No. 11-31046

IN THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

In re BENJAMIN RAGOS AND STELLA CANNON RAGOS,
Debtors.

S.J. BEAULIEU
Chapter 13 Trustee-Appellant

— v. —

BENJAMIN RAGOS and STELLA CANNON RAGOS,
Appellees

ON APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF LOUISIANA – NO. 11-10522

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

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CERTIFICATE OF INTEREST AND CORPORATE DISCLOSURE STATEMENT

S.J. Beaulieu v. Benjamin and Stella Cannon Ragos. – No. 11-31046

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.**

2) For non-governmental corporate parties please list all publicly held companies that hold 10% or more of the party's stock. **NONE.**

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.**

Pursuant to 5th Circuit Local Rule 28.2.1, the undersigned counsel of record certifies that the following listed persons and entities as described in the fourth sentence of Rule 28.2.1 have an interest in the outcome of this case. These representations are made in order that the judges of this court may evaluate possible disqualification or recusal.

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Dated: March 27, 2012

TABLE OF CONTENTS

TABLE OF AUTHORITES

Cases

Statutes

State Constitutions and Statutes

Other Authorities

STATEMENT OF INTERST

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys ("NACBA") is a non-profit organization of more than 4,800 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. Additionally, NACBA advocates nationally on issues that cannot adequately be addressed by individual member attorneys. It is the only national association of attorneys organized for the specific purpose of protecting the rights of consumer bankruptcy debtors.

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 for 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. This Court should not ignore the statutory language and force some debtors to contribute social security benefits for the payment of unsecured creditors. It is essential that this Court adhere to the plain language of these statutes, as well as Congress's clear legislative intent.

CONSENT

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

CERTIFICATION OF AUTHORSHIP

Pursuant to Federal Rule of Appellate Procedure 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

Well before the enactment of the 1978 Bankruptcy Code, Congress had designated a special protected status for Social Security benefits. The Social Security Act directed that these benefits be kept outside the scope of operation of the bankruptcy laws and shielded from other debt collection actions. In accordance with this protected status, upon the filing of a bankruptcy petition, the debtor's income derived from Social Security benefits does not pass into the bankruptcy estate.

The 2005 amendments to the Bankruptcy Code mandated that Social Security income be excluded from the "disposable income" used to calculate how much certain debtors must pay to creditors through a chapter 13 plan. 11 U.S.C. §§ 1325(b)(1), (2), 101(10A). The U.S. Supreme Court's decision in *Hamilton v. Lanning*[1] did not authorize variations in the substantive elements used to calculate this "disposable income." The Court's decision only allowed the calculation to take into account temporal changes in amounts of income defined by the Code as included in "disposable income."

Debtors act in good faith when they exclude Social Security income from the calculation of "disposable income" to be paid under a chapter 13 plan. The

[1] 130 S. Ct. 2464 (2010).
[2] Social Security Amendments of 1983. House Conference Report No. 98-47 Joint

trustee in the instant appeal advocates the application of a "good faith" standard under 11 U.S.C. § 1325(a)(3) that works in derogation of clear statutory definitions, replacing congressionally mandated standards with subjective views of fairness. Congress in the 2005 amendments to the Code sought to rein in this type of discretion in favor of concrete standards. In the same amendments, Congress intended to promote consumers' use of chapter 13 bankruptcies over chapter 7 liquidations. The trustee's position, if adopted, would ultimately discourage chapter 13 bankruptcies by making chapter 7 a more attractive option for debtors with Social Security income.

ARGUMENT

I. Congress Mandated That Social Security Benefits Must Not Be Subject "To The Operation of Any Bankruptcy or Insolvency Law" Unless a Congressional Enactment Expressly Directs Otherwise.

Since the nineteen thirties, a consistent feature of the consumer credit marketplace has been that benefits under the Social Security Act are protected from seizure by the beneficiary's creditors. 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 extend credit and enter into consumer transactions with full knowledge that these eventualities could

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.

This appeal addresses the question of whether a bankruptcy court may order debtors to pay their protected Social Security income to creditors as a condition to confirmation of a chapter 13 plan. The answer is no. There is nothing unfair about this outcome. *Vis a vis* the debtor's protected Social Security benefits, this result does 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 Reiterated the Protected Nature of Social Security Income in Bankruptcy Through Four Different Enactments

Congress recognized the protected status of Social Security benefits in bankruptcy in four distinct enactments. Two of these enactments appeared in the Social Security Act and two in the Bankruptcy Code.

1. The Social Security Act. The Social Security Act's basic provision protecting benefits from creditors is currently found in subsection (a) of 42 U.S.C. § 407. This subsection contains both a general prohibition against subjecting Social Security benefits to any "legal process" as well as 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).

The Supreme Court has had occasion to interpret the term "other legal process" found in § 407(a). According to the Court, "other legal process" in § 407(a) refers not only to formal execution measures, but also to other 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).

Two common occurrences in any chapter 13 bankruptcy case would violate § 407(a) if they had an impact on Social Security benefits. First, the filing of a bankruptcy case transfers the debtor's interest in many forms of property from the debtor to the bankruptcy estate. Treating the filing of a bankruptcy case as transferring the debtor's property interest in Social Security benefits from the debtor to the bankruptcy estate would be a transfer of control over the funds from the beneficiary to another entity in contravention of § 407(a). Second, a bankruptcy court's order related to approval of a chapter 13 plan may direct portions of the debtor's income to be paid to a trustee. The trustee in turn pays

these funds toward the discharge of pre-bankruptcy debts. A bankruptcy court order having the effect of making a debtor contribute Social Security income toward payment of pre-petition debts under a chapter 13 plan would violate § 407(a).

With the exception of extremely rare involuntary chapter 7 cases, the overwhelming majority of consumer bankruptcy cases are filed voluntarily. The voluntary nature of the initial bankruptcy petition filing cannot be construed as a waiver of § 407(a)'s protections. The Supreme Court held long ago that beneficiaries who voluntarily signed up for state-sponsored welfare programs could not be treated as having agreed to a waiver of their rights under § 407(a) by seeking these benefits. *Philpott v. Essex County Welfare Board*, 409 U.S. 413 (1973) (requirement to reimburse state for welfare benefits out of Social Security income violated § 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.

2. *Exemption for Social Security benefits under the 1978 Code.* In enacting 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). Louisiana is one of thirty-four states that have "opted-out" of the federal bankruptcy exemptions, restricting bankruptcy debtors to exemptions claimed under state law or federal non-bankruptcy law. 11 U.S.C. § 522(b)(2), (3). Exemptions for Social Security benefits exist under many state laws. Bankruptcy debtors in opt-out states may also assert the federal non-bankruptcy exemption under 42 U.S.C. § 407(a). Thus, the 1978 Bankruptcy Code allows a debtor to claim an exemption for Social Security benefits in all cases.

3. *Congress reinforced the Social Security Act protections in 1983.* Finding that certain bankruptcy courts had been lax in enforcing the protections of § 407, Congress in 1983 amended the Social Security Act to make the protections for Social Security benefits in the bankruptcy process as unambiguous as possible. 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, Congress must expressly state its intention to modify the scope of § 407 in order for any enactment to be construed as limiting § 407's protections. Thus, no statute may be interpreted as allowing Social Security benefits to be subject to the operation of the Bankruptcy Code unless that statute expressly states that it was intended to function in derogation of § 407. By virtue of this provision, the trustee pursuing the instant appeal must direct the Court to

specific legislation that expressly allows Social Security benefits to be subject to the operation of the bankruptcy laws despite the mandate of § 407.

The legislative history of the 1983 Social Security Act amendments indicates that misinterpretation of the original version of § 407 led to the need for clarifying legislation. The misinterpretations that Congress intended to correct in 1983 were essentially the same arguments the trustee is pursuing in the instant appeal. The relevant House Conference Report stated as follows:

> Since 1935, the Social Security Act has prohibited the transfer or assignment of any future social security or SSI benefits payable and further states that no money payable or rights existing under the Act shall be subject to execution, levy, attachment, garnishment, or other legal process, or to the operation of any bankruptcy or insolvency law.
>
> 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 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".[2]

Nearly thirty years ago Congress acted to correct certain bankruptcy courts that had considered Social Security benefits to be income for purposes of chapter

[2] 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. Code Congressional and Administrative News 98th Cong. First Session p. 443.

13 plans. Since 1983, Congress has not enacted legislation expressly allowing treatment of Social Security benefits as income for these plans. Under § 407(a), an express Congressional directive would be required to effect such a change.

4. The 2005 Bankruptcy Code amendments further clarified the protected status of Social Security benefits. The 2005 BAPCPA legislation amended the Bankruptcy Code to create 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 testing and new chapter 13 provisions 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).

This CMI definition expressly excluding Social Security benefits is incorporated into the calculation that determines eligibility to file under Chapter 7. 11 U.S.C. § 707(b)(2). The identical definition is incorporated 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 expressly subjected Social

Security benefits to the operation of the bankruptcy laws, Congress again amended the Code to expressly 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.

B. The Courts Have Interpreted § 407 to Exclude Social Security Income From The Bankruptcy Estate.

Section 407 of the Social Security Act precludes subjecting Social Security income to any provisions of the Bankruptcy Code. The courts have construed § 407 to exclude Social Security benefits from property of the bankruptcy estate in chapter 7 and in chapter 13 cases. Social Security benefits therefore have a status distinct from that of 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) (construing applicability of § 407 in chapter 7: "We conclude § 407 must be read as an exclusion provision, which automatically and completely excludes social security proceeds from the bankruptcy estate, and not as an exemption provision which must be claimed by the debtor."); In re *Buren*, 725 F.2d 1080, 1085-87 (6th Cir. 1984); In re *Miller*, 445 B.R. 504, 507 (Bankr. S.C. 2011) ("the language of section 407(a) of the Social Security Act unambiguously

prevents a debtor from being forced to use Social Security income to fund his chapter 13 plan."). *See also* 4 Alan N. Resnick & Henry J. Sommer, *Collier on Bankruptcy* ¶ 522.09[10][a] n.76 (16th ed. 2011).

II. The 2005 BAPCPA Amendments, Mandated a New Definition For "Disposable Income" and That Definition Determines the Income the Debtors Must Pay to Unsecured Creditors Under a Chapter 13 Plan.

As noted above, 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 definition must be read in conjunction with the requirements of 11 U.S.C. § 1325(b).

Under § 1325(b) (1) of the Bankruptcy Code, 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 Code subsection, § 1325(b)(2), defines "disposable income." "Disposable income" means '*current monthly income* received by the debtor" minus certain possible deductions and

amounts defined further in the subsections as reasonably necessary expenditures. 11 U.S.C. § 1325(b)(2). (emphasis added).

The term "current monthly income" ("CMI") mentioned in § 1325(b)(2) as the base for determining "disposable income" 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). In the 2005 amendments, Congress codified an "ability to pay" test for chapter 13 cases. That test contains a definition of the income that courts must include and exclude in applying the ability to pay test.

The trustee's reliance on pre-2005 cases such as In re *Hagel*, 184 B.R. 793 (B.A.P. 9th Cir. 1995) ignores the effect of the BAPCPA amendments. Unlike the trustee, the courts have routinely acknowledged the impact of the disposable income definition that Congress placed in the Code in 2005. The courts have recognized the significant effect this definition now has in determining what income the debtor must pay to unsecured creditors in a chapter 13 case. In re *Welsh*, 440 B.R. 836, 849 (Bankr. D. Mont. 2010) *aff'd* 2012 WL 603818 (B.A.P 9th Cir. Feb. 17, 2012) ("Given the enactment of § 101(10A)(B) in 2005, the decision in *Hagel* that debtors must use social security benefits for their basic

needs and include them in the disposable income calculation is no longer valid.") . *See also 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 *Vandenbosch*, 459 B.R. 140, 144 (M.D. Fla. 2011) ("Refusal to confirm the amended plan because of the failure to include social security benefits as projected disposable income was therefore an error of law."); In re *Cranmer*, 2011 WL 6100323 * 3 (D. Utah Dec. 7, 2011) (BAPCPA amended the definition of disposable income to exclude benefits received under Social Security Act); In re *Bartelini*, 434 B.R. 285, 294 (Bankr. N.D. N.Y. 2010) (§ 1325(b) always contained a definition of disposable income, "but that definition was significantly revised by Congress in 2005 by substitution of the newly defined term CMI in place of 'income which is received by the debtor.'"); In re *Hardacre*, 338 B.R. 718, 723 (Bankr. N.D. Tex. 2006) ("Section 101(10A) continues to apply inasmuch as it describes the sources of revenue that constitute income, as well as those that do not."); In re *Barfknecht*, 378 B.R. 154, 162 (Bankr. W.D. Tex. 2007) ("The trustee through his objections has raised only the narrow issue whether Social Security benefits must be counted as projected disposable income. This court has answered that question in the negative. An

exclusion is an exclusion, whether looking backward or looking forward. That is what the plain meaning of the statute dictates.")

III. *Lanning* Dealt Only With Temporal Changes To a Debtor's Statutorily-Defined "Disposable Income" And Did Not Authorize Substantive Changes to the Code's "Disposable Income" Definition.

In his brief the trustee asserts that "[t]he concept of 'disposable income' in § 1325(b)(2) and 'projected disposable income' in § 1325(b)(1)(B) are separate concepts which require separate calculations." In other words, the trustee contends 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 by a trustee, "The trustee would have to insist that the addition of the adjective 'projected' unhinges the remaining two words from their Code-mandated definitions." In re *Barfknecht*, 378 B.R. 154, 161 (Bankr. W.D. Tex. 2007). The trustee in the instant case makes the same logically and semantically inconsistent leap. The word "projected" placed in front of the words "disposable income" does not in any way, shape, or form imbue the term "disposable income" with different substantive components.

The trustee's butchering of the language of Code section 1325(b) derives entirely from his forced misreading of *Hamilton v. Lanning*, 130 S. Ct. 2464 (2010). 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 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 of CMI the debtor should pay during the plan period. The court addressed only this temporal aspect of CMI, not the substantive nature of what forms of income must be excluded from and included in CMI.

Since the *Lanning* decision, several trustees have made similar arguments regarding the effect of the word "projected" appearing before the words "disposable income" in § 1325(b)(2). The courts consistently rejected these arguments, holding that they flew in the face of the statutory definition of CMI. *Baud v. Carroll*, 634 F.3d 327, 346 (6th Cir. 2011) ("Thus, post-*Lanning*, courts have continued to exclude from the calculation of projected disposable income the items excluded by § 101(10A)."); 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. In re *Barfknecht*, 378 B.R. 154, 162 (Bankr. W.D. Tex. 2007) (in construing "projected disposable income," the Code's plain language "forces us to acknowledge that the term must incorporate a debtor's 'disposable income' and whatever limitations engrafted on that definition as a result of its reference to current monthly income as defined in section 101(10A)."); In re *Devilliers*, 358 B.R. 849, 865 (Bankr. E.D. La. 2007) ("Unlike an unknown or unanticipated change in income, social security benefits are both predicable and certain. It appears that Congress, through BAPCPA, effected a policy decision that regardless of income level, a debtor's social security benefits would be protected from creditor interests."). *See also* 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.").

Applying the reasoning of the *Devilliers* court, there are two options for deciding the issue presented by this appeal. One is that the *Lanning* court meant to take a fixed definition of disposable income based on CMI and project that fixed definition forward. The other option is to view *Lanning* as authorizing a different

definition of CMI and project that definition forward for a plan period. Only the former option harmonizes all other Code provisions.

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

A. Section 1325(b)(2) Controls Any Question of the Amount of Payment of Disposable Income Under a Chapter 13 Plan

The trustee argues that the debtors' failure to "commit all available income, including social security income, into their Chapter 13 Plan" violates both the requirement for payment of the debtors' disposable income under 11 U.S.C. 1325(b)(1) and the good faith standard of 11 U.S.C. § 1325(a)(3). Trustee's Brief pp. 44-45. There is nothing nuanced about the trustee's position. The trustee contends that the debtors' retention of *any* Social Security income that could otherwise be paid to unsecured creditors amounts to a *per se* violation of the two statutory provisions.

The trustee's basic argument is that in chapter 13 bankruptcy cases Social Security benefits must be treated as any other type of income. In the trustee's view, Social Security dollars are interchangeable with all other 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. If not, the court cannot approve the debtor's plan under 11 U.S.C. § 1325(b)(1)(B) (plan must provide that all debtor's projected disposable income will be applied to make payments to

unsecured creditors under the plan). Furthermore, according to the trustee, the debtor who fails to pay *all* disposable income (defined to include Social Security benefits) to unsecured creditors violates the "good faith" provision of 11 U.S.C. § 1325(a)(3) ("the plan must have been proposed in good faith and not by an means forbidden by law.").

An initial problem with trustee's argument is that he views the "disposable income" test under § 1325(b)(1)(B) and the good faith test under § 1325(a)(3) as identical. Under the trustee's analysis, the good faith test is redundant, as it covers the identical situation addressed by the disposable income test. Courts should not accept contentions that Congress intended such a redundancy. Since the disposable income test of § 1325(b)(1)(B) specifically defines the debtor's obligation to pay disposable income to unsecured creditors, § 1325(b)(1)(B) is the controlling standard. The trustee's call for a distinct and separate good faith analysis of the same facts under 1325(a)(3) is unnecessary and duplicative. *See* 8 *Collier on Bankruptcy, supra* ¶ 1325.04 [1] ("Because Congress dealt with the issue quite specifically in the ability–to-pay provisions, there is no longer any reason for the amount of a debtor's payments to be considered as even a part of the good faith standard.").

B. The Trustee Seeks Adoption of a *Per Se* Lack of Good Faith Standard For Social Security Income Under 11 U.S.C. § 1325(a)(3).

The trustee seeks a ruling that the instant debtors have shown a lack of good faith based solely on the fact that they are retaining some of their Social Security benefits while paying less than 100% of unsecured creditors' claims. There is no middle ground in the trustee's proposed treatment of Social Security income. In his view, all available Social Security income must be contributed to payment of unsecured debts. The retention of any available social security income amounts to a lack of good faith. In the record for this appeal it is undisputed that, aside from the trustee's Social Security claim, no other indicia of bad faith exist.

A number of courts have considered trustees' requests for a *per se* bad faith finding based solely on a debtor's failure to contribute Social Security benefits to chapter 13 plan payments. The Bankruptcy Appellate Panel in In re *Thompson*, 439 B.R. 140, 144 (B.A.P. 8th Cir. 2010) addressed precisely the same bad faith contention from a trustee under facts similar to those presented in this appeal. The *Thompson* court refused to let the trustee gloss over the *per se* nature of his bad faith claim. The *Thompson* Court stated:

> "In reality, the trustee's arguments all stem from one operative fact: the Debtors' failure to contribute all of their Social Security income to their plan. The record on appeal does not suggest any other facts to show bad faith. Good faith must be assessed based on the totality of the circumstances. Standing alone, the Debtor's retention of Social Security income 'is insufficient to warrant a finding of bad faith under sec. 1325(a)(3).' [citation omitted]. A determinant of bad

> faith by this court based solely on the Debtors' failure to contribute all of their Social Security income in their plan would amount to a *per se* rule that failure to devote Social Security income to plan payments always constitutes bad faith. Like the bankruptcy court, we decline to adopt such a rule." 439 B.R. at 144.

Other courts have rejected the same trustee argument as improperly posing a *per se* rule compelling a finding of bad faith based solely on one factor. In re *Barfknecht*, 378 B.R. 154, 164 (Bankr. W.D. Tex. 2007) ("the trustee offers what amounts to a *per se* rule that any retention of income (in the macro sense of that term) must of necessity be bad faith. The Fifth Circuit, however, proscribes such a *per se* rule in favor of applying the totality of circumstances test."); In re *Burnett*, 2011 WL 204907 *5 (Bankr. N.D. N.Y Jan. 21, 2011). In addition, a rule that retention of Social Security benefits constitutes lack of good faith under § 1325(a)(3) poses a direct conflict with other statutes, including 11 U.S.C § 101(10A)(B) and 42 U.S.C. § 407. *Cramner v. Anderson*, 2011 WL 6100323 * 5 (D. Utah. Dec. 7, 2011).

The bankruptcy courts have observed that application of the good faith standard under § 1325(a)(3) has occurred with "mixed consistency," but that in applying the test "[t]he trick seems to be not placing too much weight on any single factor, but in the court's looking at how a number of factors in any given case operate together to betray a plan proposed in bad faith." In re *McLaughlin*, 217 B.R. 772,

775-76 (Bankr. W.D. Tex. 1998). The trustee's position in the instant case places its weight entirely on one factor.

C. Defining Disposable Income Under § 1325(b)(2) Leaves Courts Ample Scope to Enforce Good Faith Standards in Chapter 13 Cases Under §1325 (a)(3).

Defining disposable income to exclude Social Security benefits does not in any way hamper application of good faith principles in appropriate cases. For example, in In re *McLaughlin*, 217 B.R. 772 (Bankr. W.D. Tex. 1998) the court found a "constellation of three factors" indicative of the chapter 13 debtor's bad faith. These factors pertained primarily to the debtor's litigation conduct preceding the filing of the bankruptcy petition. *Id.* at 778. The *McLaughlin* court noted that one of these factors alone would not have supported a bad faith finding. "We would not deny confirmation to 'penalize' the debtors for the presence of any one of these factors. However, the synergistic effect of these factors leads us to the conclusion that these plans have not been proposed in good faith." *Id.*

Other instances in which courts in the Fifth Circuit applied §1325(a)(3)'s good faith standard included cases involving repeat filers (In re *Charles*, 334 B.R. 207 (Bankr. S.D. Tex. 2005)); failure to disclose assets and the pre-petition transfer of substantial assets to family members (In re *Cuevas*, 2009 WL 1515041 (Bankr. S. D. Miss. May 28, 2009)); evasion of responsibility for dissipating funds of a family member (In re *Reinicke*, 338 B.R. 292 (Bankr. N.D. Tex. 2006)); and the

debtor's bad faith in seeking a plan modification when eligible for a hardship discharge (In re *Vasquez*, 261 B.R. 654 (Bankr. N.D. Tex. 2001)).

In other § 1325(a)(3) cases, courts found that debtors incurred substantial and unnecessary expenses shortly before filing for bankruptcy, then sought to deduct those expenses dollar for dollar from current monthly income in order to reduce the disposable income they would have available to pay unsecured creditors under their chapter 13 plans. For example, the court in In re *Devilliers*, 358 B.R. 849, 866 (Bankr. E.D. La. 2007) reviewed the facts of several debtors' cases and found certain property acquisitions to be evidence of bad faith. One debtor had commenced deductions of $700 monthly for a retirement account immediately before filing a bankruptcy petition. This debtor then sought to deduct these monthly payments from disposable income, leading to a dollar per dollar loss to creditors.

Inquiries into whether debtors may be manipulating their disposable income by choosing to incur new expenses for unnecessary luxury items or by suddenly commencing large retirement plan deductions immediately before filing a chapter 13 case raise good faith questions that are not present in the cases of debtors who receive Social Security benefits. Distinct and clear statutory guidelines preclude consideration of Social Security income in bankruptcy. More important, eligibility for Social Security benefits is not susceptible to bad faith manipulation. Individuals

become eligible to receive Social Security benefits based upon age, disability, or the death of certain family members.[3] These are fundamentally different events from decisions to purchase unnecessary or luxury items in order to avoid higher payments to creditors or to acquire exempt property in contemplation of bankruptcy for the purpose of shielding assets from creditors.

D. This Appeal Presents Only an Issue of Law

The record in this appeal contains references to the burden of proof on the good faith issue that initially appear to be confusing. The bankruptcy court stated that the trustee "failed to meet his burden of proof under the totality of circumstances test." In re *Ragos*, 2011 WL 3101436 * 8 (E.D. La. July 21, 2011). The trustee in his brief contends that the debtors "have not borne their burden of proving by a preponderance of the evidence that their plan was proposed and filed in good faith." (Trustee Brief p. 37). However, when viewed in context, the references to burden of proof in both the bankruptcy court opinion and the Trustee's Brief do not refer to any factual issues. The parties disagree over a question of law. The record does not indicate any basis for a finding of bad faith other than the trustee's legal argument that all of the debtors' Social Security income must be considered available for payment to creditors. This is an issue of

[3] Eligibility for Social Security benefits based on disability must be determined through a final ruling by the Social Security Administration, a determination that is entitled to administrative res judicata.

law. The trustee and the debtors agree that a *de novo* standard of review applies to the issues on appeal (Trustee's Brief p. 36; Debtors' Brief pp. 8). The inconsistent references to burden of proof should not be a factor in the court's consideration of the basic legal issue raised by the parties.

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

One clearly foreseeable consequence of adopting the trustee's reasoning will be to encourage filing of chapter 7 instead of chapter 13 bankruptcies. In enacting the current Code in 1978, Congress evidenced a clear preference that consumer debtors file for relief under chapter 13 rather than chapter 7.[4] In chapter 13 cases debtors make regular payments to creditors, while in chapter 7 debtors obtain a complete discharge of most unsecured debts with little delay. The 2005 BAPCPA amendments strongly reinforced this Congressional preference for consumers to file chapter 13 bankruptcies over chapter 7.

Here, the trustee has raised his Social Security arguments in a case involving above-median income debtors. These debtors must proceed under chapter 13 with a repayment plan of five, rather than three years. However, the trustee's arguments for contributing Social Security benefits to debt repayment in chapter 13 do not apply only to above-median income debtors. If the reasoning of the trustee were

[4] *See, e.g.,* Matter of Rash, 90 F.3d 1036, 1057 (5th Cir. 1996) (discussing legislative history of chapter 13 provisions of 1978 Act) *rev'd on other grounds* 520 U.S. 953 (1997).

adopted, any chapter 13 debtor receiving Social Security income would be required to treat that income as available to pay creditors, just as any other income. This would occur even though, outside of bankruptcy, the same Social Security income would be fully protected from all collection efforts. Thus, debtors with Social Security income would be substantially worse off if they chose to file for bankruptcy relief under chapter 13. Filing under chapter 13 would effectively strip away the strong federal protection that Social Security benefits otherwise receive. The perverse effect of adopting the trustee's argument would thus be to encourage debtors receiving social security income to file under chapter 7 and avoid chapter 13 altogether. This is precisely the outcome that Congress wanted to avoid when it created the modern version of Chapter 13 bankruptcy in 1978 and when it revised the Code in 2005 to encourage Chapter 13 filings.

F. The Trustee's View of Unfairness Versus What the Federal Statutes Say.

In essence, the trustee's argument is that the debtors' retention of a substantial portion of their monthly Social Security benefits while paying less than the full amounts they owe to creditors under a chapter 13 plan is unfair. The debtors' retention of roughly $20,000 Social Security income annually while paying less than the full amount they owe to creditors would perhaps seem unfair to some people. The trustee has pointed out one of many tensions between rights Congress

intended debtors to have under the Bankruptcy Code and popular conceptions of fairness. The danger in the trustee's approach is that he essentially converts § 1325(a)(3) into authority for a kind of roving commission that can override other specific Code provisions on the basis of sympathetic fairness arguments. As discussed above, courts have found ample scope for their exercise of a supervisory role under § 1325(a)(3) without treading upon clear Congressional directives. The path down which the trustee is asking this Court to proceed leads to a very slippery slope. It leads to a place where subjective views replace concrete statutory directives.

In considering the trustee's unfairness contention, it is important to view the treatment of Social Security income in relation to other Bankruptcy Code provisions that allow debtors to retain significant value in specific property while discharging debts. For example, a 2005 amendment to the Code expanded the scope of federal exemptions allowed for pensions and retirement accounts.[5] These funds are often shielded under state exemptions laws as well. The new federal bankruptcy exemption in § 522(d)(12) applies to funds in IRA accounts that are exempt from federal taxation. Currently, the Bankruptcy Code sets a cap for this

[5] 11 U.S.C. §522(d)(12). Funds in ERISA qualified pension and employee benefit plans do not come into the bankruptcy estate at all. *Patterson v. Shumate*, 504 U.S. 753 (1992). Debtors may claim the Code's other general exemption for retirement accounts even in states that generally opt out of the federal bankruptcy exemptions. 11 U.S.C. § 522(b)(3)(C).

exemption at $1,171,650.[6] Current disbursements from the account as well as amounts held for future disbursements are protected by the exemption. In order to claim the exemption it is not necessary that the debtor prove that the funds are necessary for the support of the debtor and the debtor's dependents. The Code's exemptions for other retirement accounts have no caps. The trustee complains that over five years the instant debtors could potentially receive nearly $100,000 in Social Security benefits that they would not have to pay to creditors. This fact, however, needs to be considered in the context of the Code's express allowance for debtors to proceed with a chapter 13 or chapter 7 case while retaining over one million dollars in a retirement account.

As with retirement accounts, Congress has also allowed bankruptcy debtors to exempt home equity up to certain values. Although the federal homestead exemption amount is currently $21,625,[7] the Code allows all debtors to claim their state homestead exemption.[8] The state homestead exemptions that debtors may claim in bankruptcy vary widely among the states. Texas and Florida do not place dollar limits on their homestead exemptions.[9] Other states have relatively high fixed homestead exemptions. These include Nevada ($550,000) and Massachusetts

[6] 11 U.S.C. § 522(n).
[7] 11 U.S.C. § 522(d)(1).
[8] 11 U.S.C. § 522(b)(3)(A).
[9] 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.

($500,000). [10] In a state such as Texas a bankruptcy debtor may file for bankruptcy relief and, consistent with 11 U.S.C. § 522(b)(3), exempt millions of dollars in home equity from the reach of the bankruptcy trustee and creditors. A chapter 13 trustee is not allowed to object that this protection as "unfair," and that therefore a chapter 13 plan is filed in bad faith.

The 2005 amendments addressing Social Security income in the context of disposable income are totally consistent with, and serve the same purposes as, the increased protection afforded retirement benefits by the same legislation. Both provisions recognize the generally more precarious finances of older and disabled debtors who tend to have fixed savings and fixed or declining regular income. These are debtors who will not likely be able to re-enter the workforce and rebuild savings.

G. Bankruptcy Courts Should Not Schedule Hearings for Chapter 13 Debtors to "Explain" What They Intend to do With Their Social Security Benefits.

At several points in his Brief the trustee describes what he thinks should occur when bankruptcy debtors are not making all their Social Security benefits available to creditors. The trustee complains that the instant debtors "have not explained" what their Social Security benefits will be used for. Trustee's Brief at pp. 8, 9. 39. Presumably what the trustee envisions is that in order to show "good faith" under

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

11 U.S.C. § 1325(a)(3) debtors who intend to retain Social Security benefits that are either exempt or not part of the bankruptcy estate will have to appear for hearings in the bankruptcy court to explain why they are not paying all available Social Security income to creditors. The trustee could just as easily ask for hearings in every bankruptcy case in which a debtor decides to keep his or her home under an exemption claim rather than sell it to benefit creditors and move to a smaller home. Similarly debtors could be required to appear in court to "explain" why they are not liquidating retirement accounts that are exempt under 11 U.S.C. § 522(d)(12) or 522(b)(3)(C). The list could go on. The point is that Congress clearly did not intend section §1325(a)(3)'s good faith standard to serve as the basis to question every debtor's assertion of a right expressly allowed under federal statutes.

Any consideration of Social Security income under the "good faith" test is simply a backdoor way of avoiding the outcome Congress clearly intended. The argument that Social Security may be used for some expenses, freeing up more of the debtors' other income for the plan has the same effect, since money is fungible, as directly including Social Security in the calculation.

Section 1325(a)(3) should not become a vehicle to justify highly subjective case-by- case reviews for "fairness" in areas where Congress has already defined rights and liabilities. Such reviews would override the clear intent of Congress.

This is clearly the outcome the trustee wants from this appeal. It is an outcome that would undermine bankruptcy as a predictable and rational legal framework.

CONCLUSION

For the foregoing reasons, *Amicus* this Court should affirm the decision of the bankruptcy court.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

This brief, exclusive of the certifications, tables of contents and authorities and the identity of counsel at the end of the brief, is 6964 words in text and footnotes as counted by Microsoft Word, the word processing system used to prepare this brief. This brief has been prepared in a proportionally spaced typeface using Microsoft Word in 14pt, Times New Roman-point font.

I certify under penalty of perjury that the foregoing is true and correct.

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CERTIFICATE OF SERVICE

I hereby certify that on March 27, 2012, I electronically filed the foregoing document with the Clerk of the Court for the Fifth Circuit Court of Appeals by using the CM/ECF system.

I further certify that parties of record to this appeal who either are registered CM/ECF users, or who have registered for electronic notice, or who have consented in writing to electronic service, will be served through the CM/ECF system.

I further certify that some of the attorneys of record to this appeal have not consented to electronic service. I have mailed the foregoing document by First-Class Mail, postage prepaid, or have dispatched it to a third party commercial carrier for delivery within 3 calendar days, to the following parties:

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