No. 12-4002

IN THE
UNITED STATES COURT OF APPEALS
FOR THE TENTH CIRCUIT

In re FRED FAUSETT CRANMER,
Debtor.

KEVIN R. ANDERSON
Chapter 13 Trustee-Appellant

— v. —

FRED FAUSETT CRANMER,
Appellee

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH – NO. 11-230

BRIEF OF *AMICUS CURIAE* NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS IN SUPPORT OF DEBTOR AND SEEKING AFFIRMANCE OF THE DISTRICT COURT'S DECISION

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June 12, 2012

CERTIFICATE OF INTEREST AND CORPORATE DISCLOSURE STATEMENT

Kevin R. Anderson v. Fred Fausett Cranmer. – No. 12-4002

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure *Amicus Curiae* the National Association of Consumer Bankruptcy Attorneys makes the following disclosure:

1) For non-governmental corporate parties please list all parent corporations. **NONE.**

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3) If there is a publicly held corporation which is not a party to the proceeding before this Court but which has a financial interest in the outcome of the proceeding, please identify all such parties and specify the nature of the financial interest or interests. **NONE.**

4) In all bankruptcy appeals counsel for the debtor or trustee of the bankruptcy estate must list: 1) the debtor, if not identified in the case caption; 2) the members of the creditors' committee or the top 20 unsecured creditors; and, 3) any entity not named in the caption which is an active participant in the bankruptcy proceedings. If the debtor or trustee is not participating in the appeal, this information must be provided by appellant. **NOT APPLICABLE.**

__/s/ Tara Twomey_____
Tara Twomey, Esq.

Dated: June 12, 2012

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STATEMENT OF INTEREST

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys ("NACBA") is a non-profit organization of more than 4,500 consumer bankruptcy attorneys nationwide. NACBA's corporate purposes include education of the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process.

The NACBA membership has a vital interest in the outcome of this case. Many consumer debtors who file for bankruptcy protection are dependent upon Social Security Benefits to answer their basic needs such as housing, food, transportation, and clothing. Because of this reliance, Congress has legislated to protect Social Security Income through the Social Security Act as well as the Bankruptcy Code. Although some debtors voluntarily contribute their social security benefits to their chapter 13 plans, if courts choose to ignore the statutory language and impose a requirement that some debtors make that contribution, more debtors will choose to file under chapter 7 rather than risk loss of their benefits. Thus, it is essential that the plain language of these statutes, as well as clear legislative intent, be respected and adhered to.

CONSENT

This brief is being filed with the consent of the parties.

CERTIFICATION OF AUTHORSHIP

Pursuant to FRAP 29(c)(5), the undersigned counsel of record certifies that this brief was not authored by a party's counsel, nor did party or party's counsel contribute money intended to fund this brief and no person other than NACBA contributed money to fund this brief.

SUMMARY OF ARGUMENT

Social Security benefits form the foundation of Americans' retirement income. Since the 1930s, Congress has shielded these benefits from the reach of a beneficiary's creditors. As part of these protections, Congress excluded Social Security benefits from "the operation of any bankruptcy or insolvency law." 42 U.S.C. § 407(a). Under the 2005 Bankruptcy Code amendments Congress defined the "disposable income" that a chapter 13 debtor must pay to creditors through a plan. 11 U.S.C. § 1325(b)(1),(2). This statutory definition of income that must be designated for plan payments expressly "excludes benefits received under the Social Security Act." 11 U.S.C. § 101(10A).

The appellant trustee asks this Court to strip Social Security benefits of all protections in Chapter 13 bankruptcy cases. He wants these benefits treated as any other income to be paid to creditors. The trustee's arguments run counter to unambiguous, long-standing congressional directives. If implemented, the trustee's views would have the perverse effect of discouraging filings of chapter 13 repayment bankruptcies, encouraging chapter 7 liquidations instead. This is precisely the outcome Congress sought to discourage through the 2005 BAPCPA amendments.

The U.S. Supreme Court's decision in *Hamilton v. Lanning*[1] does not authorize courts to vary the substantive elements used to calculate debtors' "disposable income" in chapter 13 cases. The decision only authorizes courts to take into account temporal changes within the categories of income the Code defines as included in "disposable income."

Chapter 13 debtors do not act in bad faith when they calculate their plan payments exactly as the Bankruptcy Code authorizes them to do. The sheltering of Social Security benefits in bankruptcy is consistent with the high level of protection Congress created for all forms of debtors' retirement income. This is an area where Congress has set the balance between the debtor's interest in a fresh start and creditors' interest in payment.

[1] 130 S. Ct. 2464 (2010).

ARGUMENT

I. Congress Mandated That Social Security Benefits Must Not Be Subject "To The Operation of Any Bankruptcy or Insolvency Law."

Benefits under the Social Security Act are protected from seizure by the beneficiary's creditors. This has been a consistent feature of the consumer credit marketplace since the 1930s. When lenders extend credit, they do so with the knowledge that if the borrower defaults, any Social Security benefits the borrower becomes entitled to receive will be shielded from collection efforts. Individuals become eligible to receive Social Security benefits by virtue of age, disability, or the death of certain family members. Creditors enter into consumer credit transactions with full knowledge that these eventualities can come to pass for any individual, entitling that person to receive and retain protected income. The protected nature of Social Security benefits is a recognized feature of doing business in the consumer credit market. The district court's decision in this matter did nothing more than place creditors in the same position they would be in absent the bankruptcy filing. In re *Devilliers*, 358 B.R. 849, 866 (Bankr. E.D. La. 2007).

A. Congress Has Shielded all Social Security Income in all Bankruptcy Cases through Four Different Enactments.

Congress recognized the protected status of Social Security benefits in two provisions of the Social Security Act and in two sections of the Bankruptcy Code.

1. The Social Security Act. The Social Security Act's basic provision protecting benefits from creditors is currently found in 42 U.S.C. § 407(a). This subsection contains both a general prohibition against subjecting Social Security benefits to any "legal process" and a specific directive removing the benefits from the reach of all bankruptcy laws. The statute provides:

> The right of any person to any future payment under this subchapter shall not be transferable or assignable, at law or in equity, and none of the moneys paid or payable or rights existing under this subchapter shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law. 42 U.S.C. § 407(a).

According to the Supreme Court, the term "other legal process" in § 407(a) refers not only to formal execution procedures, but also to any processes that "seem to require the utilization of some judicial or quasi-judicial mechanism, though not necessarily an elaborate one, by which control over property passes from one person to another in order to discharge or secure discharge of an allegedly existing or anticipated liability." *Washington State Department of Social and Health Services*, 537 U.S. 371, 385 (2003).

In chapter 13 bankruptcy, the debtor loses control over his or her property in two ways. First, the initial filing of a bankruptcy case transfers the debtor's interest in many forms of property from the debtor to the bankruptcy estate. Second, a bankruptcy court's order confirming a chapter 13 plan directs portions of the debtor's income to be paid to a trustee. The trustee in turn pays these funds to

creditors who apply the payments toward pre-petition debts. The transfer of the debtor's property interest in Social Security benefits from the debtor to the bankruptcy estate would transfer control over the funds from the beneficiary to another entity in contravention of § 407(a). A bankruptcy court order having the effect of directing the debtor's Social Security income toward payment of pre-petition debts under a chapter 13 plan would also violate § 407(a).

The final phrase of § 407(a) gives the broadest and strongest possible protection to Social Security benefits in the context of bankruptcy. This language mandates that Social Security benefits not be subject to the operation of *any* bankruptcy law. Social Security benefits do not become property of the bankruptcy estate in chapter 7 and chapter 13 cases. Social Security benefits have a status distinct from that of other exempt property. Exclusion of the benefits from the bankruptcy estate precludes any attempt by the bankruptcy court or trustee to exercise control over Social Security income. In re *Carpenter*, 614 F.3d 930, 936 (8th Cir. 2010) ("§ 407 must be read as an exclusion provision, which automatically and completely excludes social security proceeds from the bankruptcy estate"); In re *Buren*, 725 F.2d 1080, 1085-87 (6th Cir. 1984); In re *Miller*, 445 B.R. 504, 507 (Bankr. S.C. 2011); 4 Alan N. Resnick & Henry J. Sommer, *Collier on Bankruptcy* ¶ 522.09[10][a] n.76 (16th ed. 2011).

2. *Congress reinforced the Social Security Act protections in 1983.* In 1983, Congress amended the Social Security Act to make the protections for Social Security benefits in the bankruptcy process unambiguous. Congress re-codified § 407 and added a new subsection 407(b) which provides:

> (b) No other provision of law, enacted before, on, or after the date of the enactment of this section, may be construed to limit, supersede, or otherwise modify the provisions of this section except to the extent that it does so by express reference to this section. 42 U.S.C. § 407(b).

Under this provision, federal statutes must expressly declare an intention to modify the scope of § 407 in order for any enactment to be construed as limiting § 407's protections.[2]

The legislative history of the 1983 Social Security Act amendments indicates that judicial misinterpretation of the original version of § 407 led Congress to enact the clarifying legislation. The relevant House Conference Report from 1983 stated as follows:

> Based on the legislative history of the Bankruptcy Reform Act of 1978, some bankruptcy courts have considered social security and SSI benefits listed by the debtor to be income for purposes of a Chapter XIII bankruptcy and have ordered SSA in several hundred cases to send all or a part of a debtor's benefit check to the trustee in bankruptcy.
>
> As a correction to misinterpretation of existing law, the Conference Committee adopts the House language of proposed Social Security

[2] *See, e.g.,* 31 U.S.C. § 3716(c)(3)(A)(i) and 42 U.S.C. § 659(e), authorizing collection of certain debts owed to the federal government and debts owed for child support "notwithstanding" § 407.

> legislation. This bill "[s]pecifically provides that social security and SSI benefits may not be assigned notwithstanding any other provision of law, including P.L. 95-598, the "Bankruptcy Reform Act of 1978".[3]

Nearly thirty years ago Congress acted to correct certain bankruptcy courts that were considering Social Security benefits to be income for purposes of chapter 13 plans.

3. The 2005 Bankruptcy Code amendments again emphasized the protected status of Social Security benefits. The 2005 amendments to the Bankruptcy Code created a means-testing threshold for consumers' access to a chapter 7 discharge. The 2005 amendments also created a new income-based formula to determine plan length and payment levels for certain debtors in chapter 13 cases. The key calculation for both the chapter 7 means test and the chapter 13 payment level focused upon the term "current monthly income" or "CMI." The 2005 amendments defined CMI as:

> [T]he average monthly income from all sources that the debtor receives ... without regard to whether such income is taxable income, ... and includes any amount paid by any entity other than the debtor ... on a regular basis for the household expenses of the debtor or the debtor's dependents ... but excludes benefits received under the Social Security Act. 11 U.S.C. § 101(10A).

The 2005 amendments incorporate this CMI definition into the calculation that determines eligibility to file under Chapter 7. 11 U.S.C. § 707(b)(2). Congress

[3] Social Security Amendments of 1983. House Conference Report No. 98-47 Joint Explanatory Statement of the Committee of Conference p.153, reprinted in 2 1983 U.S.C.C.A.N. 98th Cong. First Session p.443.

incorporated the identical definition into the Code section defining the requisite "disposable income" that a debtor must pay for the benefit of unsecured creditors under a chapter 13 plan. 11 U.S.C. §1325(b)(2). Thus, since 1983, rather than enacting legislation that subjected Social Security benefits to the operation of the bankruptcy laws, Congress expressly amended the Code to exclude these benefits from the scope of the bankruptcy laws and specifically excluded the benefits from the calculation of the debtor's income to be paid under a chapter 13 plan. It is difficult to conceive of what more Congress could have done to achieve the objective of protecting Social Security benefits and removing them from all income calculations in bankruptcy.

4. ***Exemption for Social Security benefits under the 1978 Bankruptcy Code.*** In the Bankruptcy Reform Act of 1978, Congress created a specific federal bankruptcy exemption for "[t]he debtor's right to receive – (A) a social security benefit." 11 U.S.C. § 522(d)(10)(A). Five of the six states within the Tenth Circuit have "opted-out" of the federal bankruptcy exemptions.[4] In the "opt-out" states bankruptcy debtors claim exemptions under state law or under federal non-bankruptcy law. 11 U.S.C. § 522(b)(3). Many state laws exempt Social Security benefits, both inside and outside of bankruptcy. In addition, under § 522(b)(3) of the Bankruptcy Code debtors in "opt-out" states may claim the federal non-

[4] New Mexico has not opted out of the federal bankruptcy exemption scheme.

bankruptcy exemption under § 407 of the Social Security Act. Thus, since 1978, the Bankruptcy Code has allowed debtors in all states to claim an exemption for all Social Security benefits in all bankruptcy cases.

B. The Voluntary Nature of Bankruptcy Filings Does Not Strip Debtors of Statutory Protections for Social Security Benefits.

Individuals do not waive the protections of § 407 of the Social Security Act because they choose to file a bankruptcy petition. The Supreme Court held long ago that beneficiaries who applied for state-sponsored welfare programs could not be treated as having agreed to a waiver of their rights under § 407(a) because they applied for the benefits voluntarily. *Philpott v. Essex County Welfare Board*, 409 U.S. 413 (1973). With § 407 of the Social Security Act Congress enacted a statute that removed Social Security benefits from the operation of "any bankruptcy or insolvency law." 42 U.S.C. § 407(a). It would have been incongruous for Congress to enact a statute applicable to "any" bankruptcy law and at the same time intend that the statute not apply to any individual bankruptcy case filed voluntarily. All chapter 13 cases are voluntary. So are, with very rare exceptions, all chapter 7 cases.[5]

It is true that several early decisions held that bankruptcy courts could order debtors to pay Social Security benefits over to a chapter 13 trustee for the benefit

[5] The rare exception would be an involuntary chapter 7 case. 11 U.S.C. § 303. These typically involve individuals engaged in commercial activities, not consumer debtors.

of creditors. *See, e.g.*, *United States v. Devall*, 704 F.2d 1513 (11th Cir. 1983). Decisions such as *Devall* reasoned that the voluntary nature of chapter 13 superseded the protections of § 407. Not surprisingly, the trustee in this appeal relies on the *Devall* decision for the same "voluntary" argument. (Trustee's Brief. P. 21). The *Devall* court's analysis was precisely the type of misinterpretation that Congress intended to correct in amending the Social Security Act in 1983. *See* I.A.2, *supra*. *Devall* has been legislatively overruled.[6]

II. The 2005 BAPCPA Amendments Created a New Definition for the "Disposable Income" That Debtors Must Pay to Unsecured Creditors Under a Chapter 13 Plan.

The 2005 BAPCPA amendments added a definition of "current monthly income" ("CMI") to the Bankruptcy Code. 11 U.S.C. § 101(10A). CMI is defined as "the average monthly income from all sources that the debtor receives . . . but excludes benefits received under the Social Security Act." *Id*. For chapter 13 cases, this CMI definition has been incorporated directly into the requirements of 11 U.S.C. § 1325(b). Section 1325(b) sets the "ability to pay" standard for chapter 13.

[6] The trustee's reference to Judge Lundin's *Chapter 13 Bankruptcy* treatise is similarly unavailing. (Trustee's Brief pp. 21-22). The referenced treatise section (Vol. I § 9.5) discusses § 109(e) of the Bankruptcy Code, not § 101(10A). Section 109(e) addresses *eligibility* to file under chapter 13. No one disputes that debtors may voluntarily contribute Social Security benefits to a plan for the purpose of showing regular income to achieve *eligibility* for chapter 13.

Under § 1325(b)(1), if the chapter 13 trustee or the holder of an allowed unsecured claim objects to confirmation of a debtor's plan that does not provide for full payment of unsecured claims, the plan may be confirmed only if it "provides that all of the debtor's projected disposable income to be received in the applicable commitment period . . . will be applied to make payments to unsecured creditors under the plan." The next subsection of § 1325(b) defines "disposable income." "Disposable income" means "*current monthly income* received by the debtor" minus certain deductions and amounts defined in further subsections as reasonably necessary expenditures. 11 U.S.C. § 1325(b) (2). (emphasis added).

The "current monthly income" designated in § 1325(b)(2) as the base for determining "disposable income" in chapter 13 is an express reference to CMI as defined in 11 U.S.C. § 101(10A). Section 101(10A) mandates exclusion of Social Security income from the calculation of CMI. The instant appeal involves a straightforward application of the Code's plain language. *United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241 (1989). Projected disposable income excludes Social Security benefits.

The courts have recognized the significant effect that the new definition of disposable income, with its exclusion of Social Security benefits, has had for determining what income the debtor must pay to unsecured creditors in a chapter 13 case. *Baud v. Carroll*, 634 F.3d 327, 345-46 (6th Cir. 2011) ("to include Social

Security benefits in the calculation of the Appellees' [debtors'] projected disposable income essentially would read out of the Code BAPCPA's revisions to the definition of disposable income."); In re *Welsh*, 440 B.R. 836, 849 (Bankr. D. Mont. 2010), *aff'd* 465 B.R. 843 (B.A.P 9th Cir. 2012); In re *Vandenbosch*, 459 B.R. 140, 144 (M.D. Fla. 2011); In re *Bartelini*, 434 B.R. 285, 294 (Bankr. N.D. N.Y. 2010); In re *Barfknecht*, 378 B.R. 154, 162 (Bankr. W.D. Tex. 2007).

III. *Lanning* Dealt Only With Temporal Changes To a Debtor's Statutorily-Defined "Disposable Income."

According to the trustee, the Supreme Court in *Hamilton v. Lanning*, 130 S. Ct. 2464 (2010), "ruled that 'Disposable Income' and 'Projected Disposable Income' are separate and distinct concepts, and that each one is calculated using a different formula and a different means of determining income and expenses" (Trustee's Brief. p. 6). Contrary to the trustee's mischaracterization, the *Lanning* Court did not hold that a "different formula" and a "different means of determining income and expenses" applied to disposable income and projected disposable income. The trustee made up this distinction out of thin air. He suggests that in the same subsection of the Code Congress intended to give "disposable income" two different meanings. Social Security income would be included in one definition and excluded in the other. There is no statutory basis for this irrational distinction. As one court noted in rejecting the same argument, "The trustee would have to insist that the addition of the adjective 'projected' unhinges the remaining two

words from their Code-mandated definitions." *Barfknecht*, 378 B.R. at 161. The word "projected" placed in front of the words "disposable income" does not imbue the term "disposable income" with different substantive components.

Contrary to the trustee's suggestion, the *Lanning* Court did not address the substantive elements of what makes up CMI. Instead, the court considered the import of the word "projected" as applied to the forms of income defined by the Code to be within CMI. All that the *Lanning* court decided was that changes in this statutorily defined income likely to occur during the pendency of a plan could be considered in determining the amount the debtor should pay during the plan period. The court addressed only this temporal aspect of CMI, not the substantive nature of what income must be excluded from and included in CMI. Unlike the one-time lump sum severance payment that skewed the debtor's six-month CMI calculation in *Lanning*, Social Security benefits are a quintessential source of predictable long-term regular income.

Since the *Lanning* decision, several trustees have made the same argument regarding the effect of the word "projected" appearing before the words "disposable income" in § 1325(b)(2). The courts consistently rejected this interpretation, holding that it runs afoul of the statutory definition of CMI. *Baud v. Carroll*, 634 F.3d at 346; In re *Burnett*, 2011 WL 204907 * 4 (Bankr. N.D.N.Y. Jan. 21, 2011) ("If Congress specifically excluded social security income from the

definition of current monthly income and, therefore, disposable income pursuant to Code § 1325(b)(2), then even under the flexible approach articulated by Justice Alito who wrote the majority opinion [in *Lanning*], 'projected' disposable income would also exclude social security income absent a debtor's voluntary commission of social security income into a plan."). In pre-*Lanning* decisions raising the same issue, courts reached the same conclusion. *Barfknecht*, 378 B.R. at 162; In re *Devilliers*, 358 B.R. 849, 865 (Bankr. E.D. La. 2007); 8 *Collier on Bankruptcy, supra,* ¶ 1325.08[4][a] ("There is no suggestion [in *Lanning*] that a bankruptcy court may rely on the term 'projected' to otherwise deviate from the formula – for example, by including income that the formula excludes, such as Social Security benefits, or altering expense allowances permitted by the formula.").

A. The Trustee's Position Strips Social Security Benefits of *All* Protections in *All* Chapter 13 Bankruptcy Cases.

No one should misconstrue the trustee's arguments in this appeal. There is no plausible way to limit the application of the trustee's position to above-median-income chapter 13 cases. Under the trustee's interpretation, *all* debtors considering filing a chapter 13 case would face complete loss of the protected status of their Social Security benefits. Even a non-filing spouse would lose this protection.

The trustee's proposed rule treats Social Security benefits as fungible dollars. If the debtors' amalgam of funds produces any disposable income, then one hundred percent of that disposable income must be paid to unsecured creditors.

The trustee offers no formula for how his rule can be applied to treat Social Security income differently from any other income in Chapter 13. There is no conceivable way that Social Security income can be lumped together with all of the debtor's income and then somehow sifted out to allow for distinct treatment. The suggestion that an appropriate standard would have the debtor commit Social Security benefits to meet basic needs, freeing up non-Social Security income to pay unsecured creditors, is a chimera. As the Bankruptcy Appellate Panel for the Ninth Circuit recently noted, "[t]his approach simply does by indirection what the Code says cannot be done, which is to include Social Security benefit payments in a debtor's disposable income calculation." In re *Welsh*, 465 B.R. 843, 856 (B.A.P. 9th Cir. 2012).

B. Adopting the Trustee's Position Will Discourage Chapter 13 Filings and Encourage Chapter 7 Filings.

The trustee's rule frustrates, rather than promotes, the goal of means testing under BAPCPA. The purpose of means testing is to encourage debt repayment, and particularly to promote chapter 13 rather than chapter 7 filings. Despite the means test, the overwhelming majority of consumer debtors today still have a choice between filing under chapter 7 or 13. The trustee's rule would encourage all debtors with Social Security income to file under chapter 7. They would avoid chapter 13, where their Social Security benefits would lose all protections. Instead of paying off some portion of the debts they owed to unsecured creditors in chapter

13, they would file under chapter 7 and pay nothing to unsecured creditors. In addition, many debtors file for chapter 13 relief in order to cure defaults on home mortgages. The trustee's rule exposes these homeowners to loss of Social Security benefits if they seek chapter 13 relief. Thus, another result of adopting the trustee's rule would be fewer chapter 13 filings by retirees seeking to save their homes.

IV. Congress Intended Strong Protections for all Forms of Retirement Income in Bankruptcy, and These Protections Come at a Cost to Creditors.

The trustee asserts that Social Security benefits must be paid to creditors in chapter 13 cases because to hold otherwise would be inconsistent with the means test's "purpose of ensuring that debtors repay creditors the maximum they can afford." (Trustee's Brief pp. 1, 24). To emphasize the unfairness to creditors of a contrary position, the trustee suggests that over the duration of a five-year plan Mr. Cranmer and his non-filing spouse could potentially "shelter" up to $87,840 in Social Security benefits (benefits that are already sheltered under non-bankruptcy law). (*Id*. at 4, 11). In the trustee's view, the mere possibility of this outcome renders Mr. Cranmer's legal position inequitable and contrary to the Bankruptcy Code. (*Id.* at 18-19).

In focusing solely on the dollar amount payable to creditors, the trustee's arguments ignore the other equally important goal of federal bankruptcy legislation – the debtor's fresh start. The Code excludes certain income and assets from the bankruptcy estate and allows for exemptions to ensure that debtors achieve this

fresh start. *Schwab v. Reilly*, 130 S. Ct. 2652, 2667 (2010) ("We agree that 'exemptions in bankruptcy cases are part and parcel of the fundamental bankruptcy concept of a 'fresh start.'")While the Congress left to the states an important role in determining the nature and extent of bankruptcy exemptions, it nevertheless emphasized "that there is a federal interest in seeing that a debtor [who] goes through bankruptcy comes out with adequate possessions to begin his fresh start." H. Rep. No. 95-595, 95th Cong.; 1st Sess. 126-127 (1977), U.S.C.C.A.N 1978 p. 6087. Over time, the Code's provisions for exemptions and exclusions from estate property designed to protect retirement income and assets have grown stronger and more pervasive.

A. The Pre-BAPCPA Bankruptcy Code's Significant Protections for Retirement Savings.

In excluding common forms of retirement savings from the bankruptcy estate and otherwise allowing for their exemption from the estate, Congress gave special protections to the long-term income needs of bankruptcy debtors. In *Patterson v. Shumate*, 504 U.S. 753 (1992), the Supreme Court broadly construed 11 U.S.C. § 541(c)(2), which allows the exclusion of ERISA-qualified retirement accounts from the bankruptcy estate. In a unanimous decision the Court affirmed the exclusion of the $250,000 retirement savings of a debtor who had been president and chairman of board of directors of a corporation. According to the court, the exclusion gave effect to the statutory goal of protecting pension benefits

– if the individual had been promised the retirement income and met the conditions for receiving it, he or she should receive the income. 504 U.S. at 765. The Supreme Court noted, as does the trustee in the instant appeal, that in excluding assets of this magnitude from the reach of creditors, there could be "strong equitable considerations to the contrary." *Id*. Nevertheless, the Supreme Court recognized that the exclusion represented a clear congressional policy choice to safeguard the stream of income for pensioners to the detriment of creditors.

In another unanimous decision, *Rousey v. Jacoway*, 544 U.S. 320 (2005), the Supreme Court held that IRA accounts were protected under the Bankruptcy Code's exemption for pensions and similar plans that condition disbursements upon "illness, disability, death, age, or length of service." 11 U.S.C. § 522(d)(10)(E). As in *Shumate*, the Court focused on the nature and purpose of these protected funds. In the Court's view, the funds that were shielded under the federal bankruptcy exemption scheme of § 522(d) provided income that "substitutes for wages lost upon retirement". 544 U.S. at 332. Social Security benefits similarly substitute for wages the beneficiary earned at an earlier time, with eligibility to receive the benefits tied to age or disability. As is true for pension and similar retirement accounts, workers pay Social Security taxes out of current income with an expectation of receiving the funds back over time at a future date.

B. The 2005 BAPCPA Amendments Strengthened the Protections for Retirement Income and Assets.

The 2005 amendments added three new provisions to the Bankruptcy Code that directly affect debtors' retirement income. These are found in sections 522(d)(12), 522(b)(3)(C), and 541(b)(7). When a chapter 13 debtor participates in some form of retirement savings plan, these amendments substantially reduce the dividend available to unsecured creditors. As one treatise noted, these heightened debtor protections tend "[i]ronically" to be greatest for "wealthier Chapter 13 debtors with CMI greater than the applicable median family income." 5 Keith M. Lundin, *Chapter 13 Bankruptcy* § 494.1 (3d ed. 2000 & Supp. 2006).

1. The new § 522(d)(12) exemption for retirement savings. New § 522(d)(12) allows debtors to exempt from the bankruptcy estate "[r]etirement funds to the extent that those funds are in a fund or account that is exempt from taxation under section 401[qualified plans], 403[annuities], 408[IRAs], 408A[Roth IRAs], 414[hybrid plans], 457[deferred compensation plans for government and tax-exempt organizations], or 501[plans funded with employee contributions only] of the Internal Revenue Code of 1986." 11 U.S.C. § 522(d)(12). This provision shelters additional types of accounts not already excluded from the bankruptcy estate. H.R. Rep. No. 109-31 at 63-64 (2005). Several aspects of § 522(d)(12) are noteworthy. Unlike the pre-BAPCPA exemption under § 522(d)(10)(E), § 522(d)(12) does not limit exempted funds to amounts "reasonably necessary for the

support of the debtor and any dependents of the debtor." There is no monetary limit for most types of pension accounts. For one type of account, Congress did set a cap. Debtors may exempt up to $1,171,650 in an IRA account. 11 U.S.C. § 522(n). However, courts may increase the cap "if the interests of justice so require." *Id*. Courts have no discretion to decrease the cap.

2. New § 522(b)(3)(C) and the extension of the federal retirement savings exemption to all bankruptcy debtors. Debtors may claim the new § 522(d)(12) exemption in states that have opted out of the federal exemption scheme. 11 U.S.C. § 522(b)(3)(C). The extension of this federal bankruptcy exemption to all bankruptcy cases, regardless of the debtor's residence in an "opt-out" state, is unique in the Code. All bankruptcy debtors in all states now have the right to shield from the reach of creditors at least $1,171,650 in common types of retirement savings.

3. New § 541(b)(7)'s exclusion from the estate of contributions to retirement accounts. Section 541(b)(7) provides that the debtor's contributions to a 401k retirement account "shall not constitute disposable income as defined in section 1325(b)(2)." 11 U.S.C. § 541(b)(7). Under a related provision, the debtor's payments to repay a loan from a 401k plan do not constitute disposable income under § 1325. 11 U.S.C. § 1322(f). Sections 541(b)(7) and 1322(f) address the

debtor's ongoing *expenditures* during a chapter 13 payment plan, namely, expenditures designed to build up retirement savings.

Here again, the detriment to creditors is obvious. In the chapter 13 context, these expenditures to accumulate retirement savings reduce dollar-for-dollar the amount available to pay creditors during the pendency of the chapter 13 plan. In re *Glisson*, 430 B.R. 920, 922 (Bankr. S.D. Ga. 2009); In re *Leahy*, 370 B.R. 620, 623 (Bankr. D. Vt. 2007); In re *Njuguna*, 357 B.R. 689, 690 (Bankr. D. N.H. 2006) ("for purposes of the bankruptcy plan, it is as if the 401k contribution does not exist."); In re *Johnson*, 346 B.R. 256 (Bankr. S.D. Ga. 2006). A 401k plan's terms limiting maximum contributions set the only limit on the size of monthly contributions subject to this exclusion. In re *Mati*, 390 B.R. 11, 17 (Bankr. D. Mass. 2008); In re *Glisson*, 430 B.R. at 922. Some authorities hold that debtors may commence new retirement savings accounts in contemplation of bankruptcy.[7]

C. Accumulation of Retirement Savings Does Not Show Bad Faith Under 11 U.S.C. § 1325(a)(3).

Because Congress expressly provided for the exclusion from disposable income of contributions to most retirement accounts, trustees' challenges to these contributions as contrary to the good faith requirement of § 1325(a)(3) must fail. In re *Egan*, 458 B.R. 836, 849 (E.D. Pa. 2011) ("In BAPCPA's legislative history, Congress specifically recognized that amendments relating to 'some retirement,

[7] *See, e.g.,* 5 Lundin, *Chapter 13 Bankruptcy* at § 492.1.

education, and other savings generally would make less money available [to creditors]" quoting H.R. Rep. 109-31(I), 2005 WL 832198 at * 35 (Apr. 8, 2005)); In re J*ohnson*, 346 B.R. at 262-63; In re *Mati*, 390 B.R. 11, 17 (Bankr. D. Mass. 2008); In re *Devilliers*, 358 B.R. at 864-65.[8]

D. As the Foundation of Retirement Income, Social Security Benefits Must Receive the Highest Degree of Protection

The Bankruptcy Code has always given even stronger and more consistent protections to Social Security benefits than to the various forms of private retirement savings. For example, in the pre-BAPCPA federal bankruptcy exemptions listed under 11 U.S.C. § 522(d), the debtor's right to receive payments under pensions, annuities and other retirement accounts was exempted only "to the extent reasonably necessary for the support of the debtor and any dependents of the debtor." 11 U.S.C. § 522(d)(10)(E). By contrast, the debtor's right to receive Social Security benefits has always been exempted without any limitation. 11 U.S.C. § 522(d)(10)(A).

[8] An exception to these rulings appeared in the Sixth Circuit's decision in In re *Seafort*, 669 F.3d 662 (6th Cir. 2012), holding that § 541(b)(7) excluded from income only *pre-petition* payments to retirement accounts. The decision ignored the clear language of § 541(b)(7) that the plan contributions do not constitute "disposable *income."* (emphasis added). Instead, the court treated the section as protecting only an exempt asset. The Sixth Circuit has already ruled on the specific issue to be addressed in the instant appeal, holding that Social Security income must be excluded from the projected disposable income calculation in chapter 13. *Baud v. Carroll*, 634 F.3d 327 (6th Cir. 2011).

Under the 2005 BAPCPA amendments Congress developed the term "current monthly income" as the key standard for the means test and Chapter 13 disposable income test. 11 U.S.C. § 101(10A). Congress defined Current Monthly Income broadly to include the debtor's income from all sources. The CMI calculation did not expressly exclude private retirement benefits. The only form of regular income Congress expressly excluded from the CMI definition was "benefits received under the Social Security Act." 11 U.S.C. § 101(10A)(B).[9]

Outside of bankruptcy, courts have held that funds in ERISA-qualified private retirement accounts were protected from attachment by creditors only up to the time they were paid out to the beneficiary. Yet, these same courts recognized that § 407 of the Social Security Act protected both the right to receive Social Security benefits in the future and benefits that had been paid out and received by the beneficiary. *Guidry v. Sheet Metal Workers Nat'l Pension Fund*, 39 F.3d 1078, 1083 (10th Cir. 1994); *Hoult v. Hoult*, 373 F3d 47, 56 (1st Cir. 2004). *See generally Philpott v. Essex County Welfare Board*, 409 U.S. at 416.

As a recent GAO study noted, "While income in retirement varies widely by source, Social Security benefits are the foundation of income for nearly all retiree

[9] The CMI definition in § 101(10A)(B) also excludes certain payments to victims of war crimes and terrorism. It is not clear to what extent these payments are sources of regular income rather than lump-sum disbursements.

households."[10] Private retirement savings supplement Social Security benefits. While nearly all individuals age 65 or older receive Social Security benefits, most do not receive income from employment-related pensions or annuities.[11]

The Bankruptcy Code generously protects private retirement savings in amounts that greatly exceed the income that a debtor will ever receive from Social Security. The average Social Security benefit paid to a retiree in the United States is $1,176 monthly.[12] This is essentially the poverty level of income for an individual.[13] Social Security benefits, like other retirement income, represent a substitute for lost wages. However, Social Security benefits cover only a small portion of the wages the typical earner has lost, making the need to shield these benefits critical.[14]

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[10] U.S. Government Accountability Office, *Retirement Income: Ensuring Income Throughout Retirement Requires Difficult Choices*, GAO Report 11-400 (June 2011) p. 3.

[11] Social Security Administration, *Annual Statistical Supplement to the Social Security Bulletin, 2011* SSA Publication No. 13-11700 p. 168 (released February 2012, presenting data as of December 2010).

[12] Social Security Administration, *Annual Statistical Supplement to the Social Security Bulletin, 2011, supra,* p. 1. The average monthly Social Security benefit paid to disabled workers is less than the retiree benefit, at $1,068 monthly. *Id*. The average federal SSI payment for all ages is $501 monthly. Social Security Admin. *Facts and Figures about Social Security* 2011 p. 23.

[13] The 2012 HHS Poverty Guideline threshold for a household of one is $11,170. http://aspe.hhs.gov/poverty/12poverty.shtml

[14] On average, Social Security replaces only 41 percent of a median earner's former wages. Selena Caldera, AARP Public Policy Institute, *Social Security: Who's Counting on It?* AARP Policy Institute, p. 4. (2011).

Retired workers cannot expect to receive anything close to their former wages again. As they go through their seventies, eighties, and nineties, retirees' income drops further.[15] As time passes, individuals over age 65 earn increasingly less from employment while depleting private retirement savings and other assets. They rely more on Social Security as their primary source of income. Because income that once supplemented Social Security tends to disappear, older individuals need to preserve and protect Social Security benefits above all else. This is particularly true as traditional fixed-benefit pensions become less common and are replaced by more volatile and limited-benefit retirement saving options.[16]

V. The Retention of Social Security Benefits as Allowed Under Federal Bankruptcy and Non-Bankruptcy Law Cannot Constitute a Lack of Good Faith Under 11 U.S.C. § 1325(a)(3).

The Bankruptcy Code requires that a court confirm a chapter 13 plan when certain conditions have been met. 11 U.S.C. § 1325(a). One of these conditions is that "the plan has been proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1325(a)(3). The good faith standard provides a check on actions

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[15] Social Security Administration, *Income of the Population 55 or Older, 2008* Section 9 (April 2008) http://www.ssa.gov/policy/docs/statcomps/income_pop55/2010/index.html . For 50.6% of beneficiaries aged 65-70, Social Security benefits provided more than half of their household income. The proportion grew steadily with age, with 76.5% of the beneficiaries over age 80 dependent on Social Security for more than half of their household income.

[16] Employee Benefit Research Institute, *Retirement Trends in the United States Over the Past Quarter-Century* June 2007, available at http://www.ebri.org/publications/facts/ .

that abuse the bankruptcy system. Prior to the BAPCPA amendments, the degree to which § 1325(a)(3) could set a standard for how much a debtor must pay under a chapter 13 plan was a subject of dispute. Several Code sections specifically regulate the level of plan payments, and many courts held that these provisions alone established the adequacy of payments. Lundin, *Chapter 13 Bankruptcy* at § 193.1. The 2005 BAPCPA amendments inaugurated use of an objective calculation for defining disposable income, further limiting judicial discretion. The amendments reinforced the case for § 1325(a)(3)'s redundancy and the irrelevance of a subjective review of the adequacy of plan payments when debtors complied with the new statutory guidelines that determine the level of their plan payments. *See* 8 *Collier on Bankruptcy, supra* ¶ 1325.04 [1].

The Tenth Circuit has not addressed the impact of the 2005 amendments on the good-faith standard enunciated in *Flygare v. Boulders*, 709 F. 2d 1344, 1347-48 (10th Cir. 1983). The Colorado bankruptcy court did so in In re *Williams*, 394 B.R. 550, 570-573 (Bankr. D. Colo. 2008). The *Williams* court concluded that a good faith review of the sufficiency of income committed to a plan remained appropriate after the BAPCPA amendments. 394 B.R at 572. However, acknowledging the impact of the BAPCPA amendments, the court held that the scope of the good faith analysis must now be limited to uncovering those debtors who were "engaging in subterfuge so blatant as to indicate that they have unfairly

manipulated the Bankruptcy Code or otherwise proposed their chapter 13 plan in such an inequitable manner that they will run afoul of § 1325(a)(3)." *Id* at 573 (internal quotes and punctuation omitted).

In its recent decision addressing the same issue raised in this appeal, the Bankruptcy Appellate Panel for the Ninth Circuit applied the *Williams* court's § 1325(a)(3) standard. *Welsh*, 465 B.R. at 854-55. The *Welsh* court concluded that, in light of the BAPCA amendments, it could still consider the debtor's good faith under a totality of the circumstances test. A bankruptcy court could find lack of good faith where the debtor misrepresented facts, unfairly manipulated the Code, or engaged in egregious behavior. *Id.* at 854-55. The court went on to say that while BAPCPA did not preclude a finding of bad faith in proposing a plan payment amount, "[t]hat finding may not, however, be based on the mere fact that the debtor has excluded income or deducted expenses that the Code allows." *Id*. at 855. According to the *Welsh* court, the convergence of Code sections 1325(b)(2), 101(10A)(B) and 42 U.S.C. § 407 established the clear right of the chapter 13 debtor to exclude Social Security benefits from the calculation of projected disposable income. *Id.* at 856. A finding of lack of good faith could not be based solely on the fact that the debtor was doing what the Code allowed. *Accord* In re *Thompson*, 439 B.R. 140, 144 (B.A.P. 8th Cir. 2010); *Burnett*, 2011 WL 204907 at *5; *Barfknecht*, 378 B.R. at 164.

In the instant appeal, the trustee's "good faith" argument merely expresses his view that, under some circumstances, certain Code provisions can operate in a manner that appears unfair to him. In essence, he disagrees with the manner in which Congress balanced a creditor's right to payment with the debtor's right to a fresh start in this area. The trustee could just as easily and inappropriately argue that debtors who claimed any exemption allowed under the Code, such as a homestead exemption, was proceeding in bad faith. The state homestead exemptions that debtors may claim in bankruptcy vary widely among the states. Texas, Florida, and Oklahoma, for example, do not place any dollar limit on their homestead exemptions.[17] Other states have relatively high fixed homestead exemptions, including Nevada ($550,000) and Massachusetts ($500,000).[18]

Congress has determined that in certain states a debtor may file for bankruptcy relief and exempt from the reach of creditors millions of dollars in home equity and over one million dollars in retirement benefits. That outcome appeared fair to Congress. No bankruptcy debtor will ever have occasion to shield sums of such magnitude in Social Security benefits. More likely, the protection for Social Security benefits will mean the difference between growing old with dignity intact, as opposed to in poverty.

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[17] 11 U.S.C. § 522(b)(3)(A).Tex. Const. art. 16 §§ 50, 51; Tex.Prop. Code § 41.001 and § 41.002; Fla.Const. art. X § 4(a)(1); Fla.Stat.Ann. § 222.01, .02; Okla.Stat. tit. 31 § 1.

[18] Nev.Rev.Stat.Ann. § 21.090; Mass.Ann.Laws ch. 188 §§ 1 and 1A.

CONCLUSION

For these reasons, Amicus, the National Association of Consumer Bankruptcy Attorneys, requests that this Court affirm the decision below.

Respectfully Submitted,

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CERTIFICATION OF COMPLIANCE
WITH TYPE-VOLUME LIMITATION

I hereby certify that the foregoing Brief contains 6,999 words, excluding the parts of the Brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii). In preparing this certification, I relied on the word-processing system used to prepare the foregoing Brief.

The foregoing Brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type style requirements of Fed. R. App. P. 32(a)(6) because it was prepared in a proportionally spaced typeface using Microsoft Word in 14-point Times New Roman font.

Dated: June 12, 2012.

_/s/ Tara Twomey
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CERTIFICATE OF SERVICE

Tara Twomey, attorney for appellant, certifies that on this 12th day of June, 2012, she caused the foregoing Brief to be electronically filed. Copies of same have been served upon the following this same date by the CM/ECF system:

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