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BAPCPA Does Not Require the Chapter 13 Means Test in Individual Chapter 11 Cases

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INTRODUCTION

The Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") was implemented in order to prevent debtors from unjustly shielding value in their estate from deserving creditors and thus abusing the functionality of the federal bankruptcy system. Specifically, one problem perceived to be very prevalent was a practice by individual debtors who would seek to avoid the stringent guidelines of the "means test" in Chapter 13 cases by running for the protection of the more relaxed standards in Chapter 11 cases. The BAPCPA Amendments to section 1129 of the Bankruptcy Code were adopted to institute stricter standards in Chapter 11 proceedings and prevent abuse in order to curtail this chapter shopping of debtors between Chapter 11 and Chapter 13. However, there is no indication that these amendments within the BAPCPA were enacted with the purpose of applying equally strict regulations to Chapter 11 debtors as well as debtors in Chapter 13 cases.

This memorandum will first address the roots of this problem based in the statutory law and then look to the method by which the drafters of the amendments sought to reach a solution to this chapter shopping problem. More importantly though, it will be seen how this attempted solution faired practically in the case of *In re Roedemeier*, how the court interpreted the purpose of the amendments, and the impact that this interpretation will have on future individual debtors

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in Chapter 11 cases. Finally, it will be shown that the bankruptcy court ultimately reached the best possible conclusion, serving the purpose of benefiting debtors and creditors while eliminating the abuse of chapter shopping that was so prevalent before the BAPCPA's enactment.

STATUTORY BACKGROUND

The "means test" in section 707(b)(2) of the Bankruptcy Code provides a stringent formula by which a debtor's disposable monthly income is calculated. *See* 11 U.S.C. § 707(2) (2006). Most debtors would seek to avoid having this test utilized in their cases as it allows for very little leeway and flexibility in determining what income is not disposable.

The test is incorporated into Chapter 13 cases as a way to rigidly calculate a debtor's "projected disposable income" and is intended to leave the debtor only with the bare minimum necessary to support the debtor and his dependents. 11 U.S.C. §1325(b)(2) (2006). Section 1325(b)(2) of the Bankruptcy Code explicitly defines this "disposable income" as the "current monthly income received by the debtor . . . less amounts reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor" as well as charitable contributions under section 548(d) and business expenditures. 11 U.S.C. §1325(b)(2). Applying the "disposable income" definition, section 1325(b)(3) of the code requires the use of the "means test" in Chapter 13 cases. It does this by providing that the "[a]mounts reasonably necessary to be expended under paragraph (2) . . . shall be determined in accordance with subparagraphs (A) and (B) of section 707(b)(2)" if the debtor's current monthly income exceeds certain thresholds. 11 U.S.C. §1325(b)(3) (2006); *see* 11 U.S.C. § 707(b)(2).

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This "means test," however, has never been incorporated into Chapter 11 cases. 1325(b)(3) applies only to Chapter 13, and, prior to the enactment of the BAPCPA Amendments, there was never any consideration given to the idea that the "means test" could be applicable to a Chapter 11 debtor. Therefore, with Chapter 11 being free of this more rigid test, debtors shied away from Chapter 13 filings and flocked to Chapter 11 for more protection. *See* 11 U.S.C. §1325(b)(3). This is an area where the BAPCPA was specifically intended to have an impact.

There is no explicit language provided by Congress within the BAPCPA that should change the well-settled notion of the "means test" being walled within the spectrum of Chapter 13 cases and kept out of the Chapter 11 bankruptcy world. However, the group of creditors in the *In re Roedemeier* case attempted to blur that barrier by pointing to the wording of an amendment to section 1129 of the Bankruptcy Code included within the BAPCPA. The new provision created this potential uncertainty by incorporating an aspect of Chapter 13 bankruptcy into Chapter 11 for the purposes of determining a debtor's disposable income. *See In re Roedemeier*, 374 B.R. 264, 271–72 (Bankr. D. Kan. 2007); 7 COLLIER ON BANKRUPTCY, ¶ 1129.03, at 1129–74.9 (Alan N. Resnick et al. eds., 15th ed. rev. 2006); *see also* 11 U.S.C. § 1129(a)(15)(B) (2006). Section 1129(a)(15)(B) states the following:

> In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to the confirmation of the plan, the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in section 1325(b)(2)) to be received during the 5-year period beginning on the date that the first payment is due under the plan, or during the period for which the plan provides payments, whichever is longer.

11 U.S.C. § 1129(a)(15)(B)**.** Since section 1129 applies to Chapter 11, the contention of the *In re Roedemeier* creditors is that the reference to section 1325(b)(2) within section 1129(a)(15)(B) somehow implies that the "means test" is now applicable to individual Chapter 11 debtors for the purposes of calculating disposable income. *See In re Roedemeier*, 374 B.R. at 272. The

incorporation of 1325(b)(2) into section 1129 appears to have been done only for clarity and should not raise the question of whether the "means test" is applicable in Chapter 11 cases. It is section 1325(b)(3) that requires the "means test" be used in Chapter 13, and, if Congress had wished to incorporate section 1325(b)(3) within Chapter 11, it would have done so explicitly and left no ambiguity.

With the overall goal to solve the problem of bankruptcy abuse, another logical purpose of including and referencing section 1325(b)(2) would be to emphasize 1325(b)(2)'s use of the term "reasonably necessary." 11 U.S.C. 1325(b)(2). The term "reasonably necessary" was correctly construed by the *Roedemeier* court as Congress intending to incorporate a level of judicial scrutiny not previously injected into these cases. *See In re Roedemeier*, 374 B.R. at 273. Chapter 11 was abused by debtors who were seeking to protect income that would otherwise be grabbed by the "means test" in a Chapter 13 proceeding. By referencing the term "reasonably necessary," Congress has shown its desire for the bankruptcy courts to curb potential abuse of Chapter 11 by using their own judicial analysis of the debtor's plan. Such deference to bankruptcy judges is common within the code and should serve to solve this particular problem of abuse.

THE APPROACH ADOPTED BY THE BANKRUPTCY COURT IN *IN RE ROEDEMEIER*

In re Roedemeier is the only case on record to specifically deal with the issue of whether Congress intended to apply the 707(b)(2) "means test" to individuals in Chapter 11 proceedings in order to curb abuse of the bankruptcy system. *See* Jerald I. Ancel, Jeffrey J. Graham & Marlene Reich, *Advising an Individual Chapter 11 Debtor on the Impact of 11 U.S.C. §§ 1129(a)(15), 1127(e)*, 27 AM. BANKR. INST. J., 20, 52 (2008). The case addresses the question

of whether the "means test" should be applied to determine the debtor's disposable monthly income in individual Chapter 11 cases or if the court should employ a less stringent standard – namely, a reasonable judicial determination of the debtor's disposable income. *See In re Roedemeier*, 374 B.R. at 271. Ultimately, the court correctly concluded that the 707(b)(2) "means test" does not apply to Chapter 11 debtors and instead uses "reasonably determinable judicial standards" to calculate disposable income. *Id.* at 272–73.

The substance of the proceeding dealt with a debtor who saw his original dental practice, Roedemeier-Quattrochi DDS, P.C. ("R-Q") crumble following a malpractice lawsuit filed against him. *Id.* at 267. The suit caused his practice to lose financing, and, after the damage that R-Q had suffered, the debtor formed a new venture, Deer Creek Family Dental Care, L.L.C. *Id.* However, creditors of R-Q continued to pursue the debtor, leading to his filing for Chapter 11 bankruptcy protection. *Id.* In his reorganization plan, the debtor made fiscal allotments for hiring of new dentists and other staff in order to return his business to a level of health that would allow him to satisfy the creditors as best as possible. *Id.* at 267–68.

Even though the only objection to the substance of the debtor's plan had been resolved, the court had the additional obligation of ensuring that the plan complies with all the requirements of section 1129 – ensuring compliance with section 1129 is a separate and distinct issue from a creditor objection to a specific provision of the debtor's reorganization plan. *Id.* at 270. As seen previously, one of the requirements under section 1129 was the "disposable income" provision in 1129(a)(15)(B). *See* 11 U.S.C. § 1129(a)(15)(B). It is this requirement that the creditors argued had not been met by the debtor. *In re Roedemeier*, 374 B.R. at 271. The creditors pointed to the language in section 1325(b)(3) that requires a debtor with monthly income above a certain threshold under section 1325(b)(2) to have his disposable income

measured by the "means test." *Id.* at 271–72. The creditors argued that it was "plausible" to interpret section 1129(a)(15)(B)'s inclusion of section 1325(b)(2) in such a way as to also incorporate section 1325(b)(3). Such an interpretation would subsequently require a "means test" determination of the debtor's monthly income in this Chapter 11 setting. *Id.* at 272.

The court, however, rejected this argument, relying heavily on two outside sources that had addressed this issue. *Id.* Firstly, the court looked to congressional advisory committee comments, which clearly stated that the "means test" in 707(b)(2) should not be utilized when calculating an individual Chapter 11 debtor's disposable income. *See id.* at 272. However, it should be noted that this opinion was promulgated after the BAPCPA was already enacted, and, consequently, it was not relied upon during the drafting of the BAPCPA Amendments. The second outside source used by the court was a leading bankruptcy treatise. The court relied on the treatise's view that reading section 1129(a)(15)(B) as the creditors did in this case was "flawed" and would lead to the unintended result of applying the "means test" in a Chapter 11 case. *Id.* at 272. *See* COLLIER at ¶ 1129.03, at 1129–74.9**.** The court felt that, if Congress had intended for the "means test" to be applied in this Chapter 11 setting, it would have done so explicitly in the statute.

Based on these reasons, the court made its ruling and laid out a standard by which future Chapter 11 debtors could potentially be judged. The court ruled that, even if there had been an objection to the debtor's plan, under its judicial determination standard, the court would have confirmed the debtor's plan regardless and was convinced the plan would satisfy the requirements of 1129(a)(15)(B). *In re Roedemeier*, 374 B.R. at 272–73. It was of the court's opinion that the expenses outlined by the debtor for himself and that of his dependents were reasonably necessary under the circumstances. *Id.* In coming to this determination, the court

lent significant weight to the practicality of the fact that the debtor's plan actually provided the creditors with more value than the debtor's actual projected disposable income. *Id.* at 273. In addition to the court's conclusion that the debtor was not subject to the "means test," the court logically came to the result that there was no sensible reason in not confirming a plan that was most beneficial to all parties involved. *See id.* This practical result is consistent with the court's view that section 1129(a)(15)(B) must be interpreted to allow for a reasonable judicial determination of the debtor's necessary expenses. *See id.* at 273.

READING THE STATUTE AS INCORPORATING THE "MEANS TEST" INTO CHAPTER 11 IS INCONSISTENT WITH CONGRESS' EXPLICIT APPLICATION OF THE TEST IN CHAPTER 13

One of the more significant influences to the *Roedemeier* court in deciding that the "means test" was inappropriate as applied to an individual chapter 11 debtor was the opinion expressed in *Collier on Bankruptcy*, a leading bankruptcy treatise. *See In re Roedemeier*, 374 B.R., at 272. The treatise opined that a reading of section 1129(a)(15)(B) in such a way as to incorporate section 1325(b)(3) and a "means test" calculation into Chapter 11 cases had significant flaws. *See* COLLIER at ¶ 1129.03, at 1129–74.9**.** Congress explicitly, and without ambiguity, required the "means test" to be used in Chapter 13 cases. It follows that, if Congress wished to have the test applied to Chapter 11 debtors, it would have done so with the same conviction with which it required the "means test" in Chapter 13. Such discretion to incorporate the "means test" in Chapter 11 was clearly within its legislative power. *Collier's* presumed the drafters purposefully left out any mention of a "means test" in Chapter 11 in order to make it clear that the "means test" had no place in Chapter 11 bankruptcy. *Id.*

Additionally, section 1129(a)(8) of the Bankruptcy Code requires that all classes of unsecured creditors accept the plan proposed by the debtor. 11 U.S.C. § 1129(a)(8). This

requirement is also indicative of Congress' desire not to impose the generic and rigid provisions of the "means test" to individual Chapter 11 debtors because bankruptcy reorganization under Chapter 11 requires a degree of flexibility in order to function properly. *See* COLLIER at ¶ 1129.03, at 1129–74.9; 11 U.S.C. § 707(b)(2).

BANKRUPTCY COURTS SHOULD FOLLOW THE *ROEDEMEIER* COURT IN USING THE LANGUAGE OF § 1129(A)(15)(B) TO REACH THE MOST EQUITABLE RESULT

As stated, the BAPCPA's chief intention, with respect to the issue of abuse in this particular area of bankruptcy, was to eliminate the incentive of avoiding the "means test" in Chapter 13 in order to unfairly retain value of the bankruptcy estate through Chapter 11. At the least, the BAPCPA Amendments to section 1129 would allow for the recovery of such value by the creditors in a Chapter 11 proceeding, preventing the debtor from receiving an unjust advantage. However, except for referencing section 1325(b)(2) in defining "projected disposable income" as all expenses reasonably necessary for the debtor and the debtor's dependents, section 1129(a)(15)(B) is largely non-instructive. *See* 11. U.S.C. § 1129(a)(15)(B). The *Roedemeier* court was correct in deciding the interpretation of what is "reasonably necessary" is to be made by individual bankruptcy judges, and this discretion left to the bankruptcy courts will provide for the most equitable results.

The *Roedemeier* court felt comfortable with confirming the debtor's plan because, under the particular set of facts related to this case, the debtor's disposable income over a five-year period would have amounted to $0 under the calculations in form B22B. Section 1325(b)(2) says that "disposable monthly income" is determined through calculating "current monthly income," which is in turn calculated by form B22B. *See* Jerald I. Ancel, Jeffrey J. Graham & Marlene Reich, *Advising an Individual Chapter 11 Debtor on the Impact of 11 U.S.C. §§*

1129(a)(15), 1127(e), 27 AM. BANKR. INST. J., 20, 52 (2008). Since a disposable income calculation determination of $0 would have naturally resulted in no payment to the creditors over the aforementioned five-year period, the court concluded that a plan including modest payments to the creditors over that time period complied with the requirements set forth in section 1129(a)(15)(B) that the payment to the creditors not be less than the "projected disposable income" of the debtor. *Id.*; *see In re Roedemeier*, 374 B.R. 273; 11 U.S.C. § 1129(a)(15)(B); 11 U.S.C. § 1325(b)(2).

Since the "means test" is inapplicable in this situation, the only way to determine if the debtor is complying with section 1129(a)(15)(B) is to assess the reasonableness of his expenses and, consequently, the legitimacy of his projected disposable income. With no test or rigid calculation designed to make that determination, it is logical that those who are considered to be knowledgeable and impartial will do the analysis. A creditor always has the right to object to a plan on any valid grounds, and, under section 1129(a)(8), the debtor must obtain an acceptance from all classes of unsecured creditors in order to have the plan confirmed. 11 U.S.C. § 1129(a)(8). This will lead to Chapter 11 cases taking on a practical case-by-case nature where the analysis is fact-driven resulting in equitable decisions.

If, as with the dentist from *In re Roedemeier*, the debtor's expenses are either determined to be reasonably necessary for the given situation or are not objected to and the payment to the creditors is not less than the amount that would have been provided for by a "projected disposable income" calculation done with the Chapter 11 forms, no judge should have any reservations about confirming that particular debtor's plan. *See In re Roedemeier,* 374 B.R. at 273. However, if a creditor has objected to the plan and challenged the necessity of any of the debtor's expenses, the validity of the reorganization plan should rightly be put in the hands of the

judges by all bankruptcy courts. If the debtor has not made any unreasonable allotments for his expenses and that of his dependents, the plan should go ahead as constructed. If the expenses are unreasonable, the plan will be rejected, and the exact abuse that the BAPCPA was trying to prevent will be avoided.

CONCLUSION

Ultimately, the determination of what the debtor reasonably needs to support himself, his dependents, and his reorganization plan proves to be a complicated issue with murky statutory guidance. It is clear from the intention of the BAPCPA Amendments that Congress sought to eliminate a portion of the abuse and the chapter shopping that was attributed to debtors avoiding the "means test" in Chapter 13 via the relaxed standards and protection of Chapter 11. And, while it can be argued that such a loose drafting only serves to complicate the matter, the decision the court came to in *In re Roedemeier* actually provided the best possible result.

The "means test" is rigid and strict and is meant to be – it is supposed to prevent the cutting of any corners and vacuum up as much of the debtor's income as possible. If Congress intended that result to extend from Chapter 13 cases to Chapter 11 cases, it would have stated that intention explicitly. Therefore, it was unnecessary to give Chapter 11 its own rigid guidelines that might be slightly less strict as there would be no guarantee that could serve the intended purpose. Instead, the loose drafting by Congress left the decision making up to the bankruptcy judges who deal with these issues daily, and, while that will lead to discrepancies and a lack of uniformity, it should also lead to the benefit of providing debtors and creditors with the protection they deserve on a case by case basis.

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