UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION

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| IN RE: | ) | |
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| Randy A. Swink and | ) | Case No. 01-13109C-7G |
| Tracey Lynnette Swink, | ) | |
| | ) | |
| Debtors. | ) | |

ORDER

This case came before the court on April 30, 2002, for hearing upon a motion to dismiss this case pursuant to 707(b) of the Bankruptcy Code that was filed by the Bankruptcy Administrator. Jeffrey P. Farran 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 has concluded that the motion should be denied.

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 Rodriguez, 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, if not entirely, consumer debts.[1] Hence, the only issue for determination is 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

[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 146, 149 (4th Cir. 1996).

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 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 giving effect to 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 not constitute a substantial abuse of the provisions of Chapter 7.

The petition in this case was filed on December 3, 2001. Debtors' undisputed evidence was that unemployment and illness contributed heavily to the filing. The male Debtor was unemployed for nearly a year during the latter part of 1997 and extending through the first part of 1998, apparently as a result of a disagreement with his employer that ended his employment. The male Debtor found employment in the Spring of 1998 and was employed full time thereafter until November of 2000. At that point, the male Debtor became totally disabled as a result of severe depression and thereafter was out of work until late May or early June of 2001, a period of some six months. The male Debtor was under the care of a psychiatrist during this period and was treated for a condition that his doctor described as a "major depressive disorder which was totally incapacitating." According to the evidence, there was a substantial reduction in the family income in 1997 and 1998, when only the female Debtor was producing income. Although the male Debtor apparently continued to receive his base salary while on sick leave during portions of 2000 and 2001, this disability compensation did not include any bonus. Additionally, while the male Debtor was out of work, he was required to pay all of the expenses related to his company car, which ordinarily would have been paid by the employer. The result was an additional automobile expense of approximately $3,800.00 that had to be repaid to the employer, which added to the financial stress that the Debtors were experiencing as a result of the unemployment and illness of the male Debtor. The court concludes that this factor weighs in favor of the Debtors and against a dismissal under § 707(b).

The Debtors have incurred consumer debt in excess of their ability to pay. However, there was no evidence that such debt was incurred for luxury items, expensive vacations or high living. Instead, according to the evidence, a substantial portion of the Debtors' unsecured debt, consisting primarily of revolving credit card debt and two signature loans, was incurred in 1998 to pay living expenses while the male Debtor was out of work and, to a lesser extent, during 2001 while the male Debtor was out on disability. Given the circumstances under which the unsecured debt was incurred, the court concludes that this factor does not weigh heavily against the Debtors.

In evaluating whether the Debtors' family budget is excessive, consideration must be given to the size of their family, which consists of two adults and three children, whose ages were 7, 5 and 1 when this case was filed in December of 2001. According to the family budget set forth in Schedule J, Debtors' current expenses total $5,640.00. However, Debtors testified that three of the items included in Schedule J are too low. Debtors established that their child care expense actually is now $582.00 greater than shown on Schedule J and that their average monthly medical expenses have increased by $225.00, based upon new dental expense for one of the children and recurring current drug prescriptions for the Debtors. Debtors also offered evidence that the family food expense has increased by $219.00 per month. The two expense items challenged by the Bankruptcy Administrator were Debtors' food expense and their housing expense. The evidence established that Debtors' food expense is higher than average, but did not establish that it is unreasonable for a family of five, taking into account that both Debtors work and both must eat lunch away from home and also must pay for school lunches for the children. Likewise, the evidence did not establish that Debtors' housing expense is unreasonable.

The Debtors live in a three bedroom home located in Summerfield, North Carolina, which they purchased in 1999. The house and lot have a value of $268,000.00 and are subject to mortgage indebtedness of $261,211.00. The monthly payment on this indebtedness is $2,392.00, which apparently includes taxes and insurance on the property. After an appropriate adjustment[2] to the monthly income listed by the Debtors in Schedule I is made, the Debtors' joint gross monthly income is $8,663.33, which means that their housing expense, including taxes and insurance, is 27.6% of their gross income. While the payment is sizeable and perhaps on the high side, the three bedroom residence which is provided through the $2,392.00 monthly payment, is no larger than is needed for Debtors' family of five. Although it appears that Debtors could rent a place to live for less, it also appears that they probably would not be able to sell their home for enough to pay off the mortgages. The size of the house payment undoubtedly makes it difficult for the Debtors to balance their budget and their decision to remain in the house certainly can be questioned. However, under all of the circumstances of this case, their decision to do so is not a sufficient ground for concluding that this is an abusive filing under § 707(b).

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[2]The adjustment consists of adding $317.33 to the joint gross income of $8,346.00 listed in Schedule I in order to account for a $317.33 increase in the female Debtor's income since Schedule I was filed.

There is no indication in the present case that the schedules and statement of financial affairs are inaccurate or misleading. The only items that were shown to be any different were the medical, food and child care expenses which were shown to be somewhat higher than shown in Schedule J. It thus appears that the schedules and statement of financial affairs do accurately reflect the true financial condition of the Debtors, which weighs in favor of the Debtors.

The ability of debtors to repay their creditors generally 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. See In re DeRosear, 265 B.R. 196 (Bankr. S.D. Iowa 2001). A 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. In deciding what incomes figures to use, it is appropriate for the court to consider whether the expenses claimed by the 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). 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, and 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.

Debtors' Schedule I lists net income of $2,980.00 for the male Debtor and $2,624.00 for the female Debtor. However, several upward adjustments to these figures must be made in arriving at Debtors' actual net income for purposes of the § 707(b) analysis. The $96.00 deduction for the male Debtor's 401(k) plan listed in Schedule I must be added back into net income.[3] The $632.00 deduction for "repay to employer" also must be added back because the employer obligation has been paid. Finally, the net amount of the female Debtor's raise ($221.00) must be added to the net monthly income shown in Schedule I. The result is that Debtors have net income of $6,553.00 for purposes of the § 707(b) analysis.

Debtors' Schedule J, as amended, lists expenses of $6,666.00. However, two adjustments to this figure are required. Debtors' telephone expense must be reduced by $49.00 to reflect a reimbursement that is made by the male Debtor's employer. Also, Debtors have included in their list of expenses a $104.00 per month payment on student loan indebtedness which must be eliminated as an

[3]Payments such as 401(k) contributions should be treated as disposable, available income for purposes of evaluating the ability of the debtor to repay creditors. See In re Taylor, 212 F.3d 395 (8th Cir. 2000).

expense. Although nondischargeable, the student loan indebtedness 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 ability to pay. Accordingly, in evaluating Debtors' ability to pay, the student loan indebtedness will be included as an unsecured debt and the Debtors' monthly expenses will be reduced by $104.00. Thus, the expense figure to be used in evaluating Debtors' ability to pay is $6,513.00.

The foregoing adjustments yield net monthly income of $6,553.00 and net monthly expenses of $6,513.00, leaving only $40.00 per month for payments to unsecured creditors. If the Debtors were in a Chapter 13 case and submitted a 36 month plan, a total of only $1,440.00 would become available for distribution, assuming that Debtors' income and expenses remained the same. The unsecured debt in this case, including the $8,942.00 student loan debt, totals $60,801.00, which means that the dividend to unsecured creditors would be no more than 2%. Such a minuscule dividend does not reflect an ability to pay for purposes of § 707(b).

The last issue to be discussed is whether this case was filed in good faith, which the court concludes should be resolved in the Debtors' favor. There was no evidence of Debtors incurring indebtedness in contemplation of filing bankruptcy or other efforts on their part to take unfair advantage of their creditors through the use of Chapter 7. Instead, according to the evidence, the

Debtors worked with a credit counseling service for nearly a year in an effort to handle their debts without having to file bankruptcy.

Having considered the totality of the circumstances presented in this case, the court concludes that the granting of Chapter 7 relief in this case would not constitute a substantial abuse of the provisions of Chapter 7 and that the motion to dismiss pursuant to § 707(b) therefore should be denied.

IT IS SO ORDERED.

This 16th day of May, 2002.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge