

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TEXAS
SHERMAN DIVISION

IN RE:	§	
	§	
DAN ALLEN GRAHAM and	§	Case No. 07-41683
TERRY LYNN GRAHAM,	§	(Chapter 13)
	§	
Debtors.	§	

MEMORANDUM OPINION

This matter is before the Court to consider confirmation of the Chapter 13 plan proposed by the Debtors, Dan and Terry Graham. The Chapter 13 trustee objects to confirmation on the grounds that the Debtors' proposed Chapter 13 plan does not provide that all of their disposable income will be applied to make payments to unsecured creditors. In particular, the Chapter 13 trustee objects to certain telecommunications, medical and dental expenses claimed by the Debtors. Based on the evidence presented at the confirmation hearing on April 4, 2008, the Court makes the following findings and conclusions pursuant to Federal Rule of Civil Procedure 52, as adopted and applied to bankruptcy cases by Federal Rule of Bankruptcy Procedure 7052.¹

JURISDICTION

This Court has jurisdiction to consider this matter pursuant to 28 U.S.C. §§157 and 1334. The Court has the authority to enter a final order in this contested matter because it constitutes a core proceeding as contemplated by 28 U.S.C. §157(b)(2)(A), (L), and (O).

¹ To the extent that any finding of fact is construed to be a conclusion of law, it is hereby adopted as such. Likewise, to the extent any conclusion of law is construed to be a finding of fact, it is hereby adopted as such.

RELEVANT FACTS

The Debtors filed a joint petition for relief under Chapter 13 of Title 11 of the United States Code (the “Bankruptcy Code”) on August 1, 2007. The Debtors had at that time two minor children. At the time of their confirmation hearing in April 2008, the Debtors’ oldest daughter had turned 18 and was attending college. The Debtors’ 18-year-old daughter nonetheless remained financially dependent on her parents.

Mr. Graham is employed as an infrastructure specialist and has worked for the same company for approximately 16 years. His gross annual salary is \$86,652. Mrs. Graham was working as a part-time sales merchandiser at the time of the confirmation hearing.

The Debtors annexed Official Form 22C (Chapter 13 Statement of Current Monthly Income and Calculation of Commitment Period and Disposable Income) (“Form 22C”) to their bankruptcy petition. In their Form 22C, the Debtors stated that they paid an average of \$639.50 each month in the six months prior to bankruptcy for health care expenses that were not reimbursed by insurance or paid by a health savings account. Additionally, the Debtors stated that they spent an average of \$164.95 each month in the six months prior to bankruptcy for telecommunications services.

The Debtors’ Schedule J (Current Expenditures of Individual Debtor(s)) (“Schedule J”), which the Debtors also filed with their bankruptcy petition, was consistent with their Form 22C. The Debtors listed monthly health care expenses totaling \$639.50 in their Schedule J consisting of \$125 in medical and dental expenses, an additional \$290 in dental expenses for braces for one of their daughters, \$124.50 in optical expenses, and \$100 for prescriptions. The Debtors also included monthly

expenses of \$120 for personal cellular services and \$40 for business cellular services in their Schedule J.

Item No. 19 in Schedule J instructed the Debtors to describe any increases or decreases in expenses reasonably expected to occur in the next year. The Debtors responded: “[Younger daughter] braces, Terry, leg surgery.”

On October 14, 2007, the Debtors amended their Schedule I (Current Income of Individual Debtor(s)) (“Schedule I”) and their Schedule J. The Debtors’ Schedule J, as amended, makes various adjustments to the Debtors’ monthly expenses. As relevant to the Chapter 13 trustee’s objection to confirmation, the Debtors have added an additional expense in the amount of \$250 for medical and dental expenses. Thus, the Debtors’ amended Schedule J lists monthly expenses totaling \$889.50 for health care expenses that they do not expect to be reimbursed by insurance or paid by a health savings account.

The Debtors filed their proposed Chapter 13 plan with their bankruptcy petition and have not sought to amend it. In their Chapter 13 plan, the Debtors propose to make monthly payments to the Chapter 13 trustee in the amount of \$570 per month for five years, for total payments to the Chapter 13 trustee of \$33,630. The Debtors propose to pay nearly this entire amount to secured creditors. The Debtors propose to pay their unsecured creditors a pro rata share of only \$311.24. The Debtors estimate that their total unsecured debt is \$131,090.61.

At the hearing on confirmation of the Debtors’ proposed Chapter 13 plan, Mr. Graham testified that he has significant, ongoing dental problems. He presented credible evidence establishing that several of his teeth are in urgent need of care and that the expected out-of-pocket cost to repair or extract those teeth is \$2,029.40. The Debtors

also testified that their older daughter shattered a molar several days prior to the confirmation hearing and was experiencing unrelated pain from her wisdom teeth. The Debtors presented credible evidence establishing that the out-of-pocket cost will be at least \$993 to repair their daughter's shattered tooth and at least \$396.80 to remove her wisdom teeth.

Mr. Graham testified that he recently arranged an extended payment plan with the orthodontist for his younger daughter's braces, and his monthly out-of-pocket cost is now \$134 (rather than \$290) for approximately 30 months. Mr. Graham further testified that his younger daughter has an impacted tooth that needs to be removed, and he presented credible evidence that this extraction is expected to cost \$1,090 after crediting amounts the Debtors' insurance may pay. The orthodontist has recommended removal of the younger daughter's wisdom teeth, which is expected to cost \$442 after crediting amounts the Debtors' insurance may pay.

The Debtors also testified about several medical procedures Mrs. Graham expects to undergo during the term of the plan. In particular, Mrs. Graham expects to undergo a colonoscopy every two years. Her most recent colonoscopy was in March 2008, and the Debtors' out-of-pocket costs were \$800.41 for the procedure and related medical charges. In addition, Mrs. Graham began treatments for a hereditary varicose vein condition prior to the confirmation hearing, and the Debtors testified that one vein in her leg needs to be surgically removed. The in-network cost of the procedure is \$3,160, and the Debtors' expect that they will have to pay at least 20% of this amount (or \$632).

Finally, the Debtors addressed their telecommunications expense at the confirmation hearing. The Debtors have one cellular phone bill, and they have budgeted

this bill for \$160 per month in their current Schedule J. In addition to their personal use of their cellular phones, Mr. Graham testified that he and his wife use their cellular phones on a regular basis to communicate with co-workers. The Debtors, therefore, have allocated \$40 of their monthly cellular phone bill as a business expense. Mr. Graham further testified that their current cellular phone expense is actually \$170-180 each month.

LEGAL DISCUSSION

Section 1325(b)(1) of the Bankruptcy Code requires that “the court may not approve the plan unless ... the plan 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.” 11 U.S.C. §1325(b)(1)(B). The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) significantly amended the method for determining a debtor’s projected disposable income under §1325(b). In this case, which is governed by the amended §1325(b), the Chapter 13 trustee argues that the Debtors are not proposing to contribute all of their projected disposable income to the Chapter 13 plan because certain telecommunications, medical and dental expenses claimed by the Debtors are not reasonably necessary and should be disallowed.

A. The Debtors’ “Projected Disposable Income”

Before the passage of the BAPCPA, projecting a debtor’s disposable income involved a flexible inquiry into Schedule I and the propriety of expenses detailed in Schedule J. As a result of the BAPCPA, “the former system of determining the reasonableness and necessity of expenditures ... through an evaluation of Schedules I and

J has been supplemented by the required overlay of the standards otherwise utilized in §707(b)(2) to determine whether a presumption of abuse exists in a Chapter 7 case.” *In re Sparks*, 360 B.R. 224, 227-228 (Bankr. E.D. Tex. 2006). In particular, new §1325(b)(3) provides that for debtors with current monthly income above the applicable state median income for their household size, such as the Debtors in this case, reasonably necessary expenses are to be calculated using the formula in §707(b)(2)(A) and (B) in order to determine payments to unsecured creditors. Such “means test” standards are implemented in Chapter 13 cases through the calculation of “disposable income” built into Form 22C.²

The means test set forth in §707(b) of the Bankruptcy Code embodies Congress’ intent “that there be an easily applied formula for determining when the Court should *presume* that a debtor is abusing the system by filing a Chapter 7 petition.” *In re Fowler*, 349 B.R. 414, 419 (Bankr. D. Del. 2006) (emphasis in original). “The means test presents a backward looking litmus test performed using mathematical computations of arbitrary numbers, often having little to do with a particular debtor’s actual circumstances and ability to pay a portion of debt.” *In re Hartwick*, 352 B.R. 867, 868 (Bankr. D. Minn. 2006). The incorporation of means test standards in the calculation of the projected disposable income of above-median debtors, when juxtaposed with the forward-looking terms such as “projected,” “to be received” and “to be expended” used in §1325(b)(2), has created some confusion among bankruptcy courts.

“Courts across the country have recognized that, though the calculation of ‘disposable income’ produced through the use of Form 22C will usually become the

² After the BAPCPA was enacted, three new Official Forms (22A, 22B and 22C) were created for individuals to complete and file in Chapter 7, 11, and 13 cases.

amount of ‘projected disposable income’ required for plan confirmation, such a result is not guaranteed.” *In re Louviere*, -- B.R. --, 2008 WL 925824 at *2 (Bankr. E.D. Tex. 2008) (collecting authority). This is because the term “projected disposable income” includes as components an estimate of the future income of the debtor as well as amounts reasonably necessary to be expended by the debtor. Projected disposable income under §1325(b)(1)(B) “necessarily refers to income that the debtor reasonably expects to receive during the term of the plan,” *In re Hardacre*, 338 B.R. 718, 723 (Bankr. N.D. Tex. 2006), and the *projected* disposable income of the debtor may vary from the disposable income calculation if “the debtor can show that there has been a substantial change in circumstances such that the numbers contained in Form 22C are not commensurate with a fair projection of the debtor's budget in the future.” *In re Jass*, 340 B.R. 411, 418 (Bankr. D. Utah 2006), as cited in *In re Sparks*, 360 B.R. at 228 and *In re Louviere* at *2. See also, e.g., *Kibbe v. Sumski (In re Kibbe)*, 361 B.R. 302 (B.A.P. 1st Cir. 2007), *Pak v. eCast Settlement Corp. (In re Pak)*, 378 B.R. 257 (B.A.P. 9th Cir. 2007), *Hamilton v. Lanning (In re Lanning)*, 380 B.R. 17 (B.A.P. 10th Cir. 2007); *In re Riggs*, 359 B.R. 649 (Bankr. E.D. Ky. 2007). See generally COLLIER ON BANKRUPTCY ¶1325.08[5][a] (15th ed. rev.) (“To the extent that courts give any meaning to the word “projected,” and courts are supposed to give meaning to every word in a statute, they may have to disregard the debtor's prior income if circumstances have changed.”) *But see*, e.g., *Coop v. Frederickson*, 375 B.R. 829 (8th Cir. B.A.P. 2007); *In re Hanks*, 362 B.R. 494 (Bankr. D. Utah 2007); *In re Alexander*, 344 B.R. 742 (Bankr. E.D. N.C. 2006).

In this case, the Debtors calculated monthly disposable income of (\$152.74) in their Form 22C. The Debtors’ disposable income subsequently increased as a result of

Mrs. Graham's employment, and the Debtors assert that their out-of-pocket health care expenses also have increased or will increase. The Debtors' amended Schedule J takes into account these post-petition changes and calculates monthly net income of \$570, which is the amount the Debtors propose to pay their creditors in their Chapter 13 plan.

The Chapter 13 trustee does not dispute that, for purposes of confirmation, the Debtors' "projected disposable income" may vary from the "disposable income" calculation in their Form 22C. Nevertheless, the Chapter 13 trustee argues that the Debtors' proposed Chapter 13 plan is not "realistic" in that the Debtors are claiming \$889.50 each month in their amended Schedule J for out-of-pocket health care expenses, which amounts to well over \$50,000 over the term of their proposed plan. The Chapter 13 trustee argues that the actual expenses that the Debtors anticipate incurring are far less than this amount. Thus, the Chapter 13 trustee asserts that the Debtors are not proposing to pay all of their disposable income to creditors as required by §1325(b) of the Bankruptcy Code and that the Court should deny confirmation of their Chapter 13 plan.

B. The Debtors' "Other Necessary Expenses"

Section 1325(b)(3) allows above-median debtors, such as the Debtors in this case, to deduct their "actual monthly expenses for the categories specified as Other Necessary Expenses" when calculating their disposable income for plan confirmation. 11 U.S.C. §707(b)(2)(A)(ii)(I). The term "Other Necessary Expenses" refers to the Internal Revenue Manual's listing of numerous categories of expenses that are not covered by the National or Local Standards. Section 1325(b)(3) expressly requires such expenses to be "reasonably necessary." 11 U.S.C. §1325(b)(3). In addition, in determining an above-median debtor's eligibility for an Other Necessary Expense deduction, various

bankruptcy courts have referred to or relied upon the Internal Revenue Service's "necessary expense test" defined in the IRS Financial Analysis Handbook (the "IRS Handbook") as "expenses ... necessary to provide for a taxpayer's and his or her family's health and welfare and/or production of income."³ See, e.g., *In re McGuire*, 342 B.R. 608, 612-13 (Bankr. W.D. Mo. 2006) (reviewing the IRS Handbook and the Internal Revenue Manual); *In re Hardacre*, 338 B.R. 718, 726-27 (Bankr. N.D. Tex. 2006) (finding the IRS Collection Financial Standards and the Internal Revenue Manual "instructive"). The IRS Handbook further provides that, "[t]he amount must be reasonable considering the taxpayer's individual facts and circumstances."⁴

In this case, the Debtors testified at the confirmation hearing that there has been a change in circumstances such that the numbers contained in their Form 22C are no longer a fair projection of their future budget. There is no dispute that the Debtors' income has increased. In addition, as detailed above, the Debtors testified that they anticipate incurring medical and dental expenses during the term of their Chapter 13 plan and that these expenses were not included in \$639.50 they listed for "Other Necessary Expenses: Health Care" in their Form 22C.

³ The IRS Handbook is a subpart of the larger Internal Revenue Manual. The legislative history accompanying BAPCPA specifically references the IRS Handbook as the source of the applicable expenditure amounts under §707(b). See H.R. Rep. 109-31, at 13-14 (2005) (footnotes omitted), *reprinted in* 2005 U.S.C.C.A.N. 88, 99-100 ("In addition to other specified expenses, the debtor's monthly expenses-exclusive of any payments for debts (unless otherwise permitted)-must be the applicable monthly amounts set forth in the Internal Revenue Service Financial Analysis Handbook as Necessary Expenses under the National and Local Standards categories and the debtor's actual monthly expenditures for items categorized as Other Necessary Expenses."). *But see generally* Hon. Eugene R. Wedoff, *Means Testing in the New 707(b)*, 79 231, 257-58 (2005) (explaining that the Internal Revenue Manual may not be the best source for analyzing BAPCPA).

⁴ See Internal Revenue Manual, Financial Analysis Handbook §5.15.1.7(1), available at <http://www.irs.gov/irm/part5/ch15s01.html#d0e200408> (last visited on July 26, 2008).

The Court finds and concludes that the Debtors established \$11,833.20 in actual, medical and dental expenses at the confirmation hearing.⁵ The Debtors' testimony and documentary evidence, however, failed to establish that they will actually incur out-of-pocket expenses of \$889.50 a month throughout the 60-month term of their proposed plan or that all of their claimed health care expenses are reasonably necessary. *See, e.g., In re Lenton*, 358 B.R. 651, 660 (Bankr. E.D. Pa. 2006) (concluding that repayment of loans from voluntary retirement accounts through mandatory payroll deduction does not meet the necessary expense test under the Internal Revenue Manual and, therefore, that the bankruptcy relief sought by the debtor was presumptively abusive); *In re Tranmer*, 355 B.R. 234, 252 (Bankr. D. Mont. 2006) (disallowing an expense and denying confirmation based on the necessary expense test in the IRS Handbook). For example, the monthly health care expenses described in the Debtors' Schedule J, as amended, include "optical expenses" of \$124.50, which would amount to \$7,470 over the term of a 60 month plan. This monthly optical expense is based on the out-of-pocket cost of 10 boxes of contacts for Mrs. Graham and her daughters every three months as well as the out-of-pocket cost of glasses for Mrs. Graham and her daughters. It is unclear from the record, however, whether the Debtors' monthly optical expense is actual or reasonably necessary. The Debtors likewise failed to establish that they will actually incur monthly out-of-pocket "dental expenses for Dan and [the older daughter]" in the amount of \$250, which would amount to \$15,000 over the term of a 60-month plan, or monthly out-of-pocket "medical

⁵ This figure includes \$2,029.40 for Mr. Graham's dental work, \$1,532 for dental work on Debtors' younger daughter, \$4020 for braces for the Debtors' younger daughter, \$1,389.80 for dental work on the Debtors' older daughter, \$632 for Mrs. Graham's leg surgery, and \$1,600 for two additional colonoscopies for Mrs. Graham during the term of the Debtors' proposed Chapter 13 plan.

and dental expenses” in the amount of \$125, would amount to an additional \$7,500 over the term of a 60-month plan.

Finally, the Debtors’ proposed Chapter 13 plan fails to incorporate all of the recent changes in their monthly expenses. In their Form B22 and their Schedule J, the Debtors list a monthly out-of-pocket health care expense of \$290 for braces for their younger daughter. The Debtors, however, testified at the confirmation hearing that their monthly expense for their younger daughter’s braces has recently decreased by \$156 due to a new payment arrangement with the orthodontist. The Debtors’ plan, as proposed, does not appear to pass through this savings to unsecured creditors or seek to step up payments to unsecured creditors when the Debtors cease making payments to the orthodontist under the new arrangement.

CONCLUSION

For these reasons, the Court concludes that the Chapter 13 trustee’s objection to confirmation should be sustained. The Court will enter an Order consistent with this Memorandum Opinion.

Signed on 7/28/2008

Brenda T. Rhoades SD
HONORABLE BRENDA T. RHOADES,
UNITED STATES BANKRUPTCY JUDGE