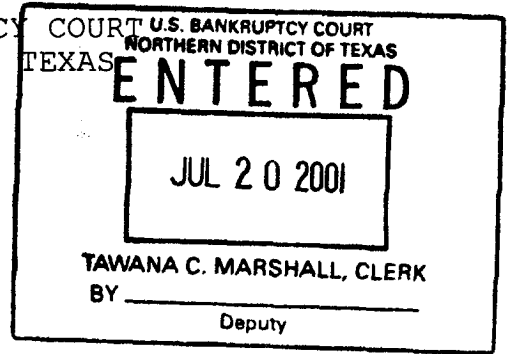


ORIGINAL

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION



IN RE:

WILLIAM SCOTT BROWN and
KATHY LYNN BROWN,

DEBTOR(S).

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CASE NO. 01-30263-RCM-7

MEMORANDUM OPINION AND ORDER

The United States Trustee moves to dismiss, pursuant to 11 U.S.C. § 707(b), the Chapter 7 case filed by William Scott Brown and Kathy Lynn Brown, asserting that the granting of relief to these debtors would amount to a substantial abuse of the provisions of Chapter 7. The debtors oppose the motion.

The motion raises a core matter over which this court has jurisdiction to enter a final order. 28 U.S.C. §§157(b)(2)(J) and 1334. The court conducted an evidentiary hearing on the motion on June 28, 2001. This memorandum opinion contains the courts findings of fact and conclusions of law. Bankruptcy Rules 7052 and 9014.

The Browns filed a petition for relief under Chapter 7 of the Bankruptcy Code. Contending that the petition amounts to a "substantial abuse," the United States Trustee moves to dismiss.

The Browns counter that they cannot make a meaningful payment to their unsecured creditors and that they have not abused the Chapter 7 process. Alternatively, rather than dismiss, the Browns request that the court provide them with an opportunity to convert their case to a case under Chapter 13 of the Bankruptcy Code, should the court agree with the position of the United States Trustee. The United States Trustee does not oppose that alternative relief.

Section 707(b)

Section 707(b) provides:

After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter. There shall be a presumption in favor of granting the relief requested by the debtor. In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to any qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4)).

11 U.S.C. § 707(b). Section 101(8) provides: "'consumer debt' means debt incurred by an individual primarily for a personal, family, or household purpose[.]" 11 U.S.C. § 101(8). "[T]he test for determining whether a debt should be classified as a

business debt, rather than a debt acquired for personal, family or household purposes, is whether it was incurred with an eye toward profit." Matter of Booth, 858 F.2d 1051, 1055 (5th Cir. 1988).

The Fifth Circuit has not yet decided when a filing constitutes a substantial abuse of the provisions of Chapter 7. Bankruptcy courts in the Fifth Circuit have crafted a substantial abuse standard that reflects the "totality of the circumstances" approach set forth in In re Krohn, 886 F.2d 123 (6th Cir. 1989) and incorporates the Ninth Circuit's approach as articulated in In re Kelly, 841 F.2d 908 (9th Cir. 1988) and the Fourth Circuit's approach in In re Green, 934 F.2d 568 (4th Cir. 1991). See In re Rubio, 249 B.R. 689, 695 (Bankr. N.D. Tex. 2000) (Jones, J.) (citing cases).

According to In re Krohn, "[s]ubstantial abuse can be predicated upon either lack of honesty or want of need." In re Krohn, 886 F.2d at 126. Among the factors that the bankruptcy court is to consider in assessing whether a debtor is honest are: whether the debtor sought Chapter 7 protection due to unforeseen or catastrophic events; the debtor's candor and good faith in filing schedules and other documents; and whether the debtor engaged in eve of bankruptcy purchases. Among the factors that the bankruptcy court is to consider in assessing whether a debtor

is needy are: the debtor's ability to repay debts out of future earnings,

whether the debtor enjoys a stable source of future income, whether he is eligible for adjustment of his debts through Chapter 13 of the Bankruptcy Code, whether there are state remedies with the potential to ease his financial predicament, the degree of relief obtainable through private negotiations, and whether his expenses can be reduced significantly without depriving him of adequate food, clothing, shelter and other necessities.

In re Krohn, 886 F.2d at 126-27. The court observed that the debtor's ability to repay debts out of future earnings, standing alone, may be sufficient to warrant dismissal. By way of clarification, the court explained that "a court would not be justified in concluding that a debtor is needy and worthy of a discharge, where his disposable income permits liquidation of his consumer debts with relative ease." Id. at 126.

According to In re Green, the concern underlying § 707(b) is "abuse of the bankruptcy process by a debtor seeking to take unfair advantage of his creditors." In re Green, 934 F.2d at 572. The Green court noted that § 707(b) provides for a presumption in favor of discharge and that § 109 does not require that a debtor be insolvent in order to file for bankruptcy. Accordingly, the Green court concluded that although a debtor's relative solvency may raise an inference that a debtor is seeking an unfair advantage over his creditors, "solvency alone is not a

sufficient basis for a finding that the debtor has in fact substantially abused the provisions of Chapter 7." Id. The court adopted a totality of the circumstances approach, instructing bankruptcy courts to evaluate whether the "total picture is abusive." Id. at 572.

According to In re Kelly, "the debtor's ability to pay his debts when due, as determined by his ability to fund a chapter 13 plan, is the primary factor to be considered in determining whether granting relief would be a substantial abuse." In re Kelly, 841 F.2d at 914. However, even if a debtor is unable to pay, the debtor's case may be dismissed as a substantial abuse if "bad faith is otherwise shown." Id. at 915.

The published decisions of bankruptcy courts in the Northern District of Texas have focused on the holdings set forth above. See In re Heasley, 217 B.R. 82, 85-88 (Bankr. N.D. Tex. 1998) (Akard, J.), In re Laman, 221 B.R. 379, 381-82 (Bankr. N.D. Tex. 1998) (McGuire, J.), In re Rubio, 249 B.R. 689, 694-97 (Bankr. N.D. Tex. 2000) (Jones, J.).

Under any and all of the approaches, the court should look to the debtor's ability to pay. According to In re Kelly, the debtor's ability to pay is the primary factor to be examined in assessing whether dismissal for substantial abuse is warranted. See In re Kelly, 841 F.2d at 914. According to In re Green, while the debtor's relative solvency is one factor in the

analysis, and may raise an inference of abuse, ability to pay alone does not warrant dismissal for substantial abuse. In re Green, 934 F.2d at 572. According to In re Krohn, a court is to consider the totality of the circumstances, however, if a debtor's disposable income permits liquidation of his consumer debts with relative ease, dismissal for substantial abuse is appropriate. In re Krohn, 886 F.2d at 126-27.

In evaluating whether a debtor's case should be dismissed as a substantial abuse of the provisions of Chapter 7, bankruptcy courts review the debtor's expenses in light of reasonableness. The bankruptcy courts are seeking to determine whether, under a hypothetical Chapter 13 scenario, the expenses would be proper maintenance or support payments under 11 U.S.C. § 1325(b)(2)(A) and (B), in determining disposable income. See In re Laman, 221 B.R. at 382. The bankruptcy courts then add up the amounts by which the various expenses are excessive. Once the courts modify the expenses by reducing them to the extent they are excessive, the courts evaluate the extent to which a debtor could repay his unsecured debt through a Chapter 13 plan.

Some courts calculate how much money the debtor had available to pay unsecured debt through a Chapter 13 plan, others calculate the percentage of unsecured debt that the debtor could service through a Chapter 13 plan. See, e.g., In re Laman, 221 B.R. at 383 ("Thus, it appears that, in a Chapter 13, the Debtors

would have disposable income of approximately at least \$635, and, in thirty-six months, \$22,860 in payments could be made. Aside from Chapter 13 Trustee's fees, it appears that there would be at least an approximate 25% dividend in a three year Chapter 13."); In re Heasley, 217 B.R. at 88 ("The excessive part of their budget is the \$633 per month they propose to pay on the credit card debts charged in Ms. Heasley's former husband's name, and the \$439.14 unexplained reaffirmation on retained property. These two items represent expenses of over \$1,000 per month; funds which could be paid to unsecured creditors."). But see In re Rubio, 249 B.R. at 698 (citing In re Laman, 221 B.R. at 384 for the proposition that "substantial abuse exists where debtors 'have the ability to pay a significant dollar amount to the unsecured creditors, irrespective of percentage" and therefore declining to determine the amount of repayment or the percentage that unsecured creditors would receive in a hypothetical Chapter 13 case).

According to In re Laman, 221 B.R. at 384, the court should consider a debtor's ability to pay through a 3 year, as opposed to 5 year, plan (citing 11 U.S.C. § 1325(b)(1)(B)¹).

¹Section 1325(b)(1) provides:

If the trustee or the holder of an allowed unsecured claim objects to the confirmation of the plan, then the court may not approve the plan unless, as of the effective date of the plan-

Once courts consider the debtor's ability to fund a Chapter 13 plan, they look to the In re Krohn factors (lack of need or lack of honesty) and the In re Green factors (bad faith) outlined above in order to evaluate whether, under a totality of the circumstances, dismissal for substantial abuse is appropriate.

Ability to Repay Debts

Based on their average monthly income for the 18 months preceding the hearing, the Browns had a gross average monthly income of \$12,273, with an average net income of \$9,373. The Browns' original Schedule J, current expenditures of individual debtors, reported average monthly expenses of \$9,500. But that schedule included monthly contributions to a 401(k) retirement plan, repayment of a loan taken from the 401(k) plan, and private school tuition. The Browns concede that the schedule did not fairly reflect their actual necessary expenses for maintenance and support. At the hearing, the Browns tendered and filed a revised schedule J reflecting monthly expenses of \$7,568.25.

Accepting the revised expenses, and using the average monthly income for the prior 18 months, the Browns have a

(B) the plan provides that all of the debtor's projected disposable income to be received in the three-year period beginning on the date that the first payment is due under the plan will be applied to make payments under the plan.

11 U.S.C. § 1325(b)(1) (emphasis added).

disposable income of \$1,820. They have scheduled unsecured debt of \$153,902. To obtain a discharge under Chapter 13, they would have to commit their disposable income to a plan for 36 months. 11 U.S.C. §1325(b)(1). Based on their monthly budget and the testimony, it appears that the Browns are current on their secured debt. Their disposable income over 36 months would yield \$64,980. Deducting 10% for the cost of administration of a Chapter 13 case and \$1,750 for attorneys fees, the disposable income available for unsecured creditors would be approximately \$56,730. That would produce a plan dividend to unsecured creditors of approximately 36-37%. That ability to pay to their unsecured creditors from future earnings weighs for a dismissal.

William Brown testified, however, that although the debtors have enjoyed substantial past earnings, his future earnings appear more problematic. In fact, he testified that he is currently on a production probation because of inconsistent sales. He also testified that he does not receive regular monthly income. Rather, as a salesman, his monthly earnings fluctuate. He receives a considerable amount of his income from commissions paid following sales, which do not necessarily occur on a regular basis. Brown also testified that the commissions tend to be greater in the first half of the calendar year, meaning that the court should not merely multiply the first half-year's earnings by two.

The court can only use the historical recent past to project earnings for the substantial abuse test. The court can only base an ability to pay on likely income, which is reflected by the immediately preceding months. Brown has not suffered a recent illness nor a recent loss of employment. He has been continually employed. Chapter 13 requires disposable income to be devoted to a plan for 36 months. But the Chapter 13 process contemplates that the disposable income may vary from time to time during those 36 months. Chapter 13 allows a court to modify a plan, on application by the debtor, to reflect that fluctuation, should it occur. 11 U.S.C. §1329(a).

In addition, at a Chapter 13 plan confirmation hearing, the court may consider evidence that a debtor's income fluctuates monthly. The court may enter an order confirming a Chapter 13 plan that authorizes relatively low monthly plan payments with annual or semi-annual large or balloon payments to capture the timing of commission payments.

But even if Brown's concern about his future income proves correct at some future time, the debtors could still make a payment to their unsecured creditors at present. Apparently, Kathy Brown does not work outside the home. But the court received no testimony that she was not able to perform household and home maintenance work. Brown testified that he must employ lawn and garden maintenance workers. Kathy Brown could perform

that work, which would produce \$10,260 for a Chapter 13 plan, even if their income decreased. The court must accept several of their expenses, such as a remarkable average monthly electricity and gas bill of \$550, and the court need not review every line item of their revised budget, but even at a lower income, the debtors may be able to maintain a modified Chapter 13 plan.

If during the 36 months they cannot maintain a plan, even as modified, the court could then consider a motion to convert back to Chapter 7. By confirming a plan and making plan payments, the Browns would have fulfilled the expectation that they make payments on their consumer debt as long as their disposable income permitted payments.

Other factors

The Browns filed their bankruptcy petition on January 10, 2001. In August 2000, they drew \$10,000 cash from credit cards but made no substantive repayment. They used that cash advance to pay their mortgage and electricity bill. Then, in October 2000, the debtors spent six days in Florida.

On the eve of the filing of their bankruptcy petition, William Brown charged a \$1,700 clock to one of his credit cards. He bought the clock on impulse as a gift for Kathy Brown. He concedes that he could not make that card payment and did not otherwise have the cash to pay for the clock.

The Browns failed to schedule 16 credit cards. William Brown testified that he used those cards for his work, such as for the purchase of gasoline, and kept the card payments current. But the Browns did not give those creditors an opportunity to participate in their bankruptcy case, by providing them notice of the case. By "current," several cards had been paid in full monthly, but others carried a balance, even if monthly payments had been made. The credit card companies should have been scheduled and provided notice of the case.

While incurring substantial credit card debt, the Browns originally filed a budget that would make a monthly payment of \$720 to their 401(k) plan to repay a note. The Browns had, in effect, used their credit cards to support their lifestyle and to repay their own retirement plan debt. Indeed, when they filed their petition, they continued to make their 401(k) plan payment and paid private school tuition for their children, while not paying their creditors.

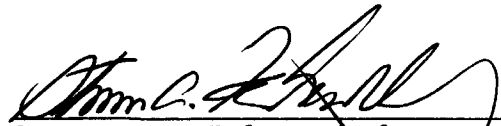
These factors coupled with an ability pay under a Chapter 13 plan leads the court to conclude that the United States Trustee has established the "substantial abuse" of §707(b). Accordingly, the case will be dismissed unless the debtors file a notice converting the case to a case under Chapter 13 of the Bankruptcy Code within ten days following the entry of this memorandum opinion and order.

Order

Based on the foregoing,

IT IS ORDERED that the motion of the United States Trustee to dismiss this case under 11 U.S.C. §707(b) is **GRANTED** and the case shall be dismissed unless the debtors file a notice to convert the case to a case under Chapter 13 of the Bankruptcy Code within business 10 days following the entry of this order.

Signed this 18th day of July, 2001.



Steven A. Felsenthal
United States Bankruptcy Judge