Will *Lanning* Bring Resolution to the Debate Over the Meaning of Projected Disposable Income?

by

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Chapter 13 allows honest but unfortunate debtors to retain possession of their assets by repaying their creditors as much as they can afford to pay for a fixed period of time. Before the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), trustees and bankruptcy courts would decide whether debtors were repaying all that they could afford by calculating whether debtors were devoting all of their projected disposable income toward funding their repayment plans. Under BAPCPA, debtors still must devote all of their projected disposable income to their plans in order to obtain plan confirmation. However, the method trustees and bankruptcy courts use to make the calculation has changed. This is largely because the definition of disposable income changed with BAPCPA but the term "projected disposable income" remained undefined.

In the four years since BAPCPA became effective, five circuit court opinions have attempted to give meaning to the phrase, including *In re Lanning*, scheduled for oral argument before the Supreme Court on March 22, 2010. This article presents an overview of the five circuit court cases and the competing schools of thought on calculating projected disposable income.

Section 1325 and Disposable Income Before and After BAPCPA

Before BAPCPA, Bankruptcy Code section 1325 defined "disposable income" as "income which is received by the debtor and which is not reasonably necessary to be expended" for the debtor's maintenance or support, charitable contributions or business expenditures. 11 U.S.C. § 1325(b)(2)(A)-(B) (2000). Then as now, debtors listed monthly income on Schedule I and monthly expenditures on Schedule J. *See* Fed. R. Bankr. P. Official Form 6, Scheds. I-J (2000). Thus, to calculate a debtor's current disposable income, trustees generally began with the monthly income listed on Schedule I and deducted any monthly expenditures listed on Schedule J that the trustee (or the bankruptcy court) determined were reasonably necessary to support the debtor, to contribute to charity or to operate the debtor's business.

To compute a debtor's projected disposable income, the trustee initially multiplied the debtor's current disposable income by the number of months in the debtor's plan. *See, e.g.*, *In re Killough*, 900 F.2d 61, 64 (5th Cir. 1990). In projecting disposable income, however, trustees and courts considered any changes to the debtor's income or expenses that appeared likely to occur during the plan period. *See, e.g.*, *In re Petro*, 395 B.R. 369, 377 (6th Cir. B.A.P. 2008) (observing that "prior to BAPCPA the schedules were a starting point and courts gave meaning to the words 'projected' and 'to be received' by taking into account a debtor['s] anticipated

future income"). In other words, before BAPCPA, projected disposable income was not merely the mechanical application of current disposable income into the future – although current disposable income formed the basis for the computation – but took into account likely changes in circumstances.

BAPCPA altered trustee procedures by changing both the definition of disposable income and the types of expenses that debtors could deduct when computing disposable income. BAPCPA defines "disposable income" as "current monthly income received by the debtor … less amounts reasonably necessary to be expended" for certain items. 11 U.S.C. § 1325(b)(2). "Current monthly income," a new term under BAPCPA, is the debtor's "average monthly income from all sources" during the six months preceding the filing. 11 U.S.C. § 101(10A)(A)(i). To determine the amount of expenses the debtor is entitled to take when computing disposable income, debtors must file Official Form 22C (formerly Form B22C), which sets forth the debtor's current monthly income as defined in section 101(10A)(A)(I), in addition to Schedules I and J. *See* Fed. R. Bankr. P. Official Form 22C (2009). Those with income below the median income of a comparably-sized household in the applicable state may claim the same types of general expenses they could claim pre-BAPCPA. 11 U.S.C. §§ 1325(b)(2)(A)(I)-(ii) and (b)(2)(B). Debtors whose current monthly income exceeds the median, however, may claim only certain expenses, subject to the limits specified in section 707(b)(2). *See* 11 U.S.C. § 1325(b)(3)(A) (incorporating 11 U.S.C. § 707(b)(2)).

Thus, BAPCPA amended the formulae for computing "disposable income" under section 1325(b)(2) in two respects: it altered the method for computing a debtor's current monthly income, and it established a new method for calculating an above-median debtor's expenses. Since the introduction of these changes to section 1325(b)(1)(B), courts of appeal have disagreed on how to compute "projected disposable income." The majority applies a forward-looking approach to computing projected disposable income that takes into account likely future changed circumstances, and the minority mechanically extrapolates projected disposable income based solely on disposable income as of the filing date.

The "Mechanical" Approach to Determining Projected Disposable Income

In the case of *Maney v. Kagenveama* (*In re Kagenveama)*, 541 F.3d 868 (9th Cir. 2008), the debtor's Schedules I and J disclosed net monthly income (Schedule I income minus Schedule J expenses) of $1,523.89 available to pay creditors. The debtor's Form 22C listed her "disposable income" as a negative number. *Id*. at 871. Despite having negative disposable income, the debtor proposed a plan that would pay $1,000 per month for 36 months. The trustee objected, arguing that the applicable commitment period for the debtor was five years pursuant to section 1325(b)(4)(A)(ii); the debtor countered that, because her disposable income was a negative number, she did not need to propose a five-year plan. The bankruptcy court agreed with the debtor, holding that, because the debtor had no "projected disposable income," she was not required to propose a plan with an "applicable commitment period" of five years.

On appeal,[1] the Ninth Circuit considered the debtor's contention that projected disposable income means disposable income multiplied by the duration of the applicable commitment period without adjustments for changed circumstances – in other words, a mechanical application of disposable income into the future. The United States Trustee filed an amicus brief urging a forward-looking definition of projected disposable income, in which "disposable income" on the Form 22C serves only as a starting point for determining projected disposable income. Under this interpretation, projected disposable income, while based on the "disposable income" calculation derived from Form 22C, is subject to adjustment to account for any significant increases or decreases in debtor's income that are likely in particular cases. The Ninth Circuit affirmed the bankruptcy court's ruling, holding that "projected disposable income" under section 1325(b)(1)(B) is calculated solely from the disposable income figure on Form 22C multiplied by the applicable commitment period, with no other adjustments.

The "Forward Looking" Approach to Determining Projected Disposable Income

A number of other circuits that have considered this question have held that projected disposable income requires a forward-looking evaluation of the debtor's likely future circumstances, rather than the mechanical application of disposable income set forth in *Kagenveama*. In *Coop v. Frederickson (In re Frederickson)*, 545 F.3d 652 (8th Cir. 2008)**,** the Eighth Circuit sought to define the terms "projected disposable income" in connection with determining the debtor's applicable commitment period. The trustee and debtor agreed that the debtor had no projected disposable income. The trustee objected to the debtor's proposed plan, however, because the length of the proposed plan was less than the five-year applicable commitment period required by section 1325. The trustee argued that the five-year applicable commitment period was mandatory even if the debtor had no projected disposable income. The bankruptcy court held that a shorter plan period was permissible and the bankruptcy appellate panel for the Eighth Circuit affirmed. *In re Frederickson*, 545 F.3d 652, 654 (8th Cir. 2008).

In reversing the lower court rulings and adopting a forward-looking approach, the Eighth Circuit reasoned that, in enacting BAPCPA, Congress sought to eliminate perceived abuse of the bankruptcy system by above-median income debtors by rigidly defining "disposable income" in section 1325(b)(2). *Id*. at 658 (*citing In re Kolb*, 366 B.R. 802 (Bankr. S.D. Ohio 2007)). The court recognized that the computation method set forth in section 1325(b)(2) is based on a retrospective, historical recounting of the debtor's disposable income, not necessarily the debtor's actual current financial situation, which might vary from the historical figures due to job loss, increase in income or increase or decrease in actual expenses. *Id.* at 659. Accordingly, the Eighth Circuit determined that the term "projected disposable income" necessarily contemplates a forward-looking approach, because "disposable income" based on historical income and certain prescribed expenses may or may not provide an accurate projection for many debtors.

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[1] The bankruptcy court certified the order for direct appeal to the Ninth Circuit.

In Hamilton v. Lanning (In re Lanning), 545 F.3d 1269 (10th Cir. 2008), *cert. granted*, No. 08-998 (Nov. 2, 2009), the Tenth Circuit affirmed the lower courts' use of the forward-looking approach that takes into account substantial changes in circumstances. *Id*. at 1282. The debtor in *Lanning* had received a buyout from her employer in the six-month period before the filing of her petition**.** The debtor's filings reflected the disparity between her current income and recent history: Form 22C set forth a monthly disposable income of $1,114.98, but Schedules I and J showed net income of $149. *Id at* 1271. The debtor proposed a 36-month plan with monthly payments of $144. *Id at* 1271. The trustee objected, arguing that section 1325(b)(1)(B) provides a "rigid formula" for determining projected disposable income based on the debtor's disposable income as reflected on Form 22C.

The debtor countered that Form 22C did not present an accurate picture of her present financial circumstances because it included income not available to her on or about the time she filed her bankruptcy petition. The bankruptcy court confirmed the plan, and the bankruptcy appellate panel for the Tenth Circuit affirmed, holding that the debtor's "current monthly income" is the starting point for calculating a debtor's "projected disposable income" unless there has been a substantial change in circumstances. *Id at* 1282.

In *Brothers v. Turner (In re Turner)*, 574 F.3d 349 (7th Cir. 2009), the Seventh Circuit applied the forward-looking approach to evaluating changes in likely future expenses. The trustee objected to the debtor's deduction of mortgage payments on a house he intended to surrender before the plan's effective date, arguing that the debtor's plan did not meet the disposable income or good faith tests.[2] Although the debtor sought to apply the "mechanical" approach to projected disposable income, the Seventh Circuit declined, stating:

> Since the object of a Chapter 13 bankruptcy is to balance the need of the debtor to cover his living expenses against the interest of the unsecured creditors in recovering as much of what the debtor owes them as possible, we cannot see the merit in throwing out undisputed information, bearing on how much the debtor can afford to pay, that comes to light between the submission and approval of a plan of reorganization.

Id at 355. Ultimately, the court agreed that although the calculation of disposable income in the plan "is a starting point for determining the debtor's 'projected disposable income'... the final calculation can take into consideration changes that have occurred in the debtor's financial circumstances." *Id at* 356.

Similarly, in *Nowlin v. Peake (In re Nowlin)*, 576 F.3d 258 (5th Cir. 2009), the Fifth Circuit affirmed the lower court's use of a forward-looking approach to computing projected disposable income based on reasonably certain future events. In *Nowlin*, the chapter 13 trustee opposed confirmation of the debtor's plan because the plan made no provision to increase plan

[2] The bankruptcy court rejected the trustee's argument and certified the order for direct appeal to the Seventh Circuit.

payments after the loan from her 401(k) plan was repaid in the 24th month. The debtor argued that repayment of the loan should not be considered for confirmation purposes because the calculation of "projected disposable income" under section 1325(b)(1) was a mechanical operation, involving nothing more than determining her disposable income under section 1325(b)(2) and multiplying that amount by the plan's term. The bankruptcy court denied confirmation of the plan and the Fifth Circuit affirmed, holding that the phrase "projected disposable income" allows consideration of reasonably certain future events.

Conclusion

The Fifth, Seventh, Eighth and Tenth Circuits have concluded that the concept of "projected disposable income" is forward-looking, and that the disposable income set forth on Form 22C serves as a starting point subject to adjustment based on the debtor's present or future financial reality. The United States supports this view. The Office of the Solicitor General, with the assistance of the Office of General Counsel for the Executive Office for United States Trustees, filed a Brief as Amicus Curiae Supporting Respondent. The Ninth Circuit, however, has held that "projected disposable income" means nothing more than the mechanical application of the "disposable income" figure on Form 22C. Other circuits, such as the First and Fourth, have stayed appeals concerning "projected disposable income" pending the Supreme Court's decision in *Lanning*. The Court's ultimate decision should resolve the split of authority regarding this undefined term, bringing certainty to the bankruptcy process for trustees, debtors and other participants in the bankruptcy system.