UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION

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| IN RE: | ) | |
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| John H. Schmonsees, Jr., | ) | Case No. 01-10844C-7G |
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| Debtor. | ) | |
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ORDER

This case came before the court on August 21, 2001, for a hearing on whether this case should be dismissed pursuant to § 707 (b) of the Bankruptcy Code. The Debtor appeared at the hearing with his attorney, Timothy L. Hanson. Also appearing at the hearing was Robin R. Palenske, appearing on behalf of the Bankruptcy Administrator. Having considered the testimony of the Debtor and the other matters of record, the court has concluded that this case should be dismissed pursuant to § 707(b) of the Bankruptcy Code based upon the following findings of fact and legal conclusions.

FACTS

This voluntary Chapter 7 case was filed by the Debtor on March 30, 2001. The Debtor's wife did not join in the filing. The Debtor is employed by the United States Department of Commerce and is a part-time professor. The Debtor's non-filing spouse is a former school teacher who currently is employed by VF Corporation. Both spouses have been employed throughout the 1990's and have had total income of $90,000.00 or more since 1995 or 1996. During 1999 the Debtor and his wife had total income of $92,038.41, consisting of $65,280.75 earned by the Debtor and $26,757.66 earned by his wife. During 2000 the Debtor and his wife had total income of $94,335.42, consisting of $65,779.12 earned by the Debtor and $28,576.30 earned by his wife. When this Chapter 7 case was filed on March 29, 2001, the Debtor and his wife were employed as they were in 1999 and 2000 and were earning essentially the same income as was earned in 1999 and 2000.

The schedules filed by the Debtor reflect secured indebtedness of $186,568.56 consisting of two mortgages on a residence valued at $295,000.00 which is owned by the Debtor and his wife as tenants by the entirety. In his Schedule F the Debtor listed unsecured indebtedness totaling $133,910.00 that includes $13,450.00 of indebtedness owed jointly by the Debtor and his wife. The Debtor also listed student loan indebtedness of $13,510.00.

The personal property listed by the Debtor includes his wearing apparel ($150.00), jewelry ($100.00), Government Thrift Savings Account ($35,730.00), 1992 Lincoln automobile ($2,000.00) and his interest in jointly-owned household furnishings and miscellaneous items.

In his claim for property exemptions the Debtor claimed all of his personal property and his interest in the jointly-owned residence as exempt property. The Debtor thus sought to retain all of his property, including an automobile, the $35,730.00 in his 401(k)/thrift savings account and equity of $135,000.00 in his residence, without paying one cent to his creditors.

On May 23, 2001, the Chapter 7 Trustee in this case objected to the Debtor's claim for property exemptions on the grounds that the residence owned by the Debtor and his wife was subject to the joint debts of the Debtor and his wife and therefore could be administered in this case in order to pay the joint creditors. This objection was resolved when, according to the Trustee's withdrawal of her objection, the Debtor "paid the debts owed to joint creditors with exempt assets."

On June 22, 2001, the court entered an order directing that a hearing be held in this case for a determination as to whether this case should be dismissed pursuant to § 707(b) of the Bankruptcy Code on the grounds that the granting of relief in this case would be a substantial abuse of the provisions of Chapter 7 of the Bankruptcy Code, and authorizing the Bankruptcy Administrator to appear at the hearing.[1] The hearing pursuant to this order was held on August 21, 2001. The evidence consisted of the Debtor's testimony and the schedules and other matters of record in this case.

LEGAL CONCLUSIONS AND DISCUSSION

Under § 707(b), the court "may dismiss a case filed by an individual debtor under this chapter whose debts are primarily

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[1]The court, "on its own motion", may raise the issue of dismissal based upon substantial abuse under § 707(b). See In re Kelly, 841 F.2d 908 (9th Cir. 1988).

consumer debts if it finds that 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. 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. In re Rodriguez, 228 B.R. 601, 603 (Bankr. W.D. Va. 1999).

The first requirement in order for § 707(b) to be applicable is that the debts of the debtor be primarily consumer debts. 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). In re Kestell, 99 F.3d 146, 149 (4th Cir. 1996). In the present case, the debts consist of two mortgages related to the purchase of Debtor's residence and credit card and other unsecured personal, family or household indebtedness that was not incurred for a profit motive or in connection with a business transaction. Debtor's debts therefore are primarily, if not entirely, consumer debts incurred by an individual, thus satisfying the first requirement under § 707(b).

The remaining issue is whether granting the Debtor in this case a Chapter 7 discharge pursuant to § 727 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 for determining "substantial abuse" have been developed by the courts. However, the rule applicable in this case is the one adopted in this Circuit 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 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 the circumstances or factors to be considered: (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 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 true financial condition; and (5) whether the petition was filed in good faith. Id. In making this evaluation, the court must accept and give effect to the presumption in favor of granting Chapter 7 relief that Congress included in § 707(b). Id.

In the present case the petition was not filed because of sudden illness, calamity, disability, unemployment or other event that reduced the income of the Debtor and his wife or increased their expenses to a significant degree. While the Debtor's wife gave up her teaching job in 1999, and was out of work for some period of time until she found other employment, the record reflects that her change of employment did not result in a significant loss of income. The Debtor received an increase in his pay and the net result was that the Debtor and his wife had essentially the same family income during 1999 and 2000 as they had during the previous two or three years. The Debtor testified that he and his wife had no greater medical expenses than average and that there was no calamity or other untoward event that forced them into bankruptcy. Hence, the first of the Green factors weighs against the Debtor.

The second factor mentioned in Green likewise weighs against the Debtor because it was quite clear from the evidence that the Debtor incurred consumer debt in excess of his ability to pay. A significant factor in evaluating whether Debtor incurred consumer debt beyond his ability to pay is the decision made by the Debtor several years earlier to purchase an expensive home which locked the Debtor into an unreasonably high housing expense. According to the Debtor, two mortgages were required in order for him to acquire the home, with the result that he became obligated for two mortgage payments which now total $2,450.00 per month. Notwithstanding this very high continuing monthly obligation, the Debtor proceeded to incur credit card and other unsecured indebtedness that totaled $133,910.00 by the time this case was filed. This indebtedness included debts of $72,950.00 and $17,175.00 that were owed to a bank on loans that were obtained by the Debtor in 1999 and credit card indebtedness of some $30,000.00 when this case was filed in March of 2001. Given the very substantial housing expense previously assumed by the Debtor, the Debtor effectively placed himself in a position in which he incurred more consumer indebtedness than he was able to pay. As described by the Debtor he found himself in a position in which he "had to borrow from Peter to pay Paul", which would seem to be an apt description of one having incurred more consumer debt than he could pay.

Whether Debtor's proposed family budget is excessive or unreasonable is closely related to whether the Debtor has the ability to repay, and requires consideration of Debtor's Schedule I and Schedule J which set forth the income and expenses included in Debtor's budget. According to the Debtor these schedules set forth the income and expenses for both him and his wife. In Schedule I the Debtor purportedly set forth his current income and that of his wife. Debtor shows $5,605.00 as his gross monthly income.

This figure includes only his income at the Department of Commerce and includes nothing for part-time teaching. Debtor has taught part-time at Elon College for several years and there is some likelihood that he will continue to have this opportunity to earn additional income. Nevertheless, in reviewing Debtor's budget and making the analysis of Debtor's ability to pay, the court has not assumed any income for Debtor other than his income from the Department of Commerce. Debtor's Schedule I also reflects $2,870.00 as his wife's current gross income and $2,185.00 as her net monthly income. Because no breakdown or itemization of the wife's deductions is included in Schedule I, the nature and amounts of the deductions are unclear. In any event, the total net monthly income shown on Schedule I for the Debtor and his wife is $5,400.00.

Debtor lists his net income from the Department of Commerce at $3,215.00 per month. However, in reaching that figure, the Debtor has deducted from his gross pay $280.00 per month for his voluntary 401(k) contribution and $450.00 per month for payment on a loan he obtained from his 401(k) account. These payments are in addition to the 7% which is deducted each month from Debtor's salary at the Department of Commerce for his federal retirement plan. Given Debtor's poor financial condition and the fact that, in effect, he is paying these 401(k) amounts to himself at the expense of his creditors, these payments are found to be unreasonable and excessive for an individual seeking Chapter 7 relief. In the context of a § 707(b) determination, such payments must 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). Accordingly, for purposes of the § 707(b) analysis of Debtor's ability to repay his creditors, the net income figure of $5,400.00 shown on Schedule I should be increased by at least $730.00 in order to properly account for the amounts allocated to his 401(k) account by the Debtor.

Debtor's Schedule J sets forth the current expenses for the Debtor and his wife and likewise contains excessive and unreasonable items. In determining whether a Chapter 7 case should be dismissed as a substantial abuse of Chapter 7, 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). The expenses that may be reviewed in making such an analysis include the mortgage payments or rent paid by the debtor for housing. See Id. at 317 (budget was "extravagant and unreasonable" based upon the amount included for mortgage payments and utilities); In re Smith, 229 B.R. 895, 899 (Bankr. S.D. Ga. 1997)(mortgage payment of $1,695.00 was not reasonable); In re Carlton, 211 B.R. 468, 473

(Bankr. W.D.N.Y. 1997)(residence rental of $3,000.00 per month for a family of four was unreasonable and excessive).

In Schedule J, the Debtor has itemized monthly living expenses that total $5,335.00, which is $65.00 less than the net income listed by Debtor on Schedule I. One of the expenses listed by the Debtor is a monthly housing cost of $2,450.00 per month. This $2,450.00 monthly payment enables the Debtor to live in a $290,000.00, four bedroom home in an upscale neighborhood and to steadily increase his already substantial equity in the home. Given that Debtor's family consists of only himself and his wife, the court concludes that such a large monthly housing expense is excessive and unreasonable for an individual seeking a Chapter 7 discharge. See In re DeRosear, 265 B.R. 196, 218 (Bankr. S.D.Iowa 2001)("While the sentimental reason underlying the Debtors' desire to continue living in their current homestead may be understandable, it does not justify permitting them to erase an otherwise manageable debt load via a Chapter 7 proceeding."). As a result, in deciding whether the Debtor has the ability to repay, this excessive monthly expense should be reduced significantly and such reduction treated as being available for payment to creditors.

A second item included in Schedule J that is excessive and unreasonable is the sum of $1,245.00 per month which the Debtor included for payments on "[s]pouse's signature loans, overdrafts, and minimum credit card payments". During his testimony, the

Debtor admitted that the amount actually required for such payments was only $900.00. This means that Debtor's actual current expenditures are an additional $345.00 less than the $5,335.00 claimed in Schedule J and that Debtor's ability to repay creditors is increased by an additional $345.00 per month.

The current expenditures claimed by the Debtor in Schedule J also include the sum of $200.00 per month for payment on Debtor's educational loan. Although nondischargeable, the 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 debtor's ability to pay. Accordingly, in evaluating Debtor's ability to repay, the educational loan will be included as an unsecured debt along with Debtor's credit card debt, and the $200.00 will be treated as being available for use in repaying such debt.

In summary, the court finds that the Debtor's family budget is excessive and unreasonable to the extent of the foregoing items, i.e., the excessive contributions to Debtor's 401(k) plan, the excessive mortgage payments, the excessive amount claimed for payment on his wife's debts and the allocation of a separate amount solely for payment on his educational loans. Hence, this factor, too, weighs against the Debtor.

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. <u>See</u> <u>In re Green</u>, 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, the debtor has stable income. It also is appropriate to consider the future income of a non-filing spouse with stable income. See In re Engskow, 247 B.R. at 316; In re Wilkinson, 168 B.R. 626, 628-29 (Bankr. N.D. Ohio 1994).

As a general rule, the ability to pay is measured by assessing how much disposable income a debtor would be able to pay his or her unsecured creditors under a three to five year Chapter 13 plan. In re DeRosear, 265 B.R. at 204. 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. 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 net income listed by the Debtor for himself and his wife is $5,400.00. For the reasons previously stated, for purposes of the § 707(b) ability to pay analysis, this figure should be increased by the sum of $730.00 based upon Debtor's unreasonable deductions for 401(k) payments. At the same time, for the reasons previously discussed, the $5,335.00 in current expenditures claimed by the Debtor in Schedule J should be reduced by $550.00 based upon the unreasonableness of Debtor's housing expense, the sum of $345.00 based upon the reduction in the amount needed for the wife's debts and the sum of $200.00 in order to deal properly with the educational loan. These adjustments yield net monthly income of $6,130.00 and net monthly expenses of $4,240.00, leaving $1,890.00 per month for payments to creditors. Thus, if the Debtor were in a Chapter 13 case and submitted only a 36 month plan, a total of $68,040.00 would become available for distribution under a Chapter 13 plan. There are no taxes or other priority debt in this case and the unsecured debt is $133,970.00, consisting of the $13,510.00 student loan and the unsecured consumer debt remaining after Debtor's post-petition payment of the joint debt. After taking into account the trustee fees and costs related to a Chapter 13, it appears that the Debtor could pay a dividend of 35% to 45% to his unsecured creditors if he were willing to proceed under Chapter 13 with a three-year plan, rather than seeking a Chapter 7 discharge. With a longer plan, the Debtor, of course, could pay a substantially higher dividend to his creditors. This constitutes an ability to pay that, under the totality of the circumstances of this case, is sufficient to render this case abusive for purposes of § 707(b).

A further factor to be considered is whether the Debtor's schedules and statement of financial affairs reasonably and accurately reflect Debtor's true financial condition. As noted earlier, Debtor's schedules include some unreasonable items involving Debtor's income and expenses. Otherwise, there was no showing that the schedules do not accurately reflect Debtor's true financial condition. Hence, this factor carried little weight in the court's conclusion that this case should be dismissed pursuant to § 707(b).

The last factor that will be discussed is whether this case was filed in good faith. In Green the court concluded that § 707(b) was intended to provide a tool for dismissing a Chapter 7 case "when 'the total picture is abusive.'" In re Green, 934 F.2d at 572. However, neither bad faith nor fraud is an element required for a finding of substantial abuse. Id. The court does not believe that the total picture in the present case is abusive and hence does not find that this case was filed in bad faith. There are, however, some aspects of this case that appear inconsistent with a good faith Chapter 7 filing. In July of 1999, when the Debtor obtained an unsecured loan of $77,000.00 from the bank, the Debtor used $20,000.00 of the loan proceeds to pay down the second mortgage on his home. In this Chapter 7 case the Debtor now seeks to exempt the $20,000.00 of equity purchased with the loan proceeds without paying anything to the bank, which was still owed $73,000.00 when this case was filed. Arguably, this represents an effort to take unfair advantage through the use of Chapter 7, particularly in light of Debtor's ability to substantially repay his creditors if he were willing to do so. However, even assuming that this case was filed in good faith, the other circumstances of the case are such that the granting of Chapter 7 relief in this case would involve a substantial abuse of the provisions of 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.

IT IS SO ORDERED.

This 21st day of September, 2001.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge