

Substantial Abuse
11 USC § 707(b)

Nancy Davenport, Case No. 601-67522-fra7

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Unpublished

The U.S. Trustee filed a motion to dismiss Debtor's chapter 7 case under Code § 707(b) on the grounds that she had substantial disposable income which she could use to pay creditors. The Debtor argued that while she may have disposable income, the motion should be denied because any payout to unsecured creditors in a Chapter 13 plan would be in the area of only 3%.

The court determined that a number of expenses shown on Schedule J should be reduced and that Debtor would have \$532 per month in disposable income in a chapter 13 case to devote toward payment of debts, which would result in close to a 20% payout in a 36 month plan. The court made it clear that there was no percentage test which would result in a finding of substantial abuse, but a determination that the debtor has the ability to make a "substantial effort" in repaying debts would constitute a substantial abuse of chapter 7. Because the court found that Debtor could make a substantial effort in repaying debts, the UST's motion was granted.

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

In Re:) Bankruptcy Case No.
) 601-67522-fra7
NANCY DAVENPORT,)
) MEMORANDUM OPINION
)
Debtor.)

The United States Trustee ("UST") has filed a motion under 11 U.S.C. § 707(b) seeking dismissal of this case on the grounds that it constitutes a substantial abuse of Chapter 7 of the Bankruptcy Code.

Finding that the Debtor has disposable income which can be used to pay unsecured debts, the Court holds that the motion must be allowed. This memorandum sets out the Court's findings of fact and conclusions of law supporting that determination.

I. BACKGROUND

Debtor is a management-level employee of a non-profit organization which provides residential care for mentally ill children. She holds a master's degree in education, is licensed as
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1 a social worker or clinical social worker in two states, and has
2 extensive professional experience.

3 As may be expected given her professional qualifications and
4 the responsibilities involved in her employment, Debtor's income and
5 expenses are relatively high. Her most recently filed Schedules I
6 and J, reflecting her income and expenses, respectively, are set out
7 in the appendix of this opinion.

8 Apart from the appropriate calculation of Debtor's annual tax
9 burden, the parties do not dispute the accuracy of the schedules.
10 As discussed in more detail below, the parties do dispute whether
11 all of the Debtor's budget items are appropriate.

12 II. DISCUSSION

13 A. *Substantial Abuse*

14 Bankruptcy Code § 707(b) provides, in pertinent part, that

15 The court...may dismiss a case filed by an individual
16 debtor under this chapter whose debts are primarily
17 consumer debts if it finds that the granting of relief
18 would be a substantial abuse of the provisions of this
19 chapter. There shall be a presumption in favor of
20 granting the relief requested by the debtor.

19 The UST contends that, because the Debtor has income
20 available to pay creditors, petitioning under Chapter 7 of the Code
21 is a substantial abuse of that chapter. Debtor does not deny that
22 she may have disposable income, but maintains that her disposable
23 income available to creditors under a Chapter 13 plan would result

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1 in only a minimal distribution. It follows, she says, that her
2 election to proceed under Chapter 7 is not a substantial abuse.¹

3 Substantial abuse is not defined in the Bankruptcy Code. No
4 doubt a variety of circumstances can be imagined where a Bankruptcy
5 Court might determine that proceeding under Chapter 7 is abusive and
6 inappropriate. Most published cases, however, address the debtor's
7 ability to pay at least some debts. The Ninth Circuit Court of
8 Appeals noted that "the [near] unanimous conclusion of bankruptcy
9 courts has been that the principal factor to be considered in
10 determining substantial abuse is the debtor's ability to repay the
11 debts for which a discharge is sought." In re Kelly, 841 F.2d 908,
12 914 (9th Cir. 1988). The Court framed the relevant inquiry in
13 determining substantial abuse as:

14 the debtor's ability to pay his debts when due, as
15 determined by his ability to fund a chapter 13 plan,
16 is the primary factor to be considered in determining
whether granting relief would be a substantial abuse.

17 Id. There is no threshold repayment percentage for a finding of
18 substantial abuse where the "ability to pay" standard is applied.
19 In re Gomes, 220 B.R. 84 (BAP 9th Cir. 1998); In re Lenartz, 263
20 B.R. 331, 338 (Bankr. D.Id. 2001).

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24 ¹ Apart from a copy of the Debtor's schedules, the parties presented no
25 evidence, and advanced no arguments, regarding the consumer debt element of
26 § 707(b). Nothing in the record suggests that Debtor is involved in any business
activities apart from her employment, and there is nothing in the schedules to
suggest that she owes anything other than consumer debts. The record is
sufficient to support a finding that the Debtor's are "primarily consumer debts."

1 Unless the trustee and all unsecured creditors agree otherwise, a
2 plan of reorganization under Chapter 13 requires that all of the
3 debtor's projected disposable income be applied to make plan
4 payments. § 1325(b)(1)(B). "Disposable income" means income
5 received by the debtor which is not reasonably necessary to be
6 expended for the debtor's maintenance or support. § 1325(b)(2)(A).
7 A determination of whether the Debtor has disposable income requires
8 a review of the Debtor's budget in order to ascertain whether all
9 claimed items are necessary for her maintenance or support.

10 Income "received by the debtor" is generally thought to mean
11 take-home pay; that is, wages or salary net of taxes and other
12 obligatory holdings. The Debtor's calculation of her income net of
13 taxes relies on tax tables describing minimum amounts of withholding
14 required by the IRS and Oregon Department of Revenue. According to
15 these tables the minimum amount to be withheld from her monthly
16 income of \$5,325.00 is \$1,827.24.

17 The UST's reckoning of the debtor's monthly tax burden
18 involves calculation of the projected total tax due for the year and
19 taking 1/12 of the total from each month's gross income. Using what
20 she described as a "conservative" approach (for example, using
21 standard deductions rather than itemizing to reduce tax liability)
22 the UST's expert projects that the Debtor's total state and federal
23 tax (including Social Security assessments) will be \$20,458.00, or
24 \$1,705.00 per month.

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1 The distinction may be academic, since it is the general rule
2 in Chapter 13 cases in this district to require refunds of excess
3 withholding to be paid into the plan in any event. However, for our
4 purposes the UST's approach is more precise, since it considers the
5 Debtor's overall tax burden, rather than simply the amount the
6 government seeks to withhold from time to time.

7 To the extent allowable for maintenance and support under
8 § 1325(b), the Debtor's expenditures set out in Schedule J are
9 effectively deductions from disposable income. "Reasonably
10 necessary" expenditures are those required to maintain a standard of
11 "adequacy, supporting the basic needs 'not related to [the debtor's]
12 former status in society or the lifestyle to which he is
13 accustomed." In re Cardillo, 170 B.R. 490, 491 (Bankr. D. N.H.
14 1994) (citing In re Sutliff, 79 B.R. 151, 157 (Bankr. N.D.N.Y.
15 1987)). A review of the Debtor's Schedule J in this case reveals a
16 number of expenditures which would not be permitted in Chapter 13,
17 and which therefore should be included in her disposable income.
18 For example:

19 Son's car insurance: Debtor has a 25 year old son, who does
20 not reside with her. Debtor describes him as currently both
21 attending school and working full time. She has agreed to pay his
22 car insurance - roughly \$75 a month in order to help him stay in
23 school full-time until he obtains a degree. While Debtor's aims
24 here are laudable, the expense is not necessary for Debtor's
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1 maintenance, or her son's, and is not excludable from Debtor's
2 income.

3 Travel expenses: Debtor is required to travel by car several
4 hundred miles a week visiting different facilities. For this she is
5 reimbursed by her employer on a mileage basis. Although she shows
6 car payments of \$447 a month on her Schedule J (and a reduced car
7 payment on her hypothetical Chapter 13 plan), she does not show this
8 reimbursement as income, or otherwise account for the net reduction
9 of her car-related costs.

10 More significantly, she shows \$200 per month in
11 "transportation costs" apart from her car payments. She testified
12 that the purpose of this expenditure is two trips a year to the
13 eastern United States to visit her children. Again, the Debtor
14 cannot be faulted for wishing to make these trips. However, the
15 expenditures are not necessary for her maintenance and support.
16 Congress did not intend that a debtor's creditors support such
17 activities, however genuine or valuable to the debtor and her
18 family.

19 Telephones: The Debtor testified that she has two cell
20 phones, one owned by the employer, which cannot be used for personal
21 calls, and one for herself. The \$150 per month scheduled is
22 excessive, and should be reduced by one-half.

23 Cable/internet: Debtor requires internet access for e-mail
24 and other purposes, associated with her employment. She has a
25 satellite-type TV system. While it is not unreasonable to have
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1 either of these things, the total cost exceeds somewhat the amount
2 reasonably necessary for her support and maintenance, and exceeds
3 what would be permissible in a Ch. 13 reorganization. (An
4 acceptable amount is included in the table below.)

5 Student loans: Debtor's budget shows \$300 per month payments
6 on a student loan debt of approximately \$35,000. Even though the
7 student loan obligation is ordinarily not subject to discharge in
8 bankruptcy, 11 U.S.C. § 523(a)(8), periodic payments on that debt
9 should not be deducted from disposable income. The plan of
10 reorganization must provide for all unsecured creditors, and a plan
11 cannot discriminate in favor of a particular unsecured creditor
12 simply because the underlying claim is a student loan excluded from
13 discharge. In re Smalberger, 157 B.R. 472 (Bankr. D. Or. 1993),
14 aff'd 170 B.R. 707 (D. Or. 1994).

15 After the adjustments discussed above are made, Debtor's
16 income and expenditures are as follows:

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18 **INCOME**

19	Gross monthly wages	\$5,325.00
20	Less: Payroll deductions	
21	--Taxes, Social Security, Workers' comp	\$1,705.00
22	-- Insurance	\$ 200.00
22	-- United Way	\$ 10.00
23	NET Monthly Take Home Pay	\$3,410.00

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25 **EXPENSES**

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1	Rent	\$1,120.00
	Utilities:	
2	-- Electricity and heating fuel	\$ 140.00
3	-- Water & Sewer	\$ 70.00
	-- Telephone	\$ 75.00
4	-- Cable/internet	\$ 96.00
	Food	\$ 350.00
5	Clothing	\$ 100.00
	Laundry/Dry Cleaning	\$ 30.00
6	Medical/dental expenses	\$ 150.00
7	Recreation, periodicals, etc	\$ 100.00
	Auto loan Payments	\$ 447.00
8	Automobile Insurance	\$ 150.00
9	Pet Care	\$ 50.00
10	Total Expenses	\$2,878.00
11	Disposable income (Take home less Expenses) \$ 532.00	

13 The Debtor believes that the Court should deny the U.S.
14 Trustee's motion because, according to her calculations, creditors
15 would not receive any material benefit from forcing her to
16 reorganize under Chapter 13. According to her analysis, a Chapter
17 13 plan, particularly with the additional legal costs it will
18 necessarily involve, would not yield more than a 3% payment to
19 unsecured creditors. She reasons that, where the creditors are not
20 materially worse off under a Chapter 7 liquidation than a Chapter 13
21 reorganization, proceeding under Chapter 7 cannot be seen to be a
22 substantial abuse. However, given the Court's findings regarding

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1 the Debtor's disposable income, the likely dividend is more in the
2 vicinity of 20%.²

3 Moreover, Debtor's theory that the relative impact on creditors
4 of Chapter 13 or 7 cases assumes that these are the only two
5 options. This is not what the Kelly court and others intended by
6 relying on a disposable income test in order to determine whether
7 substantial abuse exists. Congress has made it clear that it does
8 not require that Chapter 13 reorganization be sought in any
9 particular case. (See, for example, Code § 706(c), prohibiting
10 conversion from Chapter 7 to Chapter 13 unless the debtor so
11 requests, and § 303, prohibiting involuntary ch.13 petitions). Even
12 though courts employ Chapter 13's description of disposable income
13 to determine whether substantial abuse exists, the effect of a
14 finding of substantial abuse is simply to prohibit relief under
15 Chapter 7.³ It does not mandate any particular alternative.

16 Courts have rejected the "percentage of payment" argument on
17 the grounds that it rewards debtors with particularly high debts
18 (and resulting low pay-outs), and, conversely, penalizes debtors

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20 ² This assumes \$20,592 in payments (\$572/month x 36). The claims register
21 shows claims of \$65,264. Adding the unsecured portion of the Debtor's car loan
22 (\$4,898) and a likely deficiency on a second mortgage (\$25,632) and \$4,000 in
23 additional legal fees, total claims would amount to \$99,794. This assumes that
the car payments are left on Schedule J. Debtor's hypothetical Chapter 13
excludes the car payment from Schedule J but provides for payments on the car
loan under the plan. This approach has a negligible effect on the percentage of
total debt paid to unsecured creditors.

24 ³ A general approach to determining disposable income as developed under §
25 1325(b) has been used in other contexts, such as determining whether a debtor's
26 finances justify exception of non-support marital obligations from discharge
under §523(a)(15). See, e.g., In re Cameron, 243 B.R. 117 (M.D. Ala. 1999), In
re Smither, 194 B.R. 102 (Bankr. W.D. Ky. 1996).

1 While conversion of the case to another Code chapter is not
2 mandated, the debtor should not be denied the opportunity to do so
3 if she wishes. The order allowing the UST's motion should provide
4 that the case be dismissed 10 days of the date the order is
5 docketed, unless prior to that time the Debtor files a motion
6 seeking conversion of the case to another chapter.

7 This memorandum constitutes the findings of fact and
8 conclusions of law required by Fed.R.Bankr.P. 7052. Counsel for the
9 UST shall lodge a form of order consistent with the foregoing.

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FRANK R. ALLEY, III
Bankruptcy Judge

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16 cc: Ms. Gail Geiger
17 Mr. Gavin Armstrong
18 Mr. Eric Roost

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