THE MEANS TEST IN CHAPTER 13 AFTER *HAMILTON V. LANNING* AND *JOHNSON V. ZIMMER*

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In a case under Chapter 13 of the Bankruptcy Code, a debtor submits a Plan to pay his or her creditors over a period of time, typically three to five years. As a rule, the funding for creditor repayment is based on anticipated future earnings. A debtor must submit a schedule of income and expenses that suffices to pay certain ordinary and reasonable expenses of maintaining a household and paying for necessaries, and provides for at least partial payment of creditors over time.

When the Bankruptcy Code was last overhauled in 2005, Congress required that debtors utilize a "means test" to calculate their disposable income. The means test is based on the debtor's recent earnings over the six-month period preceding a bankruptcy filing. At the same time, a debtor must use his or her "projected disposable income" -- a future-looking concept -- to ascertain the funding of the Plan. For debtors with fairly steady income, the forward- and backward-looking calculations were not much different. But for debtors whose income fluctuates, as for example persons who recently lost their jobs, became separated or divorced, or whose income fluctuates with the season or the economy, pre- and post-bankruptcy income may differ significantly.

While funding for a repayment plan is based on a debtor's "projected disposable income," Congress curiously did not define that term in the Bankruptcy Code nor in the 2005 revisions to the Code. The term "disposable income," central to the means test, is defined as the debtor's current monthly income less amounts necessary for maintenance and support and certain other qualifying expenses. Current monthly income ("CMI") is defined as one's average gross income during the six month period prior to bankruptcy. Whether CMI is above or below the median income for a similar size household in the debtor's state of residence, plays an important role in determining one's eligibility to file "straight" bankruptcy (under Chapter 7) as well as calculating current monthly income. (A below-median-income debtor may deduct all expenses reasonably needed to maintain and support him- or herself, while an above-median-income debtor may only include certain specified expenses in that calculation.)

Hamilton v. Lanning

The case of *Hamilton v. Lanning*, 130 S.Ct. 2464 (2010) presented the Supreme Court with a rather fundamental question of statutory interpretation. In determining future funding of a Chapter 13 plan, did Congress intend that a debtor's income be measured strictly by his or her earnings during the preceding six-month period? Such a mechanical approach can yield anomalous results, as where a previously steady earner has lost his or her job or experienced a business failure, precipitating a bankruptcy filing. Or did a court have authority under the Bankruptcy Code to adjust the Chapter 13 plan funding based on anticipated future income rather than on strictly applying a debtor's historical income?

In *Lanning*, the debtor's regular income in the six months before filing bankruptcy was bolstered by a one-time buyout from her former employer. Post-filing, her earnings from a new position would be far less. She proposed a payment to creditors – based on current rather than past income – of $144 per month for five years. But the bankruptcy trustee contended that the statute required her to calculate a repayment plan based on so-called current monthly income, averaging her past six months income -- including the buyout -- which would yield a monthly payment of $756 for five years, a differential of $36,720 over the life of the proposed plan.

The bankruptcy court approved the $144 per month plan, reasoning that the statute's requirement that the plan be based on projected disposable income required a future-looking analysis. The Tenth Circuit affirmed. In an 8-to-1 decision (with Justice Scalia dissenting), the Supreme Court affirmed the lower courts. The majority noted that where a debtor's disposable income is higher in the pre-bankruptcy period than would be anticipated over the life of the post-filing plan, a mechanical approach mandating payments based on a level of income that no longer existed would produce "senseless" results. In response to the trustee's suggestion that a debtor could avoid such a harsh result by deferring the bankruptcy filing, the court noted that many potential debtors file for bankruptcy protection as a last option, only when they are "one step from financial Armageddon."

The Court approved a common sense guideline for determining what constitutes "projected disposable income" in such circumstances. The calculation begins by determining disposable income, based upon the debtor's recent earning history during the six months before filing. If there no significant change in the debtor's income is expected after filing bankruptcy, nothing more need be considered. But where special circumstances are present, the repayment plan should account for changes in the debtor's income or expenses that are known or virtually certain when the plan is before the Court for consideration.

Johnson v. Zimmer

Recently, on July 11, 2012 the United States Court of Appeals for the Fourth Circuit, which includes Maryland, decided *Johnson v. Zimmer*. The Court considered how to calculate the means test in situations where the size of one's household varies from time to time, such as when separated or divorced couples have split custody arrangements, or where a child attends a residential school outside the family home.

In *Johnson*, the debtor and her ex-husband shared custody of two minor sons and shared the children's expenses on a roughly equal basis. In addition, the debtor's current husband had three children who resided in the household half-time. In calculating the means test, the debtor listed a household size of seven (two adults and five children). A creditor (the ex-husband) objected, contending that the calculation overstated the true household size and thereby exaggerated the debtor's household expenses.

After observing that the Bankruptcy Code does not define the term "household," the bankruptcy court considered three different approaches to calculating household size: "Heads on beds," an approach deriving from the Census Bureau's practice of counting everyone who occupies a household on a particular measuring date; an "income tax dependent" approach, in which all persons who are or could be claimed as dependents on the debtor's tax return are counted; and an "economic unit" approach that counts the number of persons in the household who collectively function as a single economic unit by intermingling their income and expenses. The bankruptcy court adopted a variant of the economic unit approach by calculating the average number of persons who resided in the household, and then rounding the result (4.59 persons) to the next highest integer, resulting in a household size of five.

The Fourth Circuit affirmed, based partly on the recognition in *Hamilton v. Lanning* that the sometimes imprecise provisions of the Bankruptcy Code are to be applied with flexibility and common sense. In the case before it, the Court reasoned that counting each child as a full household member despite only spending part of the time living in the household, would result in overstating the anticipated expense attributable to each such child. Such an approach would be inconsistent with

the objectives of the Bankruptcy Code to fairly estimate the amounts reasonably needed to be expended for household members who are present only part of the time, and would understate the disposable income available to satisfy creditors' claims.

The Court likewise rejected the income tax dependent model as tending to understate the household size. For example, that approach would not permit a debtor to include children who reside in the household but who, by agreement with the ex-spouse, are not claimed by the debtor as tax dependents. The tax dependent method also would exclude persons such as a cohabiting fiancé or live-in elderly relatives, who reside in the household but who do not meet the Internal Revenue Code definition of a dependent.

The Court thus concluded that Congress's lack of precision in drafting the household-size language of the statute should be viewed as deferring to the bankruptcy courts a case by case determination of household size based upon circumstances such as the average number of household residents and the extent to which such residents are financially interdependent.

Conclusion

Household size, which at first might seem to have little connection to the relief sought by a bankruptcy petitioner, actually is central to determining a prospective debtor's eligibility to file for relief under Chapter 7, and likewise to the funding of a repayment plan in a Chapter 13 case. Whether Congress deliberately left this important area of the law largely undefined is a matter for speculation. In the real world courts and practitioners do not have the luxury of musing, but instead must fashion workable solutions to issues presented by the parties. In *Hamilton v. Lanning*, the Supreme Court has authorized bankruptcy courts to apply the statute with a degree of flexibility and practicality.

Back to Menu

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