

CASE No.: 99-70431

**IN THE
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT**

IN RE: LUISA V. ANES
IN RE: ROBERT TIERNEY and BEVERLY TIERNEY

Debtors.

LUISA A. ANES;
ROBERT TIERNEY and BEVERLY TIERNEY

Appellants.

v.

CHARLES J. DEHART, III

Appellee.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
for the Middle District of Pennsylvania
Civ. No. 3:98-CV-0314

**BRIEF OF AMICUS CURIAE
NATIONAL ASSOCIATION OF CONSUMER BANKRUPTCY ATTORNEYS**

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**STATEMENT OF IDENTITY, INTEREST AND AUTHORITY
OF NACBA AS AMICUS CURIAE**

Incorporated in 1992, the National Association of Consumer Bankruptcy Attorneys ("NACBA") is a non-profit organization of more than 1,300 consumer bankruptcy attorneys nationwide. Member attorneys and their law firms represent debtors in an estimated 300,000 bankruptcy cases filed each year. Third Circuit NACBA members file many thousands of bankruptcy cases per year. NACBA's corporate purposes include education of the bankruptcy bar and the community at large on the uses and misuses of the consumer bankruptcy process. Additionally, NACBA advocates nationally on issues which cannot adequately be addressed by individual member attorneys. NACBA has filed amicus curiae briefs in various appellate courts seeking to protect the rights of consumer bankruptcy debtors. *See, e.g., Kawaauhau v. Geiger*, 118 S.Ct. 974 (1998); *Capital Comm. Fed. Credit Union v. Boodrow (In re Boodrow)*, 126 F.3d 43 (2d Cir. 1997).

The NACBA membership has a vital interest in the outcome of this appeal. NACBA members primarily represent individual low- and moderate-income wage-earners, many of whom have not accumulated adequate retirement funds in their pension plans. Prohibiting such debtors from repaying loans from their pension plans, often obtained when in financial distress as a last effort to avoid bankruptcy, will further erode pension benefits desperately needed by such debtors for support during their retirement years. NACBA members are also concerned that affirmance of the decisions below will discourage debtors from seeking relief under Chapter 13.

SUMMARY OF ARGUMENT

Under the extraordinarily broad definitions of a "debt" and "claim" provided in the Bankruptcy Code, a pension loan is a claim entitled to inclusion in a debtor's Chapter 13 plan. As a claim subject to offset against property of the debtor, it may also be treated as a secured claim. In finding that a pension loan repayment obligation does not create a debt, the courts below disregarded the plain meaning of the relevant Code provisions and ignored the controlling precedent in Johnson v. Home State Bank, 501 U.S. 78, 111 S.Ct. 2150, 115 L.Ed.2d 66 (1991).

The courts below have also adopted a blanket rule that all Chapter 13 plans providing for repayment of pension loans must be denied confirmation. Such a rigid treatment is inconsistent with the Code's disposable income test under Chapter 13. Like other budget items, whether such pension loan repayments are reasonably necessary for the support of debtors and their dependents must be subject to a case-by-case determination.

Moreover, reversal is warranted as the courts below failed to consider the overriding national policy favoring the protection and promotion of retirement savings. If affirmed, this ruling will have a chilling effect on debtors contemplating the filing of Chapter 13.

ARGUMENT

I. CONTRARY TO THE PLAIN MEANING OF THE RELEVANT BANKRUPTCY CODE PROVISIONS, THE COURTS BELOW INCORRECTLY CONCLUDED THAT A REPAYMENT OBLIGATION ON A PENSION LOAN IS NOT A DEBT OR CLAIM.

The fundamental holding of the decision below is that the loans obtained by the debtors from their pension plans are not debts within the meaning of the Bankruptcy Code. Appendix No. 7, Memorandum, Opinion and Order, p. 3. Based on this determination, the court below concluded that there was no need to reach the issue of whether a debtor's repayment of a pension loan was reasonably necessary for the support or maintenance of the debtor or the debtor's dependents under the disposable income test.¹ In so doing, the court below ignored the plain meaning of the relevant Code provisions and left unanswered an essential issue in resolving this dispute.

As in all cases of statutory construction, the starting point in this case must be the statutory language. Toibb v. Radloff, 501 U.S. 157, 111 S.Ct. 2197, 115 L.Ed. 2d 145 (1991); Pennsylvania Department of Public Welfare v. Davenport, 495 U.S. 552, 110 S.Ct. 2126, 2130, 109 L.Ed. 2d 588 (1990); United States v. Ron Pair

¹ In addition to wrongly concluding that a pension loan does not create a debt, the court below further misapplies the Chapter 13 Code provisions by finding that payments which are not "debts" must "be included in disposable income and must be applied toward the respective Debtor's Chapter 13 Plan." Appendix No. 7, p.3. In normal practice, many routine expense items in a Chapter 13 debtor's budget, such as payments for food and clothing, are not "debts" as viewed by the court below though they are clearly not included in disposable income. The question of what constitutes disposable income does not turn on whether the proposed expense item may be classified under the Code's definition of a "debt."

Enters., Inc., 489 U.S. 235, 109 S.Ct. 1026, 1030, 103 L.Ed.2d 290 (1989). "The plain meaning of legislation should be conclusive, except in the rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intention of the drafters." Ron Pair, 109 S.Ct. at 1031 (*quoting* Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 571 (1982)).

The meaning of "debt" in the bankruptcy context is found in the definition section of the Code. Section 101(12) simply defines "debt" as "liability on a claim." This definition thus depends upon further construction of the term "claim", which is defined in § 101(5):

(A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or

(B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured;

In construing this language, the Supreme Court has stated that "Congress desired a broad definition of claim." Ohio v. Kovacs, 469 U.S. 274, 279, 105 S.Ct. 705, 708, 83 L.Ed.2d 649 (1985)(injunction against officer of corporation requiring him to clean up toxic waste site held to be "claim" under the Code). In Pennsylvania Dep't of Public Welfare v. Davenport, 495 U.S. 552, 110 S.Ct. 2126, 109 L.Ed. 588 (1990), the Supreme Court again afforded this statutory language the broad interpretation Congress intended by holding that restitution orders imposed as a condition of probation in a criminal proceeding are debts dischargeable in a

Chapter 13 case.²

Recognizing that Congress adopted the "broadest available definition for 'claim'" in § 101(5), the Court in Johnson v. Home State Bank, 501 U.S. 78, 111 S.Ct. 2150, 115 L.Ed.2d 66 (1991), held that a mortgage lien that passes through a debtor's Chapter 7 bankruptcy unaffected by the discharge of personal liability on the underlying note nevertheless is a "claim" within the meaning of the Code which may be subject to payment in a subsequent Chapter 13 proceeding. The Court reasoned that while the bank's interest is limited to an *in rem* claim enforceable only against the debtor's property, it is still a "'claim against the debtor' for purposes of the Code," Johnson, 501 U.S. at 85, referring to one of the Rules of Construction set forth as an interpretive guide in § 102 of the Code. Section 102(2) expressly provides that whenever the phrase "claim against the debtor" appears in the Code, it "includes claim against property of the debtor." In sum, the same argument being made by the Trustee here, that there cannot be a claim because the debtors do not owe a debt, was rejected by the Supreme Court in Johnson based on the plain language in § 102(2).

Despite the expansive definition of debt found in the Code, several courts including those below have concluded that the repayment obligation under a pension loan does not give rise to a debt or claim. *See, e.g., In re Villarie*, 648 F.2d 810 (2nd Cir. 1981), In re Goewey, 185 B.R. 444 (Bankr.N.D.N.Y. 1995). While Villarie was decided notably before Johnson, none of the cases following Villarie

² As noted by the Supreme Court in a subsequent case, although Congress overruled the result in Davenport, it did so by making such restitution orders non-dischargeable under § 1328(a), not by limiting or amending the definition of "claim" in § 101(2). Johnson v. Home State Bank, 501 U.S. 78, 84, f.n.4 (1991).

have addressed or attempted to distinguish the Supreme Court's ruling in Johnson. These decisions largely turn on the fact that the plan administrator is not permitted to sue if a participant defaults on a pension loan. The right to sue, however, is not a qualification for a debt expressly provided for in the Code's definition. Surely Congress knew how to incorporate such restrictive language and chose not to, as recognized in Johnson.

Additionally, the right to sue is but one of several collection tools available to a creditor and is generally not the method of first choice on a secured loan. Though the Second Circuit in Villarie acknowledged that a pension plan has the right to "offset the amount borrowed" against the debtor's accrued benefits in the plan, this did not enter into the court's analysis of what constitutes a debt or claim. Rather than address the alternate language found in § 101(5)(B) concerning the "right to an equitable remedy for breach of performance if such breach gives rise to a right to payment", the Villarie court cited § 502(b) of the Code, stating that since "this claim is unenforceable against the debtor'... it cannot give rise to a debt...." Villarie, 648 F.2d at 812.

Reliance upon § 502(b) is misplaced as this section deals exclusively with the allowance or disallowance of a claim, not whether a claim exists. Moreover, the Villarie court ignores the controlling language immediately following its abbreviated citation: a claim may be allowed except to the extent that "such claim is unenforceable against the debtor **and property of the debtor,**..." 11 U.S.C. § 502(b)(emphasis added). Since the pension plans in this case (and in Villarie) can enforce the loan obligations against property of the debtor, namely the accrued benefits of the debtor in the plan, § 502(B), contrary to Villarie, actually lends further support for the view that a pension loan creates a debt.

Similarly, in wrongly finding that the right to sue is an essential element of a debt or claim, courts following Villarie have also failed to consider § 102(2), the provision relied upon by the Supreme Court in Johnson. Finding this language to be critical to its analysis that a pension loan does create a debt, the court in In re Buchferer emphasized the obvious: "In other words, if one holds a claim against property of the debtor, then one holds a claim against the debtor." In re Buchferer, 216 B.R. 332, 337 (Bankr.E.D.N.Y. 1997).

As the court in Buchferer further reasoned by considering the interplay between sections 553(a) and 506(a)³, the retirement plan's right of setoff in the event of non-payment against the participant's vested plan account balance affords the plan a valid secured claim in a bankruptcy case. These provisions, together with the definition sections discussed earlier, lead to the inescapable conclusion that a pension plan's right to offset against a borrower's vested plan account, as granted by the debtor as a condition for loan approval, provides the plan with a secured claim in bankruptcy.

There can be no question that the pension loans in this case are secured. The appellee Trustee has stipulated below that if either debtor in this case were to default on the loans, the retirement plans have the right to deduct the loan balance

³ Section 553(a) provides that the Code does not:
"affect the right of a creditor to offset a mutual debt owing by such creditor to the debtor ..., except to the extent that - (1) the claim of such creditor against such debtor is disallowed."

Section 506(a) states:

An allowed claim of a creditor ... that is subject to setoff under section 553 of this title, is a secured claim to the extent ... of the amount of the setoff.

from the proceeds of the retirement account before distribution. Appendix No. 3. Such security for pension loans is not only customary but is required under federal law for ERISA qualified pension plans. In order to be an approved plan, loans made by the plan must be "adequately secured." 29 U.S.C. § 1108(b)(1)(E). Department of Labor regulations interpreting this provision state:

A loan will be considered to be adequately secured if the security posted for such loan is something in addition to and supporting a promise to pay, which is so pledged to the plan that it may be sold, foreclosed upon, or otherwise disposed of upon default of repayment of the loan, the value and liquidity of which security is such that it may reasonably be anticipated that loss of principal or interest will not result from the loan.

29 C.F.R. § 2550.408b-1(f).

Several courts following Villarie have alternatively concluded that a pension loan is not a debt because the security for the loan, the debtor's ERISA pension account, is not property of the estate. *See, e.g., In re Scott*, 142 B.R. 126, 130 (Bankr.E.D.Va. 1992), *see also, Patterson v. Shumate*, 504 U.S. 753 (1992). However, Congress did not limit the definition of claim in § 101(5) in that manner, and § 102(2) makes clear that a claim against the debtor includes a claim against "property of the debtor" (as distinguished from the more limiting concept of "property of the estate"). Additionally, § 506 specifically includes as an allowed secured claim a claim that is subject to setoff under § 553.

Other courts rejecting pension loan repayments in Chapter 13 have based their decisions on the view that a pension loan is merely an advance of the debtor's own funds. Under the terms of the pension loans in this case, however, both debtors are required to repay the loans through payroll deductions over a term not exceeding

5 years together with interest. In the case of debtor Anes, the New York Employee's Retirement System specifically provides under "consequences of non-payment" that the debtor must make "direct payments" to the plan if she is no longer employed or does not receive a paycheck from the employer. See Appendix No. 2, Terms of Loan. The plan documents further specify that "the amount borrowed is from other retirement system funds." *Id.* In fact, the pension loans in this case have many of the same attributes found in traditional loan transactions.

Like the bank in *Johnson*, the pension plans in this case have a nonrecourse loan remedy enforceable against the debtors' accrued interest in their pension plans.

Amicus urges this Court to consider *Villarie* to be effectively overruled by *Johnson* and to adopt *Johnson's* plain meaning construction in finding that the pension loans in this case are debts and that the pension plans have claims against the debtors. Moreover, given the pension plans' right to offset against property of the debtors, such claims are secured claims subject to inclusion in the debtors' Chapter 13 plans, where ongoing payments may be made outside the plan as with other secured loans such as home mortgages and auto loans.

II. APPLICATION OF THE DISPOSABLE INCOME TEST IN THIS CASE WARRANTS A REVERSAL OF THE DECISIONS BELOW.

Although the courts below did not apply the disposable income test in these cases, those courts which have concluded that the repayment of pension loan obligations in Chapter 13 violates 11 U.S.C. § 1325(b) have generally based such decisions on flawed policy grounds. These decisions focus almost exclusively on perceived debtor abuse, which *Amicus* contends may be addressed through other Code provisions, and largely ignore the overriding national policy favoring the

protection and promotion of retirement savings.

Section 1325(b)(1) provides that if the Trustee or an unsecured creditor objects to confirmation, a bankruptcy court may not confirm the plan unless all of the debtor's projected disposable income over a three year period is dedicated to the plan. Subsection (b)(2) attempts to define "disposable income" as "income which is received by the debtor and which is not reasonably necessary to be expended ... for the maintenance or support of the debtor or a dependent of the debtor...."⁴

In deciding whether repayment of a pension loan is an expense that should be excluded from a debtor's disposable income, this Court should affirm the importance it has placed on policy considerations in prior decisions involving pension plans. In holding that an IRA containing approximately \$143,000 was not property of the debtor's estate and therefor immune from creditors' claims in a Chapter 7, this Court in *In re Yuhas*, 104 F.3d 612 (3rd Cir. 1997) stated:

[T]here can be no doubt that Congress has expressed a deep and continuing interest in the preservation of pension plans, and in encouraging retirement savings, as reflected in the statutes which have given us ERISA, Keogh plans and IRAs. We believe it reasonable to

⁴ While the Code provides no additional guidance for this potentially value-laden test, and the legislative history provides little direction as to what expenses may be deemed reasonably necessary for maintenance and support, a contemporaneous amendment to a different section of the Code employing similar language is illustrative. In excepting from discharge certain "luxury goods or services", § 523(a)(2)(C) defines these as not including "goods and services reasonably acquired for the support or maintenance of the debtor or a dependent of the debtor...." The corollary to this suggests that expenses for luxuries are what Congress intended to include in a debtor's disposable income. *See*, 8 Collier on Bankruptcy, § 1325.08[4][a] at 1325-51 (15th ed. 1996).

conclude that Congress intended to provide protection against the claims of creditors for a person's interest in pension plans, unless vulnerable to challenge as fraudulent conveyances or voidable preferences.

Yuhas, 104 F.3d at 615, *quoting Velis v. Kardanis*, 949 F.2d 78, 82 (3rd Cir. 1991).

Despite the strong policy considerations recognized by this Court, several bankruptcy courts have adopted a *per se* rule that pension loan repayment expenses may never be reasonably necessary for the maintenance or support of debtors and their dependents. According to these courts, this rule is justified because allowing debtors to repay such loans "would be unfair to their creditors" and "would provide an inappropriate message to future debtors", encouraging debtors "contemplating bankruptcy [to] take out loans against their retirement fund and then insulate these sums from the Chapter 13 Trustee."⁵ In re Jones, 138 B.R. 536, 539 (Bankr.S.D.Ohio 1991); *see also* In re Scott, 142 B.R. 126 (Bankr.E.D.Va. 1992); In re Delnero, 191 B.R. 539 (Bankr.N.D.N.Y. 1996).

Given Congress' clear statement that ERISA qualified pension plans and certain other retirement plans are not property of the debtor's estate under 11 U.S.C. § 541(c)(2), it seems illogical that Congress would likewise intend that repayment of pension loans in all instances should violate § 1325(b). Such contradictory policy determinations would produce the absurd result that a debtor with \$250,000 in an ERISA plan who files a Chapter 7 without repaying debts may keep the full pension

⁵ Adoption of such an unbending rule certainly violates the intention of § 1325(b) which calls out for case-by-case review. In re Smith, 207 B.R. 888 (9th Cir. BAP 1996)(rejecting blanket rule, issue of whether life insurance is necessary expense must be decided on case-by-case basis).

whereas a debtor with a \$10,000 pension seeking to repay a \$5,000 pension loan along with other debts in a Chapter 13 will be precluded from doing so, will likely have his pension account further eroded by an offset of the loan amount and accrued interest, and will be required to pay additional taxes and penalties based on IRS regulations.

While such rulings are repugnant to policies encouraging private pension savings, they also penalize debtors in financial trouble who attempt in good faith to avoid bankruptcy by paying creditors with pension loan proceeds. Such debtors who later elect to file Chapter 13 will lose the opportunity to replenish their modest pension savings and will have their pension balances reduced by offsets or increased finance charges. Affirmance of the decisions below will discourage debtors from borrowing on their pensions so as to avoid bankruptcy. Rather than "provide an inappropriate message" to debtors that some courts have noted, these rulings likewise provide a powerful disincentive to debtors contemplating the filing of a Chapter 13 and send the message that debtors who want to preserve their pension savings and continue making pension loan repayments should file Chapter 7 rather than Chapter 13. Surely Congress did not intend such a result.

Moreover, such blanket prohibitions against pension loan repayments may not always be in the best interest of unsecured creditors. For example, a debtor having financial difficulties who must replace an automobile needed to get to work or a broken home furnace could possibly obtain an equity mortgage or car loan. Assuming there are problems in the debtor's credit history, such loans are likely to be available in the 14% - 18% range, with monthly payments significantly higher than would be available on a pension loan at 4% - 7% interest. A decision barring pension loan repayments in Chapter 13 would discourage debtors from taking the

more economical loan option thereby reducing disposable income for unsecured creditors if a Chapter 13 is subsequently filed. Additionally, if the balance on the pension loan is treated as taxable income to the debtor during the life of the plan, and a 10% penalty is imposed, the debtor will no doubt move to modify the plan based on a reduction in disposable income caused by the additional tax burden.

Similarly, debtors in Chapter 13 concerned about the depletion of their pension account may attempt to continue repaying their pension loans during the plan by taking funds budgeted for other necessities such as food and clothing. Given that most Chapter 13 budgets are already stretched too thinly, this will almost certainly result in failure of the plan and likely conversion to Chapter 7.

As to the perception of some courts that pension loan repayments could be subject to abuse, perhaps by obtaining such loans pre-petition to take a vacation or purchase luxury items later exemptible in bankruptcy, *Amicus* urges this Court to adopt a similar response to arguments raised in *In re Yuhas*, *supra*, 104 F.2d 612, concerning pre-petition transfers into pension plans. Quite simply, there are other ways to combat such abuse under the Code without imposing the blanket rule that all pension loan repayment plans are not confirmable. For example, courts concerned about real abuses can deny confirmation based on the debtor's lack of good faith under 11 U.S.C. § 1325(a)(3).

Likewise, by applying the disposable income test on a case-by-case approach and taking into consideration factors such as the age of the debtor, the amount of the pension loan and the debtor's retirement savings, bankruptcy courts will exclude from maintenance and support pension loan payments which are the equivalent of a luxury. *See, e.g., In re Hedges*, 68 B.R. 18 (Bankr.E.D.Va. 1986)(\$9,000 pleasure boat was a luxury item and therefore payments on secured debt not reasonably

necessary for maintenance or support).

In conclusion, reversal of the decisions below is warranted as the debtors have satisfied the disposable income test. Unlike the debtor in *In re Scott, supra*, 142 B.R. 126, who proposed to repay his pension loan at the rate of \$790.36 while making plan payments of \$425 per month, there is no such imbalance in the payments proposed by the debtors in this case. In addition, both debtors have only modest sums in their pension accounts and the inability to repay these loans will certainly affect their ability to maintain and support themselves during their retirement years.

Respectfully submitted,

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CERTIFICATION OF BAR MEMBERSHIP

I hereby certify that I am a member of the bar of the United States Court of Appeals for the Third Circuit.

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CERTIFICATION OF WORD LIMIT

I hereby certify that this brief contains less than the 7,000 word limit set forth in the Rules Requirements for Preparation of Briefs.

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CERTIFICATION OF SERVICE

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