

## Real Estate Abandonments and the Means Test

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Due to the recent recession, there has been a substantial increase in bankruptcy filings. For example, personal bankruptcy filings rose to 1.41 million in 2009, a 32 percent increase from 2008.<sup>1</sup> Real estate driven bankruptcies have similarly increased substantially over the last few years.<sup>2</sup>

A new phenomenon has also arisen recently. Many debtors no longer fight to retain their properties, but instead are abandoning their properties in both chapter 7 and chapter 13<sup>3</sup> cases. This surrendering of real estate has occurred with primary residences and investment property purchased within the last seven years, and has occurred primarily in the hardest-hit real estate markets.<sup>4</sup> Nationwide, the hardest-hit real estate markets have been in Florida, California, Nevada and Arizona.<sup>5</sup>

When real estate is surrendered in bankruptcy, the debtor remains the legal owner up until the bank completes the foreclosure proceeding.<sup>6</sup> This is true even if the debtor filed a statement of intention to surrender the property and also has already been discharged. Since the debtor is still the owner, insurance must be maintained on the property. There have been cases where the debtor owned

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<sup>1</sup> Sara Murray and Conor Dougherty, "Personal Bankruptcy Filings Rising Fast," Wall Street Journal, Jan. 7, 2010, available at <http://online.wsj.com/article/SB126263231055415303.html>.

<sup>2</sup> Many individuals owe more on their mortgages than their homes are worth. According to a recent report, the number of underwater homeowners recently hit a record high of 16 million. See Armour, Stephanie, "More Walk Away from Homes, Mortgages," USA TODAY, Nov. 3, 2009. Data collected by the Consumer Counseling Services of Greater Atlanta last year showed that one in five people who received credit counseling services prior to filing for bankruptcy cited avoiding foreclosure as their primary reason for filing. See "One in Five People Filed for Bankruptcy to Avoid Foreclosure In June," available at [www.cccsinc.org/mediaRoom/pressReleaseDetail.jsp?id=3145](http://www.cccsinc.org/mediaRoom/pressReleaseDetail.jsp?id=3145) (press release).

<sup>3</sup> *In re Sneijder*, 407 B.R. 46, 48-53 (Bankr. S.D.N.Y. 2009).

<sup>4</sup> According to the Realtytrac year-end 2009 Metropolitan Foreclosure Market Report, the metropolitan areas of Florida, California, Nevada and Arizona have the highest foreclosure rates. See "Realtytrac Year-End Report Shows Record 2.8 Million U.S. Properties with Foreclosure Filings in 2009," available at [www.realtytrac.com/contentmanagement/pressrelease.aspx?channelid=9&itemid=8333](http://www.realtytrac.com/contentmanagement/pressrelease.aspx?channelid=9&itemid=8333) (press release).

<sup>5</sup> See *id.*

<sup>6</sup> *Sneijder*, 407 B.R. 46 at 52-53.

and abandoned investment property and received a discharge. However, the debtor had hostile tenants who, despite their failure to pay rent, filed complaints, and the debtor had possible exposure for substantial fines and penalties.

The real estate decline has brought to light new issues. In chapter 13 cases, confirmation hearings are now held a few months after the case is filed. Since a lot can happen between the filing and the confirmation, the proper methodology for valuing unsecured claims of property to be abandoned is difficult to determine.<sup>7</sup> Furthermore, in both chapter 7 and chapter 13 cases, the ambiguous statutory language of the means test has left courts split over whether the remaining mortgage payments on a debtor's surrendered property should be factored in or taken out of the means test calculation. This article will focus on secured mortgage abandonments and the means test.

### **Treatment of Secured Debt on Property that the Debtor Intends to Surrender (Means Test)**

The primary purpose of the means test is to determine whether an above-median-income debtor is in need of bankruptcy relief, or alternatively, whether a presumption of abuse of the bankruptcy process arises. When Congress enacted the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA),<sup>8</sup> its intent was to create a 'mechanical' formula for presuming abuse of chapter 7.<sup>9</sup>

In the context of the means test, the current conflict between the courts over whether a debtor may deduct secured debt payments on property that the debtor intends to surrender is rooted in differing statutory interpretations. The relevant statute, § 707(b)(2)(A)(iii), states that:

The debtor's average monthly payments on account of secured debts shall be calculated as the sum of: (I) the total of all amounts scheduled as contractually due to secured creditors in each month of the 60 months following the date of the petition; and (II) any additional payments to secured creditors necessary for the debtor, in filing a plan under Chapter 13 of this title, to maintain possession of debtor's primary residence, motor vehicle, or other property necessary for the support of the debtor and the debtor's dependents, that serves as collateral for secured debts; divided by 60.<sup>10</sup>

#### Chapter 7 Analysis

##### ***The Snapshot Approach (Majority view)***<sup>11</sup>

Under the "snapshot approach," the courts have held that long-term secured payments that are "scheduled as contractually due" on the date of the debtor's petition may be deducted as a monthly expense regardless of a debtor's intention to surrender the property in the future.<sup>12</sup> Under this view, the

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<sup>7</sup> *Id.* at 48-49. This case provides an excellent discussion regarding abandonments and how to value the unsecured claim.

<sup>8</sup> Pub. L. 109-8, 119 Stat. 23, enacted April 20, 2005.

<sup>9</sup> *In re Randle*, 358 B.R. 360, 363-365 (Bankr. N.D. Ill. 2006), *aff'd*, 2007 U.S. Dist. Lexis 54985, 2007 WL 2668727 (Bankr. N.D. Ill. 2007). See Report of the Committee on the Judiciary, House of Representatives, to accompany S. 256 H.R. Rep. No. 109-31, Pt 1, p. 553, 109<sup>th</sup> Cong., 1<sup>st</sup> Sess. (2005).

<sup>10</sup> 11 U.S.C. § 707(b)(2)(A)(iii)(I) & (II).

<sup>11</sup> The 1<sup>st</sup>, 2<sup>nd</sup>, 3<sup>rd</sup>, 6<sup>th</sup>, 7<sup>th</sup>, 9<sup>th</sup> & 11<sup>th</sup> circuits have numerous cases using this approach. However, even though the 4<sup>th</sup>, 8<sup>th</sup> & 10<sup>th</sup> circuits have some cases with this approach, they also have cases using the Forward Approach.

<sup>12</sup> *In re Walker*, 2006 Bankr. Lexis 845, \*9-19 (Bankr. N.D. Ga. 2006).

means test is believed to be a “backward-looking test” that measures a debtor’s financial health based on historic income and expense figures as of the petition date.<sup>13</sup> Taking a snapshot of the debtor’s obligations on the petition date is believed to be in accord with the statute’s plain meaning.<sup>14</sup> The phrase “scheduled as contractually due”<sup>15</sup> is intended to refer to payments that a debtor is legally obligated to pay under a contract on certain dates in the future.<sup>16</sup> A debtor’s contractual liability for the debt is not eliminated upon the surrender of the collateral securing the debt.<sup>17</sup> Therefore, the court should determine how many payments are owed under the contract for each secured debt at the time of filing.<sup>18</sup> The courts have interpreted the statute’s plain language as providing a mechanical test that “avoids the uncertainties that surround a debtor’s announced, but not yet executed, plan to surrender property or reaffirm secured debts.”<sup>19</sup> This mechanical test is designed to *estimate*, and not accurately predict, a debtor’s ability to repay its creditors through a chapter 13 plan.<sup>20</sup> Congress chose to base the means test on historic income and fixed expense figures despite the fact that the IRS collection standards and other external factors are likely to change during the course of the 60 months after the petition.<sup>21</sup>

### **Dismissal under Totality of the Circumstances: Protection for Debtor Abuses of Snapshot**

Despite passing the chapter 7 means test, a debtor may have his or her petition dismissed under § 707(b)(3) if “the totality of the circumstances...of the debtor’s financial situation demonstrates abuse.”<sup>22</sup> In a 2009 case in the E.D. of New York, the debtor listed two condominium properties on Schedule A and despite the fact that he indicated his intent to surrender his properties, he deducted his future monthly payments on the debt secured by them.<sup>23</sup> The court found that the debtor passed the means test, and thus a presumption of abuse did not arise.<sup>24</sup>

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<sup>13</sup> *Id.* at \*16.

<sup>14</sup> *In re Hayes*, 376 B.R. 55, 60-63 (Bankr. D. Mass 2007) (citing *United States v. Ron Pair Enter., Inc.*, 489 U.S. 235, 241 (1989)).

<sup>15</sup> The main controversy in most cases is regarding the meaning of these words. *Id.* at 60. Some courts state that the word ‘scheduled’ “refers[s] to a debt being listed on the Debtor’s official schedules...” *Id.* at 61 (citing *In re Singletary*, 345 B.R. 455, 467-473 (Bankr. S.D. Tex. 2006), as well as other cases. *Walker* held that ‘scheduled’ has the plan dictionary meaning of “planned for a certain date.” *Walker*, 2006 Bankr. Lexis 845 at \*9. *The Hayes court* was persuaded by the *Walker* reasoning and thus, “ ‘scheduled as contractually due’ means those payments required to be made on a monthly basis according to the debtor’s contract with the secured lender.” *Hayes*, 376 B.R. 55 at 62. The *Hayes court* further referred to *In re Randle*, which stated that there is no bankruptcy schedule that requires a listing of amounts to be paid to secured creditors in 60 months. *Id.* See also *Randle*, 358 B.R. 360 at 365.

<sup>16</sup> *Hayes*, 376 B.R. 55 at 63.

<sup>17</sup> *Id.* (citing *Walker*, 2006 Bankr. Lexis 845 at \*12).

<sup>18</sup> *Id.* at 64.

<sup>19</sup> *In re Rudler*, 576 F.3d 37 at 52 (1st Cir. 2009). This mechanical test is preferable to trying to decipher debtor’s ‘true’ intentions. See also *In re Kogler*, 368 B.R. 785, 790 (Bankr. W.D. Wisc. 2007). To argue otherwise would “essentially punish[] debtors for their honesty, as debtors who say they plan to reaffirm secured debts but do not do so would seemingly still ‘pass’ the test.” *Id.* at 790.

<sup>20</sup> *Walker*, 2006 Bankr. Lexis 845 at \*19.

<sup>21</sup> *Id.* at \*17.

<sup>22</sup> 11 U.S.C. § 707(b)(3).

<sup>23</sup> *In re Perelman*, 419 B.R. 168, 171-178 (Bankr. E.D.N.Y. 2009).

<sup>24</sup> *Id.* at 176.

However, the court is permitted to consider income made available to debtors as a result of surrendering their real property under the totality of the circumstances test in § 707(b)(3).<sup>25</sup>

In *Perelman*, the court found that the debtor's "stable employment, significantly above-median income, absence of dependants and major reduction in expenses through the surrender [of his property]" showed that he had more than adequate monthly disposable income to make a meaningful distribution to his unsecured creditors. Therefore, he was ineligible for chapter 7 relief.<sup>26</sup>

### ***The Future-Oriented Approach (Minority View)***

On the other hand, courts utilizing the 'future-oriented approach' or 'forward-looking approach' interpret 'scheduled as contractually due' to allow deductions on the means test for only the expenses that the debtor reasonably expects to pay during the next 60 months. Most courts following this approach conclude that payments to secured creditors on property that a debtor intends to surrender cannot be deducted in the means test calculation.<sup>27</sup>

In *Burden*, the court closely examined section 707 (b)(2)(A)(iii)(I) in the context of section 707 (b)(2)(a)(iii)(II) and determined that it applies only to payments on debts secured by collateral that a debtor intends to keep.<sup>28</sup> "...The Court has no problem binding debtors to what they say they plan to do when they file bankruptcy...If a debtor indicates that he intends to surrender property, his financial condition will be judged at the time of the statement, which, more often than not, is the petition date."<sup>29</sup>

### **The 3rd Approach (5th Circuit)**

In the *Singletary* case,<sup>30</sup> the court came up with a combination of the backward looking and forward looking approaches. It held that debtors should be allowed to include payments to secured creditors on the means test even though the statement of intention listed these debts as debts to be abandoned. However, if the property was already surrendered as of the date the presumption of abuse motion was filed, then the payments to these secured creditors are not permitted on the means test.<sup>31</sup>

First, the *Singletary* court interpreted the word 'scheduled' to refer to a debt on the debtor's official schedules, as contrasted with the *Walker* definition.<sup>32</sup> Then it defined the term 'as contractually due' to mean that even if the property was already surrendered, the debtor is still obligated to these debts up until the time of discharge.<sup>33</sup> Finally, the court defined the term 'to secured creditors' and held "... upon surrender of the collateral to the secured party, the estate no longer has any interest in the collateral and the creditor's only remaining claim for any deficiency is the unsecured Article 9 of the Texas Business and Commercial Code."<sup>34</sup>

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<sup>25</sup> *Id.* at 178.

<sup>26</sup> *Id.*

<sup>27</sup> *In re Burden*, 380 B.R. 194, 202-204 (Bankr. W.D. Mo. 2007) (following *In re Skaggs*, 349 B.R. 594 (Bankr. E.D. Mo. 2006)). See also *In re Harris*, 353 B.R. 304 (Bankr. E.D. Okla. 2006). The *Staggs* case is one of the first and the leading case for the minority argument. The minority defines the term 'scheduled' as that which is listed in the statement of intention.

<sup>28</sup> *Burden*, 380 B.R. 194 at 202.

<sup>29</sup> *Id.* at 203.

<sup>30</sup> *Singletary*, 345 B.R. 455.

<sup>31</sup> *Id.* at 473.

<sup>32</sup> *Id.* at 467.

<sup>33</sup> *Id.* at 468.

<sup>34</sup> *Id.* at 469.

## Chapter 13 Analysis

### ***The Future-Oriented Approach (Majority View)***<sup>35</sup>

The future-oriented approach is commonly applied in the context of chapter 13 cases, where a debtor commits his or her projected disposable income toward paying his creditors.<sup>36</sup> In a chapter 13 case, per § 1325(b)(1)(B), if a trustee or holder of an allowed secured claim objects to the confirmation of the chapter 13 plan, the court may not approve the plan unless “all the debtor’s projected disposable income to be received in the applicable commitment period...will be applied to make payments to the unsecured creditors under the plan.”<sup>37</sup> Since ‘projected’ is not specifically defined in the Bankruptcy Code, several courts have looked to its dictionary definition and have concluded that a debtor must account for events that actually occur during the course of the plan.<sup>38</sup> Therefore, under the future-oriented approach, a chapter 13 debtor cannot claim a means-test deduction for property that he or she intends to surrender because “[i]f Congress intended to create a means test as a blunt measure of ability to pay without regard to a Chapter 13 plan, that would lead to results that are illogical and sometimes produce a strange result.”<sup>39</sup> As the *Perelman* court in Eastern District of New York recently noted, the question of whether monthly payments on secured property to be surrendered can be deducted in calculating a chapter 13 debtor’s projected disposable income involves different considerations than whether the same can be done in determining chapter 7 eligibility<sup>40</sup>

The United States Trustee Program has detailed its position on many issues currently arising under the Chapter 13 Means test and has stated the following:

#### Line 47. Future payments on secured claims

Outside of the First Circuit, does not include payments when the debtor intends to surrender the collateral securing the loan either in the plan or independent of the plan.<sup>41</sup>

### ***The Snapshot Approach (Minority View)***<sup>42</sup>

The most cited case in this category is *In re Burmeister*.<sup>43</sup> These cases follow the same reasoning

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<sup>35</sup> The 8<sup>th</sup>, 10<sup>th</sup> and 11<sup>th</sup> circuits have decisions supporting this approach. The 4<sup>th</sup>, 6<sup>th</sup> and 7<sup>th</sup> circuits also have decisions supporting this approach, but they also have cases supporting the competing approach. Nevertheless, this approach is deemed the majority approach especially in light of US Trustee Chapter 13 Means Test analysis and a recent Supreme Court decision discussed subsequently.

<sup>36</sup> “Dismissal or Conversion: Debtors Giving Up Home Have ‘Meaningful Ability’ to Repay Debts Through Chapter 13,” 21 BBLR 1632 (Nov. 19, 2009).

<sup>37</sup> 11 U.S.C. § 1325(b)(1)(B).

<sup>38</sup> *In re Vernon*, 385 B.R. 342 (Bankr. M.D. Fla. 2008); *In re McPherson*, 350 B.R. 38, 44 (Bankr. W.D. Va. 2006).

<sup>39</sup> *Vernon*, 385 B.R. 342 at 347.

<sup>40</sup> *Perelman*, 419 B.R. 168 at 174.

<sup>41</sup> U.S. Trustee’s Position on Legal Issues Arising Under the Chapter 13 Disposable Income Test, available at [http://www.justice.gov/ust/eo/bapcpa/docs/chapter13\\_analysis.pdf](http://www.justice.gov/ust/eo/bapcpa/docs/chapter13_analysis.pdf), page 9.

<sup>42</sup> While the 1<sup>st</sup>, 2<sup>nd</sup>, 6<sup>th</sup>, 7<sup>th</sup> & 9<sup>th</sup> circuits have cases using this approach, most circuits have decisions using the competing approach. The United States Trustee’s Office only states that the 1<sup>st</sup> circuit is deemed to be allowed to use this approach.

<sup>43</sup> *In re Burmeister*, 378 B.R. 227 (Bankr. N.D. Ill. 2007). Other cases citing *Burmeister* include the following: *In re Hoskings*, 2008 Bankr. Lexis 1785 (Bankr. E.D. Va. 2008), *In re Willette*, 395 B.R. 308

of the leading cases under the Chapter 7 Majority Approach discussed above.

***Recent Supreme Court Case***

Most recently, in June 2010, the Supreme Court held that the forward looking approach is correct in determining 'projected disposable income.'<sup>44</sup> Even though this case does not discuss the secured debt payments issue, it describes in detail the intent of the new law to take into account projected changes.<sup>45</sup>

Since this case endorses the forward approach with respect to income and touches on expenses in the analysis, we would expect this approach to be used exclusively in the future, even in the 1st Circuit.

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(Bankr. D. Vt. 2008), *In re Richardson*, 2009 Bankr. Lexis 773 (Bankr. C.D. Ill. 2009). *In re Turner*, 384 B.R. 537 (Bankr. S.D. Ind. 2008) also is cited a number of times and has a good discussion on the case history.

<sup>44</sup> *Hamilton v. Lanning*, 177 L. Ed. 2d 23, 2010 U.S. Lexis 4568 (2010).

<sup>45</sup> "Congress did not amend the term 'projected disposable income' in 2005, and pre-BAPCPA bankruptcy practice reflected a widely acknowledged and well-documented view that courts may take into account known or virtually certain changes to debtors' income or expenses when projecting disposable income. In light of this historical practice, we would expect that, had Congress intended for 'projected' to carry a specialized-and indeed, unusual—meaning in Chapter 13, Congress would have said so expressly." *Id.* at \*22-23.