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State Laws, Court Splits, Local Practice Make Consumer Bankruptcy Anything but "Uniform"

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The Bankruptcy Clause authorizes Congress to establish "uniform Laws on the subject of Bankruptcies throughout the United States."² Because the Bankruptcy Code is a federal statute, it might be expected that it would be applied in a more or less uniform manner throughout the nation.³ Yet in practice, consumer bankruptcy varies significantly from state to state. There are three main reasons for these differences: (1) Bankruptcy Code provisions that apply "non-bankruptcy" (state) law, (2) variations in statutory interpretation among bankruptcy as well as appellate courts, and (3) a multitude of differing local rules, and written and unwritten practices, established by bankruptcy courts and trustees.

Non-Bankruptcy Law



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Several sections of the Code incorporate the use of non-bankruptcy, forum state law. For consumer debtors, perhaps the most significant sections deal with exemptions. Every state has exemption statutes under which judgment debtors may shield specific property from seizure by creditors. These exemptions typically include both personal property and a homestead

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exemption, but types and amounts of exemptions can vary widely. For example, a debtor in Alabama may exempt no more than \$5,000 of value in a homestead,⁴ while in New York the amount is \$50,000.⁵ Massachusetts is far more generous at \$500,000,⁶ and Florida and Texas have unlimited homestead exemptions.⁷ There is no homestead exemption

\$21,625 for a homestead, \$3,450 for a motor vehicle and \$11,525 for household goods, plus a "wild card" and partial unused homestead exemption.¹³ Although the federal homestead exemption may not be lavish compared to some states, the federal personal property exemptions are far more generous than most states.

Under § 522(b)(1), debtors may choose between state or federal exemptions. However, § 522(b)(2) allows states to "opt out" of the federal scheme.¹⁴ All but 15 states have opted out of federal exemptions, thus limiting debtors in those states to state exemptions,¹⁵ resulting in a substantial difference in the exemptions available. A well-off debtor in Texas, for example, which has an unlimited homestead exemption and a \$60,000 combined personal property exemption, is going to

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in Pennsylvania, although that state does provide an entireties exemption.⁸

Exemptions in personal property also vary by state. Some states have liberal personal property exemptions, such as California (\$20,750)⁹ and Texas (\$60,000 per household).¹⁰ Other states are more parsimonious, for example, New Jersey (\$2,000)¹¹ and Pennsylvania (\$300, plus a family Bible and certain tools).¹²

The Bankruptcy Code contains its own exemption schedule in § 522(d). Federal exemptions include, *inter alia*,

fare much better in bankruptcy than one in Alabama, where the exemption is limited to \$5,000 for a homestead, \$3,000 in personal property, plus wearing apparel, and family portraits and books.¹⁶

Another area in which forum state law impacts bankruptcy is reaffirmation of secured debt in chapter 7. Under § 521(a)(2), debtors must file a "statement of intention" for all property subject to a security interest. The debtor must choose whether he or she intends to surrender or redeem the collateral,¹⁷ or enter into a reaffirmation agreement

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² U.S. Const. art. I, § 8, cl. 4.

³ The Supreme Court has ruled that the Bankruptcy Code may use state law in a way that results in disparate treatment of parties, but only if "the general operation of the law is uniform." *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 190, 22 S.Ct. 857, 46 L.Ed. 1113 (1902). See also *Blanchette v. Connecticut General Ins. Corps.*, 419 U.S. 102, 160, 95 S.Ct. 335, 42 L.Ed. 320 (1974) (federal law may account for regional differences, but must "apply equally to all creditors and debtors").

⁴ Ala. Code §§ 6-10-2, 4 and 39.

⁵ N.Y. Civ. Prac. Law & Rules §5206.

⁶ M.G.L. Ch. 188 §§ 1 and 1A.

⁷ Fla. Stat. Ann. §§ 222.01, 222.02 and 222.05; Tex. Prop. Code §§ 41.0001 and 41.0002.

⁸ In an entireties exemption, property jointly owned by spouses may not be used to satisfy a debt owed by just one spouse. *In re Gallagher's Estate*, 352 Pa. 476, 43 A.2d 132, 133 (1945).

⁹ Cal. Civ. Proc. Code §§ 703.140 and 704.020.

¹⁰ Tex. Prop. Code § 42.001.

¹¹ NJ Stat. §§ 2A:17-19, 2A:26-4 and 38A:4-8.

¹² 42 Pa. C.S. §§ 8123, 8124, 8125 and 8127.

¹³ 11 U.S.C. §§ 522(d) (1), (2), (4) and (5).

¹⁴ Section 522(b)(2) provides that "property listed in this paragraph is property that is specified under subsection (d), unless the State law that is applicable to the debtor...specifically does not so authorize."

¹⁵ States that allow debtors to choose between federal or state exemptions include Arkansas, Connecticut, Hawaii, Massachusetts, Michigan, Minnesota, New Jersey, New Mexico, Pennsylvania, Rhode Island, South Carolina, Texas, Vermont, Washington and Wisconsin, as well as the District of Columbia.

¹⁶ Ala. Code § 6-10-6.

¹⁷ 11 U.S.C. § 722

with the creditor. Sections 362(h)(1) and 521(a)(6)(B) provide for early termination of the automatic stay if the debtor fails to timely file and perform his or her statement of intention. Once the stay is terminated, the creditor may enforce its contract rights under the law of the forum state. A debt that is properly reaffirmed is not discharged.¹⁸

Even though debtors are required to file a statement of intention, whether a debtor will actually reaffirm a debt is very much affected by state law. All states permit the creditor to obtain judgment and repossess the collateral if the debtor is in default for nonpayment, but some states also permit a creditor to repossess for *ipso facto* or nonmonetary default.¹⁹ Almost all consumer credit agreements include insolvency or filing for bankruptcy as an event of default, even if the debtor is current on payments. In states where a creditor may enforce an *ipso facto* clause, debtors are far more likely to enter into a reaffirmation agreement than in states that do not permit *ipso facto* default. Thus, in Massachusetts, which prohibits enforcement of *ipso facto* provisions,²⁰ reaffirmation agreements are filed in only 8 percent of chapter 7 cases, whereas in Alabama, which allows repossession for *ipso facto* default,²¹ debtors filed reaffirmation agreements in 43 percent of cases.²² Overall, reaffirmation percentages by state correspond closely to whether a state allows for enforcement of *ipso facto* provisions.²³

Differences in Judicial Interpretation

Many Code provisions have been interpreted differently by bankruptcy and appellate courts. One of the most important was the division among courts over the meaning of the term “projected disposable income” for chapter 13 plan confirmation under § 1325(b)(1)(B). Some courts applied the “mechanical application” by calculating the debtor’s projected disposable income (amount to be paid to unsecured creditors) using the debtor’s average monthly income for the six-month period prior to filing

the bankruptcy petition.²⁴ Essentially, this meant relying solely on the standardized income and expenses calculations from Bankruptcy Form 22C. Other courts favored the “forward-looking approach” by projecting future disposable income based on the debtor’s actual expected income as shown on the debtor’s Schedules I (income) and J (expenditures).²⁵ Courts in the Tenth Circuit adopted the “rebuttable presumption” approach, holding that while the six-month averaging was presumed to apply (based on Form 22C), debtors could rebut the presumption by showing that the debtor’s financial situation had changed (using Schedules I and J).²⁶ Because of the lack of a consistent standard, debtors could fare very differently depending on where the case was filed.

The Supreme Court in *Hamilton v. Lanning*²⁷ recently addressed this issue, essentially adopting the Tenth Circuit’s rule that projected disposable income should be calculated using changes in the debtor’s income “known or virtually known” at the time of plan confirmation.²⁸ Almost immediately, bankruptcy courts were divided on their interpretations of the case. For example, is a debtor required to include Social Security benefits as income in a chapter 13 plan? Courts in Idaho, Missouri and Utah, each citing *Hamilton v. Lanning*, have reached completely different conclusions.²⁹

Courts also disagree on whether unsecured debts are discharged in a no-asset chapter 7 bankruptcy. In the First Circuit, if a debtor fails to list a creditor on his or her schedules and the creditor otherwise has no knowledge of the bankruptcy, the creditor’s claims are not discharged.³⁰ Other courts apply a “no harm, no foul” approach, allowing discharge of unsecured debts in no-asset cases.³¹ Given that many debtors do not keep organized records, or may

have forgotten about or be unaware of debts, this is a significant distinction in the relief available to consumer debtors.

Another issue is whether a secured lender may charge the debtor for post-petition costs such as filing a proof of claim or legal fees incurred in the bankruptcy. Section 1322(e) provides that if a chapter 13 debtor proposes to cure a default under a plan, “the amount necessary to cure the default shall be determined in accordance with the underlying agreement and applicable nonbankruptcy law.” However, § 506(b) prescribes that post-petition interest and costs may be added only if a claim is oversecured and such fees are allowed by the underlying contract and state law. If allowed, proof-of-claim fees and other charges can add hundreds of dollars to the amount owed by the debtor.³² Bankruptcy courts in Mississippi do not allow fees for claim preparation,³³ and in other states such fees are recoverable only if the lender is oversecured.³⁴ In contrast, courts in North Carolina and Florida permit fees for proof-of-claim preparation and other services if the fees are disclosed.³⁵ Court policies toward such fees can even differ within the same state. Proof-of-claim fees are permitted in the Bankruptcy Court for the Southern District of Texas,³⁶ but not the Northern District of Texas.³⁷

The Supreme Court recently accepted *certiorari* in *In re Ransom*,³⁸ which will address a split among jurisdictions over whether a debtor may claim an ownership expense deduction under the means test, regardless of whether there is an ownership or lease expense associated with the vehicle.³⁹ The Fifth, Seventh and Eighth Circuits, as well as Bankruptcy Appellate Panels in the First and Sixth Circuits, have ruled that a debtor is entitled to do so.⁴⁰ The Ninth Circuit holds otherwise. This is an opportunity for the court to bring some needed uniformity to consumer bankruptcy law.

¹⁸ 11 U.S.C. § 524(c).

¹⁹ A table comparing state *ipso facto* laws is set forth in Austin and Lassman, *Reaffirmation Agreements*, 2d (ABI, 2010), at Appendix F.

²⁰ M.G.L. ch. 255B, § 20A.

²¹ See *Sumlin Construction Co. LLC v. Taylor*, 850 So. 2d 303, 314-15 (Ala. 2002).

²² A table showing the number of reaffirmation agreements by state for 2009 is available at www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BAPCPA/2009/Table4.pdf.

²³ Austin and Lassman, *supra*, n.18 at pp. 6-8. A table showing reaffirmation percentages for 2007 and 2008 is set forth in Austin and Lassman, Appendix A.

²⁴ *Maney v. Kagenveama (In re Kagenveama)*, 541 F.3d 868, 872 (9th Cir. 2008).

²⁵ This was the rule in the First, Sixth and Eighth Circuits, as well as bankruptcy courts in other circuits. *Kibbe v. Sumski (In re Kibbe)*, 361 B.R. 302, 313 (1st Cir. B.A.P. 2007); *Hildebrand v. Thomas (In re Thomas)*, 395 B.R. 914, 923 (6th Cir. B.A.P. Oct. 31, 2008); *Coop v. Frederickson (In re Frederickson)*, 545 F.3d 652, 659 (8th Cir. 2008); *In re May*, 381 B.R. 498, 507 (W.D. Pa. 2008).

²⁶ *Hamilton v. Lanning (In re Lanning)*, 545 F.3d 1269, 1282 (9th Cir. 2008).

²⁷ *Hamilton v. Lanning*, 130 S.Ct. 2464; 2471, 177 L.Ed.2d 23, 2010 U.S. Lexis 4568 (2010).

²⁸ *Hamilton v. Lanning*, 130 S.Ct. at 2478.

²⁹ *In re Westing*, 2010 WL 2774829, *3 (Bankr. D. Idaho July 13, 2010) (Social Security is not used to calculate projected-disposable income but can be used to determine debtor’s good faith); *In re Thompson*, 2010 WL 358400, *2-3 (8th Cir. B.A.P. Sept. 16, 2010) (Social Security income is not used for disposable income or to determine good faith); *In re Cranmer*, 433 B.R. 391, 399 (Bankr. Utah 2010) (Social Security income is used to determine disposable income and good faith).

³⁰ *Colonial Surety Co. v. Weizman*, 564 F.3d 526, 530 (1st Cir. 2009).

³¹ *Bezeley v. California Land Title Co. (In re Bezeley)*, 994 F.2d 1433, 1434 (9th Cir. 1993); *Judd v. Wolfe*, 78 F. 3d 110, 114 (3d Cir. 1996); *Stone v. Caplan (In re Stone)*, 10 F.3d 285, 289 (5th Cir. 1994).

³² See John Rao, “‘Proof of Claim’ and Bankruptcy Fees: Are They Really Attorneys’ Fees?,” *ABI Journal*, March 2010 at p.12, n.6.

³³ *In re Madison*, 337 B.R. 99, 105 (Bankr. N.D. Miss. 2006) (denying fees for claim preparation because “preparation and filing a proof of claim... is basically a mathematical computation”).

³⁴ *In re Burrell*, 346 B.R. 561 (1st Cir. B.A.P. 2006); *In re McGuier*, 346 B.R. 151 (W.D. Pa. 2006).

³⁵ *In re Barch*, 2009 WL 3853215 (Bankr. M.D.N.C. Nov. 16, 2009) (allowed \$350 fee); *In re Palmer*, 386 B.R. 875 (Bankr. N.D. Fla. 2008) (approved \$300 fee).

³⁶ *In re Rangel*, 408 B.R. 650, 663 (Bankr. S.D. Tex. 2009).

³⁷ *In re Allen*, 215 B.R. 503, 505 (Bankr. N.D. Tex. 1997).

³⁸ *In re Ransom*, 577 F.3d 1026 (9th Cir. 2009), cert. granted, 2010 U.S. LEXIS 3359 (2010).

³⁹ See Stephen W. Sather, “Supreme Court to Decide Whether Means Test Allows for Deduction for Unencumbered Vehicles,” *ABI Journal*, June 2010, p. 12.

⁴⁰ *Tate v. Bolen*, 571 F. 3d 423, 429 (5th Cir. 2009); *In re Ross-Tousey*, 549 F. 3d 1148 (7th Cir. 2008); *In re Washburn*, 579 F. 3d 934, 938 (8th Cir. 2009); *In re Kimbro*, 389 B.R. 518, 532 (6th Cir. B.A.P. 2008).

Local Practice Differences

Chapter 13 cases are administered by standing chapter 13 trustees appointed in each district by the U.S. Trustee,⁴¹ except for Alabama and North Carolina, which are under the Bankruptcy Administrator Program.⁴² Chapter 13 trustees are not U.S. government employees, and each trustee manages his or her own office, so chapter 13 practices vary widely. For example, trustee fees are capped at 10 percent, but it is up to the trustee to decide how much below the cap to charge as a commission for distributions to creditors under the plan.⁴³ Commission rates range from 1.7 percent in the Western District of Kentucky to the 10 percent in Oregon.⁴⁴

Another difference is whether chapter 13 debtors may pay secured debt outside the plan, and thus avoid paying the trustee's commission. In Massachusetts and the Northern District of Illinois, secured debt is typically paid outside the plan, but in the Western District of Pennsylvania, secured debt must be paid in the plan.⁴⁵ Debtors in the Southern Districts of Indiana and Ohio must make mortgage payments inside the plan if there is an arrearage as of the petition date,⁴⁶ while in the Northern District of Indiana, debtors must also pay in the plan unless it provides for 100 percent payment to unsecured creditors and there is no mortgage arrearage.⁴⁷ The Southern District of Georgia and Western District of Kentucky allow debtors to pay the current payments outside the plan, but mortgage arrearages must be paid through the plan.⁴⁸ In Oregon, a debtor is required to pay within the plan, but may request the trustee to waive this requirement.⁴⁹

As for the plans themselves, some districts use "pool" plans and some use "percent payment" plans. A pool plan looks to the total amount that a debtor pays into the plan, and from this deducts attorney fees, administrative costs and unsecured priority payments. Any remaining money is paid to unsecured creditors.⁵⁰ In contrast, courts requiring a percentage payment plan look to the percentage of payment to unsecured

creditors, which must be disclosed in the plan.⁵¹ If the plan does not pay a specified percentage, then the plan (and the debtor's expenses) will be subject to greater scrutiny from the court.⁵²

A further difference deals with the manner in which plan payments are made. Section 1325(c) of the Code authorizes the court to order the debtor's employer to deduct the amount from the debtor's paycheck and forward the payments directly to the trustee. Local rules in the Western District of Pennsylvania and Southern District of Ohio require debtors to submit a wage attachment/payroll deduction order along with the plan.⁵³ The local rules for the Western District of Kentucky do not require wage attachment, but the chapter 13 trustee does.⁵⁴ In Oregon, the debtor must include a payroll-deduction order with the plan, but at the meeting of creditors, may request the trustee to waive the wage attachment requirement.⁵⁵ In contrast, neither the Northern District of Illinois, District of New Jersey, nor the Middle District of Tennessee require payroll deduction.

Conclusion

All consumer bankruptcy cases are filed under the Code, and virtually all consumer bankruptcy debtors are seeking a "fresh start," but this is where uniformity ends. The administration of chapter 7 and 13 cases, as well as costs, plan content, exemptions, treatment of secured debt and other elements, varies significantly based on state law, regional judicial precedent, and local rules and practices. Consumer bankruptcy more closely resembles a patchwork of distinctive legal environs rather than a uniform system of debt relief. ■

Editor's Note: *Prof. Austin is co-author of Reaffirmation Agreements in Consumer Bankruptcy Cases, Second Edition (ABI, 2010), which is available for purchase at <http://bookstore.abi.org>.*

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⁴¹ 28 U.S.C. § 586(b).

⁴² Bankruptcy Judges, U.S. Trustees and Family Farmer Bankruptcy Act of 1986, Pub. L. No.99-554, 100 Stat. 3119, 3123, § 302(d)(3)(i).

⁴³ 28 U.S.C. §586(e)(1)(B)(i).

⁴⁴ Some other rates include: C.D. Cal., 10 percent; D. Conn., 7.9 percent; S.D. Fla., 5 percent; S.D. Ga., 7.4 percent; N.D. Ill, 6.3 percent; N.D. Ind., 3 percent; D. Minn. (St. Paul), 8.1 percent; N.D. Ohio, 3.9 percent; N.D. Tex., 10 percent; E.D. Va., 8 percent; and D. Wyo., 9.9 percent. Note that these rates increased after Oct. 1, 2010.

⁴⁵ PA Local Bankruptcy Rule 3015-1 and Local Form 10.

⁴⁶ Indiana Bankruptcy Court General Order 09-0005; S.D. Ohio Local Bankruptcy Rule 3015-1(d)(1).

⁴⁷ There is no written rule for this, but it is customary local practice.

⁴⁸ See, e.g., www.louchapter13.com/Images/Chapter13Practices.pdf.

⁴⁹ Oregon Local Bankruptcy Rule 3015-1 (7).

⁵⁰ See, e.g., E.D. Ky. Local Bankruptcy Form 2.

⁵¹ See, e.g., www.louchapter13.com/Images/Chapter13Practices.pdf.

⁵² In the Western District of Kentucky, if the plan proposes to pay unsecured creditors less than 70 percent, the debtor must appear in person for a plan-confirmation hearing. If the plan pays more than 70 percent, it will be confirmed without a separate hearing. See www.louchapter13.com/Images/Chapter13Practices.pdf.

⁵³ Pennsylvania Local Bankruptcy Rule 3015-2; S.D. Ohio Local Bankruptcy Rule 3015-1(e). In Oregon, the debtor must include wage-attachment order with the plan, but at the meeting of creditors may request the trustee to waive the wage-attachment requirement. See Oregon Local Bankruptcy Rule 3015-1(2).

⁵⁴ See www.louchapter13.com/Top_Ten/Top_Ten.html.

⁵⁵ See Oregon Local Bankruptcy Rule 3015-1(2).

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