

# Bankruptcy Law Letter

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## WHOSE PROBLEM IS IT, ANYWAY? SOME THOUGHTS ON § 541(B)(7)'S HANGING PARAGRAPH

By Laura N. Coordes\*

### INTRODUCTION

Recently, my third grader has become interested in grammar. She has been learning sentence diagramming and grammar rules in school, and sometimes, she'll quiz me at dinner to see if I can correctly identify various parts of a sentence. Her interest in this subject (and her fixation on getting the rules down pat) gives me hope for her generation, which one day will occupy seats in Congress.

By contrast, whenever I read § 541(b)(7) of the Bankruptcy Code, I find myself dismayed at a previous Congress' poor drafting. Section 541(b)(7) is home to an infamous hanging paragraph,<sup>1</sup> one that has bedeviled courts since its placement into the Bankruptcy Code in 2005. Hanging paragraphs are often confusing. This hanging paragraph, in particular, seems like very poor drafting. Recently, I had occasion to revisit this hanging paragraph upon reading the Ninth Circuit's recent decision in *In re Saldana*.<sup>2</sup> However, it appears that the Ninth Circuit majority has no problem with the hanging paragraph. In *Saldana*, the court held that § 541(b)'s hanging paragraph "unambiguously excludes voluntary contributions from a debtor's disposable income in a Chapter 13 case."<sup>3</sup>

This holding is not as inevitable as it seems, however. Notably, with *Saldana*, the Ninth Circuit created a circuit split with respect to whether voluntary contributions to employer-managed retirement plans are disposable income in a chapter 13 bankruptcy.<sup>4</sup> But what struck me about the Ninth Circuit's decision in particular is the ease with which the majority concluded that the hanging paragraph was plain and unambiguous.

Commentators have already written about how bad Congress'

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drafting was in this particular instance,<sup>5</sup> and this *Bankruptcy Law Letter* is not going to rehash all of those criticisms. Instead, I will walk through the hanging paragraph problem and explain why I think the result in *Saldana* has the potential to direct attention away from the very entity that could solve this problem. Because *Saldana* has created a circuit split, the Supreme Court may now be more interested in granting *certiorari* and seeking to clarify this issue. Nevertheless, it is Congress' poor drafting that has created the problem of numerous, conflicting interpretations of the hanging paragraph. The Supreme Court's resources are not put to their best use if the Court is asked to puzzle through which of those interpretations should govern. Instead, Congress should act to resolve the problem that it created: Congress can and should clarify its meaning through an amendment to the Bankruptcy Code.

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## CHAPTER 13 AND THE HANGING PARAGRAPH

As readers of this *Law Letter* likely already know, a chapter 13 bankruptcy allows an individual with regular income to file for bankruptcy and propose a repayment plan, paying back some or all of their debts over a three to five year period.<sup>6</sup> A significant benefit of chapter 13 is that the debtor can typically keep their assets while paying off their debts through the plan.<sup>7</sup> A trustee is appointed in each chapter 13 case to administer the case and make the distributions contemplated by the debtor's plan to creditors.<sup>8</sup>

Unsurprisingly for those of us familiar with bankruptcy law, there are numerous requirements with which a chapter 13 plan must comply. Among these is the "best interests" test, which requires a chapter 13 plan to pay unsecured creditors at least as much as they would get in a chapter 7 liquidation.<sup>9</sup> Historically, this "best interests" test was the primary protection provided to unsecured creditors in a chapter 13; however, this test was little comfort to creditors if the debtor had no unencumbered, nonexempt assets—a situation that is, in fact, "fairly common."<sup>10</sup> To give more protection to unsecured creditors in this situation (where application of the best interests test meant that those creditors could receive nothing), Congress in 1984 amended the Bankruptcy Code to add a "projected disposable income test" in § 1325(b). Pursuant to this provision, if either the chapter 13 trustee or an unsecured creditor objects to plan confirmation, the debtor must either show that the plan proposes to pay the objecting creditor's unsecured claim in full or that all of the debtor's projected disposable income will be applied to plan payments.<sup>11</sup> This test is in addition to the best interests test, so upon a relevant objection, the debtor must also satisfy this test.

It follows that an important part of applying this test is determining the calculation of a debtor's "projected disposable income." The "disposable" facet of this definition is perhaps the easiest to understand: "disposable income" is income

that exceeds a debtor's expenses.<sup>12</sup> However, in order to put a number to this definition, the bankruptcy judge must determine the debtor's allowed income and expenses.<sup>13</sup> Prior to 2005, judges had a fair amount of discretion when making this calculation. This discretion had the benefit of flexibility, but also the uncomfortable side effects of taking up judicial resources and turning bankruptcy judges into arbiters of a debtor's personal lifestyle.<sup>14</sup> Congress sought to ameliorate this problem through the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA), which incorporated by reference the chapter 7 approach for calculating the presumption of abuse under the "means test"<sup>15</sup> and defined "disposable income" in § 1325(b)(2).<sup>16</sup> In addition to providing more detail about "disposable income," Congress also sought, through BAPCPA, to encourage more individual debtors to file for chapter 13.<sup>17</sup>

In spite—or perhaps because—of congressional changes, there is still room for courts to differ over what, exactly, counts as "disposable income." Although § 1325(b) provides a definition for "disposable income," some other exclusions and deductions from disposable income may be found in other sections of the Bankruptcy Code.<sup>18</sup> One of the issues on which the courts are divided is whether voluntary contributions to a retirement plan are "disposable income."<sup>19</sup> Prior to BAPCPA, courts mostly held that such contributions were disposable income and therefore must be used instead for plan payments.<sup>20</sup> But BAPCPA complicated matters by making changes to another section of the Bankruptcy Code.

That section is § 541, which, generally speaking, defines which of the debtor's assets constitute property of the estate. Section 541(a) lists a variety of interests that are included in property of the estate, while § 541(b) lists exclusions from property of the estate. The relevant BAPCPA amendments for our purposes are found in § 541(b)(7), which provides that property of the estate does not include:

(7) any amount—

(A) withheld by an employer from the wages of employees for payment as contributions—

(i) to—

(I) an employee benefit plan that is subject to title I of the Employee Retirement Income Security Act of 1974 or under an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986;

(II) a deferred compensation plan under section 457 of the Internal Revenue Code of 1986; or

(III) a tax-deferred annuity under section 403(b) of the Internal Revenue Code of 1986;

except that such amount under this subparagraph shall not constitute disposable income as defined in section 1325(b)(2); or

(ii) to a health insurance plan regulated by State law whether or not subject to such title; or

(B) received by an employer from employees for payment as contributions—

(i) to—

(I) an employee benefit plan that is subject to title I of the Employee Retirement Income Security Act of 1974 or under an employee benefit plan which is a governmental plan under section 414(d) of the Internal Revenue Code of 1986;

(II) a deferred compensation plan under section 457 of the Internal Revenue Code of 1986; or

(III) a tax-deferred annuity under section 403(b) of the Internal Revenue Code of 1986;

except that such amount under this subparagraph shall not constitute disposable income, as defined in section 1325(b)(2); or

(ii) to a health insurance plan regulated by State law whether or not subject to such title<sup>21</sup>

The infamous hanging paragraph may be found in two places in this subsection, each time starting with the words "except that."

There are many reasons why courts have struggled to interpret the hanging paragraph, and nearly all have to do with its placement within this section of the Bankruptcy Code. A representative list of reasons follows.

First, § 541 is a Code provision generally applicable to all types of bankruptcy filings, which serves mainly to define what is and is not property of the estate. It mostly addresses assets of the debtor. Even § 541(b)(7) primarily speaks about assets, such as accumulated 401(k) contri-

butions; the hanging paragraph, however, is talking about income,<sup>22</sup> and assets are separate from income.<sup>23</sup>

Second, the words “except that” have thrown courts for a loop, because it is not clear what those words are referring to. As one court has put it, this use of the phrase “except that” “makes no sense grammatically,” because an exclusion from disposable income is not an exception to an exclusion from property of the estate, even though the placement of “except that” within the statute would seem to indicate exactly that.<sup>24</sup>

Third, another Bankruptcy Code provision, § 1322(f), explicitly excludes payments made toward 401(k) loans from disposable income.<sup>25</sup> If Congress truly wanted to exclude voluntary 401(k) contributions from disposable income, it would seem to make more sense for Congress to have added that exclusion in § 1322—or at least elsewhere in chapter 13 itself—rather than in the chapter of the Bankruptcy Code that deals with the bankruptcy estate.

Finally, as mentioned earlier, Congress incorporated reference to the chapter 7 means test in § 1325, and neither § 707(b)(2)(A) nor (B) provide that voluntary retirement contributions are an allowable, necessary expense that could be deducted from the debtor’s income for purposes of determining “disposable income.”

All of this confusion has led to at least three (though some say four) different approaches to ascertaining whether a debtor can voluntarily contribute to a retirement plan, such as a 401(k), during the course of the debtor’s chapter 13 plan.

## THE THREE (FOUR?) DIFFERENT APPROACHES

### *RETIREMENT CONTRIBUTIONS ARE NOT DISPOSABLE INCOME*

Most of the courts to have addressed the issue have said that retirement contributions do not constitute “disposable income.” Indeed, the majority view holds that § 541(b)(7) excludes all

retirement contributions from disposable income, limited only by other law governing maximum contributions to such plans.<sup>26</sup> In jurisdictions adopting the majority view, a chapter 13 debtor may thus make retirement contributions up to the maximum amount allowed by the IRS, even if that debtor had made no contributions prior to bankruptcy, although some courts also require the deductions to be made in “good faith.”<sup>27</sup> The majority view is also the most debtor-friendly, thus perhaps aligning with Congress’ goal in BAPCPA to encourage chapter 13 filings.

A representative example of the majority approach is *In re Johnson*,<sup>28</sup> decided by the Bankruptcy Court for the Southern District of Georgia. The *Johnson* court read § 541(b)(7)’s hanging paragraph as just another disposable income exclusion,<sup>29</sup> reasoning that § 541(b) “plainly” states that 401(k) contributions “shall not constitute disposable income.”<sup>30</sup>

This approach also seems to be endorsed by Collier, which explains that the reference to § 1325(b) in § 541(b)(7)(A)(i)’s hanging paragraph “removes any doubt” that qualifying voluntary retirement contributions “are to be excluded from the disposable income calculation.”<sup>31</sup>

### *IT DEPENDS*

A second view takes the position that whether retirement contributions constitute disposable income depends on what the debtor was doing before bankruptcy. Under this view, debtors can exclude voluntary retirement plan contributions from disposable income, but only to the extent/amount of the contributions they were making pre-petition. This approach is highly practical, although it requires courts to cobble together various Code provisions for support.

The Sixth Circuit, the first circuit court to address this issue, adopted this approach in *In re Davis*.<sup>32</sup> The court began with the question of how to define the debtor’s “projected disposable income.” Citing the Supreme Court’s decision in *Hamilton v. Lanning*,<sup>33</sup> the *Davis* court stated that a chapter 13 debtor’s “projected disposable

income” is simply the debtor’s “disposable income,” as defined in § 1325(b)(2), adjusted for any changes in the debtor’s income or expenses that are known or virtually certain at the time of confirmation of the debtor’s plan.<sup>34</sup>

*Davis* then moved to an examination of the hanging paragraph, finding two contradictory understandings. The court first noted that the hanging paragraph excludes the amount of the debtor’s 401(k) contributions from “disposable income as defined in Section 1325(b)(2).”<sup>35</sup> In § 1325(b)(2), disposable income is defined in terms of monthly income and expenses.<sup>36</sup> Thus, the court reasoned, this suggests that a debtor’s monthly 401(k) contribution is the “amount” that “shall not constitute disposable income” per the hanging paragraph.<sup>37</sup> However, given that the hanging paragraph is also positioned as an exception to § 541(b)(7)’s general rule that property of the estate does not include the amount of the debtor’s 401(k) contributions, the “amount” that does not constitute disposable income could be viewed as the debtor’s aggregate (as opposed to monthly) 401(k) contributions.<sup>38</sup>

Finally, the court reiterated the problem with the phrase “except that,” which the court found is generally used to introduce an exception to an otherwise applicable rule.<sup>39</sup> In this case, however, the exception has “no logical connection” to the general rule of § 541(b)(7), because property of the estate and disposable income are separate and independent concepts.<sup>40</sup>

Finding the plain meaning of the hanging paragraph elusive, the *Davis* court used “established canons of construction”<sup>41</sup> to conclude that “the hanging paragraph is best read to exclude from disposable income the monthly 401(k)-contribution amount that *Davis*’s employer withheld from her wages prior to her bankruptcy.”<sup>42</sup> Because the Bankruptcy Code defines “current monthly income” as the debtor’s average income over the six months prior to bankruptcy,<sup>43</sup> the Sixth Circuit read the hanging paragraph as saying that a chapter 13 debtor’s post-petition monthly 401(k) contributions are not “disposable

income” as long as those contributions were regularly withheld from the debtor’s wages before bankruptcy.<sup>44</sup> Thus, if the debtor was contributing to her 401(k) prior to bankruptcy, she may continue to make the same contributions in the same amount after bankruptcy by deducting those contributions from her disposable income. The Sixth Circuit majority also recognized, however, that the debtor must be making those contributions in “good faith.”<sup>45</sup>

The Sixth Circuit’s decision was not unanimous; Judge Readler dissented, saying that BAPCPA had drawn a “simple, bright-line rule: a debtor’s pre-filing 401(k) contributions are protected from creditors; post-petition contributions made during the post-filing chapter 13 reorganization period are not.”<sup>46</sup> The dissent viewed BAPCPA as merely codifying the predominant judicial interpretations prior to 2005 that required the debtor to include 401(k) contributions in her disposable income.<sup>47</sup>

The dissent’s view was more in line with dicta in a previous Sixth Circuit decision, *In re Seafort*.<sup>48</sup> *Seafort* involved a debtor who was repaying a 401(k) loan. The debtor was due to finish repaying the loan during the period of her chapter 13 plan. The debtor sought to use her newly freed-up money to begin making 401(k) contributions, and *Seafort* held that she could not, because “post-petition income that becomes available to debtors after their 401(k) loans are fully repaid is ‘projected disposable income.’”<sup>49</sup> In dicta, the court suggested that a chapter 13 debtor can never deduct voluntary post-petition retirement contributions in any amount, regardless of whether the debtor was making such contributions pre-petition.<sup>50</sup> The Sixth Circuit majority, however, declined to follow this dicta.

The Sixth Circuit has had yet another opportunity to support its position that whether a debtor’s voluntary 401(k) contributions count as disposable income depends on what the debtor was doing before bankruptcy in *In re Penfound*.<sup>51</sup> There, the Sixth Circuit held that even if a chapter 13 debtor had historically contributed to

a 401(k) plan, if the debtor had not contributed in the six months leading up to her bankruptcy filing, she could not exclude her voluntary, post-petition contributions from the “disposable income” calculation.<sup>52</sup>

Another variant of the “it depends” view, and what some say is a distinct third approach, holds that debtors may exclude an amount equal to the average of their monthly contributions during the six months prior to filing. This view, like the Sixth Circuit’s position in *Davis*, has been criticized as lacking textual support.<sup>53</sup>

A representative example of this view is *In re Anh-Thu Thi Vu*,<sup>54</sup> decided by the Bankruptcy Court for the Western District of Washington. After reviewing the various court decisions on the subject, the court justified its decision to go with the monthly average exclusion by saying that it “gives substantive application to the hanging paragraph,” that it “results in above- and below-median debtors being treated the same” and that it “fosters the overall policy seen throughout the 2005 amendments of protecting debtors’ retirement contributions.”<sup>55</sup>

#### RETIREMENT CONTRIBUTIONS ARE DISPOSABLE INCOME

The final view holds that voluntary retirement contributions are disposable income available to a chapter 13 debtor’s creditors, even if the debtor was making such contributions prior to bankruptcy. This was the approach taken by the Ninth Circuit Bankruptcy Appellate Panel in *In re Parks*,<sup>56</sup> although *Parks* is now abrogated by the Ninth Circuit’s *Saldana* decision. *Parks* framed the relevant question as “what is ‘excluded’ from property of the estate under § 541(b)(7)(A) which also does not constitute disposable income?”<sup>57</sup> *Parks* read the hanging paragraph’s reference to “such amount” as meaning that only pre-petition contributions do not constitute disposable income and declined to extend § 541(b)(7) to the post-petition period.<sup>58</sup> In support of this reading of the statute, *Parks* found it significant that § 1306(a)(2) makes a

debtor’s post-petition earnings part of their estate, yet nowhere does chapter 13 explicitly exclude voluntary retirement contributions from disposable income.<sup>59</sup>

The Bankruptcy Court for the District of Montana came to a similar conclusion in *In re Prigge*, holding that “disposable income” for chapter 13 purposes includes all voluntary retirement contributions.<sup>60</sup> *Prigge* read the hanging paragraph in context, observing that it is placed in the § 541 general provisions concerning the contents of property of the estate. In this context, the *Prigge* court reasoned, the hanging paragraph has a very limited meaning: it is intended only to protect amounts withheld by employers from employees that are in the employer’s hands at the time of filing.<sup>61</sup>

Collier has criticized the approach of *Prigge* and others, saying that it “makes no sense, because any funds in the hands of the employer as of the chapter 13 petition date would never be considered to be disposable income, which only includes income received by the debtor after the petition is filed.”<sup>62</sup> In addition, Collier points out that funds that have already been paid to the debtor’s retirement account are separately addressed in other sections of the Code.<sup>63</sup>

#### SUMMING UP

What is clear from a review of these approaches is that § 541(b)(7)’s hanging paragraph is not clear. There is no straightforward way to read it; all of the approaches above “do some violence to the text” of the statute.<sup>64</sup> In *Saldana*, however, the Ninth Circuit did find that the hanging paragraph has a plain, unambiguous meaning, and the next section discusses that case.

#### THE SALDANA CASE

In *Saldana*, the Ninth Circuit became the second circuit court to address the issue of whether voluntary contributions to employer-managed retirement plans are “disposable income” in a chapter 13 bankruptcy. The Ninth

Circuit held that such contributions are not disposable income, reversing the district court below.<sup>65</sup>

In April of 2022, Jorden Saldana filed for chapter 13 bankruptcy.<sup>66</sup> When she initially calculated her monthly disposable income, she excluded \$601 for qualified retirement contributions.<sup>67</sup> Her first proposed plan, submitted concurrently with her bankruptcy petition, contemplated her unsecured creditors receiving no repayment.<sup>68</sup>

The chapter 13 trustee objected to this plan, arguing that Saldana was not devoting all of her disposable income to repaying her unsecured creditors.<sup>69</sup> Saldana then filed a declaration stating that she had reduced her voluntary retirement contributions to \$484 a month.<sup>70</sup> After a few more rounds of trustee objections and retirement contribution re-calculations, the bankruptcy court sustained the trustee's objection to Saldana's plan, holding that *Parks* required Saldana to count her voluntary retirement contributions as disposable income.<sup>71</sup> Saldana subsequently updated her disposable income to reflect only her retirement loan repayments and filed a third amended plan, which contemplated paying approximately 30% of her unsecured debt.<sup>72</sup> The bankruptcy court confirmed this plan, but Saldana appealed to the district court, which affirmed the bankruptcy court.<sup>73</sup> Saldana then appealed to the Ninth Circuit.

Like the Sixth Circuit in *Davis*, the Ninth Circuit did not reach a unanimous conclusion. The majority looked at the hanging paragraph, which has resulted in no fewer than four different interpretations, and said, somewhat surprisingly, that it was clear and unambiguous.<sup>74</sup>

According to the Ninth Circuit, the clear and unambiguous interpretation of the statutory text is that voluntary retirement contributions are excluded from a debtor's disposable income. The Ninth Circuit held that the hanging paragraph obviously and plainly provides that debtors can exclude any amount of their voluntary retirement contributions to employer-managed plans

from their chapter 13 disposable income calculation.<sup>75</sup>

In support of its interpretation of the statutory text, the Ninth Circuit majority looked to congressional intent and canons of statutory construction, neither of which would seem to be necessary if the statute was truly clear and unambiguous. The court first noted that its read of the text is consistent with Congress' intent (with BAPCPA) to encourage chapter 13s over chapter 7s, as allowing debtors to exclude their retirement contributions from their disposable income available to pay creditors undoubtedly makes chapter 13 a more enticing option.<sup>76</sup> Next, the court noted that, since the majority of pre-BAPCPA courts had held that voluntary retirement contributions were disposable income, Congress intended to alter that consensus by amending § 541.<sup>77</sup> The court did not provide much detail on why Congress sought to alter a consensus on a chapter 13 topic via amendment to a Code provision pertaining to property of the estate.

The remainder of the majority opinion was devoted to explaining why other interpretations of the hanging paragraph are problematic. The court first criticized the reasoning of those courts holding that disposable income includes all voluntary retirement contributions by remarking that courts following this interpretation read the hanging paragraph in context—in the context of § 541, of chapter 13, and of the Code as a whole.<sup>78</sup> These courts give the hanging paragraph a “very limited meaning,” saying merely that it is intended to protect amounts withheld by employers from employees that are in the employer's hands at the time of filing bankruptcy, prior to remission of the funds to the plan.<sup>79</sup> The court then remarked that, actually, this interpretation does not give the hanging paragraph any meaning.<sup>80</sup> The court downplayed the placement of the hanging paragraph in chapter 5 of the Bankruptcy Code, rather than in chapter 13, where, it acknowledged, “the bulk of Chapter 13's disposable income analysis is dictated,” because § 541(b)(7) explicitly references § 1325.<sup>81</sup>

But what about the “except that” language in the hanging paragraph? Doesn’t that mean that Congress meant to make the disposable income exclusion an exception of some sort? No, said the court. Congress uses “except that” throughout the Code to mean “moreover,” or “and also.”<sup>82</sup> Nor does the legislative history contain any language that suggests Congress intended the hanging paragraph to serve as an exception to the rest of § 541, however much the words “except that” might indicate otherwise.<sup>83</sup>

Finally, the court sought to assuage the chapter 13 trustee’s concerns that adopting this approach would upset the balance of interests between debtors and creditors and invite debtor abuse by noting that there are limitations to its holding. First, the types of retirement plan contributions protected by the hanging paragraph are generally subject to annual contribution limits.<sup>84</sup> And second, all chapter 13 debtors are subject to a good faith requirement.<sup>85</sup> Finally, the court dismissed the remaining two approaches (described under “It Depends,” above) by pointing out that they lack textual support in the Bankruptcy Code.<sup>86</sup>

Judge Callahan, in dissent, criticized the majority for characterizing the hanging paragraph as “unambiguous,” as well as the majority’s reliance on canons of statutory construction to reach a result “that is contrary to the general purpose of the underlying statute.”<sup>87</sup> Focusing on how voluntary retirement contributions are, well, “voluntary,” the dissent stressed that, since 2005, both bankruptcy and circuit courts have found the hanging paragraph to have four different meanings, rendering it “truly ambiguous.”<sup>88</sup>

In contrast to the majority, which sought to give “real and substantial effect” to the hanging paragraph, the dissent characterized it as “a truly minor provision in a broader piece of legislation, which most courts have found to be incomprehensible.”<sup>89</sup> Given that Congress’s intent in enacting the “hanging paragraph” is not obvious (through a lack of legislative history), the dissent urged an interpretation that

“fits into, and complements, the other provisions of bankruptcy law.”<sup>90</sup> Overall, the dissent seemed most inclined to adopt the “It Depends” approach, excluding from a debtor’s disposable post-petition income contributions to a retirement plan that are consistent with the debtor’s contributions for six months prior to bankruptcy. Though perhaps an imperfect read of the statute, the dissent defended this interpretation, saying that it constitutes a “workable solution” that recognizes the competing policy interests and is consistent with the overall purpose of bankruptcy law.<sup>91</sup>

## IMPLICATIONS

The Ninth Circuit’s *Saldana* decision has several important implications. First, chapter 13 debtors in the Ninth Circuit are now able to make retirement contributions up to the limits imposed by tax law, regardless of whether they had made any contributions before bankruptcy, and limited only by a good-faith analysis.<sup>92</sup> *Saldana* is very debtor friendly, and one hopes that the majority is correct that sufficient safeguards exist such that this decision does not open the door to debtor abuse. Some courts have required monitoring of the debtor’s post-petition retirement contributions, such that if the debtor stops making those contributions, the money earmarked for those contributions will instead be directed to creditors.<sup>93</sup>

Even assuming (correctly, I hope) that Ninth Circuit chapter 13 debtors will not abuse their ability to make post-petition retirement contributions, *Saldana* is still important because it creates a split with the Sixth Circuit, laying “the groundwork for the Supreme Court to grant *certiorari*.”<sup>94</sup> Although the Supreme Court may like nothing better than wading into the technicalities of the Bankruptcy Code to clear up a bunch of conflicting statutory interpretations, it seems to me that Congress is better positioned to resolve this issue.

With the notable exception of the Ninth Circuit, courts and scholars almost always acknowl-

edge that the hanging paragraph is “lousy drafting.”<sup>95</sup> Even Collier states that the hanging paragraph’s appearance in § 541(b)(7) is “perhaps poor drafting.”<sup>96</sup> In saying that the hanging paragraph is plain and unambiguous, *Saldana* seems to be forgiving this sloppy drafting. Yet, courts should not have to puzzle over the meaning of these provisions when it seems fairly easy for Congress to delete the hanging paragraph and clarify its position by making a change to chapter 13 itself.

Because the hanging paragraph is unclear, every court’s interpretation of it requires some manipulation of the text. Rather than allowing the courts—and especially the Supreme Court—to take up time and resources in wrestling with the problematic hanging paragraph—and potentially to come up with further contortions of the statute—Congress should fix the problem that it has created. Regardless of what Congress meant to do with the hanging paragraph, it could clarify its meaning, and preferably do so in chapter 13 itself, though a legislative amendment. Hopefully, Congress will do so soon; or at the very least, before my daughter and her third-grade peers reach the age where they can run for a congressional seat.

## ENDNOTES:

<sup>1</sup>Technically, § 541(b)(7) contains two hanging paragraphs—one in § 541(b)(7)(A), and one in § 541(b)(7)(B). Both are reproduced in the following section of this *Law Letter*. However, for ease of reference and because they say exactly the same thing, I will simply refer to both as “the hanging paragraph.”

<sup>2</sup>In re *Saldana*, 122 F.4th 333, 74 Bankr. Ct. Dec. (CRR) 32 (9th Cir. 2024).

<sup>3</sup>*Saldana*, 122 F.4th at 341.

<sup>4</sup>Bill Rochelle, *Creating a Circuit Split, Ninth Circuit Allows Retirement Contributions in Chapter 13*, ROCHELLE’S DAILY WIRE (Nov. 27, 2024), <https://www.abi.org/newsroom/daily-wire/creating-a-circuit-split-ninth-circuit-allows-retirement-contributions-in> (“The divided panel in the Ninth Circuit creates a stark split of circuits.”).

<sup>5</sup>See, e.g., *id.* (“The hanging paragraph may have been intended to clarify the meaning as to

contributions after filing, but lousy drafting made matters worse, especially the inexplicable use of the words ‘except that.’ ”); Heather McGovern, *Good-Faith 401(k) Contributions: When is it Reasonable to Expect Creditors to Fund Them?*, 39-OCT AM. BANKR. INST. J. 23, 23 (2020) (“[T]he courts have reached consensus only in finding that the hanging paragraph is poorly drafted.”).

<sup>6</sup>*Chapter 13 - Bankruptcy Basics*, U.S. COURTS, <https://www.uscourts.gov/court-programs/bankruptcy/bankruptcy-basics/chapter-13-bankruptcy-basics>.

<sup>7</sup>See *id.* (“[C]hapter 13 offers individuals an opportunity to save their homes from foreclosure.”).

<sup>8</sup>*Id.*

<sup>9</sup>11 U.S.C.A. § 1325(a)(4); Charles Jordan Tabb, Kara J. Bruce, & Laura Napoli Coordes, *LAW OF BANKRUPTCY*, 6th ed. § 12.16 (West Academic 2024).

<sup>10</sup>Tabb, Bruce, & Coordes, *supra* note 10 at § 12.17.

<sup>11</sup>11 U.S.C.A. § 1325(b)(1)(B) (noting 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 beginning on the date that the first payment is due under the plan will be applied to make payments to unsecured creditors under the plan”).

<sup>12</sup>Tabb, Bruce, & Coordes, *supra* note 10 at § 12.17.

<sup>13</sup>*Id.* (“Whether what the debtor claims as income and as expenses will be allowed is, of course, ultimately up to the bankruptcy judge.”).

<sup>14</sup>*Id.* (noting that this determination “inevitably placed the court in the position of having to make sensitive value-laden judgments about the appropriate lifestyle of the debtor”).

<sup>15</sup>See 11 U.S.C.A. § 707(b)(2).

<sup>16</sup>See *Saldana*, 122 F.4th at 339-340 (“For debtors whose income is below the census median, § 1325 does not mandate a specific calculation of reasonably necessary expenses. . . . However, for above-median income debtors, § 1325(b) primarily follows the means test, while including a few other deductions from disposable income.”).

<sup>17</sup>*Saldana*, 122 F.4th at 340 (“The BAPCPA aimed to reverse a trend of consumers filing for Chapter 7 bankruptcy. . . [and] instead encouraged consumers to reorganize under Chapter 13. . . .”).

<sup>18</sup>*Saldana*, 122 F.4th at 340 (citing §§ 1322(f)

and 101(10A)(B) as two such examples of other sections).

<sup>19</sup>Tabb, Bruce, & Coordes, *supra* note 10 at § 12.17.

<sup>20</sup>*Saldana*, 122 F.4th at 341-42 (citing the “overwhelming consensus” pre-BAPCPA).

<sup>21</sup>11 U.S.C.A. § 541(b)(7)(A), (B).

<sup>22</sup>Carl W. Mills, Karen M. Chau, & Hilary McDonnell, *Retirement Contributions Under § 541(b)(7): The True History of BAPCPA § 323: Part II*, 42-JAN AM. BANKR. INST. J. 68, 69 (2023).

<sup>23</sup>In re Davis, 960 F.3d 346, 355, 68 Bankr. Ct. Dec. (CRR) 205, Bankr. L. Rep. (CCH) P 83528 (6th Cir. 2020) (“Those accumulated funds would never be considered disposable income under § 1325(b)(2).”) (internal quotations omitted).

<sup>24</sup>*Davis*, 960 F.3d at 355 (internal citations omitted).

<sup>25</sup>11 U.S.C.A. § 1322(f).

<sup>26</sup>Mills, Chau & McDonnell, *supra* note 23 at 68.

<sup>27</sup>Bill Rochelle, *Sixth Circuit Allows Chapter 13 Debtors to Continue Retirement Plan Contributions*, ROCHELLE’S DAILY WIRE (June 3, 2020), <https://www.abi.org/newsroom/daily-wire/sixth-circuit-allows-chapter-13-debtors-to-continue-retirement-plan>.

<sup>28</sup>In re Johnson, 346 B.R. 256 (Bankr. S.D. Ga. 2006).

<sup>29</sup>*Johnson*, 346 B.R. at 263.

<sup>30</sup>*Johnson*, 346 B.R. at 263 (“Congress has placed retirement contributions outside the purview of a Chapter 13 plan. Debtors may fund 401(k) plans in good faith, so long as their contributions do not exceed the limits legally permitted by their 401(k) plans.”).

<sup>31</sup>Collier on Bankruptcy, ¶ 541.23[1] (16th ed. rev.).

<sup>32</sup>In re Davis, 960 F.3d 346, 68 Bankr. Ct. Dec. (CRR) 205, Bankr. L. Rep. (CCH) P 83528 (6th Cir. 2020).

<sup>33</sup>*Hamilton v. Lanning*, 560 U.S. 505, 130 S. Ct. 2464, 177 L. Ed. 2d 23, 53 Bankr. Ct. Dec. (CRR) 67, Bankr. L. Rep. (CCH) P 81780 (2010).

<sup>34</sup>*Davis*, 960 F.3d at 350.

<sup>35</sup>*Davis*, 960 F.3d at 354.

<sup>36</sup>*Id.*

<sup>37</sup>*Id.*

<sup>38</sup>*Id.*

<sup>39</sup>*Id.*

<sup>40</sup>*Id.*

<sup>41</sup>*Id.*

<sup>42</sup>*Davis*, 960 F.3d at 355.

<sup>43</sup>11 U.S.C.A. § 101(10A).

<sup>44</sup>*Davis*, 960 F.3d at 357.

<sup>45</sup>*Davis*, 960 F.3d at 358 (“Our holding should not be read to curtail the good-faith analysis required by § 1324(a)(3).”).

<sup>46</sup>*Davis*, 960 F.3d at 358 (Readler, J., dissenting).

<sup>47</sup>*Davis*, 960 F.3d at 359 (Readler, J., dissenting) (“Given the universal view that pre-filing 401(k) savings were protected from creditors, and the majority (but not universal) view that post-filing voluntary 401(k) contributions were not, Congress sought to codify expressly these predominant judicial interpretations. It did so in 11 U.S.C.A. § 541.”).

<sup>48</sup>In re Seafort, 669 F.3d 662, 67 Collier Bankr. Cas. 2d (MB) 99, 52 Employee Benefits Cas. (BNA) 2114, Bankr. L. Rep. (CCH) P 82163 (6th Cir. 2012).

<sup>49</sup>*Seafort*, 660 F.3d at 663.

<sup>50</sup>*Seafort*, 660 F.3d at 667, 674 n.7.

<sup>51</sup>In re Penfound, 7 F.4th 527, 70 Bankr. Ct. Dec. (CRR) 149 (6th Cir. 2021).

<sup>52</sup>In re Penfound, 7 F.4th 527, 70 Bankr. Ct. Dec. (CRR) 149 (6th Cir. 2021).

<sup>53</sup>Tabb, Bruce, & Coordes, *supra* note 10 at § 12.17 (“[T]hese decisions feel more like a Solomonic ‘split the baby’ story.”).

<sup>54</sup>In re Anh-Thu Thi Vu, 73 Collier Bankr. Cas. 2d (MB) 1568, 2015 WL 6684227 (Bankr. W.D. Wash. 2015).

<sup>55</sup>In re Anh-Thu Thi Vu, 73 Collier Bankr. Cas. 2d (MB) 1568, 2015 WL 6684227 at \*4 (Bankr. W.D. Wash. 2015).

<sup>56</sup>In re Parks, 475 B.R. 703, Bankr. L. Rep. (CCH) P 82281 (B.A.P. 9th Cir. 2012).

<sup>57</sup>*Parks*, 475 B.R. at 708.

<sup>58</sup>*Id.*

<sup>59</sup>*Id.*

<sup>60</sup>In re Prigge, 441 B.R. 667 (Bankr. D. Mont. 2010).

<sup>61</sup>*Prigge*, 441 B.R. at 677 n.5 (observing that § 541(b)(7) “seems intended to protect amounts withheld by employers from employees that are in the employer’s hands at the time of filing bankruptcy, prior to remission of the funds to the plan.”).

<sup>62</sup>Collier on Bankruptcy, ¶ 541.23[1] (16th

ed. rev.).

<sup>63</sup>*Id.*

<sup>64</sup>*Davis*, 960 F.3d at 354.

<sup>65</sup>*Saldana*, 122 F.4th at 337.

<sup>66</sup>*Id.*

<sup>67</sup>*Id.*

<sup>68</sup>*Id.* at 337-38.

<sup>69</sup>*Id.* at 338.

<sup>70</sup>*Id.*

<sup>71</sup>*Id.*

<sup>72</sup>*Id.*

<sup>73</sup>*Id.*

<sup>74</sup>*Id.* at 341 (“Here, the statutory text unambiguously excludes voluntary contributions from a debtor’s disposable income in a Chapter 13 case.”).

<sup>75</sup>*Id.* (“The words are plain enough.”).

<sup>76</sup>*Id.*

<sup>77</sup>*Id.* at 342.

<sup>78</sup>*Id.*

<sup>79</sup>*Id.*

<sup>80</sup>*Id.*

<sup>81</sup>*Id.* at 343.

<sup>82</sup>*Id.*

<sup>83</sup>*Id.* at 343 n.1.

<sup>84</sup>*Id.* at 344.

<sup>85</sup>*Id.*

<sup>86</sup>*Id.* at 345.

<sup>87</sup>*Id.* at 346 (Callahan, J., dissenting).

<sup>88</sup>*Id.*

<sup>89</sup>*Id.* at 349 (Callahan, J., dissenting).

<sup>90</sup>*Id.* at 353 (Callahan, J., dissenting).

<sup>91</sup>*Id.* (“This approach does the least amount of harm until such time as Congress decides to clarify the statute or change the law.”).

<sup>92</sup>Rochelle, *supra* note 5.

<sup>93</sup>*Id.*

<sup>94</sup>Rochelle, *supra* note 5.

<sup>95</sup>*Id.*; Mills, Chau, & McDonnell, *supra* note 23 (“Although some courts have stated that § 541(b)(7)’s language is clear, that conclusion is at odds with the hanging paragraph’s substantive and grammatical issues—most fundamentally that most of § 541(b)(7) deals with assets while the hanging paragraph deals with income, rendering the ‘except that’ language ambiguous.”); McGivern, *supra* note 6 (“Courts have reached consensus only in finding that the hanging paragraph is poorly drafted.”).

<sup>96</sup>5 Collier on Bankruptcy, ¶ 541.23[1] (16th ed. rev.).

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