Means Test - § 707(b)(2)
Constitutionality
Bad Faith
Dismissal under §707(b)

Gary Daniel Williams, Case No. 11-61683-fra7
Appellate No. 6:12-cv-671-HO

8/9/2012 Hogan aff'g FRA Unpublished

The bankruptcy court entered a memorandum opinion and order dismissing Debtor's chapter 7 case based on a nonrebutted presumption of abuse under § 707(b)(2), after determining that the means test is constitutionally valid, and on the totality of the circumstances and bad faith grounds under §707(b)(3). Debtor appealed to the District Court.

The District Court affirmed on all grounds.

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF OREGON

In re: GARY DANIEL WILLIAMS, Debtor.	No. 6:12-cv-671-HO ORDER
DANIEL GARY WILLIAMS, Appellant, v. UNITED STATES TRUSTEE, Appellee.	

Gary Williams appeals from an order of the bankruptcy court granting the United States Trustee's motion to dismiss the debtor's case under 11 U.S.C. § 707(b)(2) or alternatively under 11 U.S.C.

§ 707(b)(3).

STANDARD

The bankruptcy court's findings of fact shall not be set aside unless clearly erroneous. Fed. R. Bankr. P. 8013. Factual determinations are clearly erroneous only when the reviewing court is left with a definite and firm conviction that a mistake has been committed. United States v. United States Gypsum Co., 333 U.S. 364, 395 (1948). Issues of law are reviewed de novo. U.S. v. Horowitz, 756 F.2d 1400, 1403 (9th Cir. 1985). Mixed questions of law and fact are reviewed de novo. Boone v. United States, 944 F.2d 1489, 1492 (9th Cir. 1991). Mixed questions arise when the historical facts are established, the rule of law is undisputed, and the issue is whether the facts satisfy the legal rule. Pullman-Standard v. Swint, 456 U.S. 273, 289 n. 19 (1982); Moss v. Comm'r., 831 F.2d 833, 838 n. 9 (9th Cir. 1987).

A bankruptcy court's decision to dismiss a case under 11 U.S.C. § 707(b) is reviewed for abuse of discretion. In Re Price, 353 F.3d 1135, 1138 (9th Cir. 2004). A court abuses its discretion if it does not apply the correct law or if it bases its ruling on a clearly erroneous view of the facts. This court cannot reverse for abuse of discretion unless it has a definite and firm conviction that there has been a clear error in judgment. In re Khachikyan, 335 B.R. 121, 125 (9th Cir. BAP 2005).

FACTUAL BACKGROUND

Debtor petitioned for Chapter 7 relief on April 13, 2011. Debtor works as a route sales driver in the Klamath Falls, Oregon area. In 2011, debtor's gross pay was $53,780.59. Debtor's income is commission based and had dropped from its 2006 high over the next five years, but his 2011 income exceeded his 2010 income. Debtor estimated that under new union rules it was possible his income could drop as much as 20% if his route dropped 2½% each six months. Debtor, however, estimated that the chance of this happening in the next four years is 50/50. Moreover, debtor stated he would look for another job if his income continued to decrease.

Debtor's obligations include a $6,000 judgment against him resulting from a 2007 auto accident, at which time he failed to carry insurance. Debtor had not made any payments on this judgment at the time he filed for bankruptcy relief. As a result of this failure, debtor faced suspension of his licence, which would result in the loss of his job. Debtor also had a judgment against him for $12,000 for default on a mobile home purchase from which he just walked away. Indeed, debtor failed to make payments on most of his unsecured debts before seeking relief.

In December of 2009, debtor, and his girlfriend, began renting, for $900 a month, a three bedroom, two bathroom mobile home on 1½ acres located on Topper Avenue in Klamath Falls.

Debtor's girlfriend contributed $300 a month toward the rent and plans to continue to contribute $300 a month toward housing.

Debtor expressed an interest in purchasing the Topper Avenue property and, in 2010, reached an agreement in principle with the owner whereby the owner would carry the financing. However, when the owner learned of the judgments against debtor, he backed out of the deal.

In March of 2011, debtor contacted his counsel to draft a land sales contract for a renewed offer for the Topper Avenue property and to provide bankruptcy services. Debtor's counsel drafted a contract in which debtor would purchase the property for $130,000, at seven percent interest, with monthly payments for the first two years of $1671.59. The remaining payments are $1,000 per month. The increased monthly payment for the first two years was in lieu of a down payment. Under the contract, debtor is also responsible for taxes and insurance. On April 12, 2011, the parties executed the contract and on the following day, debtor petitioner for Chapter 7 relief. Debtor asserts that he was afraid that the owner of the property would pass away and speculates that the owner's children might sell the property to someone else.

On his petition, debtor reported that monthly payment for the Topper Avenue property, including taxes and insurance, is $1778.25, or $878.25 more than his previous rent on the property. Debtor intends to retain the property and reaffirm the land sales

contract.

On May 5, 2011, debtor filed an amended means test form which reported monthly income of $4,313.51 and an additional source of income from his girlfriend of $300 per month for a total of $4,613.51. The form indicated total allowed deductions of $4,332.06, resulting in $281.45 monthly disposable income. Consequently, the form indicated a presumption of abuse. Debtor also contended that he should be permitted an additional $200 per month of expenses for an "older" vehicle which would drop him below the threshold for presumption of abuse.

The Trustee presented evidence demonstrating that, based on debtor's recalculated current monthly income (CMI), debtor did indeed meet the threshold for a presumption of abuse.[1] Accordingly, the Trustee moved to dismiss asserting abuse of Chapter 7.

DISCUSSION

The United States Trustee commenced a contested proceeding against debtor seeking dismissal under 11 U.S.C. § 707(b). The Trustee asserted dismissal was warranted under 11 U.S.C. §

[1]The presumption arises when monthly disposable income exceeds $195.42 11 U.S.C. § 707(b)(2)(A)(i)(II). During depositions, debtor asserted that he did not expect his income to remain at 2010-11 levels, but the Trustee's analyst found that using average income based on recent post-petition pay advices, the presumption of abuse would still arise. Debtor could only speculate as to whether future earnings would diminish.

707(b)(1) and (2) or, alternatively, under 11 U.S.C. § 707(b)(3)(A) and (B). Debtor denied that he filed the petition in bad faith, and asserted that section 707(b)(2) is unconstitutional and that the Internal Revenue Service's (IRS) National and Local Standards could not be applied because they were not adopted in conformance with the Administrative Procedures Act (APA).

The bankruptcy court stated three distinct basis for dismissal. The bankruptcy court determined that debtor's amended means test form indicated that the section 707(b)(2) presumption of abuse arose subjecting debtor to the means test. Debtor's counsel stipulates that if the IRS standards are applicable, the presumption of abuse arose and was not rebutted. The bankruptcy court determined that the standards are constitutional and that the standards are not subject to the APA's rulemaking procedures.

In addition, the bankruptcy court determined that debtor contrived to move nearly $800 per month in income out of reach of his creditors with no change in his living circumstances via the purchase of the Topper Avenue property rather than continued rental.[2] The Court determined that this constituted bad faith under section 707(b)(3)(A), which itself warranted dismissal of the Chapter 7, because debtor did not place the interest of his

---

[2]When property taxes and insurance are added into the equation, debtor actually increased his monthly expenses by nearly $900 per month.

creditors on equal standing with his own in making the eve of bankruptcy purchase. The court declined to accept that debtor has the right to live where and how he pleases and declined to accept debtor's argument that he was required to purchase the property on the eve of bankruptcy because the owner was elderly and might have died before a sale could be accomplished.

Moreover, the bankruptcy court found that under the totality of the circumstances, the debtor's financial situation shows that he has sufficient disposable income to sustain a Chapter 13 plan to make additional effort to repay his creditors, warranting dismissal under section 707(b)(3)(B).

On appeal, debtor contends that: the IRS standards upon which the means test is based were not "in effect" because they have not been adopted pursuant to the APA; the finding of bad faith because of the home purchase was in error; and the finding that debtor had sufficient disposable income to sustain a chapter 13 was in error.

A. The Means Test

As noted above, debtor concedes that if the IRS standards are in effect, then the Chapter 7 should be dismissed because of an unrebutted presumption of abuse. A court may dismiss a Chapter 7 case, involving primarily consumer debts, or convert it to a Chapter 13 if granting relief would be an abuse of Chapter 7. 11 U.S.C. § 707(b)(1).

> In considering under ... whether the granting of relief would be an abuse of the provisions of this chapter, the court shall presume abuse exists if the debtor's current monthly income reduced by the amounts determined under clauses (ii), (iii), and (iv), and multiplied by 60 is not less than the lesser of--
>
> > (I) 25 percent of the debtor's nonpriority unsecured claims in the case, or $7,025, whichever is greater; or
> >
> > (II) $11,725
>
> (ii)(I) The debtor's monthly expenses shall be the debtor's applicable monthly expense amounts specified under the National Standards and Local Standards, and the debtor's actual monthly expenses for the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides, <u>as in effect on the date of the order for relief, for the debtor, the dependents of the debtor, and the spouse of the debtor in a joint case, if the spouse is not otherwise a dependent</u>....

11 U.S.C. § 707(b)(2)(A) (emphasis added).

The standards are part of the IRS Internal Revenue Manual and are used to determine appropriate periodic payments to compromise tax claims. There is no authority for the proposition that these guidelines are rules subject to the APA procedures.[3] Indeed, the manual "does not have the force of law and does not confer rights

---

[3]"'Rule' means the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy or describing the organization, procedure, or practice requirements of an agency and includes the approval or prescription for the future of rates, wages, corporate or financial structures or reorganizations thereof, prices, facilities, appliances, services or allowances therefor or of valuations, costs, or accounting, or practices bearing on any of the foregoing." 5 U.S.C. § 551(4).

on taxpayers," and are not codified regulations Fargo v. C.I.R., 447 F.3d 706, 713 (9th Cir. 2006).

More importantly, Congress converted the nonbinding guidelines into a statute by incorporating them directly in the means test in section 707(b)(2)(A)(ii). The standards became statutory as a result of Congress' authority to legislate, not binding via an agency's rulemaking authority delegated by Congress. Federal statutes need not comply with the APA's rulemaking requirements. See 5 U.S.C. §§ 701(b)(1)(A) and 551(4) ("rule means ... agency statement ..." and "agency" does not include Congress). Congressional incorporation of the Standards in the means test does not require that those standards independently comply with the APA. Cf. United States v. Clayton, 506 F.3d 405, 408-09 (5th Cir. 2007) (taxpayer argument that statute requiring filing tax returns exceeding exemption amount is invalid because the statute incorporates the CPI developed by an agency, without complying with APA, is unpersuasive because congressional incorporation of standard does not trigger the APA).

Debtor contends that section 707(b)(2)(A) makes the standards rules because they now have future effect implementing the Bankruptcy Abuse Prevention and Consumer Protection Act and prescribe law related to allowable deductions under the Act, and approve allowances for prices, facilities, appliances and services as well as valuations and costs bearing on them. Accordingly,

debtor contends that because the standards were not properly established pursuant to the APA, they are not "in effect" and therefore inapplicable. Debtor's argument is circular and reductio ad absurdum. Debtor confuses law with regulation. In essence, he argues that, while Congressional acts are not subject to the APA, Congress engages in rulemaking when it incorporates agency guidelines into its statutes and therefore must comply with the APA, i.e., Congress cannot incorporate previously non-rules unless they are rules. The standards are merely means to ascertain a number that are not by themselves an enforceable law. There binding effect, in this instance, is strictly a creature of congressional authority and not agency action. Accordingly, the bankruptcy court correctly concluded that the standards are not rules subject to the APA and were applicable to determining whether debtor abused the provisions of Chapter 7. As such, the court did not err in dismissing debtor's Chapter 7 petition.

B. Bad Faith

The bankruptcy court's alternative basis for dismissal under section 707(b)(3)(A) was also free of error.

Section 707(b)(3)(A) requires that bad faith exist at the time of commencing a bankruptcy, focusing on the debtor's intent, purpose and conduct. In Re Hageney, 422 B.R. 254, 260 (Bankr. E.D.Wash. 2009).

> Bad faith may involve a dishonest debtor or nefarious acts, but such motivation or intent is not necessary. Bad faith exists if the filing of the bankruptcy was for a purpose not consistent with the Bankruptcy Code or policy even though the purpose may otherwise be lawful.... Absent allegations of subjective intent to commit wrongful acts, the evidence relevant to the determination of bad faith is the evidence which existed at the time of filing the petition.... Evidence relevant to an examination of bad faith under § 707(b)(3)(A) may be the filing of incomplete schedules or the existence of a voidable transfer prior to filing the case, but the inquiry focuses on the debtor's conduct, not the debtor's financial affairs.

Id.

Applicable legal standards regarding the bad faith determination include:

> (1) whether the debtor has a likelihood of sufficient future income to fund a Chapter 11, 12, or 13 plan which would pay a substantial portion of the unsecured claims; (2) whether the debtor's petition was filed as a consequence of illness, disability, unemployment, or some other calamity; (3) whether the schedules suggest the debtor obtained cash advancements and consumer goods on credit exceeding his or her ability to repay them; (4) whether the debtor's proposed family budget is excessive or extravagant; (5) whether the debtor's statement of income and expenses is misrepresentative of the debtor's financial condition; (6) whether the debtor has engaged in eve-of-bankruptcy purchases; (7) whether the debtor has a history of bankruptcy petition filings and case dismissals; (8) whether the debtor intended to invoke the automatic stay for improper purposes, such as for the sole objective of defeating state court litigation; and (9) whether egregious behavior is present.

In Re Mitchell, 357 B.R. 142, 155 (Bankr. C.D.Cal. 2006).

The bankruptcy judge's factual findings do not demonstrate error with respect to whether Debtor's action in purchasing the residence he was renting and incurring more than $800 a month in

increased expenses was inconsistent with the Bankruptcy Code of maximizing return to creditors while providing a debtor with fresh start. See In Re Hageny 422 B.R. at 262 ("purchase of ... unnecessary luxury item merely worsened the debtors' insolvency and occurred at the expense of the debtors' unsecured creditors. Such a purchase must result in a determination of bad faith under § 707(b)(3)(A)").

Plaintiff argues that there is no finding that the purchase of the Topper Avenue residence was unreasonable. Debtor misses the point. While debtor may have feared that the residence may be sold, if the owner died, the bankruptcy court did not err in finding that debtor did not have a right to live where and how he pleases. In purchasing the property, debtor put his interest above those of his creditors, rather than on equal footing. Debtor's speculative fear of having the property he rented sold at some point in the future does not justify putting another $800+ out of reach of his creditors. This is especially true given that debtor admits he was not paying many of his creditors prior to incurring this additional expense and intended to avoid paying the judgment related to his uninsured accident and keep his licence for work. See Excerpt of Record (#4) at pp. 72 (Debtor's counsel notes that the filing of the bankruptcy stayed the suspension and will discharge the debt upon which it would be triggered). The court did not err in finding that debtor's actions demonstrated that

debtor used the petition for reasons inconsistent with the Code. See In Re Boyce, 446 B.R. 447, 450, 452 (D.Or. 2011) (dismissal appropriate for bad faith where debtor claims he is unable to afford student loans, but withdrew money from his 401K to purchase consumer goods and in effect attempted to use Chapter 7 to subordinate every creditor to debtor's 401k loan to be paid back to debtor himself). Debtor here attempted to secure a property he was already renting via a purchase on the eve of bankruptcy and subordinate all creditors to his interest as a result. The court did not err in determining that the purchase was not necessary and worsened the position of creditors in contravention of the dual purpose of the Bankruptcy Code in balancing debtor and creditor interests.

C. Disposable Income

Debtor also takes issue with the bankruptcy court's finding that debtor has sufficient disposable income to sustain a Chapter 13 plan. The evidence demonstrated that debtor would have $78 per month in disposable income, even with the purchase of the Topper Avenue residence. Further, the land sales contract demonstrates that after two years, debtor's disposable income will increase by more than $500. From this finding, this court cannot conclude that the bankruptcy court committed a clear error of judgment. The bankruptcy court appropriately relied on the Trustee's analysis

demonstrating a 60 month disposable income of about $16,000 to $20,000. Debtor merely speculated that his income may decrease and that his expenses may increase. The bankruptcy court did not err in finding that dismissal was also warranted under section 707(b)(3)(b).[4]

CONCLUSION

For the reasons stated above, the bankruptcy court's decision is affirmed.

DATED this 9th day of August, 2012.

United States District Judge

[4]In considering whether the granting of relief would be an abuse, the court shall consider whether the totality of the circumstances of the debtor's financial situation demonstrates abuse. 11 U.S.C. § 707(b)(3)(B).

UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF OREGON

DANIEL GARY WILLIAMS,

Appellant,

v. **Civil No. 6:12-cv-671-HO**

UNITED STATES TRUSTEE,

Appellee.

JUDGMENT

The Bankruptcy Court's decision is affirmed. This action is dismissed.

Dated: August 10, 2012

MARY L. MORAN, Clerk

s/ S. Nogelmeier
by
S. Nogelmeier, Deputy Clerk