Consumer Bankruptcy: Substantial Abuse and Section 707 of the Bankruptcy Code

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CONSUMER BANKRUPTCY: SUBSTANTIAL ABUSE AND SECTION 707 OF THE BANKRUPTCY CODE

I. INTRODUCTION

Bankruptcy originated as a means to ensure the equitable distribution of a debtor's assets when those assets are insufficient to pay his debts in full. Congress also intended that the bankruptcy laws would ensure the equitable treatment of creditors, and at the same time provide the debtor with the so-called "fresh start." There are those who feel that the bankruptcy laws have evolved into something very different than the equitable remedy envisioned. They would say that the bankruptcy laws have "evolved into a method of escaping those debts at little or no sacrifice." As a result of this belief, these individuals and groups have initiated various changes in the bankruptcy laws, among them the so called "Consumer Credit Amendments."3

Bankruptcies can take a number of forms depending upon the nature of the debtor's obligations. Businesses and individuals alike have a number of alternatives to weigh in determining which chapter of the bankruptcy code they will use to seek protection from their creditors.4

A consumer bankruptcy usually takes one of two forms: a Chapter 7 liquidation5 or a Chapter 13 wage earner plan.6 In a Chapter 7

2. Id. at 327, 328.
4. Businesses and consumers alike can elect a Chapter 7 liquidation. Chapter 11 reorganization is available to businesses and in certain circumstances to individuals. Individuals also have the option to elect a Chapter 13 "wage earner" plan. In addition, farmers have the option of electing a Chapter 12 bankruptcy. See generally 11 U.S.C. § 109 (1988).
6. 11 U.S.C. ch. 13 (1988). Under certain circumstances an individual may also elect to enter a Chapter 11 reorganization. See In re Moog, 774 F.2d 1073 (11th Cir. 1985). See generally B. WEINTRAUB & A. RESNICK, BANKRUPTCY LAW
proceeding all of the debtor's non-exempt property\textsuperscript{7} is liquidated and the proceeds are distributed to creditors. Any deficiency is discharged, subject to certain limitations.\textsuperscript{8} This discharge has given debtors a so-called "fresh start" and a chance to begin their financial life anew. The fresh start has an important and significant place in our national history because bankruptcy was one of the protections granted by the framers of the Constitution.\textsuperscript{9} The Supreme Court has acknowledged the importance and purpose behind the theory of the fresh start:

The power of the individual to earn a living for himself and those dependent upon him is in the nature of a personal liberty quite as much as, if not more than, it is a property right. To preserve its free exercise is of the utmost importance, not only because it is a fundamental private necessity, but because it is a matter of great public concern. From the viewpoint of the wage-earner there is little difference between not earning at all and earning wholly for a creditor . . . . The new opportunity in life and the clear field for future effort, which it is the purpose of the bankruptcy act to afford the emancipated debtor, would be of little value to the wage-earner if he were obliged to face the necessity of devoting the whole or a considerable portion of his earnings for an indefinite time in the future to the payment of indebtedness incurred prior to his bankruptcy.\textsuperscript{10}

A Chapter 13 plan involves the commitment to a repayment of some portion of the debtor's future earnings in exchange for the right to retain at least some of the otherwise non-exempt property which would otherwise be subject to liquidation in a Chapter 7 proceeding.\textsuperscript{11}

Until recently, a debtor desiring Chapter 7 relief had an "unfettered choice to elect a no-asset chapter 7 liquidation."\textsuperscript{12} Unlike a Chapter 7, which in certain circumstances can be initiated by creditors, a Chapter 13 proceeding is entirely voluntary.\textsuperscript{13} Creditors could not force

\begin{footnotes}
\item[7] Non-exempt property is that property which is excluded from the bankrupt's estate either by operation of state law or by federal statute. \textit{See} 11 U.S.C. § 522 (1988).
\item[8] Certain debts are not dischargeable and the debtor will continue to be liable for those, notwithstanding the bankruptcy proceeding. \textit{See} 11 U.S.C. § 523 (1988).
\item[9] U.S. CONST. art. I, § 8, cl. 4.
\end{footnotes}
debtor's ability to utilize any of their future income to satisfy their debts by forcing them into a Chapter 13.\textsuperscript{14} As a result, in a number of cases debtors who could have paid a significant portion of their unsecured obligations through a commitment of future income failed to do so and received a discharge of their obligations in a Chapter 7 proceeding while their creditors received little or nothing. Creditors pressured Congress to pass bankruptcy reform legislation aimed at curtailing the right of debtors to utilize a Chapter 7 proceeding.

\section*{II. HISTORY OF THE AMENDMENTS}

The credit industry\textsuperscript{15} had mobilized as early as 1980 in an attempt to curtail the access of debtors to Chapter 7 relief.\textsuperscript{16} This move was brought about by the increasingly popular perception that people were using the bankruptcy system, not to extricate themselves from an unfortunate situation, but rather as a method of avoiding debts even though they were not suffering economic hardship and possessed future income sufficient to meet their obligations.\textsuperscript{17} According to the consumer credit industry, this "needless discharge" of debt led to the shifting of the repayment burden for literally billions of dollars of debt to the public at large, and principally to those who utilized consumer credit at increasingly higher interest rates.\textsuperscript{18}

Much of the empirical evidence used to support the proposition that debtors who possessed the ability to repay were discharging debt needlessly was provided in a study conducted by the Credit Research Center, Krannert Graduate School of Management, at Purdue University. The credit industry paid for the study and it was an influential document in the adoption of the Consumer Credit Amendments.\textsuperscript{19} The

\begin{enumerate}
\item Breitowitz, supra note 1, at 328 n.10.
\item The credit industry is not officially represented by any single group, but the legislative hearings contain testimony from such groups as the Credit Union National Association, the National Association of Federal Credit Unions, the National Consumer Finance Association, the American Retail Federation and the National Retail Merchants Association. Gross, supra note 3, at 61 n.4.
\item Breitowitz, supra note 1, at 328 n.12 (citing Ginsberg, The Proposed Bankruptcy Improvement Act: The Creditors Strike Back, 1982 N. ILL. U.L. REV. 1). The predecessor to the amendments, which were ultimately passed in 1984, was S. 2000, 97th Cong., 2nd Sess. (1982), proposed in earlier sessions of Congress.
\item In re Grant, 51 Bankr. 385, 390 (Bankr. N.D. Ohio 1985).
\item Breitowitz, supra note 1, at 336-41.
\item Sullivan, Warren, & Westbrook, Rejoinder: Limiting Access To Bankruptcy Discharge, 1984 Wis. L. REV. 1087. For a discussion of the Consumer Credit Amendments, see infra notes 29-34 and accompanying text.
\end{enumerate}
results of this study indicated that debtors seeking Chapter 7 relief had the ability each year to collectively repay 1.1 billion dollars of debt. Because of this fact these debtors should be denied access to Chapter 7 and they should be forced to elect a Chapter 13 or forego the protection offered by the bankruptcy statutes.  

This study was not without its detractors. Professors Sullivan, Warren, and Westbrook\textsuperscript{21} authored a critical analysis of the study,\textsuperscript{22} citing what they identified as a number of shortcomings within the study and labeling it as an "adversarial document."\textsuperscript{23} In making the claim that debtors could have repaid as much as 1.1 billion dollars of debt that was being discharged in bankruptcy each year,\textsuperscript{24} the study assumed that the present level of income for all debtors would remain the same, without interruption, for the next five years.\textsuperscript{25} Given the demonstrated erratic employment history of debtors finding themselves in bankruptcy, this was a risky assumption. Additionally, the study made this claim based upon the calculation of allowed expenses at the Federal poverty level;\textsuperscript{26} it is not clear at all that under Chapter 13 courts would restrict the allowed expenses of the debtor to these low levels in calculating the debtor's disposable income. Notwithstanding these criticisms, the conclusions presented in the Purdue study found widespread acceptance with Congress and the press.\textsuperscript{27}

III. SECTION 707(b)  

Even though earlier attempts to address these perceived problems in the Bankruptcy Code had failed,\textsuperscript{28} many substantive changes to the Code were made with the passage of the Consumer Credit Amendments (Amendment(s)) in July of 1984.\textsuperscript{29} The Amendments, as finally passed, were much less solicitous of creditor interests than the earlier revisions

\begin{itemize}
  \item 20. See id.
  \item 21. Id. at 1087.
  \item 22. Id. at 1088-90.
  \item 23. Id.
  \item 24. Id.
  \item 25. Id. at 1093.
  \item 26. Id. at 1088.
  \item 27. Id. at 1087.
  \item 28. Earlier bills had been introduced in previous sessions of Congress but had failed to gain the support needed to pass and become law.
\end{itemize}
which had been offered, but they still represented substantive changes in the Code for consumer bankruptcies.

One of the most significant changes was the addition of subsection (b) to section 707 of the Federal Bankruptcy Code. It states:

After notice and a hearing, the court, on its own motion and 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.

This addition represents a marked change from the previous position taken in the Bankruptcy Code. As stated earlier, debtors electing to file for Chapter 7 relief had enjoyed "unfettered access" to the Code absent some egregious misconduct described in section 727 of the Code. In interpreting section 707(b), the determination of what is "primarily consumer debt" and what is "substantial abuse" along with the application of the standards have created significant issues for the courts to resolve. The result has been a less than uniform application of the law.

A. Legislative History

The legislative history of section 707(b) has been very influential in the determination of what constitutes substantial abuse as contemplated by the Code. The Amendments were the product of substantial debate and negotiation between the proponents and the opponents of the legislation. The final Amendment to section 707, as passed, was not accompanied by an official committee report. Therefore, no formal legislative history exists and the courts have felt free to rummage through the closet of the Congressional Record to find the legislative

30. S. 2000, 97th Cong., 2nd Sess. (1982), an amendment package offered but not passed in 1982, was far more restrictive of the rights of debtors than the amendments which were ultimately passed in 1984. See Broitowitz, supra note 1, at 329.


33. Section 727 provides a list of 10 acts which work to deny a debtor discharge in a Chapter 7 proceeding. 11 U.S.C. § 727 (1988).
history that seems appropriate in the particular case. In sifting through the reports, the reader finds a veritable smorgasbord of comments from which to choose in justifying a particular interpretation of legislative intent. The courts have not hesitated to do just that. For example, in *In re Walton*, a case decided by the Eighth Circuit, the majority refused to consider the statements of legislators made when the legislation was passed. The court cited a Ninth Circuit case, *In re Kelly*, which in turn cited a recent Supreme Court case, saying that "'[t]o the extent that legislative history may be considered, it is the official committee reports that provide the authoritative expression of legislative intent,' not the 'stray comments by individual legislators.'" The Ninth Circuit, in *Kelly*, turned to the committee reports on Senate Bill 445 (S. 445), predecessor to the bill ultimately passed, as "the best available evidence of Congress' intent in enacting section 707(b)." The Eighth Circuit adopted this reasoning in *Walton*. The consideration of the legislative history of S. 445 was anticipated by Congress and both the proponents and opponents of the legislation expressly agreed that the legislative history of S. 445 was applicable to the larger bill of bankruptcy reform.

The Amendment, as advanced, represented a major change from the bills originally proposed, primarily because of vehement opposition to the original bills from Senators Metzenbaum and Kennedy. These early proposals contained a mechanical formula for determining the ability of the debtor to repay his obligations out of future income. The opposition of Senators Metzenbaum and Kennedy prompted negotiations between the proponents and the opponents of the legislation. They resolved the disagreement by deleting language which considered the future income of the debtor in the application of the substantial abuse standard. Senator Metzenbaum made clear his understanding that he had "successfully worked out with the author of

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34. 866 F.2d 981 (8th Cir. 1989).
35. 841 F.2d 908 (9th Cir. 1988).
37. *Walton*, 866 F.2d at 983 (quoting *In re Kelly*, 841 F.2d 908, 912 n.3 (9th Cir. 1988)).
39. *Kelly*, 841 F.2d at 914 n.7.
40. *Walton*, 866 F.2d at 983.
42. Id.
43. Id. (remarks of Sen. Metzenbaum).
44. Id. at S5359 (remarks of Sen. Thurmond); id. at S5359-S5361 (remarks of Sen. Metzenbaum).
this amendment the total elimination of the future income language . . . . [T]he future income matter is no longer in the legislation."

House Bill 5174 (H.R. 5174)\(^46\) contained language that resembled the substantial-abuse language of S. 445. Representative Rodino remarked that the proposed amendment to section 707(b) "would not create a future income test."\(^47\) During consideration of H.R. 5174 on the floor of the House following the conference, Committee Chairman Rodino remarked that "the conferees did not alter the consumer credit amendments. These amendments are fair to both debtors and creditors, and contain no threshold or future income test."\(^48\)

The Ninth Circuit in _Kelly_ determined that the statements of Senator Metzenbaum and Representative Rodino (quoted above) indicated that the future income test had been eliminated from the bill, but in no way did this "suggest that a debtor's ability to repay his debts is no longer a consideration in determining whether there is abuse."\(^49\) In fact:

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\text{[T]he committee report on the final version of S. 445 states clearly that dismissal for substantial abuse is intended to "uphold[] creditors' interests in obtaining repayment where such repayment would not be a burden," and that "if a debtor can meet his debts without difficulty as they become due, use of Chapter 7 would represent a substantial abuse."}^{50}
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The use of the legislative history of a predecessor bill, rejected by committee and subjected to several amendments prior to passage, to determine the legislative intent of legislation passed at a later time, is the type of judicial interpretation which led Antonin Scalia, Associate Justice of the United States Supreme Court to question the reliability of legislative history in determining Congressional intent.\(^51\)

45. _Id._ at S5361 (remarks of Sen. Metzenbaum).
48. 130 _CONG. REC._ H7489 (daily ed. June 29, 1984); see also Block-Lieb, Using Legislative History To Interpret 1984 Amendments To Sections 548 and 707, 10 _NORTON BANKR. L. ADVISOR_ 2 (1986).
49. _Kelly_, 841 F.2d at 914.
50. _Id._ (quoting S. REP. NO. 65, 98th Cong., 1st Sess. 53, 54 (1983)).

Associate Justice Antonin Scalia delivered the Earl F. Nelson lecture to an assembly of law students at the University of Missouri-Columbia on September 20, 1989, in which he addressed the questionable manner in which the courts
B. The Elements of Section 707(b)

1. Substantial Abuse

Substantial abuse is the standard set forth in section 707(b) of the Bankruptcy Code for determining whether the court should dismiss the debtor's petition as an abuse of Chapter 7 of the Code. Substantial abuse is not defined within the Code. Substantial abuse implies that the debtor has obtained "some kind of an unfair advantage . . . against his creditors." One court has dismissed a petition "upon the simple judgment that it is unfair and inequitable for a debtor to request that this Court discharge his debts while he accumulates substantial disposable income over the next several years while living a relatively high life style."

The dispute over what constitutes substantial abuse has focused primarily upon the ability of the debtor to repay some or all of his or her debts out of future income. The threshold questions are twofold: first, whether ability to repay is a factor that should be considered at all, and second, if it is to be considered, what percentage of repayment over what time period should constitute substantial abuse? While a few courts and commentators have argued that ability to repay is not a proper factor for consideration, the vast majority of the courts have declined to follow that reasoning and have considered a number of factors including an ability to repay, in making the substantial abuse determination. Courts have considered the following factors:

1. Whether the debtors have a likelihood of sufficient future income to fund a Chapter 13 plan which would pay a substantial portion of the unsecured claims;
2. Whether the debtors petition was filed as a consequence of illness, disability, unemployment or some other calamity;
3. Whether the schedules suggest the debtor incurred cash advancements and consumer purchases in excess of their ability to repay them;
4. Whether the debtors proposed family budget is excessive or extravagant;

have utilized legislative history in an attempt to divine legislative intent.
55. See In re Keniston, 60 Bankr. 742 (Bankr. D.N.H. 1986); see generally Gross, supra note 3.
5. Whether the debtors Statement of Income and Expenses is misrepresentative of their true financial condition. 56

The courts that have applied these factors have placed particular emphasis upon the ability of the debtor to repay unsecured debts out of future income. 57 For example, the court in In re Grant 58 determined that it would be a substantial abuse to allow a debtor, who could repay 68% of his unsecured debts by reducing his standard of living, to receive Chapter 7 relief. Similarly, in In re Gaskins, 59 the court determined that a debtor who could repay 54% of his unsecured debts was undeserving of Chapter 7 relief.

It is noteworthy that the Grant court, in concluding that the debtor was able to repay 68% of his unsecured debt, did so on the basis of a five year repayment plan. 60 One can question the legitimacy of this determination considering that, in a Chapter 13 plan, if the debtor proposes to pay less than 100% of his unsecured debts, the Court will not confirm the plan unless it provides for the payment of all the debtor's disposable income over a period of three years. 61 In other words, the judge in Grant, in evaluating the debtor's Chapter 7 petition, applied a Chapter 13 type repayment period that she could not have required if the debtor actually had filed a Chapter 13 petition. 62 The application of a five year repayment period has not been confined to the Grant court. 63

Factors other than the ability of the debtor to repay his or her debts should be considered in determining whether substantial abuse exists because the other factors may tend to aggravate or mitigate the abusiveness of the filing. 64 Illness or other calamity which prompted the filing, obtaining of cash advances without intent to repay, the


60. Grant, 51 Bankr. at 394.


62. Id. For a discussion of the fact that extension of the repayment period provided for by 11 U.S.C. § 1322(c) (1988) should be extended from three years to five only at the option of the debtor, see In re Capodanno, 94 Bankr. 62, 66 n.3 (Bankr. E.D. Pa. 1988) and the authorities cited therein.


64. In re Herbst, 95 Bankr. 98, 101 (W.D. Wis. 1988).
nature of the proposed budget of the debtor, and misrepresentation of schedules filed with the court" should be considered.\footnote{65}

\textbf{a. Raising the Issue of Substantial Abuse}

Section 707(b) provides that "[a]fter notice and a hearing, the court, on its own motion or on a motion by the United States Trustee,\footnote{66} but not at the request or suggestion of any party in interest, may dismiss a case."\footnote{67} One court,\footnote{68} has stated that the reason that creditors are not permitted to raise the issue of substantial abuse is that "[e]very creditor feels that a bankruptcy discharge constitutes a substantial abuse."\footnote{69} This provision permitting only the court or the U.S. Trustee to raise the issue of substantial abuse, has been interpreted to include the panel or case trustee.\footnote{70} Congress itself intended "[t]he 'party in interest' phrase in section 707(b) . . . to mean creditors—not panel trustees."\footnote{71}

What is less than clear, however, is whether a violation of the section forbidding creditors to move for a dismissal will foreclose the substantial abuse issue. In this area the courts are divided. In \textit{In re Latimer},\footnote{72} the court concluded that when the creditor's "suggestion" that the case was appropriate for a section 707(b) dismissal preceded any action by the court, the proceeding was tainted and foreclosed a section 707(b) dismissal on the merits.\footnote{73}

The Third Circuit declined to decide the "taint" issue in \textit{In re Christian}\footnote{74} because it was not presented properly on appeal.\footnote{75} In a footnote, however, the court stated that congressional intent appeared to allow the court to consider a dismissal under section 707(b) even after a party in interest had moved improperly for dismissal.\footnote{76}

\begin{footnotes}
\item[65] Id.
\item[66] The language allowing the United States Trustee to raise the substantial abuse issue was added by amendment in 1986. Previously only the court was authorized to raise the issue. \textit{See supra} note 32 and accompanying text.
\item[68] \textit{In re Ploegert}, 93 Bankr. 641 (Bankr. N.D. Ind. 1988).
\item[69] Id. at 641.
\item[70] Id. at 641-42.
\item[71] Id. at 642 (quoting 132 \textit{CONG. REC.} H9000 (daily ed. Oct. 2, 1986) (statement of Rep. Fish)).
\item[73] \textit{Id.; see also In re Cecil}, 71 Bankr. 730 (Bankr. W.D. Va. 1987).
\item[74] 804 F.2d 46 (3d Cir. 1986).
\item[75] Id. at 49.
\item[76] Id. at 48.
\end{footnotes}
The *In re Hudson*[^77] court addressed the dilemma posed by a party in interest raising the issue of substantial abuse. According to the court, even though foreclosing the issue upon violation would have a deterrent effect upon creditors, at the same time it would prevent "the Court from acting in cases where an abuse of Title 11 Chapter 7 is most likely to be occurring."[^78] The court concluded that "[i]f given the choice as to which of these violations should be overlooked, this Court believes that public policy and equity require that it be the [raising of the issue by a party in interest]."[^79]

When the prohibition against a party in interest moving the court on the issue of substantial abuse is read in the context of the presumption favoring the relief requested by the debtor,[^80] it appears that the conclusion followed in the *Latimer* decision is the more desirable result. To conclude otherwise would leave the prohibition meaningless in that no penalty would attach to a violation on the part of creditors.

### 2. Defining "Primarily Consumer Debts"

The application of section 707(b) requires a determination of whether the debtor's obligations are primarily consumer debts.[^81] If they are not, section 707(b) does not apply.[^82] The reason for the distinction between consumer debts and those of a business nature is not explained in the legislative history to section 707(b). The most logical explanation lies in the fact that the major proponent of the amendments was the consumer credit industry, which "perceived"[^83] that a large number of consumer debtors were "needlessly" discharging millions of dollars of debt which they were fully capable of repaying.[^84]

At least one court has observed that the distinction between consumer debts and debts of any other nature is a denial of equal

[^78]: Id. at 420.
[^79]: Id.
[^80]: The last sentence of Section 707(b) states that "[t]here shall be a presumption in favor of granting the relief requested by the debtor." 11 U.S.C. § 707(b) (1988).
[^82]: Id.; see also supra note 33 and accompanying text.
[^83]: There is some evidence that the increase of consumer bankruptcies has not exceeded proportionately the increase in consumer borrowing brought about by aggressive marketing by consumer credit providers. See Gross, supra note 3, at 76, 77; see also 130 CONG. REC. H1941 (daily ed. Mar. 26, 1984) (statements of Rep. Rodino).
[^84]: See generally Gross, supra note 3, at 61-62.
protection because no rational basis appears for the distinction.\textsuperscript{85} The court did not analyze the issue, however, because the parties did not brief or argue the equal protection argument. The \textit{In re Kelly} Court did not address the equal protection issue directly, but did note that laws which "regulate economic activity not involving constitutionally protected conduct are subject to a quite lenient test for constitutional sufficiency."\textsuperscript{86}

The determination of what is primarily consumer debt can have serious consequences for the debtor. If the court determines that the debt is nonconsumer in nature, then section 707(b) does not apply and the debtor is eligible for the relief requested. If the court determines that the debt is consumer debt, then the debtor may face dismissal through the application of section 707(b). In \textit{In re Booth},\textsuperscript{87} the Fifth Circuit dealt with this issue. The Booths, both physicians, had invested in various real estate projects that were unsuccessful. The doctors filed a bankruptcy petition listing total debts of $642,491.17.\textsuperscript{88} The district court had accepted the conclusion of the bankruptcy court that the debts were primarily consumer in nature and had dismissed the case pursuant to section 707(b).\textsuperscript{89} The district court had rested its conclusion on the determination that the signature loans were "unquestionably consumer loans regardless of the use to which the debtor apply[ed] the funds."\textsuperscript{90} The Fifth Circuit rejected that reasoning and instead chose to adopt the "profit motive" definition, stating that "the 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."\textsuperscript{91} The court rejected the position taken in some courts\textsuperscript{92} that debt secured by real estate should be excluded from the definition of consumer debt. Thus, the court included purchase money mortgages in the consumer debt category.\textsuperscript{93} In concluding its analysis, the court determined that

\textsuperscript{85} \textit{In re Keniston}, 60 Bankr. 742, 744 (Bankr. D.N.H. 1986).
\textsuperscript{87} 858 F.2d 1051 (5th Cir. 1988).
\textsuperscript{88} \textit{Id.} at 1055.
\textsuperscript{89} \textit{Id.} at 1053.
\textsuperscript{90} \textit{Id.}
\textsuperscript{91} \textit{Id.} at 1055.
\textsuperscript{93} \textit{Booth}, 858 F.2d at 1055; see also \textit{In re Kelly}, 841 F.2d 908, 912 (9th Cir. 1988).
"primarily," as used in section 707(b), meant those instances in which consumer debt exceeds 50% of the total debt of the debtor.94

3. Presumption In Favor of the Debtor

Section 707(b) expressly states that "there shall be a presumption in favor of granting the relief requested by the debtor."95 Rather than classifying this presumption as one of evidence, at least one circuit has viewed it as "a caution and a reminder to the bankruptcy court that the Code and the Congress favor the granting of bankruptcy relief."96 "[A]ccordingly 'the court should give the benefit of any doubt to the debtor and dismiss a case only when a substantial abuse is clearly present."97 Another court has concluded that it "should accord great weight to the debtor's own assessment of [his] financial condition."98 It seems appropriate then to apply section 707(b) with an eye toward the effect that dismissal would have on the debtor as opposed to the effect it would have on the creditor.99

C. Application of the Substantial Abuse Standard

Two courts of appeals have dealt with section 707(b) dismissal. The Ninth Circuit heard the substantial abuse issue in In re Kelly.100 In that case, Thomas G. Kelly III, an attorney, and his wife had filed a Chapter 7 petition following a judgment against them in the amount of $21,980.63.101 Before filing the petition, the Kellys had paid off all of their other creditors, leaving only the judgment outstanding.102 The Bankruptcy Court dismissed the Kelly's petition as a substantial abuse of the Code pursuant to section 707(b).103 In the appeal that followed the Kelly's argued, among other things, that their ability to repay their debts out of future income was irrelevant to the issue of substantial abuse (a factor the lower court had focused on in ordering the dismissal pursuant to section 707(b)).104 The Ninth Circuit dismissed this

94. Booth, 858 F.2d at 1055; see also Kelly, 841 F.2d at 913.
96. Kelly, 841 F.2d at 917.
97. Id. (quoting 4 COLLIER ON BANKRUPTCY ¶ 707.08 (L. King 15th ed. (1979)).
100. 841 F.2d 908 (9th Cir. 1988).
101. Id. at 910.
102. Id. at 910-11.
103. Id.
104. Id.
contention, noting that other courts had determined, with few exceptions, that "the principal factor to be considered in determining substantial abuse is the debtor's ability to repay the debts for which a discharge is sought."\textsuperscript{105} In\textit{Kelly}, the Ninth Circuit looked to the predecessor bills of section 707(b) and concluded that the elimination of the future income test in the subsequent legislation was simply a retrenchment from a mechanically applied threshold formula, which "does not suggest that a debtor's ability to repay his debts is no longer the primary consideration in determining whether there is abuse."\textsuperscript{106} Using the committee report on the final version of S. 445,\textsuperscript{107} the court determined that dismissal for substantial abuse is intended to uphold creditors' interests in obtaining repayment when such repayment would not be a burden. The report stated that "if a debtor can meet his debts without difficulty as they become due, use of Chapter 7 would represent a substantial abuse."\textsuperscript{108} Thus, the court concluded that "[a]ccordingly, we hold that 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."\textsuperscript{109}

In\textit{In re Walton}\textsuperscript{110} the Eighth Circuit affirmed the lower court's dismissal of the debtor's Chapter 7 petition as a substantial abuse of the Code: The Bankruptcy Court had found from the record that the debtor's monthly income exceeded his monthly expenses by $218.00. According to the court's findings, this surplus would be sufficient to pay off more than two-thirds of his debts under a three-year plan and 100% of his debts under a five-year plan.\textsuperscript{111} To the Bankruptcy Court, this fact constituted a substantial abuse of Chapter 7; therefore, the court dismissed the debtor's petition.\textsuperscript{112} On appeal the debtor asserted that the legislative history of section 707(b) indicated that Congress specifically had precluded courts from applying a future income test in determining whether there was substantial abuse.\textsuperscript{113} Like the Ninth Circuit in\textit{Kelly}, the Eighth Circuit declined to consider the comments of the legislation's opponents, namely Senators Kennedy and Metzen-
baum. Instead, it chose to look to the reports of the earlier versions of the bill for the legislative intent surrounding the legislation.\footnote{Id. at 983.} The court discounted the importance of the deletion of the future income language from these earlier amendments, and concluded that this deletion "does not foreclose the courts from considering, \textit{inter alia}, the debtor's ability to pay his debts out of his future income."\footnote{Id.} The debtor advanced the argument that Congress had intended substantial abuse to mean "bad faith" and that no evidence of bad faith was present to constitute substantial abuse.\footnote{Id.} The majority, however, concluded that such an interpretation was not logical in that such a narrow construction "would needlessly duplicate other provisions of the Code that have always required petitioners to file in good faith."\footnote{Id. at 985.}

The \textit{Walton} court concluded that the record reflected the debtor had a monthly surplus of $497.00 which would pay off 100\% of his unsecured debts over a period of five years. "[T]he facts adequately rebut the statutory presumption in 11 U.S.C. § 707(b) in favor of granting the relief requested by the debtor."\footnote{Id. at 987 (McMillian, J., dissenting).}

In a well reasoned dissent, Circuit Judge McMillian disagreed that the debtor's petition fell within the scope of section 707(b) of the Code. He reviewed the same language in the legislative history to section 707(b) and concluded that the future income analysis was not incorporated into the language of section 707(b) by the accompanying words of legislative intent.\footnote{Id. at 985.} Judge McMillian concluded that the court had ignored the language of section 707(b) which indicates there shall be a presumption in favor of granting the relief requested by the debtor.\footnote{Id.} The dissent noted that the debtor had suffered:

\begin{quote}
[More than his share of mishaps: he has been ill; he and his wife have separated and then been reunited; his home has been vandalized; his paycheck has sometimes been little more than $100.00 per week because of garnishments and offsets. Yet, the majority opinion of this panel, despite appellant's wretched financial conditions, would deny him a fresh start through a Chapter 7 liquidation bankruptcy.]
\end{quote}\footnote{Id. at 987.}
1. Problems In Applying the Standard

The problems presented by the application of section 707(b) are at least threefold. First, determining whether debtors have sufficient income to pay a large enough portion of their debts so that the granting of Chapter 7 relief would constitute a substantial abuse of the Code necessarily involves the judge in the day-to-day financial life of the debtor.\textsuperscript{122} Thus, the courts are required to determine the appropriateness of a debtor's personal expenditures. For example, in In re Braley,\textsuperscript{123} the United States Trustee sought to disallow budgeted items for the support of a son living at home who was over the age of eighteen.\textsuperscript{124} The court responded, "I can't wait to get home to tell this to my son who just turned eighteen."\textsuperscript{125}

Consider the situation addressed by the court in In re Edwards.\textsuperscript{126} The court was forced to determine whether to allow a proposed one hundred dollar monthly religious contribution.\textsuperscript{127} Such situations highlight the problems created by the application of the substantial abuse standard.

Certainly facts like those in In re Grant\textsuperscript{128} cry out for the application of the substantial abuse provision to dismiss the defendant's liquidation petition. In Grant, the debtors had annual income exceeding $65,000.00 and were unable to meet their financial obligations.\textsuperscript{129} Among other items drawing the court's attention was the fact that the debtor was driving a late model Mercedes automobile. The debtor filed an amended schedule of expenses showing that he had returned the

\textsuperscript{122} See In re Braley, 103 Bankr. 758 (Bankr. E.D. Va. 1989). The court's opinion suggested tongue-in-cheek that the United States Trustee would be reviewing a petitioner's lifestyle to determine whether or not he was eating too many candy bars and smoking too many cigarettes and whether or not his daughter's teeth really did in fact require braces. \textit{Id.} at 759.

\textsuperscript{123} 103 Bankr. 758 (Bankr. E.D. Va. 1989).

\textsuperscript{124} \textit{Id.} at 760.

\textsuperscript{125} \textit{Id.}

\textsuperscript{126} 50 Bankr. 933 (Bankr. S.D.N.Y. 1988)

\textsuperscript{127} \textit{Id.} at 940. The court in Edwards did allow the contribution. However, the court questioned "whether church contributions of $100 a month should come ahead of repayment to creditors. . . . At what point such inquiries and decisions by a bankruptcy court would become an affront to a society's sensibilities or the U.S. Constitution remains uncertain." \textit{Id.} at 940 n.9. See also In re Gaulker, 63 Bankr. 224 (Bankr. D.N.D. 1986), in which the court allowed a monthly religious contribution of $700.00 per month, stating, "this Court is not so presumptuous as to inflict its personal views of religious and financial responsibility upon [the debtors]." \textit{Id.} at 226.

\textsuperscript{128} 51 Bankr. 385 (Bankr. N.D. Ohio 1985).

\textsuperscript{129} \textit{Id.} at 386-87.
Mercedes, but to replace it he had leased not one, but two brand new, albeit smaller automobiles.\(^{130}\) In addition, listing Christmas expenses in the amount of $9,000.00 received criticism from the court.\(^{131}\) A survey of the cases involving the substantial abuse issue, however, rarely reveal such egregious conduct on the part of the debtor.

A second problem created by the application of the substantial abuse standard is the resulting lack of uniformity. What constitutes a luxury to one judge is a necessity to another, and the definition of substantial repayment of unsecured debts likely will not be the same in different courts. Uniform treatment of debtors and creditors alike is a policy goal of the bankruptcy system.\(^{132}\)

A survey of the cases in which the substantial abuse standard has been applied shows that no courts have applied the standard in situations in which the debtor is unable to pay more than 50% of his or her unsecured debts over the life of a plan. If this fifty percent level is in fact a threshold as it appears to be, one has to wonder how long it will be before attorneys begin counseling debtors to reduce their income, at least temporarily, so they will fall below this threshold. The debtor would qualify for Chapter 7 relief, with the unstated intention of resuming employment after the discharge of the bankrupt's debts. Such a situation is conceivable in the case of a married couple, where one of the spouses has not been employed consistently outside the home or is in a position of employment that provides no long-term career opportunities, but rather simply provides a second income for the family. There is a possibility that the court would find that such conduct, by itself, constitutes substantial abuse within the meaning of section 707(b) or fraud within the meaning of section 727(a).\(^{133}\) The difficulty of proving fraud within the meaning of section 727(a) is highlighted by the struggle the courts are having with the issue of exemption planning.\(^{134}\) The court would review a myriad of factors to determine whether terminating employment to circumvent application of a provision in the

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\(^{130}\) Id. at 395.

\(^{131}\) Id. at 396. The court commented that "the Grant's Christmases must be quite an extravaganza." Id.


\(^{134}\) A similar dispute has arisen over the issue of pre-petition exemption planning. Exemption planning refers to the debtors' practice prior to the filing of a bankruptcy petition of shifting all or part of their assets to assets which would maximize the exemptions from seizure provided to them under state and federal law. For a thorough discussion of this topic see, Koger & Reynolds, Is Pre-filing Engineering Prudent Planning Or Section 727 Fraud, 93 COM. L.J. 465 (1988).
Bankruptcy Code would constitute fraud or substantial abuse. Such factors would include the timing of the act and whether the debtor can cite other reasons for the termination, such as distance to work, parental concerns, or health. The point is that the determination would be difficult and time consuming for an already heavily burdened bankruptcy system. A judge faced with this situation would not be able to order the debtor back to work and the debtor would have obtained the desired access to Chapter 7 relief through the socially undesirable avenue of unemployment.  

IV. CONCLUSION

There can be no serious dispute about the desirability of requiring those debtors who are able to pay their debts to pay them. The ability of the debtor to repay debts out of future income, however, should be but one of the factors considered by the courts in determining whether to grant the relief requested or to dismiss the case due to substantial abuse under section 707(b) of the Bankruptcy Code. Application of the substantial abuse standard as stated in the Eighth and Ninth Circuits, where the ability to pay is the primary factor for consideration, makes it just a matter of time before debtors adjust their income as an analog to the so-called "exemption planning," thus neutralizing the value of the substantial abuse standard. Rather, courts should review the particular circumstances of each individual debtor and apply the standard so as to prevent the abuse of the bankruptcy system by

135. A similar situation has been faced in the domestic relation situation in which one spouse retires early or reduces income and as a result is unable to meet alimony or child support obligations. The courts are unable to order that individual back to work because of the constitutional prohibition against involuntary servitude. The response of some courts has been that while they cannot force the individual to work, they will not relieve him of his obligation and if the debtor does not meet it he will face contempt charges. This poses difficult issues for the court and one would wonder whether the bankruptcy courts would follow that reasoning because the strong public policy of providing support for the family is not present in the bankruptcy context. Would a court order a debtor back to work to make his monthly payments to creditors under the threat of contempt?

136. Admittedly, the other factors which the courts have considered in applying the substantial abuse standard, see supra note 56 and accompanying text, would still possibly provide grounds for dismissal as a substantial abuse. However, if the debtor had "adjusted" his or her income so as to fall below the 50% threshold, this would effectively eliminate the "ability to pay" analysis. Recall that both the Eighth and Ninth Circuit Courts of Appeal have considered the ability to pay as the principal factor to be considered. See supra notes 100-118 and accompanying text.
undeserving debtors, while at the same time recognizing the historical significance of the fresh start concept and the actual monetary recovery that ultimately will be realized by creditors.137

The substantial abuse standard should be applied in moderation with full awareness of the presumption favoring the relief sought by the debtor. Its application should be confined to use in those instances in which the actions of the debtor fall short of the "cause" standard of section 707(a)138 and the fraud standard of section 727,139 but still offend the sensibilities of the judge and leave him with the distinct impression that this particular debtor is seeking a "head start" as opposed to the desired "fresh start."140

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138. 11 U.S.C. § 707(a) (1988) allows the judge to dismiss a case filed under Chapter 7 upon a finding of "cause" as defined in that subsection.
139. 11 U.S.C. § 727 (1988); see supra notes 117-18 and accompanying text.