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Bankruptcy Courts Helping Individuals, Despite the Statute?

Two recent bankruptcy court cases remind counsel of the great importance of knowing the proclivities of the presiding panel of judges who will hear your client's case. Experienced practitioners know the law and the best advocates also know the assigned judges. Both cases discussed below illustrate the importance, at least in bankruptcy practice, of arguing the law in a fashion that addresses the court's sense of what is fair and proper under the case's unique circumstances.

Voluntary Retirement Plan Contributions Are Required for Maintenance or Support?

In re Davis, 960 F.3d 346 (6th Cir. 2020)[[1](#)] saw a Chapter 13 debtor who made voluntary contributions to her 401(k) retirement plan. The contributions were made via employer withholdings. The money was never received by Davis. Therefore, Davis' proposed Chapter 13 payment plan excluded those monies from funds available to her creditors. As many will recall, Chapter 13 requires debtors to recognize all their "disposable income" in their servicing of a Chapter 13 plan for the plan's approved time period.

Bankruptcy Code Section 1325(b)(2) defines "disposable income" as the debtor's "current monthly income ... less amounts reasonably necessary to be expended ... for the maintenance or support of the debtor." For Davis and other Chapter 13 debtors with above average income, the "amounts reasonably necessary to be expended" are determined using standards promulgated by the IRS. See 11 U.S.C. 1325(b)(3). "Projected disposable income," as used in Section 1325(b)(1), is not defined anywhere in the Bankruptcy Code so it might or might not include funds diverted from a paycheck into a 401(k) account. See *Hamilton v. Lanning*, 360 U.S. 505 (2010). In short, all of Davis' income above the IRS' guidelines is her "disposable income," that at first reading of the statute should be paid in service of her plan.

Over the 60 months of her Chapter 13 bankruptcy plan, Davis intended to pay a fraction of her over \$189,000 in unsecured debts by paying \$19,380 (\$323 per month for 60 months). Despite leaving over \$169,000 of unsecured debt unpaid, Davis' plan was to continue contributing \$220.66 per month (\$13,239.60 over 60 months) into her retirement plan.^[2] Of course, Davis' 401(k) retirement plan is safe from her creditors – past, present, and future. If one includes the funds transferred into the 401(k) account, Davis' plan was to contribute only 59.4%^[3] of her apparent disposable income towards her unsecured debts.

Davis was not the first Chapter 13 debtor who wanted to fund a retirement account while not paying unsecured creditors in full. Rejecting Davis' effort, the bankruptcy court judge said he was constrained by strong dicta in the Sixth Circuit's decision *Seafort v. Burden (In re Seafort)*, 669 F.3d 662 (6th Cir. 2012) (the Bankruptcy Code always counts voluntary retirement contributions as disposable income, even if the debtor began making those contributions prior to bankruptcy). The *Seafort* decision adverse to Davis' argument included this in 2012:

Ultimately then, we find that the *Prigge/McCullers* interpretation is the most persuasive because it gives effect to every word in the statute. See *Penn. Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 562, 110 S.Ct. 2126, 109 L.Ed.2d 588 (1990) ("Our cases express a deep reluctance to interpret a statutory provision so as to render superfluous other provisions in the same enactment."); *Mackey v. Lanier Collection Agency & Serv., Inc.*, 486 U.S. 825, 837 & n. 11, 108 S.Ct. 2182, 100 L.Ed.2d 836 (1988) (same). Although "awkward" perhaps, we conclude, based on the language and structure of Chapter 13, incorporating § 541, that Congress intended to exclude from disposable income and projected disposable income available for unsecured creditors only voluntary retirement contributions already in existence at the time the petition is filed. . . .

In sum, for the foregoing reasons, we hold that the income made available once Debtors' 401(k) loan repayments are fully repaid is properly committed to the debtors' respective

Chapter 13 plans for distribution to the unsecured creditors and may not be used to make voluntary retirement contributions.

Id., 669 F.3d at 674.

Despite the *Seafort* decision only 8 years earlier, the *Davis* court revisited the issue and reversed.^[4] The *Davis* court's path towards change starts with three important statements: (i) "Before 2005, the 'overwhelming consensus' among bankruptcy courts was that wages voluntarily withheld as 401(k) contributions formed part of a debtor's disposable income."; (ii) "In 2005, however, Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA)";^[5] and (iii) After BAPCPA, some bankruptcy courts began to approve Chapter 13 plans like the one proposed by Davis. *Id.*

The *Davis* court states that the "leading case" favoring Davis' interpretation of BAPCPA and permitting voluntary retirement contributions by Chapter 13 debtors is a 2006 decision from a Georgia bankruptcy court. That decision predates *Seafort*. The *Davis* court acknowledges this fact saying "[w]ithout deciding the precise question before us today, this court squarely rejected Johnson's reasoning in *Seafort*, 669 F.3d at 674." *Davis* at 351. In other words, the *Davis* court admits that the *Seafort* decision post-dates the statutory change it is about to analyze.

The *Davis* majority and the dissent agree that there are 4 competing interpretations of BAPCPA on this issue. That discussion does not matter for our purposes; what matters for this analysis is that the Sixth Circuit revisited the question and reached a variant result without a change in BAPCPA between 2012 and 2020. Although the *Davis* majority opinion and dissent both contain a long analysis of grammar and rules of statutory construction, one is left to conclude that the *Davis* majority is giving an answer different from *Seafort*, at least in part, because of the judges' sense that it is for the better that Americans save for retirement. The *Davis* court seems to believe the new rule is better because retirement saving should not be delayed during the period of the Chapter 13 plan, notwithstanding the losses placed on unsecured creditors.

Emergency Medical Care is Not Spending For a “Personal Purpose”?

In re Sijan, 611 B.R. 850 (Bankr. S.D. Ohio2020) offers the same lesson on statutory interpretation – if a plain statutory reading seems wrong, try for a different result. This time, however, the case concerns dischargeable debts in Chapter 7.

When incurring debt, both the lender and borrower should have the intent and expectation that debt will be paid. A borrower’s belief on that topic can be important for both moral and legal reasons. Apparently agreeing, Congress restricted the ability of bankrupt individuals to obtain a discharge via Chapter 7 if they were discharging mostly debts incurred for a “personal purpose.” The idea was that debtors who knew they were headed for bankruptcy should not be able to discharge debts recklessly incurred that they never intended to pay – think the vacation at Disneyland charged to a credit card the month before a planned bankruptcy filing. One bankruptcy judge described Congress’ concerns as directed at “unscrupulous” debtors.[\[6\]](#)

For Chapter 7 debtors, Congress’ restriction is in Bankruptcy Code Section 707 and related provisions. 11 U.S.C. § 707 titled *Dismissal of a Case or conversion to a case under chapter 11 or 13* states in relevant part:

(b)(1) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, trustee (or bankruptcy administrator, if any), or any party in interest, **may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts**, or, with the debtor’s consent, convert such a case to a case under chapter 11 or 13 of this title, if it finds that the granting of relief [a discharge of debts] would be an abuse of the provisions of this chapter. . . .

(emphasis added).

A quick primer here regarding the “conversion” referenced in the above-quoted section of the bankruptcy code: (i) Chapter 7 bankruptcy cases to which 11 U.S.C. § 707 applies is a classic “straight” bankruptcy in which most of the debtor’s debts are eliminated or “discharged” in exchange for the debtor surrendering

all non-exempt assets; and (ii) a Chapter 7 case can sometimes be “converted” into a Chapter 13 case which requires a debtor to make payments over 36 to 60 months before receiving a discharge but permits the bankrupt debtor to retain certain property. Many debtors consider a Chapter 7 immediate fresh start bankruptcy case more beneficial than a Chapter 13 bankruptcy payment plan.

The definition of “consumer debt” that triggers the above-quoted Section 707(b) is found in Bankruptcy Code Section 101(8). That definition is “debt incurred by an individual **primarily for a personal, family, or household purpose.**” (emphasis added).

There is little doubt that debt incurred to obtain medical services for the debtor qualify as “consumer debt” because it is for a personal purpose. Given that determination, a Chapter 7 case that has the requisite portion of those debts is subject to dismissal or conversion if the tests of Section 707 and related sections are not met.

In re Sijan, 611 B.R. 850 (Bankr. S.D. Ohio 2020) involved medical debt incurred involuntarily by the debtor who unexpectedly required six weeks in an intensive care unit after being told that the alternative was death. Medical debt seems clearly to be “incurred . . . primarily for a personal . . . purpose” and so Section 707(b)(1) was implicated due to the size of Sijan’s medical debt.^[7] When the United States Trustee moved to dismiss Sijan’s Chapter 7 case, the debtor responded by arguing that he did not “voluntarily incur” the emergency medical debt.

Before examining the application of Section 707(b)(1), the *Sijan* court reviewed the purpose of that section saying:

[T]he Bankruptcy Code includes provisions, such as 11 U.S.C. § 707(b), which is intended to prevent debtors from obtaining Chapter 7 shelter if they have an ability to pay their creditors [perhaps via a Chapter 13 payment plan], and § 727, which is **intended to keep unscrupulous debtors from obtaining bankruptcy relief.** *In re Krohn*, 886 F.2d 123, 126 (6th Cir. 1989); *Wise v. Wise* (In re Wise), 590 B.R. 401, 429 (Bankr. E.D. Mich. 2018) (citing *Robin Singh Educ. Servs., Inc. v. McCarthy* (In re McCarthy), 488 B.R. 814, 825 (1st Cir. BAP 2013); see also H.R. REP. NO. 109–31, pt. 1, at 2 (2005) (stating that the

provisions Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 were enacted to deter abuse in consumer bankruptcy filings).

(emphasis added). *Id.*, 611 B.R. 850 at para. 14–5.

Bankruptcy courts have put a gloss on the term “consumer debts” requiring that the debt be voluntarily incurred. See *IRS v. Westberry*, 215 F.3d 589, 591 (6th Cir. 2000) (court used the voluntariness requirement to exclude tort judgments and IRS liens from consumer debts).[8] I agree that it seems consumer debts should be voluntary; but I also agree that requirement is not written in the statute. My first reaction to the *Westberry* facts discussed in the footnote below is not to consider a tort judgment or IRS lien as “incurred . . . primarily for a personal . . . purpose.” Still, courts choose to use the judicial gloss of a voluntariness requirement to exclude those debts from the definition of “consumer debts” rather than analyze the purpose for which the debt was incurred (as opposed to why the debt went unpaid – so that the money was used for other purposes).

The *Sijan* court extended the voluntary debt idea beyond taxes and tort judgments to emergency life-saving medical debts. The *Sijan* court admitted that most medical debts (regular visits, cosmetic procedures, elective procedures, a planned course of treatment) are consumer debts because they are voluntary and for a personal purpose. To the contrary, the *Sijan* court found that is not true with respect to life saving emergency medical care, saying:

Furthermore, the Debtor did not voluntarily incur the debt arising out of his emergency medical treatment at Broward Health Medical Center. The Debtor did not intend to have a near death experience and be subjected to six weeks of medical treatment after visiting the emergency room. This is more akin to judgment from a tort action, in which some sort of accident occurs and the debtor is found liable for the unforeseen damages.

Id., 611 B.R. at 857. The *Sijan* court uses and extends the non-statutory, but logical voluntariness requirement, to permit the debtor to remain in Chapter 7. One perceives that this

adjudication is not an unfair result, but it is not obvious legal conclusion from a literal reading of the statute.

Conclusion

The statute at issue in *Sijan* was also added to the Bankruptcy Code by the so-called “anti-debtor” BAPCPA. These cases are potentially important developments for counsel who represent individuals in bankruptcy. They also demonstrate that knowing the law is not always enough. Rather, better advocacy explains that fairness results from application of the advocated position. As a mentor once explained: Tell the court what the law is and then give the judge a reason to feel good about ruling in your favor. Both these bankruptcy cases remind lawyers to be creative and reach for the best possible result for their clients.

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[1] The *Davis* decision discussed below is a 2-1 ruling with a long dissent.

[2] Davis' Chapter 13 plan proposed to pay less than 11% of her unsecured debt.

[3] This would equal \$323, which is 59.4% of \$543.66 (the total available funds discussed by the court). If all the available funds were dedicated to her plan payments, Davis could have paid over 17% of her unsecured debt.

[4] The *Seafort* decision acknowledges that other courts have come to a different conclusion but determines that Congress' language requires this result in favor of unsecured creditors.

[5] When it was enacted, most commentators labeled BAPCPA “anti-debtor.” Consider this from vox.com “[Presidential candidate Elizabeth] Warren's quarrel with Biden isn't personal. It's about a 2005 bankruptcy bill he supported as a senator. Warren opposed

the bill so vehemently that its passage inspired her transition from a Harvard bankruptcy law professor, who studied middle-class economics, to a senator and now a presidential hopeful. 'I got in that fight because [families] just didn't have anyone and Joe Biden was on the side of the credit card companies,' [Warren said after an April rally in Iowa](#). 'It's all a matter of public record.'" It is hard to understand that this supposedly credit card company beneficial law was intended to permit Chapter 13 debtors to voluntarily contribute to retirement plans – but that is what courts have held.

[6] See the *Memorandum Opinion and Order Granting Debtor's Motion for Summary Judgment Denying United States Trustee's Motion to Dismiss*. *In re Sijan*, above. Hereinafter, sometimes this decision is the "Order."

[7] Mr. Sijan's medical debt was about three-fourths of his total debt.

[8] The money not paid to the IRS in *Westberry* was used by the debtor for family purposes and so the bankruptcy court held that the debt owed to the IRS was incurred for a personal purpose and hence a consumer debt. The Sixth Circuit disagreed, stating in part: "[f]irst, a tax debt is 'incurred' differently from a consumer debt. Although it is true that tax debts may be incurred under the Bankruptcy Code, this incurrence is not voluntary on the part of the taxpayer. See *Reiter*, 126 B.R. at 964; see also *Marshalek*, 158 B.R. at 706 (stating that 'volition is essential' to a classification as consumer debt in finding that a vehicular accident judgment was not consumer debt under Chapter 7). We may at least hope to choose to incur consumer debt; its certainty being nothing like death and taxes. See Letter from Benjamin Franklin to Jean-Baptiste Le Roy (Nov. 13, 1789)."

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