UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
DURHAM DIVISION

IN RE:	)	
	)	
Frank W. Hallstrom and	)	Case No. 02-80013C-7D
Jane L. Hallstrom,	)	
	)	
Debtors.	)	
	)	

MEMORANDUM OPINION

This case came before the court on May 23, 2002, for hearing upon a motion to dismiss pursuant to § 707(b) of the Bankruptcy Code that was filed by the Bankruptcy Administrator. Cheryl Y. Capron appeared on behalf of the Debtors and Robyn C. Whitman appeared on behalf of the Bankruptcy Administrator. Having considered the evidence offered by the parties and the arguments of counsel, the court hereby makes findings of fact and conclusions of law in accordance with Rules 7052 and 9014 of the Federal Rules of Bankruptcy Procedure, as follows:

FACTS

The Debtors were married in 1970. After some 13 years of marriage, the male Debtor enrolled in law school in 1983. At that time, the Debtors had four children. The male Debtor graduated from law school in 1986 and thereafter was employed as a judicial law clerk for three years. The male Debtor began practicing law in 1989 as an associate with a small personal injury firm. In 1997, the male Debtor switched law firms and began work with the law firm by whom he currently is employed. His current practice consists

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almost entirely of handling personal injury claims and suits on behalf of plaintiffs.

The female Debtor also is a collage graduate and in recent years has worked outside the home, usually on a part-time basis. However, in 2000, the female Debtor was employed full-time at Midway Airlines as a reservations sales agent. The female Debtor also has worked as a substitute teacher and as an independent sales representative for Shaklee Products.

This case was filed on January 3, 2002. According to Debtors's Schedule I, the male Debtor had gross monthly income of $8,482.17 when this case was filed. The female Debtor's income was listed at $100.00 per month. Together, the Debtors listed net monthly income of $5,231.70 after deducting $2,556.50 for payroll taxes and social security, $243.97 for insurance and a 401(k) contribution of $450.00.

The Debtors scheduled monthly expenses of $5,250.26 in their Schedule J. The monthly expenses itemized in Schedule J include living expenses such as rent, food, etc., as well as a student loan payment of $223.85 per month, $611.00 per month for charitable contributions and $400.00 per month for "miscellaneous expense; savings to replace car."

The Debtors scheduled total indebtedness of $297,483.34. This debt includes a $230,804.00 mortgage on a residence located in Chapel Hill, North Carolina, where the Debtors resided until

approximately December of 2001, when they moved into an apartment located in Chapel Hill. The Debtors scheduled unsecured debt of $66,679.34, consisting almost entirely of credit card debt except for a $13,053.54 student loan indebtedness.

The assets listed by the Debtors in their schedules include the residence in Chapel Hill. Although the residence was surrendered to the mortgage holder in December of 2001, the Debtors were unsure as to whether the mortgage holder had yet foreclosed on the property and have not been contacted by mortgage holder regarding any further claim. The personal property listed by the Debtors was valued at a total of $20,845.00 in Debtors' Schedule B. The scheduled personal property consists primarily of household goods and furnishings, clothing and personal effects, four older model automobiles and the male Debtor's $7,214.00 401(k) fund. In their exemptions the Debtors claimed as exempt property all of the property in which there was any equity, including the male Debtor's 401(k) fund.

The Bankruptcy Administrator's motion to dismiss was filed on April 2, 2002. In the motion, the Bankruptcy Administrator asserts that under the totality of the circumstances of this case, granting the Debtors a Chapter 7 discharge would be a substantial abuse of the provisions of Chapter 7 and prays that this case be dismissed pursuant to § 707(b) of the Bankruptcy Code.

DISCUSSION

A. Applicable Law

Under § 707(b) the court "may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds the granting of relief would be a substantial abuse of the provisions of this chapter." This provision represents an attempt to strike a balance between allowing debtors a fresh start and stemming abuse of consumer credit by providing the bankruptcy court with a means of dealing equitably with the situation in which a debtor seeks to take unfair advantage of his or her creditors through the use of Chapter 7. See In re Green, 934 F.2d 568, 570 (4th Cir. 1991). Section 707(b) should be applied in a manner in which a truly needy debtor is allowed a fresh start, while denying a head start to the abusers. See In re Rodriquez, 228 B.R. 601, 603 (Bankr. W.D. Va. 1999).

There are two requirements in order for § 707(b) to be applicable: the debts in the case must be primarily consumer debts and it must be shown that granting the debtor a Chapter 7 discharge would involve a "substantial abuse" of the provisions of Chapter 7. In the present case, it is undisputed that the debts are primarily consumer debts.[1] Hence, the only issue for determination is

[1]Under § 101(8) of the Bankruptcy Code a consumer debt is a "debt incurred by an individual primarily for a personal, family, or household purpose." A debt "not incurred with a profit motive or in connection with a business transaction" is considered consumer debt for purposes of § 707(b). See In re Kestell, 99 F.3d

whether granting the Debtors a Chapter 7 discharge would involve a substantial abuse of the provisions of Chapter 7.

There is no statutory definition of "substantial abuse" to aid in this determination. Various tests or rules have been developed by the courts. However, the applicable rule in the Fourth Circuit is the one adopted in In re Green, 934 F.2d 568 (4th Cir. 1991). In Green the court declined to adopt a per se rule under which a debtor's ability to pay his or her debts, standing alone, justifies a § 707(b) dismissal. Instead, while specifically recognizing that the debtor's ability to pay is the primary factor to be considered, the court ruled that "the substantial abuse determination must be made on a case-by-case basis, in light of the totality of the circumstances." Id. at 573. The court then provided five examples of circumstances or factors to be considered in addition to ability to pay: (1) whether the bankruptcy petition was filed because of sudden illness, calamity, disability or unemployment; (2) whether the debtor incurred consumer credit in excess of his or her ability to pay; (3) whether the debtor's family budget is excessive or unreasonable; (4) whether the schedules and statement of financial affairs reasonably and accurately reflect the debtor's true financial condition; and (5) whether the petition was filed in good faith. See id. Having considered these factors and the other attendant circumstances in this case, and having given effect to

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146, 149 (4th Cir. 1996).

the presumption in favor of granting Chapter 7 relief that Congress built into § 707(b), the court has concluded that the granting of a Chapter 7 discharge in this case would constitute a substantial abuse of the provisions of Chapter 7.

B. Application of Law

The evidence did not establish any sudden illness, disability or calamity that was a cause of Debtors' bankruptcy filing. Rather, it appears that the indebtedness that prompted the Debtors to file this case accumulated over a period of time as the Debtors continued to spend more than they were earning. The evidence did indicate that substantial medical expenses were incurred when one of Debtors' children required surgery to correct a birth defect. However, this occurred some ten years before this case was filed and the evidence did not show that this medical procedure was the cause of this bankruptcy case being filed.

The evidence established that the Debtors have incurred consumer debt beyond their ability to pay. When this case was filed the Debtors had unsecured credit card indebtedness of some $54,000.00 involving seven different credit card accounts. The Debtors had additional unsecured debt of $13,053.54, apparently representing student loan indebtedness dating back to 1986 when the male Debtor graduated from law school. Debtors admitted that when this case was filed they could not service this debt and pay the living expenses for their family. In fact, according to the male

Debtor, they were falling further behind because the interest and service charges on their debt was greater than the amount that the Debtors were able to pay to the various credit card companies. It is not clear from the evidence exactly why the Debtors had the debt load that existed when they filed this case. It did not appear from the evidence that the Debtors have lived lavishly or spent money excessively on expensive vacations or luxury items. And it is true that during the three or four years prior to the filing of this case, the Debtors had two children at home and one in college and undoubtedly had higher living expenses than those of a smaller family. However, during those years the male Debtor was a practicing attorney with a substantial income, which was supplemented by income generated by the female Debtor's employment. Moreover, the male Debtor testified that the children have always worked after school and helped out with their expenses. Most families with comparable or less income, even those the size of Debtors' family, are able to manage their financial affairs in a manner not resulting in excessive and unmanageable consumer debt, and there was no showing of any extraordinary circumstances which would account for the inability of the Debtors to do so.

Whether Debtors' proposed family budget is excessive or unreasonable requires an examination of Debtors' Schedule I and Schedule J, which set forth the income and expenses included in their budget. In evaluating whether a debtor's budget is excessive

in the context of a § 707(b) motion, the court is not bound by the amounts listed by the debtor. Instead, it is appropriate for the court to consider whether the expenses claimed by a debtor can be reduced significantly without depriving the debtor of adequate food, clothing, shelter and other necessities of life. See In re Engskow, 247 B.R. 314 (Bankr. M.D. Fla. 2000). Such an analysis in the present case reveals that a number of the expenses claimed by the Debtors are excessive and can be reduced without depriving the Debtors of a reasonable and comfortable standard of living.

The Debtors have included in their budget a telephone expense of $245.00 per month. The court finds that such telephone expense is excessive and should be reduced by $100.00. The court further finds that the Debtors' food expense of $700.00 per month is excessive and likewise should be reduced by $100.00, considering that the Debtors will have only one child at home beginning in approximately August or September of 2002 and there will be only three people in the household. Another excessive item is the $275.00 which the Debtors included in their budget for "pet, gifts, haircuts, newspapers, school expenses", which will be reduced by $100.00 as well. The Debtors have included in their budget $400.00 per month for "miscellaneous expense; savings to replace car." Such an expense is not reasonably necessary for the maintenance or support of the Debtors and is not properly included in Schedule J. See In re Tindall, 184 B.R. 842 (Bankr. M.D. Fla. 1994); In re

Vesnesky, 115 B.R. 843 (Bankr. W.D. Pa. 1990). The current expenditures claimed by the Debtors also include the sum of $223.85 for payment of one or more educational loans. Although nondischargeable, an educational loan is an unsecured debt that stands on the same footing as any other unsecured debt in the context of a § 707(b) analysis of a debtor's budget. Accordingly, in evaluating Debtors' budget and their ability to pay in this case, the $223.85 per month will be treated as being available for use in repaying Debtors' unsecured debt. Finally, the Debtors have included in their budget $611.00 per month for charitable contributions. According to Debtors' evidence, this charitable contribution is made to their church. Section 707(b) provides that the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions to a qualified religious or charitable entity in deciding whether a case should be dismissed. However, this does not mean that the court must accept the amount of charitable contribution that a debtor lists in Schedule J where the evidence does not reflect that the debtor, in fact, has given or is giving the listed amount to charity. See In re Smihula, 234 B.R. 240 (Bankr. D.R.I. 1999). The evidence in the present case reflects that the amount of the charitable contribution listed in Schedule J is significantly greater than the amount which the Debtors have contributed to all charities in the years preceding the filing of this case. For example, according to

the Debtors' income tax returns, in the year 2000, the Debtors' total gifts to charity were $5,100.00 or $425.00 per month, while in the year 2001, Debtors' total gifts to charity were $5,309.00 or $443.00 per month. Thus, even assuming that the only charity to which the Debtors contributed was their church, the Debtors gave an average of $434.00 per month to the church rather than the $611.00 per month listed in Schedule J. Based upon the totality of the evidence, the court finds that the monthly charitable contributions of the Debtors do not exceed $450.00 and that the $611.00 figure listed in Schedule J therefore should be reduced by $161.00. To the extent of foregoing amounts, the court concludes that the Debtors' budget as set forth in Schedule J is excessive and unreasonable. The total of these adjustments is $1,084.85, which reduces the Debtors' monthly expenses from the $5,250.26 listed in Schedule J to $4,165.41.

Making an analysis of a debtor's ability to pay under § 707(b), of course, involves examining the debtor's future income and future expenses. See In re Green, 934 F.2d at 572 (exploring "the relation of the debtor's future income to his future necessary expenses" is part of § 707(b) analysis); In re Krohn, 886 F.2d 123, 126 (6th Cir. 1989); Waites v. Bailey, 110 B.R. 211, 214-15 (E.D. Va. 1990). This is particularly true where, as in the present case, a debtor has stable income.

Generally, the ability to pay is measured by assessing how

much disposable income a debtor would be able to pay his or her creditors under a three to five year Chapter 13 plan. See In re DeRosear, 265 B.R. 196, 204 (Bankr. S.D. Iowa 2001). The debtor's disposable income is determined in accordance with the definition contained in § 1325(b)(2) of the Bankruptcy Code using income and expense figures that are reasonable and accurate. See id. Many courts base the ability to pay determination upon the percentage of unsecured debt that could be repaid by the debtor in a Chapter 13 case. The percentages regarded as reflecting an ability to pay have varied from case to case. See In re Norris, 225 B.R. 329, 332 (Bankr. E.D. Va. 1998). However, "the essential inquiry remains whether the debtor's ability to repay creditors with future income is sufficient to make the Chapter 7 liquidating bankruptcy a substantial abuse." In re DeRosear, 265 B.R. at 204.

In the present case, the male Debtor's income in the past has been relatively stable and can be utilized to arrive at a reasonably reliable projection of his future income. The male Debtor moved to his present employer in 1997 and after his first year with the new firm, his income has increased each year. Such increase is reflected in the record of income (DX-1A), which shows income of $65,371.00 in 1998, $70,260.00 in 1999 and $77,222.00 in 2000, and Debtors' statement of financial affairs which shows income of $101,792.18 in 2001. The male Debtor's 2002 income is reflected in the pay stub that was offered into evidence by the

Bankruptcy Administrator as Exhibit 3. This exhibit reflects that for the first four months of the year the male Debtor has received gross income of $29,446.12, or an average of $7,361.53 of gross income per month. Debtor's net income through April of 2002 is $18,195.22. However, the male Debtor's pay stub reflects that he is making monthly contributions to his 401(k) fund which, as of the end of April, have totaled $1,766.78. Such contributions are not reasonably necessary for the support and maintenance of a debtor or dependents of a debtor and in the context of a § 707(b) determination should be treated as disposable, available income for purposes of evaluating whether the debtor has the ability to repay his creditors. See In re Taylor, 212 F.3d 395 (8th Cir. 2000); In re Anes, 195 F.3d 177 (3d Cir. 1999); In re Heffernan, 242 B.R. 812 (Bankr. D. Conn. 1999); In re Johnson, 241 B.R. 394 (Bankr. E.D. Tex. 1999). This means that the male Debtor's disposable income through April of 2002 for purposes of the § 707(b) motion is $19,962.00 or an average of $4,990.50 per month. Based upon the foregoing income picture, the court concludes that it is reasonable to utilize a net income figure of at least $4,990.50 for the male Debtor in analyzing the ability of the Debtors to repay their creditors.

According to the Debtors' statement of financial affairs, the female Debtor had income of $10,288.00 during 2001, the year immediately preceding the filing of this case. During 2000 the

female Debtor had income of at least $12,860.00 and at least $5,572.00 during 1999 (DX-1A). There was no evidence of any change in the female Debtor's ability to earn, such as illness or inability to find work. Yet, Debtor's Schedule I listed the female Debtor's income at only $100.00 per month. It is not appropriate for debtors to terminate or reduce earnings in an effort to facilitate a Chapter 7 filing or to head off or undermine a dismissal pursuant to § 707(b). If such conduct occurs, the court may and should look to the debtor's prior earnings picture in evaluating their ability to pay. See In re Blum, 255 B.R. 9, 15 (Bankr. S.D. Ohio 2000); In re Dubberke, 119 B.R. 677, 679-80 (Bankr. S.D. Iowa 1990); In re Helmick, 117 B.R. 187, 190 (Bankr. W.D. Pa. 1990). In the present case, the female Debtor is an able-bodied adult with a college education who has a consistent record of earnings. There was no showing by the evidence that such earnings cannot or will not continue in the future. Under the circumstances of this case, it is appropriate to project future gross income of at least $700.00 per month and net monthly income of at least $500.00 from the female Debtor in analyzing the ability of the Debtors to repay their creditors.

The foregoing adjustments yield net monthly income of $5,490.50 and monthly expenses of $4,165.41, leaving $1,325.09 per month available for distribution under a Chapter 13 plan. Thus, if the Debtors were in a Chapter 13 case and submitted only a 36 month

plan, a total of $47,703.24 would become available for distribution under a Chapter 13 plan. There are no taxes or other priority debts in this case. The unsecured debt listed in Schedule F is $66,679.34. Even after taking into account the trustee's fees and costs related to a Chapter 13 case, it appears that the Debtors could pay their unsecured creditors a dividend in excess of 60%. According to the evidence, it is unlikely that any type of deficiency claim would be filed in a Chapter 13 case by the mortgage holder to whom the Debtors surrendered their former residence. However, even if such a claim were filed, based upon the value of the property and the amount of the debt, it appears that the claim would not exceed $30,000.00. Even with such an increase in the unsecured debt, the Debtors still could pay a dividend in excess of 40%. This constitutes an ability to pay that, under the totality of the circumstances of this case, is sufficient to render this case substantially abusive for purposes of § 707(b). The court reaches this conclusion without attributing any bad faith on the part of the Debtors in filing this case and after concluding that the evidence of substantial abuse was sufficient to rebut the presumption in favor of granting relief under Chapter 7.

CONCLUSION

Having considered the totality of the circumstances presented by this case, the court concludes that the granting of Chapter 7

relief in this case would be a substantial abuse of the provisions of Chapter 7 and that this case, therefore, should be dismissed under § 707(b) of the Bankruptcy Code.

This 2nd day of August, 2002.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
DURHAM DIVISION

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	)	
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Jane L. Hallstrom,	)	
	)	
Debtors.	)	
	)	

ORDER

For the reasons stated in the memorandum opinion filed contemporaneously with this order, this case is hereby dismissed pursuant to § 707(b) of the Bankruptcy Code.

This 2nd day of August, 2002.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge

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