

Confirmation Denied where Debtors substantially increased retirement contributions on eve of bankruptcy filing

18-10020 Sheffield

Facts: On the eve of filing bankruptcy, the Debtors substantially increased their voluntary contributions to their retirement plans (Husband increased his retirement contributions from 0% to 17% of his gross income; Wife increased her retirement contributions from 5% to 18% of her gross income, for a combined contribution of \$1,832 per month). The Debtor's Chapter 13 Plan proposed to pay the unsecured creditors a projected dividend of 7.4%.

The Trustee objected that the Plan was not proposed in good faith as required by 11 U.S.C. 1325(a)(3) in light of the substantial increase in the retirement contributions on the eve of bankruptcy filing. The Trustee argued that, in light of the Debtors' history of contributions, the retirement contributions should be capped at 5% of their gross income.

The Debtors argued that they were now allowed to increase their contributions pursuant to the provisions of 11 U.S.C. 541(b)(7) and that the Plan was not proposed in bad faith.

Ruling: The Court denied confirmation of the Plan, thereby limiting the Debtors' voluntary contributions to their respective retirement accounts to 9.5% of their gross income.

In so ruling, the Court struck a balance between the provisions of 11 U.S.C. 541(b)(7) which permits voluntary retirement contributions in the post-petition period and the provisions of 11 U.S.C. 1325(a)(3) that requires a debtor to propose a Chapter 13 Plan in good faith. In so doing, the Court noted the following:

While the Debtors' efforts to increase their voluntary 401(k) contributions by some amount on the eve of bankruptcy did not *per se* evidence a bad faith intent, the sheer size of the Debtors' increases demand a greater scrutiny. ...

In this case, the Debtors' decision to increase exponentially their respective 401(k) contributions--his from 0% to 17% and hers from 5% to almost 18%--violates any sense of fairness or balance between the Debtors' legitimate retirement needs and the right of creditors to expect a reasonable repayment effort. Each Debtor's current contribution amount is not, as the Debtors contend, a fair amount. It is the maximum amount. That imbalance is further aggravated by the Debtors' failure to offer a compelling financial justification for that immediate maximum increase. The Debtors currently have 22 years before reaching their anticipated retirement age of 65. Though they may regret that they did not contribute more in their younger years, the Debtors are not without a remedy. They are not close to retirement age. After conclusion of the plan term, the Debtors will have 17 years to prioritize their voluntary contributions prior to their planned retirement. Any temporary reduction the 401(k) contribution percentage during the 5-year plan term necessary to ensure a fair distribution to creditors is thus subject to immediate restoration at the close of the plan term at the Debtors' sole discretion. When viewed against the backdrop of the Debtors obtaining the benefit of a substantial discharge of debt upon the completion of their plan payments, such a temporary reduction in retirement contributions is compelled in order for the Debtor to present a plan proposed in good faith.

...a fair balance is reached by limiting the Debtors to a voluntary 401(k) contribution level of 9.5% of their respective gross incomes received during the plan term. Such a limitation will ensure a substantial, ongoing 401(k) contributions by the Debtors during the plan term which will collectively protect over \$1,000 per month from the scope of disposable income based upon current salaries while simultaneously providing a significant distribution dividend to creditors. ...

Conclusion: The Trustee will continue to examine closely any increases in voluntary retirement contributions on the eve of filing bankruptcy. In so doing, the Trustee will be looking at the debtor's history of voluntary retirement contributions. If you have such a case, be prepared to argue that the facts in your particular case justify the increase in the retirement contributions. For example, if the Debtors in this case were only a few years from retirement, the Debtors might could justify such an increase.