Under this compromise, Congress would issue general guidelines about which debtors qualify for Chapter 7. Past that, Congress would allow judges discretion to

28. Although the Bankruptcy Amendments and Federal Judgeship Act set "substantial abuse" as the standard for refusing bankruptcy protection, the statute failed to define "substantial abuse." *Id.* at 570–71; *In re Balaja*, 190 B.R. 335, 337 (Bankr. N.D. Ill. 1996); *In re Heller*, 160 B.R. 655, 657 (Bankr. D. Kan. 1993).

29. See ELIZABETH WARREN & AMELIA WARREN TYAGI, *THE TWO INCOME TRAP: WHY MIDDLE CLASS MOTHERS AND FATHERS ARE GOING BROKE* 81 (2003) (emphasizing that most Chapter 7 bankruptcies during the 1980s and 1990s were filed by families under pressure because of medical costs, job loss, or divorce).

30. Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. No. 109-8, 119 Stat. 23 (2005).

31. Credit industry lobbyists, Jeff Tassej among them, argued that judicial discretion was not a sufficient barrier to bankruptcy abuse. Tassej said of bankruptcy judges, "They're part of the . . . problem. . . . They're not real judges . . ." Peter G. Gosselin, *Judges Say Overhaul Would Weaken Bankruptcy System*, L.A. TIMES, Mar. 29, 2005, at A1.

32. 11 U.S.C. § 707(b) (Supp. V 2005) (establishing the means test).

33. *Id.* § 707(b)(2)(A)(i)–(b)(3) (limiting the situations in which judges have discretion to allow a bankruptcy petition for a debtor who fails the means test).

distinguish between those debtors who need Chapter 7 and those who are abusing the bankruptcy system.

I. THE HISTORY OF CHAPTER 7

Traditionally, individual debtors have had two bankruptcy options: Chapter 13 and Chapter 7.³⁴ Both options potentially enable debtors to discharge a portion of their debt.³⁵ The primary difference between Chapter 13 and Chapter 7 is that in Chapter 13, debtors promise to make partial payments out of their future income but keep their present assets, whereas in Chapter 7, debtors surrender their present assets in return for a fresh start going forward.³⁶

In Chapter 13, debtors promise to turn over a portion of their future income for at least three years under a wage earner's plan.³⁷ The portion of monthly income that debtors are required to pay is based on what they can afford, given their income and reasonable expenses.³⁸ Money that debtors turn over under the plan is then used to recompense their creditors in order of priority.³⁹ After they complete a wage earner's plan, debtors are no longer liable for their remaining debt.⁴⁰ Debtors who owe over a certain dollar limit, however, are ineligible to file for Chapter 13.⁴¹

Alternatively, debtors may elect to pursue an immediate discharge of their debt under Chapter 7. Chapter 7 is intended to give the "honest but unfortunate" debtor an opportunity for a fresh start.⁴²

34. WARREN & WESTBROOK, *supra* note 3, at 281.

35. *See id.* (noting both that Chapter 7 debtors can freeze immediate assets and get relief from certain future obligations and that Chapter 13 debtors pay future income up to an agreed payout amount and subsequently get relief from their remaining obligations).

36. *Compare* 11 U.S.C. § 1306(b) (2000) ("Except as provided in a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate."), *with* 11 U.S.C. § 726(a) (Supp. V 2005) (outlining priority for distribution of present assets).

37. 11 U.S.C. § 1322 (2000) (specifying the contents of a wage earner's plan).

38. *Id.* § 1325(b)(1)–(2) (requiring that all "projected disposable income" be distributed to unsecured creditors under the plan and defining "disposable income" as current monthly income "less amounts reasonably necessary to be expended" for certain purposes).

39. *Id.* § 1322(a)(2) (providing for the full payment of all claims entitled to priority).

40. *Id.* § 1328(a) (stating that no discharge will be granted until all payments under the plan have been made).

41. *Id.* § 109(e).

42. *In re Johnson*, 318 B.R. 907, 919–20 (Bankr. N.D. Ga. 2005) ("The most fundamental goal of the bankruptcy code is to relieve an 'honest but unfortunate debtor' of his indebtedness, allowing him to make a 'fresh start.'"); *In re Reynolds*, 193 B.R. 195, 200 (Bankr. D.N.J. 1996) (noting that the Bankruptcy Code's "overriding purpose" is to afford "honest but unfortunate"

The fresh start has a long tradition in American bankruptcy law,⁴³ and it has been available to certain American debtors since the enactment of the first permanent Bankruptcy Act in 1898.⁴⁴ Without it, people who never expected or intended to incur debt might be forced to spend their lives working to pay their creditors, never able to take home their own pay.⁴⁵ At committee hearings on the BAPCPA, Senator Kennedy of Massachusetts explained the tradition of a fresh start in American bankruptcy law:

In 1833, Supreme Court Justice Joseph Story . . . explained . . . that bankruptcy laws were intended to . . . relieve unfortunate and honest debtors from perpetual bondage to their creditors. He said that bankruptcy legislation should relieve the debtor from a slavery of mind and body which robs his family of the fruits of his labor.

One hundred years later, the Supreme Court emphasized Justice Story's views . . . The power to earn a living, the Court said, is a "personal liberty," and:

from the viewpoint of the wage-earner there is little difference between not earning at all and earning wholly for a creditor.

In short, the same fundamental values which led this Nation to abolish debtors' prisons, also led us to offer debtors a fresh start.⁴⁶

Under Chapter 7, a fresh start is available only to those debtors willing to relinquish all of their nonexempt assets.⁴⁷ Chapter 7 debtors may keep only their exempt assets, which generally cover basic needs like clothing and shelter.⁴⁸ The relinquished assets are liquidated, and the proceeds are distributed to creditors on a priority basis.⁴⁹ After

debtors a "fresh start"); *see also In re Bammer*, 112 F.3d 1355, 1357 (9th Cir. 1997) ("The Bankruptcy Code is 'designed to afford debtors a fresh start . . .'"), *withdrawn*, 131 F.3d 788 (9th Cir. 1997).

43. 151 CONG. REC. S1836 (daily ed. Mar. 1, 2005) (statement of Sen. Kennedy).

44. H.R. REP. NO. 109-31, pt. 1, at 10-11 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 97.

45. 151 CONG. REC. S1836 (daily ed. Mar. 1, 2005) (statement of Sen. Kennedy).

46. *Id.*

47. 11 U.S.C. § 726 (Supp. V. 2005) (providing for the distribution of all of the nonexempt assets as property of the estate).

48. *See id.* § 707(b)(2)(A)(ii) (listing assets included in "expenses" and therefore exempt from creditors).

49. *Id.* § 726.

this distribution, debtors are no longer liable for the remaining debt.⁵⁰ “[They] can get back to work or start a new business, flat broke and without much in the way of assets, but knowing that the benefits of tomorrow’s hard work will not go to the creditors.”⁵¹

Generally, creditors receive less in consumer bankruptcy cases filed under Chapter 7 than in those filed under Chapter 13. This is true, in part, because debtors who have few present assets can discharge their debts under Chapter 7 without making any significant payments.⁵² Creditors have long argued for limitations on Chapter 7, especially when debtors with few present assets have the means to pay back their loans over time.⁵³ Congress first responded to this concern with the Federal Judgeship Act of 1984.⁵⁴

A. *The First Limitations on Chapter 7: The Federal Judgeship Act*

Before 1984, debtors had virtually unfettered access to Chapter 7.⁵⁵ Courts could deny them access only “after notice and a hearing and only for cause.”⁵⁶ For-cause dismissals required egregious acts, such as making false statements on a bankruptcy petition or unreasonably delaying court proceedings.⁵⁷ As long as debtors were honest with the bankruptcy court, they had the option to relinquish all their nonexempt present assets in exchange for a total discharge of all of their debts under Chapter 7, notwithstanding their financial situations.⁵⁸

50. *Id.* § 727 (providing for discharge).

51. WARREN & WESTBROOK, *supra* note 3, at 149.

52. *See* § 707(b)(2)(A)(ii)–(iv) (requiring only that the debtor relinquish nonexempt assets to obtain a Chapter 7 discharge).

53. *See* Jean Braucher, *A Fresh Start for Personal Bankruptcy Reform: The Need for Simplification and a Single Portal*, 55 AM. U. L. REV. 1295, 1302 (2006) (noting that the credit industry pushed for limitations on Chapter 7 from 1978 to 1984 and again throughout the 1990s).

54. Bankruptcy Amendments and Federal Judgeship Act, Pub. L. No. 98-353, 98 Stat. 333 (1984) (codified as amended in scattered sections of 11 and 28 U.S.C.).

55. 11 U.S.C. § 707(a) (1982) (“The court may dismiss a case under [Chapter 7] only after notice and a hearing and only for cause, including . . . unreasonable delay by the debtor . . . [and] nonpayment of any fees and charges . . .”).

56. *Id.*

57. *See* S. REP. NO. 95-989, at 7 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5793 (noting that a debtor would be granted a Chapter 7 discharge except in cases of “specific and serious infractions on [the debtor’s] part”).

58. *See* 11 U.S.C. § 707(a) (1982) (“The court may dismiss a case under [Chapter 7] only after notice and a hearing and only for cause . . .”).

Creditors were understandably uncomfortable with this arrangement.⁵⁹ It allowed debtors who could easily have paid off their loans over a few years to opt not to do so by filing for Chapter 7.⁶⁰ Consider, for example, a hypothetical young lawyer: just graduated from law school, with sixty thousand dollars in credit card debt, no nonexempt personal assets, and having accepted a law firm job paying one hundred and sixty thousand dollars. Given the high earning potential, this young professional could easily pay off the credit card debt within a few years. With no nonexempt personal assets, however, the lawyer could wipe out the debt in Chapter 7 without any personal sacrifice whatsoever.

In 1984, Congress responded to this situation with the Federal Judgeship Act (FJA).⁶¹ The FJA gave judges discretion to dismiss filings that were a “substantial abuse” of the Bankruptcy Code.⁶² In the FJA, however, Congress gave very little guidance as to what constituted substantial abuse.⁶³ As a result, a large body of case law developed on the matter.⁶⁴ By 2005, most circuits had issued decisions on the substantial abuse standard.⁶⁵

59. See Braucher, *supra* note 53, at 1302 (noting that the credit industry pushed for limitations to keep debtors with sufficient disposable income out of Chapter 7 in the years leading up to the 1984 Act).

60. Before 1984, a debtor’s level of disposable income did not affect whether the debtor would be able to file for Chapter 7. See generally Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (containing no disposable income requirement).

61. Bankruptcy Amendments and Federal Judgeship Act, Pub. L. No. 98-353, 98 Stat. 333 (1984) (codified as amended in scattered sections of 11 and 28 U.S.C.).

62. See 11 U.S.C. § 707(b) (2000), amended by 11 U.S.C. § 703 (Supp. V 2005) (“After notice and a hearing, the court . . . may dismiss a case . . . if it finds that the granting of relief would be a substantial abuse . . .”).

63. E.g., *In re Green*, 934 F.2d 568, 570–71 (4th Cir. 1991); *In re Balaja*, 190 B.R. 335, 337 (Bankr. N.D. Ill. 1996); *In re Heller*, 160 B.R. 655, 657 (Bankr. D. Kan. 1993).

64. See, e.g., *In re Cortez*, 457 F.3d 448, 454–56 (5th Cir. 2006) (considering whether debtor’s postpetition employment developments should be included in substantial abuse determinations); *In re Behlke*, 358 F.3d 429, 436–37 (6th Cir. 2004) (holding that retirement sum contributions should be included in disposable income calculations for purposes of substantial abuse determinations); *In re Price*, 353 F.3d 1135, 1139–40 (9th Cir. 2004) (holding that purchase money mortgage debt was “consumer debt” for purposes of substantial abuse determinations); *In re Stewart*, 175 F.3d 796, 808–09 (10th Cir. 1999) (surveying circuit court case law regarding the definition of “substantial abuse” and adopting the “totality of the circumstances” approach); *In re Kornfield*, 164 F.3d 778, 781 (2d Cir. 1999) (comparing the “ability to pay” approach with the “totality of circumstances” approach and concluding that “[e]ven under the former approach, the debtor’s personal circumstances are relevant to the determination of ability to pay”); *In re Lamanna*, 153 F.3d 1, 3–5 (1st Cir. 1998) (adopting the “totality of circumstances” test and rejecting “any per se rules mandating dismissal for ‘substantial abuse’ whenever the debtor is able to repay his debt out of future disposable income”); *In re Kestell*, 99 F.3d 146, 149

In every circuit but one that addressed the question, the primary factor in determining substantial abuse was the ability of debtors to pay their creditors outside of Chapter 7.⁶⁶ Courts measured ability to pay by deducting the debtor's reasonable monthly expenses from expected monthly income.⁶⁷ If there was a substantial amount left over for the creditors, courts were likely to dismiss the Chapter 7 petition.⁶⁸

When courts determined ability to pay under the FJA, they had discretion to adjust reasonable monthly expenses and expected monthly income in light of individual circumstances.⁶⁹ In *In re Kornfield*,⁷⁰ the Second Circuit noted that "the debtor's personal circumstances are relevant to . . . ability to pay."⁷¹ The court explained, "[A] *per se* test would not survive the first case of a frugal family with income over the designated level but with unusually large medical expenses necessary to a child's life."⁷² Personal circumstances could also weigh in favor of dismissal of a Chapter 7 petition. In *In re Lamanna*,⁷³ the First Circuit held that despite his low income, the debtor could not file for bankruptcy.⁷⁴ Because the particular debtor

(4th Cir. 1996) (employing the "totality of circumstances" approach to find substantial abuse by husband who used the bankruptcy system to ensure that his former wife could not collect on a debt he owed her); *In re Green*, 934 F.2d at 570–73 (holding that the fact that debtor had income in excess of his necessary expenses was not sufficient to support a substantial abuse determination and remanding case for a consideration of the "totality of the circumstances"); *In re Krohn*, 886 F.2d 123, 126–27 (6th Cir. 1989) (upholding a dismissal on substantial abuse grounds and noting that "a court should ascertain from the totality of the circumstances whether [the debtor] is merely seeking an advantage over his creditors, or instead is 'honest,' . . . and whether he is 'needy'"); *In re Walton*, 866 F.2d 981, 984–85 (8th Cir. 1989) (upholding a dismissal on substantial abuse grounds because "the courts below properly considered [the debtor's] future income in applying the 'substantial abuse' language").

65. See *In re Cortez*, 457 F.3d at 454–55; *In re Behlke*, 358 F.3d at 436–37; *In re Price*, 353 F.3d at 1139–40; *In re Stewart*, 175 F.3d 796 at 808–09; *In re Kornfield*, 164 F.3d at 781; *In re Lamanna*, 153 F.3d at 3–5; *In re Kestell*, 99 F.3d at 149; *In re Green*, 934 F.2d at 570–73; *In re Krohn*, 886 F.2d at 126–27; *In re Walton*, 866 F.2d at 984–85.

66. Even in the Fourth Circuit, ability to pay was a factor (though not necessarily the primary factor) in determining bankruptcy abuse. *In re Green*, 934 F.2d at 572–73 n.7.

67. See, e.g., *In re Krohn*, 886 F.2d at 127 (evaluating ability to pay based on income and reasonable expenditures).

68. *Id.* at 127–28 (dismissing the Chapter 7 petition because the debtor had ability to pay).

69. *In re Kornfield*, 164 F.3d at 781.

70. *In re Kornfield*, 164 F.3d 778, 778 (2d Cir. 1999).

71. *Id.* at 781.

72. *Id.* at 783.

73. *In re Lamanna*, 153 F.3d 1 (1st Cir. 1998).

74. *Id.* at 5.

in *Lamanna* was living with his parents, he had lower expenses and an increased ability to pay.⁷⁵

Courts developed some general rules of thumb for how to determine income and expenses. Expected monthly income could be adjusted to take into account postpetition events, such as promotion or job loss.⁷⁶ Also, assets that would be exempt in a bankruptcy proceeding, such as retirement distributions, were not necessarily barred from reasonable monthly income calculations.⁷⁷ Finally, secured loan payments were not deducted from monthly income in determining ability to pay.⁷⁸

Even though ability to pay was the primary factor in determining abuse in most circuits, in no circuit did ability to pay, standing alone, *mandate* dismissal. Judges always had discretion to consider other factors,⁷⁹ including:

- (1) Whether the bankruptcy petition was filed because of sudden illness, calamity, disability, or unemployment;
- (2) Whether the debtor incurred cash advances and made consumer purchases far in excess of his ability to repay;
- (3) Whether the debtor's proposed family budget [was] excessive or unreasonable;
- (4) Whether the debtor's schedules and statement of current income and expenses reasonably and accurately reflect[ed] the true financial condition; and
- (5) Whether the petition was filed in good faith.⁸⁰

75. *Id.*

76. *In re Cortez*, 457 F.3d 448, 458 (5th Cir. 2006).

77. See *In re Koch*, 109 F.3d 1285, 1289 (8th Cir. 1997) (“[R]evenues received from exempt sources during the life of a Chapter 13 plan are ‘income,’ the disposable portion of which must be paid to unsecured creditors if the plan is to be confirmed . . .”).

78. *In re Krohn*, 886 F.2d 123, 127 (6th Cir. 1989) (taking into account the debtor's high monthly mortgage in determining whether the debtor could cut back and pay his creditors).

79. The Ninth Circuit in *In re Kelly*, 841 F.2d 908 (9th Cir. 1988), left open the suggestion that ability to pay might per se constitute substantial abuse. *Id.* at 914–15. It made clear in later cases, however, that judges had discretion to allow a Chapter 7 filing even if there was ability to pay. *In re Price*, 353 F.3d 1135, 1140 (9th Cir. 2004).

80. *In re Green*, 934 F.2d 568, 572 (4th Cir. 1991). These factors are examples of criteria utilized by a court in determining whether substantial abuse exists in a particular case. Courts have utilized a variety of criteria under the “totality of the circumstances” standard. See, e.g., *In re Price*, 353 F.3d at 1139–40 (9th Cir. 2004) (considering the five factors in *Green* as well as “whether the debtor has engaged in eve-of-bankruptcy purchases”); *In re Stewart*, 175 F.3d 796, 809 (10th Cir. 1999) (recognizing “the factors articulated by the other courts as instructive, but conclud[ing] [that] they are not inclusive of all factors considered”); *In re Snow*, 185 B.R. 397,

Beginning in the 1990s, creditors became dissatisfied with the FJA and began to push for more limitations of Chapter 7.⁸¹ Specifically, creditors wanted a bright-line means test that would restrict judicial discretion to allow Chapter 7 filings when the debtor had sufficient disposable income.⁸²

B. More Limitations: The Bankruptcy Abuse Prevention and Consumer Protection Act

Despite the FJA's limitations on Chapter 7, the number of bankruptcy filings rose dramatically between 1978 and 2005.⁸³ Creditors contended that the increase in filings reflected an unacceptable decline in financial responsibility and an increased willingness to file for bankruptcy.⁸⁴ Congress answered with the BAPCPA, which instituted a mechanized, objective test, known as the means test, to determine ability to pay.⁸⁵ This test, according to Congress, would be a more trustworthy tool than judicial discretion in rooting out abuse.

The BAPCPA was intended to prevent bankruptcy abuse by “restoring personal responsibility and integrity in the bankruptcy system and ensur[ing] that the system is fair for both debtors and creditors.”⁸⁶ Congress enacted the BAPCPA because it felt that judicial discretion under the FJA was not sufficient to prevent certain debtors from using bankruptcy as a “first resort, rather than a last resort.”⁸⁷ Insofar as the BAPCPA was passed to correct the FJA's

404 (Bankr. D. Mass. 1995) (noting that *Green* and similar cases “may be collectively summarized as requiring an analysis of the facts and circumstances of the individual case”).

81. Braucher, *supra* note 53, at 1302.

82. Credit industry lobbyists expressed concern that bankruptcy judges were unable or unwilling to clamp down on abusive debtors. When asked whether judicial discretion was sufficient to curb bankruptcy abuse, Jeff Tasse, an influential credit industry lobbyist, replied, “They’re part of the . . . problem. . . . They’re not real judges” Gosselin, *supra* note 31; see also Jack F. Williams, *Distrust: The Rhetoric and Reality of Means-Testing*, 7 AM. BANKR. INST. L. REV. 105, 108 (1999) (noting that those who favor means testing generally seek to restrict judicial discretion). See generally H.R. 3150, 105th Cong. (1998) (providing an example of a bright-line means test proposal).

83. H.R. REP. NO. 109-31, pt. 1, at 3–4 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 90.

84. *Id.* at 4 (citing a growing perception that bankruptcy is used as “a first rather than a last resort”).

85. Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. No. 109-8, § 102, 119 Stat. 23, 27–35 (2005).

86. H.R. REP. NO. 109-31, pt. 1, at 2 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 89.

87. *Id.* at 4.

failures, it was a response to the perceived inability of the bankruptcy bench to recognize and crack down on abusive debtors.⁸⁸

The BAPCPA was designed to ensure that no abusive debtor slips through the cracks. It requires every debtor to submit means test calculations to the court before filing for Chapter 7 bankruptcy.⁸⁹ The U.S. Trustee's office must then review means test submissions and send a statement reporting the test's outcome to every creditor.⁹⁰ The bankruptcy judge "shall presume abuse exists" if the means test shows that the debtor has sufficient income to make meaningful payments on the debt.⁹¹

1. *Means Test Mechanics.* How exactly does the means test evaluate whether debtors have the ability to pay down their debt over time? Put simply, the test asks two questions. First, it asks whether a debtor's monthly income is above the median income in the state in which the debtor resides.⁹² If so, the test then goes on to ask whether the debtor's income minus expenses leaves enough money for the debtor to make payments to creditors.⁹³ If the answer to both questions is yes, the debtor is presumed to be abusing the bankruptcy system.⁹⁴ In the vast majority of these cases, the judge then dismisses the Chapter 7 filing.⁹⁵

The means test mechanizes both income and expense calculations. It provides that current monthly income is the average of the debtor's monthly income from the six months preceding the filing.⁹⁶ All types of income—including employee wages, interest, stock dividends, unemployment compensation, and income tax refunds—are includable in income determinations.⁹⁷ If current monthly income, as defined by the BAPCPA, is greater than the median income in the state in which a debtor resides, the debtor must

88. See *supra* note 61 and accompanying text.

89. 11 U.S.C. § 521(a)(1) (Supp. V 2005).

90. *Id.* § 704(b)(1).

91. *Id.* § 707(b)(2)(A)(i).

92. *Id.* § 707(b)(6).

93. *Id.* § 707(b)(2).

94. *Id.* § 707(b)(2)(A)(i).

95. *Id.* § 707(b)(2)(B) (allowing the presumption to be rebutted only under limited "special circumstances").

96. *Id.* § 101(10A).

97. WARREN & WESTBROOK, *supra* note 3, at 160.

complete the second step of the means test to determine Chapter 7 eligibility.⁹⁸

After a debtor has calculated current monthly income, the means test allows a deduction of certain expenses from that amount to determine disposable income.⁹⁹ There are three categories of deductible expenses. First, the debtor may deduct certain basic living expenses, such as expenses for housing, transportation, taxes, food, clothing, and health care.¹⁰⁰ The amount a debtor may deduct for these expenses is determined by standards set by the IRS rather than by the debtor's actual expenditures.¹⁰¹ Second, debtors may deduct payments on secured and priority debts.¹⁰² These payments include the total of all payments contractually due to secured creditors in the five years following bankruptcy and any other "payments to secured creditors necessary for the debtor to maintain possession of [a] primary residence, motor vehicle, or other property necessary for the support of the debtor and the debtor's dependents that serves as collateral for secured debts."¹⁰³ There is no limit on the amount of secured loan payments that a debtor may deduct from income for the purposes of the means test.¹⁰⁴ Finally, the debtor may deduct actual expenses for a limited class of expenses specified by the Bankruptcy Code.¹⁰⁵ These include the actual cost of reasonably necessary health insurance, disability insurance, health savings accounts, and the actual cost of protection from domestic violence.¹⁰⁶

The amount of monthly disposable income—which is measured by income minus authorized expenses—dictates whether or not a debtor passes the means test.¹⁰⁷ If disposable income is \$100 or less,

98. 11 U.S.C. § 707(b)(2) (Supp. V 2005).

99. *Id.* § 707(b)(2)(A)(ii).

100. *Id.* § 707(b)(2)(A)(ii)(I).

101. *See id.* (providing that debtors are allowed to deduct the amounts specified in the Internal Revenue Service's Allowable Expense Tables); *see also* Internal Revenue Service, Collection Financial Standards, <http://www.irs.gov/individuals/article/0,,id=96543,00.html> (last visited Nov. 10, 2007) (showing deductible amounts for basic living expenses).

102. 11 U.S.C. § 707(b)(2)(a)(iii) (Supp. V 2005).

103. *Id.*

104. *See id.* (not limiting the amount of deductible secured loan payments); WARREN & WESTBROOK, *supra* note 3, at 164 ("[Secured] loans—such as car loans—can be deducted in full, no matter how large, along with any payment arrearages.").

105. 11 U.S.C. § 707(b)(2)(A)(ii) (Supp. V 2005).

106. *Id.* § 707(b)(2)(A)(ii)(I).

107. *Id.* § 707(b)(2)(A)(i).

the debtor passes the means test¹⁰⁸ and may continue Chapter 7 proceedings without a presumption of abuse.¹⁰⁹ If disposable income is greater than \$166.66, the test identifies the debtor as able to pay,¹¹⁰ and a presumption of abuse arises against the debtor.¹¹¹ If disposable income is between \$100 and \$166.66, the debtor passes the means test only if the amount of disposable income is less than 0.4167 percent of the total unsecured debt.¹¹² Unless income minus expenses is between \$100 and \$166.66, the amount the debtor owes is not relevant to the abuse determination.¹¹³

2. *When Do Judges Have Discretion to Correct the Means Test?*

When a debtor fails the means test, judges have no choice but to presume abuse.¹¹⁴ Section 707(b) of the BAPCPA states that judges “shall presume abuse exists if . . . income reduced by . . . expenses [is greater than \$166.66 per month].”¹¹⁵ Once established, the presumption of abuse is extremely difficult to rebut.¹¹⁶ “It may only be rebutted by demonstrating special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces.”¹¹⁷ Furthermore, special circumstances are only relevant to the extent that they necessarily affect future income or expenses.¹¹⁸ It is

108. *Id.*; WARREN & WESTBROOK, *supra* note 3, at 164–65 (translating the statute).

109. *See* 11 U.S.C. § 707(b)(2)(A)(i) (providing no presumption of abuse when the debtor passes the means test).

110. *Id.* § 707(b)(2)(A)(i); WARREN & WESTBROOK, *supra* note 3, at 164–65 (translating the statute).

111. *Id.* 11 U.S.C. § 707(b)(2)(A)(i) (Supp. V 2005).

112. *See* WARREN & WESTBROOK, *supra* note 3, at 165 (providing that if a debtor’s disposable income is between \$100 and \$166.66 per month, the debtor passes the means test only if disposable income is less than 25 percent of the unsecured debt divided by sixty).

113. *See* 11 U.S.C. § 707(b)(2)(A)(ii) (not factoring the amount of debt in the determination of abuse unless the debtor’s disposable income is between \$100 and \$166.66).

114. *Id.* § 707(b)(2)(A)(i).

115. *Id.*

116. *See id.* § 707(b)(2)(B)(i) (“In any proceeding brought under this subsection, the presumption of abuse may only be rebutted by demonstrating special circumstances . . . that justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative.”).

117. *Id.* To establish special circumstances that rebut the presumption of abuse, the debtor must provide supporting documentation and “a detailed explanation of the special circumstances that make such expenses or adjustments to income necessary and reasonable.” 11 U.S.C. § 707(b)(2)(B)(ii) (Supp. V 2005).

118. *See* 11 U.S.C. § 707(b)(2)(B)(i) (noting that special circumstances are relevant to the extent “they justify additional expenses or adjustments to current monthly income for which there is no reasonable alternative”).

not per se a special circumstance, for example, if a debtor files for bankruptcy because of a medical emergency. Even if the medical debt is completely involuntary and very large, the medical emergency counts as a special circumstance only to the extent that it affects the debtor's future income and expenses.¹¹⁹

Judges have more discretion in the opposite direction, to presume abuse when a debtor passes the means test. Section 707(b)(3) states that when the presumption of abuse “does not arise or is rebutted, the court shall consider whether the petition was filed in bad faith; or [whether] the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse.”¹²⁰ Courts agree that under this provision, judges may dismiss filings when a debtor passes the means test but acts in bad faith. It is more questionable, however, whether this provision allows judges to dismiss filings when they believe that a debtor who passes the means test has ability to pay.

Some commentators argue that judges do have such discretion under the plain language of § 707(b)(3),¹²¹ which allows judges to find abuse when a debtor passes the means test but the “totality of the circumstances of . . . [the] financial situation demonstrates abuse.”¹²² Courts that accept this approach¹²³ rely on pre-BAPCPA case law to determine whether the totality of the circumstances of the debtor's situation demonstrates abuse.¹²⁴

Others argue that judges do not have discretion to dismiss filings when the debtor passes the means test.¹²⁵ They contend that the means test is the sole measure of ability to pay and that it trumps pre-

119. *Id.*

120. *Id.* § 707(b)(3).

121. *See, e.g.*, Hon. Eugene R. Wedoff, *Judicial Discretion to Find Abuse Under Section 707(b)(3)*, 71 MO. L. REV. 1035, 1035–51 (2006) (arguing that a judge has some discretion to dismiss filings when the judge believes that a debtor who passes the means test has the ability to pay).

122. 11 U.S.C. § 707(b)(3).

123. *See, e.g., In re Pak*, 347 B.R. 239, 244 (Bankr. N.D. Cal. 2006) (holding that judges may dismiss the petition of a debtor who passes the means test if the totality of the debtor's financial situation demonstrates ability to pay); *In re Paret* 347 B.R. 12, 17 (Bankr. D. Del. 2006) (same).

124. *See, e.g., In re Paret*, 347 B.R. at 17 (accepting trustee's argument that even when a debtor passes the means test, the debtor can be held to be abusing the Bankruptcy Code based on pre-BAPCPA case law).

125. Marianne B. Culhane & Michaela M. White, *Catching Can-Pay Debtors*, 13 AM. BANKR. INST. L. REV. 665, 667 (2005); *see also In Re Walker*, No. 05-15010-whd, 2006 Bankr. LEXIS 845, *20 (Bankr. N.D. Ga. May 1, 2006) (holding that courts may not find abuse when the debtor passes the means test, even if the debtor becomes able to pay later on).

BAPCPA totality-of-the-circumstances case law.¹²⁶ As Professor Elizabeth Warren states, “It is one thing for a judge to be aggressive in the interpretation of ‘substantial abuse’ . . . when there are no other ‘can-pay’ provisions. It is quite something else to look past Congress’ specific instructions and add a second judge-made can-pay test.”¹²⁷ Regardless of which side of this debate is correct, judges have less discretion under the BAPCPA than under the FJA.¹²⁸ The result is that the lets some debtors who are abusing the bankruptcy system into Chapter 7 while keeping certain honest but unfortunate debtors out.

II. WHY THE MEANS TEST WAS A POLICY MISTAKE

Because the means test replaces judicial discretion with a rigid and formulaic rule, it is both over- and underinclusive as to its primary goal of preventing abuse. It catches debtors who legitimately need relief by failing to take into account why the debtor incurred the debt¹²⁹ and by mechanizing income and expenses in ways that can overstate the debtor’s actual disposable income.¹³⁰ It also creates loopholes that allow affluent debtors to qualify for Chapter 7 by understating their actual expenses. Finally, although the means test replaces a fuzzy standard with a bright-line rule, it is not more efficient. The Congressional Budget Office estimates it will cost almost \$400 million over its first five years.¹³¹

A. *The Means Test Catches Debtors Who Legitimately Need Relief*

The means test overshoots its abuse prevention goal by catching some debtors who are legitimately in need of relief. It does this first

126. Culhane & White, *supra* note 125, at 667.

127. *Id.* (quoting e-mail from Professor Elizabeth Warren, Leo Gottlieb Professor of Law, Harvard Law School, to listserv Bankr-UNLV (May 31, 2005, 8:09 CDT)).

128. Even if the BAPCPA is interpreted to allow judges discretion to dismiss petitions when the debtor passes the means test, the statute explicitly states that judges do not have discretion to allow petitions when the debtor fails the means test. 11 U.S.C. § 707(b)(2)(B)(i) (Supp. V 2005).

129. *See generally id.* § 707(b)(2) (not factoring into the means test why the debtor incurred the debt).

130. *See id.* § 101(10A) (mechanizing the calculation of current monthly income); *id.* § 707(b)(2) (mechanizing expense calculations).

131. CONG. BUDGET OFFICE, COST ESTIMATE FOR BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005, at 1, *available at* <http://www.cbo.gov/ftpdocs/61xx/doc6130/s256.pdf>.

by failing to take into account *why* a debtor incurred debt.¹³² It thus fails to distinguish between a chronic overspender and a family forced into bankruptcy by a large and unexpected expense. Second, the means test mechanizes the calculations of income and expenses in a way that might not reflect the debtor's actual financial situation.¹³³ When, because of one of these deficiencies, the means test prevents a needy debtor from filing for bankruptcy, the bankruptcy judge rarely has discretion to correct the result.¹³⁴

1. *The Means Test Ignores the Reason for Filing.* There are a variety of reasons, some less sympathetic than others, why a person might file for Chapter 7 bankruptcy. At one end of the spectrum, a debtor might run up one too many credit card bills with new cars and expensive jewelry. At the other, a financially responsible person might incur overwhelming debt because of a serious medical problem. In the middle, a family breadwinner might become unemployed, and thus be unable to cover even modest expenses. In light of the tradition of American bankruptcy as a last-ditch safety net for the "honest but unfortunate debtor,"¹³⁵ and in light of the legislative goal of preventing abuse,¹³⁶ the law ought to treat these very different situations differently.

Prior to the BAPCPA, it did. Under the FJA, judges had discretion to take into account why the debtor was filing for bankruptcy when deciding whether to allow the bankruptcy petition.¹³⁷ In *In re Green*,¹³⁸ the Fourth Circuit directed lower courts to consider the cause of the bankruptcy—"whether the bankruptcy petition was filed because of sudden illness, calamity, disability, or

132. See generally 11 U.S.C. § 707(b)(2) (not factoring into the means test why the debtor incurred the debt).

133. See *supra* note 130.

134. *Id.* § 707(b)(2)(B)(i) (providing that when a debtor fails the means test, a judge has discretion to allow a Chapter 7 filing only under limited special circumstances); Culhane & White, *supra* note 125, at 667 (arguing that because the means test is the sole measure of abuse, when debtors pass the means test, judges do not have discretion to dismiss their Chapter 7 filings). *But see* Wedoff, *supra* note 121, at 52 (arguing that judges do have discretion to dismiss petitions even when a debtor passes the means test).

135. See *supra* note 42.

136. H.R. REP. NO. 109-31, pt. 1, at 5 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 92 (noting that the BAPCPA will cut down on bankruptcy abuse).

137. See *supra* Part I.A.

138. *In re Green*, 934 F.2d 568 (4th Cir. 1991).

unemployment.”¹³⁹ The First, Second, and Tenth Circuits explicitly adopted the Fourth Circuit’s approach.¹⁴⁰ Every other circuit that addressed the issue agreed that judges were not required to find abuse when the debtor had ability to pay; they could look at other factors, including the debtor’s reason for filing. Even the Eighth and Ninth Circuits—which had the most creditor-friendly interpretations of the FJA—held that judges had discretion to look at the debtor’s reason for filing for bankruptcy.¹⁴¹

Under the BAPCPA, by contrast, the debtor’s reason for filing is generally irrelevant. The reason for filing never affects whether a debtor passes or fails the means test.¹⁴² In limited situations, the reason for filing can affect whether the presumption of abuse is rebuttable: the BAPCPA allows a debtor to rebut the abuse presumption under “special circumstances, such as a serious medical condition or a call or order to active duty in the Armed Forces.”¹⁴³ These special circumstances, however, are relevant only insofar as they affect the debtor’s income or expenses.¹⁴⁴ A good reason for filing is irrelevant unless it affects the debtor’s presumed income or expenses in the future.¹⁴⁵ Generally, therefore, bankruptcy judges have no choice but to treat the most sympathetic debtor—one who is financially responsible but falls down-and-out due to a bout of unexpected bad luck—in the same manner as a chronic and manipulative overspender.¹⁴⁶

Consider, for example, a financially responsible accident victim who incurs eight hundred thousand dollars in accident-related medical expenses. Over the course of a few years, the victim recovers and gets back to work—taking home \$170 in disposable income per

139. *Id.* at 572.

140. *In re Stewart*, 175 F.3d 796, 809 (10th Cir. 1999); *In re Kornfield*, 164 F.3d 778, 781 (2nd Cir. 1999); *In re Snow*, 185 B.R. 397, 402 (Bankr. D. Mass. 1995).

141. *In re Price*, 353 F.3d 1135, 1140 (9th Cir. 2004) (holding that although ability to pay standing alone is *sufficient* to prove abuse, it does not necessarily lead to that finding); *In re Walton*, 866 F.2d 981, 984–85 (8th Cir. 1989) (same).

142. *See supra* note 132 and accompanying text.

143. *Id.* § 707(b)(2)(B)(i) (providing that the presumption is rebuttable under special circumstances, which are generally circumstances in which the debtor has a good reason for filing for bankruptcy).

144. *Id.* (stating that the presumption may be rebutted under special circumstances only “to the extent such special circumstances that [*sic*] justify additional expenses or adjustments of current monthly income”).

145. *Id.*

146. *Id.*

month—but begins to realize that this is not enough to pay off even the interest on the medical debt.¹⁴⁷ Facing an impossible situation, the debtor files for bankruptcy but fails the means test because the past medical emergency affects neither future income nor future expenses. The accident is therefore not a special circumstance sufficient to rebut the means test result. The bankruptcy judge—unable to consider either the large size of the debt or the sympathetic reason for filing—must deny this debtor a Chapter 7 chance for a fresh start.¹⁴⁸

2. *The BAPCPA Mechanizes Income and Expense Calculations in Ways that Can Overstate Disposable Income.* Another way that the BAPCPA keeps needy debtors out of Chapter 7 is by mechanizing income and expense calculations in ways that can overstate actual income and understate actual expenses.¹⁴⁹ The means test can overstate income because it presumes that current monthly income is the average of a debtor's monthly income in the six months prior to filing.¹⁵⁰ This presumption wrongly assumes that all debtors have a constant stream of income in the months before and after their bankruptcy filing, which is just the time when many debtors are experiencing financial dislocations.¹⁵¹

The presumption can be problematic for debtors who file for bankruptcy because they have lost their jobs and cannot find new ones with comparable salaries.¹⁵² In those situations, the means test has the potential to overstate current monthly income by factoring in a debtor's old salary.¹⁵³ To determine current monthly income, the

147. At the modest rate of 8 percent, the first month's interest on an \$800,000 debt would be \$5,351.20.

148. Debtors who cannot file for Chapter 7 are not always allowed to use Chapter 13 as an alternative. If they have too much unsecured debt, they will be forced out of bankruptcy entirely. 11 U.S.C.A. § 109(e) (2007) (limiting Chapter 13 bankruptcy to debtors with less than \$336,900 of unsecured debt). In that situation, debtors could end up paying off their creditors for the rest of their lives.

149. *See supra* note 130.

150. *See id.* § 101(10A) (defining current monthly income as the average income of the six months prior to filing).

151. Income loss (downsizing, job loss, or other salary reduction) is the most common reason why people file for bankruptcy, followed by medical problems and divorce. WARREN & WESTBROOK, *supra* note 3, at 120.

152. There are many debtors who fall in this category. *See id.* (discussing some of the reasons debtors file for bankruptcy).

153. *See* 11 U.S.C. § 101(10A) (factoring in salary from the six months prior to filing).

means test looks backwards to the six months prior to filing.¹⁵⁴ If unemployed debtors are not savvy enough to wait six months after losing their jobs to file for bankruptcy, the means test will take their old salaries into account in determining current income.¹⁵⁵ The sooner debtors file for bankruptcy after losing their jobs, the more their old salaries will factor in the means test, and the worse the overstatement of current income will be.¹⁵⁶

Before the BAPCPA, judges had discretion to consider postpetition developments in determining income and expense.¹⁵⁷ If a debtor had lost a job and filed for bankruptcy, the judge could consider developments in the debtor's employment situation that occurred after the filing but before the bankruptcy hearing.¹⁵⁸ It was relevant whether the debtor had found a new job, and whether the new job paid more or less than the old one.¹⁵⁹ Under the BAPCPA, however, judges look only to the six months prior to filing to determine the debtor's income.¹⁶⁰ If that number comes out too high, judges do not have discretion to make a correction.¹⁶¹

Another problem is that the means test can understate actual expenses, thereby overestimating the ability of debtors to pay back their creditors.¹⁶² The BAPCPA determines allowable expenses by reference to IRS allowable expense tables, whether or not these amounts reflect actual reasonable expenses.¹⁶³ Only in limited enumerated situations may debtors include their actual expenses in means test calculations.¹⁶⁴

154. *Id.*

155. *See supra* note 153.

156. *See supra* note 153.

157. *In re Cortez*, 457 F.3d 448, 455 (5th Cir. 2006) (holding that the court may consider postpetition events).

158. *See id.* (“[T]he court is entitled to focus on subsequent developments in the debtor’s financial condition.”).

159. *Id.*

160. 11 U.S.C. § 101(10A) (Supp. V 2005).

161. If the debtor fails the means test, the judge has no choice but to presume abuse. *Id.* § 707(b)(2)(A)(i). That presumption may be rebutted only under “special circumstances, such as a serious medical condition or a call to active duty in the Armed Forces.” *Id.* § 707(b)(2)(B)(i).

162. *See id.* § 707(b)(2)(A)(ii) (providing that means test expenses are based on IRS tables, rather than the actual reasonable expenses of the individual debtor).

163. *Id.* § 707(b)(2)(A)(ii)(I) (“The debtor’s monthly expenses shall be the . . . amounts specified under the National Standards and the Local Standards . . .”).

164. *Id.* § 707(b)(2)(A)(ii) (providing that the debtor may include certain enumerated actual expenses, including expenses for reasonably necessary health and disability insurance, expenses reasonably necessary to protect the family from family violence, expenses for care or support of

The IRS publishes the allowable expense tables for “use in calculating the repayment of delinquent taxes.”¹⁶⁵ A delinquent taxpayer is allowed to keep a certain level of income per month for subsistence needs, but must turn the rest over to the IRS.¹⁶⁶ The allowable expense tables tell how much income the delinquent taxpayer may keep.¹⁶⁷ The IRS separates allowable expenses into three categories: housing and utility costs, transportation costs, and other costs.¹⁶⁸ For housing and utility costs, the allowable expense level differs by county, depending on the real estate market.¹⁶⁹ Similarly, the allowable transportation expenses differ by region.¹⁷⁰ All other allowable expenses (food, housekeeping supplies, apparel, and services) have national levels. Oddly, these expense levels go up as a delinquent taxpayer’s income goes up.¹⁷¹ Although a person who makes less than \$833 per month may only keep \$175 per month for food, a person whose monthly income is at least \$5834 may keep almost three times that amount!¹⁷²

There are two reasons why the means test potentially understates actual reasonable expenses by reference to the IRS tables. The first is a flaw in the IRS tables themselves: what could justify allowing people who have less monthly income to keep significantly less money for food? The discrepancy across income ranges suggests that the IRS tables might shortchange low income debtors, allowing them less than reasonable expenses.¹⁷³

The second problem with using the IRS tables is in the way the means test applies them. The expenses in the table were designed to be used as a floor.¹⁷⁴ When the IRS uses the tables for delinquent

an elderly or chronically ill person, and expenses of up to fifteen hundred dollars per child for education).

165. Internal Revenue Service, Collection Financial Standards, <http://www.irs.gov/individuals/article/0,,id=96543,00.html> (last visited Nov. 27, 2007).

166. *Id.*

167. *Id.*

168. *Id.*

169. *Id.*

170. *Id.*

171. *Id.*

172. A person whose monthly income exceeds \$5833 may keep \$483 per month for food. *Id.*

173. Alternatively, it is possible that the IRS tables allow high income debtors more than their reasonable expenses.

174. WARREN & WESTBROOK, *supra* note 3, at 163 (“[T]he IRS uses these guidelines as a floor . . . leav[ing] some room for agents to . . . permit people to spend more for their basic living expenses if there seems to be a good reason to do so . . .”).

taxpayers, it allows the taxpayers to show that they have reasonable expenses in excess of the table amount.¹⁷⁵ The means test, however, limits debtors to an upward adjustment of 5 percent of the table amounts.¹⁷⁶ It does not consider expenses over that amount, even if they are necessary in the debtor's situation.¹⁷⁷

B. The BAPCPA's Loopholes Let Abusive Debtors off the Hook

Not only does the BAPCPA block access to Chapter 7 for certain needy debtors, it also creates loopholes that allow well-informed debtors to pass the means test, even though they have the ability to pay back their debts. First, because of the mechanical way that the means test determines current monthly income, debtors who generally have high incomes can pass the means test by reducing their income for a short period of time prior to filing.¹⁷⁸ Second, the means test allows unlimited deductions for secured loan payments.¹⁷⁹ Debtors who know this ahead of time can reduce their disposable income, as determined by the means test, by tying up their monthly income in secured loan payments.¹⁸⁰ When a debtor uses one of these loopholes to pass the means test, it is debatable whether the bankruptcy judge has discretion to prevent the Chapter 7 filing.¹⁸¹ It is ironic that the savvy (and likely more affluent) debtors who can take

175. *Id.* at 162–63 (noting that the IRS explains on its website that “[i]f the IRS determines that the facts and circumstances of your situation indicates [*sic*] that using the scheduled allowance of necessary expenses is inadequate to provide for basic living expenses, we will allow for your actual expenses. However, you must provide documentation that supports a determination that using national and local expense standards leaves you an inadequate means of providing for basic living expenses.”).

176. 11 U.S.C. § 707(b)(2)(A)(ii)(I) (Supp. V 2005) (“[I]f it is demonstrated that it is reasonable and necessary, the debtor’s monthly expenses may also include an additional allowance for food and clothing of up to 5 percent.”).

177. *See id.* (limiting the upward adjustment to 5 percent).

178. *See id.* § 101(10A) (looking only to the six months prior to filing to determine current monthly income).

179. *Id.* § 707(b)(2)(A)(iii).

180. *See id.* (allowing for unlimited secured loan deductions).

181. Culhane & White, *supra* note 125, at 667 (arguing that judges do not have discretion to dismiss the Chapter 7 filing when a debtor passes the means test). *But see* Wedoff, *supra* note 121, at 52 (arguing that judges do have discretion to dismiss petitions even when a debtor passes the means test).

advantage of these loopholes are exactly the people who Congress intended to keep out of Chapter 7 when it passed the BAPCPA.¹⁸²

1. *Manipulating Income.* The means test defines current monthly income as the average of the debtor's income in the six months preceding the bankruptcy filing.¹⁸³ As discussed, this definition of income can overstate actual income when a debtor files for Chapter 7 bankruptcy within six months of becoming unemployed.¹⁸⁴ Well-informed debtors, however, can use the rigid definition of income to their advantage, manipulating the means test to *understate* their income.¹⁸⁵ Consider a debtor who loses one job but has the ability to easily find another. This debtor will have a period without any income—after losing the first job but before finding the second. If the time between jobs is at least six months, and if the bankruptcy filing occurs at the end of this period, the current monthly income at the time of the bankruptcy petition will be zero, and the debtor will easily pass the means test, even with high earning potential and encouraging job prospects.¹⁸⁶ Attorneys who represent consumer debtors are well aware of this phenomenon and know how to use it to their clients' advantage.¹⁸⁷

182. See H.R. REP. NO. 109-31, pt. 1, at 5 (2005), reprinted in 2005 U.S.C.C.A.N. 88, 92 (justifying the BAPCPA in part to close “loopholes . . . that allow and—sometimes—even encourage opportunistic personal filings and abuse”).

183. 11 U.S.C. § 101(10A) (Supp. V 2005).

184. See *supra* Part II.A.2 (discussing how the means test overstates income); see also 11 U.S.C. § 101(10A) (factoring old salary into current monthly income when laid-off workers file for bankruptcy within six months of losing their jobs).

185. See Braucher, *supra* note 53, at 1316 (noting the different ways in which debtors might reduce their incomes before filing).

186. See 11 U.S.C. § 101(10A) (defining current monthly income as the average income in the six months before bankruptcy and not considering earning potential or job prospects in the determination of current monthly income).

187. See, e.g., Posting of Kevin Chern to The Bankruptcy Lawyers' Blog: Surviving Bankruptcy Reform and Bankruptcy Law Changes, <http://blog.startfreshtoday.com/2005/09/articles/bankruptcy-means-test/when-it-comes-to-income-timing-is-everything/> (Sept. 14, 2005, 19:49 EST) (“If your client notifies you of a sudden increase in income, a quick filing may be in your client's best interest. If you wait two months after the income change, the six-month average may increase by enough to bring your client above the median income for the debtor's household, triggering application of the means test. You may want to file quickly Conversely, if your client has a sudden decrease in income, before filing, you should reassess whether the means test applies. By waiting a month to three months, the debtor's six-month average income may decrease by enough to eliminate the application of the means test.”).

2. *Deductions for Secured Loan Payments.* A potentially more dangerous loophole in the means test is the unlimited deduction for secured loan payments. In calculating disposable income, the BAPCPA allows debtors to deduct their average monthly payments on account of secured debt.¹⁸⁸ Deductible payments include “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,”¹⁸⁹ and “any additional payments to secured creditors necessary for the debtor, in filing . . . under Chapter 13 . . . to maintain possession of [a] primary residence, motor vehicle, or other property necessary for the support of the debtor and the debtor’s dependents”¹⁹⁰

A debtor should be able to deduct payments on a secured loan taken out to pay for a basic need, such as a modest home or car. Expenses for basic needs are deductible under the IRS expense tables when the debtor pays for them outright.¹⁹¹ There is no reason why those same basic expenses should not be deductible when financed with a secured loan. For example, a renter who files for bankruptcy can deduct reasonable rent under the IRS allowable expense tables.¹⁹² It is only fair, then, that homeowners who file for bankruptcy be able to deduct their reasonable mortgage payments. Financing decisions should not affect a debtor’s ability to file for Chapter 7.

The problem arises because secured debts do not have to be reasonable to be deductible.¹⁹³ Any amount “contractually due to secured creditors” is deductible, even if the debtor takes out the loan to purchase a totally unreasonable luxury item.¹⁹⁴ A debtor who takes out a secured loan to buy a piece of jewelry, for example, may deduct the payments on that loan from income.¹⁹⁵ A debtor who pays for the jewelry outright is, of course, out of luck: the IRS tables do not allow deductions for luxury jewelry expenses.¹⁹⁶ Prior to the means test, the

188. 11 U.S.C. § 707(b)(2)(A)(iii) (Supp. V 2005).

189. *Id.* § 707(b)(2)(A)(iii)(I).

190. *Id.* § 707(b)(2)(A)(iii)(II).

191. *Id.* § 707(b)(2)(A)(ii)(I).

192. Internal Revenue Service, Collection Financial Standards, www.irs.gov/individuals/article/0,,id=96543,00.html (last visited Nov. 10, 2007).

193. *See* 11 U.S.C. § 707(b)(2)(A)(iii) (Supp. V 2005) (allowing deduction of all secured loan payments).

194. *Id.* § 707(b)(2)(A)(iii)(I).

195. *Id.* § 707(b)(2)(A)(iii) (allowing for the deductibility of secured loan payments, regardless of reasonableness).

196. Internal Revenue Service, *supra* note 165 (allowing only basic expenses).

FJA did not give payments on secured loans such special treatment. They were deductible only to the extent that they were reasonable under the debtor's circumstances.¹⁹⁷

The problem with the secured loan deduction is not only that it treats debtors with mostly secured debt much better than debtors with mostly unsecured debt. More seriously, it also allows unscrupulous debtors to shelter their income by taking out secured loans before filing for bankruptcy.¹⁹⁸ Consider two debtors, both of whom want to file for Chapter 7, and both of whom have a monthly income of \$5000, which is just above the median income in their respective states. One attempts to file for Chapter 7 as is, but fails the means test because a monthly income of \$5000 is too high.¹⁹⁹ The other takes out a secured loan with payments of \$1000 per month. When filing for bankruptcy, the second debtor will be able to deduct the \$1000 from what would otherwise be that individual's disposable income.²⁰⁰ This may be enough to allow the second debtor to pass the means test.²⁰¹

3. *Judicial Discretion to Correct the Means Test When the Debtor Passes.* Because the means test has loopholes which sometimes allow affluent debtors to pass, the question of whether judges have discretion to find abuse when a debtor passes the means test is critical. There is a debate as to the degree of discretion that judges have to find abuse when a debtor passes the means test.²⁰² Everyone agrees that judges have discretion to find abuse when a debtor files in bad faith.²⁰³ A debtor's use of the loopholes discussed in the previous section, however, may be considered either bad faith or legitimate bankruptcy planning, depending on the degree of income and expense manipulation. What happens when a debtor passes the

197. See *In re Krohn*, 886 F.2d 123, 125 (6th Cir. 1989) (taking into account the debtor's high monthly mortgage in determining whether the debtor could cut back and pay his creditors).

198. Braucher, *supra* note 53, at 1316.

199. See 11 U.S.C. § 707(b)(2) (Supp. V 2005) (setting forth the means test).

200. See *id.* § 707(b)(2)(iii) (allowing deductions for secured loan payments).

201. See *id.* § 707(b)(2) (basing means test results on disposable income, which is income minus expenses). Of course, if debtors are too brazen with their plans, they will have to worry about judges finding bad faith and dismissing their cases under § 707(b)(3), which allows judges to dismiss any bankruptcy petition filed in bad faith. *Id.* § 707(b)(3).

202. See sources cited *supra* note 181.

203. 11 U.S.C. § 707(b)(3)(A) (explicitly stating that judges may dismiss a bankruptcy petition filed in bad faith).

means test only because of one of its loopholes, but the debtor's actions do not rise to the level of bad faith?

Section 707(b)(3) states that when the presumption of abuse “does not arise or is rebutted, the court shall consider whether the debtor filed the petition in bad faith; or [whether] the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse.”²⁰⁴ Some commentators argue that under the plain language of this provision, judges have discretion to find abuse when a good faith debtor passes the means test.²⁰⁵ Others disagree, arguing that if a debtor passes the means test, a judge must allow the bankruptcy petition unless it was filed in bad faith.²⁰⁶ If judges do not have discretion to find abuse when a good faith debtor passes the means test, loopholes become an even more serious problem.²⁰⁷

C. *The Means Test as Red Tape*

One defense commonly offered in favor of bright-line rules like the means test is that although they do not always get the correct result, they are more efficient.²⁰⁸ Although this may be true generally, it is not true in the case of the means test. The means test has tremendously complicated the process of filing for bankruptcy, and the Congressional Budget Office estimates that in its first five years, it will have increased budget deficits by almost \$400 million.²⁰⁹

This expense is primarily the result of increased administrative requirements for both filers and the government.²¹⁰ Under the BAPCPA, debtors must submit evidence of any payment received

204. 11 U.S.C. § 707(b)(3).

205. See Wedoff, *supra* note 121, at 52 (arguing that under the plain language of the statute, judges have discretion to dismiss petitions even if the debtor passes the means test).

206. See Culhane & White, *supra* note 125, at 667 (arguing that because the means test is the sole measure of abuse, judges do not have discretion to dismiss petitions when a debtor passes the means test).

207. Congress ought to change income and expense calculations to crack down on these loopholes. See *infra* Part III.B–C. If Congress is unwilling to do that, however, it becomes essential to allow judges discretion to find abuse when a debtor uses a loophole to pass the means test.

208. See generally Kathleen Sullivan, *The Justices of Rules and Standards*, 106 HARV. L. REV. 22, 63 (1992) (“[R]ules promote economies for the legal decisionmaker by minimizing the elaborate, time consuming, and repetitive application of background principles to facts.”).

209. CONG. BUDGET OFFICE, *supra* note 131, at 1.

210. See Braucher, *supra* note 53, at 1308 (noting the ways in which the 2005 Act creates more paperwork for debtors and their attorneys).

from an employer during the sixty days prior to filing.²¹¹ Furthermore, each debtor must submit a tax return and a certificate of notice of various credit counseling services.²¹² These are the least of the means test's administrative burdens. Under the BAPCPA, even the poorest of debtors must submit a Form B22A means testing calculation to file for bankruptcy.²¹³ The U.S. Trustee's office then reviews every means test result and sends a statement of its findings to every creditor.²¹⁴ Then, for every above-median debtor, the Trustee's office must either move to dismiss the Chapter 7 petition,²¹⁵ or if the Trustee's office decides not to make such a motion, make a statement explaining its decision.²¹⁶

As this Part has discussed, the BAPCPA makes life unnecessarily difficult for debtors who honestly need the bankruptcy system, it opens up loopholes for those sophisticated enough to manipulate the bankruptcy system, and it costs taxpayers money. But what can be done to address these problems? The next Part proposes revisions to the BAPCPA that would make the Act both less costly and more effective at achieving its primary abuse prevention goal.

III. RECOMMENDATIONS

Congress should revise the means test to allow judges more discretion in identifying abusive debtors. The most effective revision would be a compromise between the BAPCPA's bright-line means test and the FJA's fuzzy substantial abuse standard. Congress should continue to dictate the acceptable level of disposable income and propose generally acceptable expenses. At the same time, however, Congress should delegate to judges the authority to determine disposable income for each debtor by adjusting allowable expenses upward or downward given individual circumstances. Also, judges should have discretion to disallow deductions for unreasonable secured loans. Finally, Congress should allow debtors to rebut the presumption of abuse whenever they incurred their debt because of an unforeseen emergency. This compromise would create a more

211. *Id.*

212. *Id.*

213. 11 U.S.C. § 707(b)(2)(C) (Supp. V 2005).

214. WARREN & WESTBROOK, *supra* note 3, at 165.

215. *Id.*

216. *Id.*

effective and efficient system for screening abusive debtors out of Chapter 7.

A. Keep the Basics: Codify the Acceptable Level of Disposable Income

First, in administering the compromise, Congress should retain the most basic tenet of the means test—the presumption of abuse when disposable income exceeds a certain amount. As demonstrated by the BAPCPA, Congress wants to keep out of Chapter 7 those people who have enough disposable income to make substantial payments outside of bankruptcy.²¹⁷ This general policy was also evident in pre-BAPCPA case law.²¹⁸ Congress should continue to state explicitly exactly how much disposable income it considers enough to make substantial payments. Under the means test, the magic number is between \$100 and \$166.66 per month, depending on the total amount owed by the debtor.²¹⁹ These numbers should remain law; they give judges a usable, quantitative standard for making abuse determinations without necessarily imposing administrative costs or unfairness.

B. Allow Judges to Determine Income and Expenses

Second, Congress should change the way in which the means test determines income and expenses. Congress should repeal the means test's rigid definition of current monthly income and instead allow bankruptcy judges to determine monthly income based on the debtor's individual circumstances.²²⁰ In making this determination, judges should be able to consider postpetition events—such as changes in a debtor's employment situation—that the means test fails to take into account. This would prevent overestimation of income

217. H.R. REP. NO. 109-31, pt. 1, at 2 (2005), *reprinted in* 2005 U.S.C.C.A.N. 88, 88 (noting that the BAPCPA is intended to ensure that debtors repay the “maximum they can afford”).

218. *See supra* note 64–68 (noting that in every circuit but one, ability to pay was the primary factor in determining abuse).

219. 11 U.S.C. § 707(b)(2)(A)(i) (Supp. V 2005).

220. The means test defines current income as the average of the debtor's income in the six months prior to filing. When debtors file for bankruptcy because they have lost their jobs and cannot find new ones with comparable salaries, this approach tends to overstate actual income by factoring in a debtor's old salary. On the other hand, when debtors lose their jobs but have the potential to find other jobs that pay just as much or more, this approach tends to understate actual income by factoring in the months when a debtor was not employed. *See supra* Part II.A.2.

when debtors lose their jobs and are unlikely to find other jobs with comparable salaries. It would also cut down on the ability of abusive debtors to shelter their income by strategically timing their petition. Finally, allowing a bankruptcy judge to determine income would cut down on the burdensome paperwork involved with Chapter 7.

Congress should also change the means test's definition of allowable expenses. The means test determines allowable expenses by reference to the IRS allowable expense tables.²²¹ But these tables are flawed in that they discriminate across income ranges. Congress should create a revised version of the IRS expense tables in which allowable expenses stay consistent throughout income ranges. Judges could use this revised table as a starting point for determining what expenses will be allowed in the disposable income calculation.

Another problem with the means test's use of the IRS tables is that judges may not consider actual necessary expenses more than 5 percent above the table amount.²²² But income should not be deemed disposable if it is used to pay necessary expenses. There are very good reasons why one debtor might have greater necessary expenses than another. Congress therefore ought to amend the law to allow debtors to prove actual necessary expenses in excess of the 5 percent limit.

C. Close the Secured Loan Loophole

Third, Congress should limit the deduction for secured loan payments to cover only payments on loans taken out to finance reasonable expenses. This would make Chapter 7 fairer by treating debtors with secured loan payments in the same manner as debtors with payments on unsecured loans. It would also shut down one major loophole that affluent debtors can use to shelter their income.²²³ As discussed in Part II, a debtor should not be allowed to deduct an unlimited amount for payments on secured loans, regardless of whether he took those loans out to pay for unreasonable luxury items or necessary goods.

221. 11 U.S.C. § 707(b)(2)(A)(ii)(I).

222. *Id.*

223. See Braucher, *supra* note 53, at 1316 (explaining the loophole created by the unlimited secured loan deduction).

D. Allow Judges to Consider the Reason for Filing

Finally, Congress ought to make the presumption of abuse rebuttable whenever debtors incur their debt because of an unforeseen emergency, even if the emergency does not alter their income or expenses. Under the BAPCPA, the presumption of abuse is rebuttable only to the extent that special circumstances affect the debtor's income and expenses.²²⁴ To prevent unfairness to debtors with good reasons for filing,²²⁵ the presumption ought to be rebuttable *whenever* the debtor has a special circumstance, regardless of whether future income or expenses will be affected.

Once the debtor rebuts the presumption of abuse, the bankruptcy judge must determine whether to allow a Chapter 7 petition in spite of the debtor's disposable income. In making this decision, judges ought to consider the burden that not being able to file will have on the debtor²²⁶ and whether the debtor could have foreseen and planned for the special circumstance that led to the filing. They should, in other words, balance the creditors' interests against the debtor's need for a fresh start.

CONCLUSION

Abandoning judicial discretion in favor of a rigid means test was a policy mistake. The means test allows some debtors who are abusing the bankruptcy system into Chapter 7 but keeps certain honest but unfortunate debtors out. Moreover, it adds another layer of red tape to an already complicated bankruptcy process. Congress should change the law to allow judges more discretion in identifying abusive debtors. Not only would this cut down on the BAPCPA's administrative burden, it would further the BAPCPA's primary goal of preventing abuse. Discretion, however, is not a cure-all. Prior to the BAPCPA, bankruptcy judges had too few guidelines as to when Chapter 7 was appropriate. This led to disparate decisions among the circuits. In such an environment, debtors like Kim Basinger were able to squirm out of their obligations.

224. 11 U.S.C. § 707(b)(2)(B)(i).

225. *See supra* Part II.A.1 (discussing debtors who have sympathetic reasons for incurring debt, such as a medical emergency).

226. In evaluating this burden, judges should consider whether the debtor is able to file for Chapter 13. *See* 11 U.S.C.A. § 109(e) (2007) (limiting Chapter 13 to debtors who owe less than \$336,900 of unsecured debt).

Thus, Congress should find a compromise between the confusion that existed under the FJA and the rigid and unforgiving means test. Congress should give judges guidelines by indicating the acceptable level of disposable income and promulgating a revised version of the IRS tables. At the same time, it should allow judges to determine disposable income for each debtor and adjust necessary expenses upward or downward given individual circumstances. Judges should also have discretion to disallow deductions for unreasonable secured loan payments. Finally, debtors should be able to rebut the presumption of abuse whenever they incurred debt because of an unforeseen emergency. Such a compromise would go a long way toward keeping debtors like Kim Basinger out of bankruptcy while leaving debtors like Shirley Nichols with their time-honored chance for a fresh start.