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IN THE UNITED STATES BANKRUPTCY COURT DISTRICT OF UTAH 350 South Main Street, Salt Lake City, Utah 84101	
IN RE: [PARTY NAME REDACTED] [PARTY NAME REDACTED] Debtor(s).	Case No. Judge William T. Thurman Chapter 7
MEMORANDUM IN SUPPORT OF DEBTOR'S OBJECTION TO U.S. TRUSTEE'S MOTION TO DISMISS CHAPTER 7 CASE UNDER 11 U.S.C. §707(b)	

[PARTY NAME REDACTED] and [PARTY NAME REDACTED], the Debtors in the above-captioned bankruptcy matter, by and through their counsel of record, David W.M. Snow, submit the following memorandum in support of the objection to the Motion of the U.S. Trustee to Dismiss their Chapter 7 case pursuant to 11 U.S.C §707 (b).

STATEMENT OF FACTS

With respect to the allegations of fact set forth in the Memorandum of the U.S. Trustee, and in the order presented therein, the Debtors answer as follows:

1. The Debtors admit the allegations set forth in Paragraph 1.

2. The Debtors admit the allegations set forth in Paragraph 2.

3. The Debtors admit the allegations set forth in Paragraph 3.

4. The Debtors admit in part and deny in part the allegations set forth in Paragraph 4. The Debtors admit the representations relating to their schedules and the paystubs submitted to the U.S. Trustee, however, the additional amount shown on the January paystub represents an annual bonus that the Debtor's employer discontinued following that payment. This bonus is not received on a monthly basis, and will not be received again.

5. The Debtors admit in part and deny in part the allegations set forth in Paragraph 5. The Debtors admit the change in Mrs. [PARTY NAME REDACTED]'s employment and income, and that the new employment does involve a shorter commute, but the Debtors deny that their transportation expenses have changed significantly as a result. The Debtors note that fuel prices have increased by approximately 10% since the filing of the petition (*Source: U.S. Energy Information Administration, http://www.eia.doe.gov/oil_gas/petroleum/data_publications/wrgp/mogas_history.html*, and have off-set the savings one could otherwise expect from a shortened commute.

6. The Debtors admit in part and deny in part the allegations set forth in Paragraph 6. The Debtors admit the allegations relating to the assets and debts listed, except that they have listed $16,000 in priority debt related to the future child support obligation. Further, the debtors note that the 2001 LandRover is their only operational vehicle (a 1969 Jeep used for parts is also listed on Schedule B), and that the monthly payment on the vehicle is $435.87 per month, on a balance of $21,070.65 as of the petition date.

7. The Debtors admit the allegations set forth in Paragraph 7.

8. The Debtors admit the allegations set forth in Paragraph 8, and note that most of the credit card debt was accumulated by the Debtor's ex-wife, and that while he may be jointly liable to those creditors, he is solely liable to his ex-wife for the debts, and that as of the petition date, those debts were possibly non-dischargeable under the operation of 11 U.S.C. §523(5) and (15) and were possibly priority debts under 11 U.S.C. §507(a)(7).

9. The Debtors deny the allegations set forth in Paragraph 9, and note that they provided ample testimony at their 2004 Examination relating to changes in their circumstances, including recent prior divorces for both spouses, an anticipated reduction in the income of the Debtor arising from changes in his compensation structure imposed by his employer, the unexpected pregnancy of Mr. [PARTY NAME REDACTED]'s daughter and her lack of other alternatives for support together with the associated financial burdens, and the effect of Mr. [PARTY NAME REDACTED]'s debt load on his health and on his ability to adequately fulfill the duties and financial obligations of his employment. Among other things, the debtor provided testimony that his employment was in danger because of his inability to pay in advance for the necessary travel for his position, that those difficulties would only be increased by the spending restraints imposed under a Chapter 13 plan, that his compensation and bonus structure had been dramatically altered by his employer prior to the bankruptcy filing, and that the stress of his financial situation was affecting his ability to oversee and properly and constructively motivate his subordinates, further endangering his income and employment.

10. The Debtors admit the allegations set forth in Paragraph 10, and note that the proceeds of the 401(k) were used to make significant reductions in the Debtors' debt load in an attempt to avoid a bankruptcy filing.

11. The Debtors admit in part and deny in part the allegations set forth in Paragraph 11. The Debtors believe that speculation regarding the availability of an additional $1000 per month fourteen months after the petition date is irrelevant to the question before the court and therefore deny that allegation.

12. The Debtors admit the allegations set forth in Paragraph 12.

13. The Debtors deny the allegations set forth in Paragraph 13. The Debtors believe the listed expenses are necessary for their support and maintenance.

14. The Debtors admit the allegations set forth in Paragraph 14.

15. The Debtors admit the allegations set forth in Paragraph 15.

16. The Debtors admit the allegations set forth in Paragraph 16, but note that they were unaware of the pet's medical condition at the time of purchase.

17. The Debtors admit in part and deny in part the allegations set forth in Paragraph 17. While support obligations for the minor daughter under the terms of the divorce decree are expected to cease in May, 2005, the daughter lives in Texas with her mother. The Debtors believe the expenses listed are in fact probably inadequate to remain as involved as necessary in this child's life and object to the U.S. Trustee's characterization of these expenses as "optional."

18. The Debtors admit in part and deny in part the allegations set forth in Paragraph 18. The debts and expenses exist as set forth in the allegation, but the Debtors deny that they are optional.

19. The Debtors admit the allegations set forth in Paragraph 19.

20. The Debtors admit the allegations set forth in Paragraph 20.

21. The Debtors deny the allegations set forth in Paragraph 21.

22. The Debtors deny any allegation not specifically admitted to herein.

ARGUMENT

The Motion of the U.S. Trustee is based on the provisions of 11 U.S.C. §707(b), which provides, in pertinent part, as follows:

> "After notice and a hearing, the court, on its own motion or on motion by the United States trustee, but not at the request or suggestion of any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the *provisions of this chapter*. There shall be a presumption in favor of granting the relief requested by the debtor." (Emphasis added)

In the case of *In re Stewart, Stewart v. U.S.,* 175 F.3d 796 (1999), the U.S. Tenth Circuit adopted a "Totality of the Circumstances Test" as a guide to courts asked to make a determination of substantial abuse under Section 707(b). This test requires the court to

determine a number of factors beyond the mere ability of the debtors to pay some or all of their debts through a Chapter 13 plan.

The *Stewart* Court listed the following ten factors to consider in conducting a substantial abuse analysis:

1. The ability of the debtors to repay their debts, either through a Chapter 13 plan, private negotiation, or under the original terms of the debt;

2. Whether the debtors have suffered unique hardships such as sudden illness, calamity, disability, or unemployment;

3. Whether the debtors have lived an extravagant lifestyle or otherwise incurred debts, including cash advances and consumer credit purchases, far in excess of their ability to pay at the time the debt was incurred;

4. The accuracy with which the true financial condition of the debtors was reflected in their schedules and statements;

5. Whether the debtors will enjoy a stable source of future income;

6. Whether the debtors can significantly reduce their expenses without being deprived of necessities;

7. Whether the debtors qualify for relief under another Chapter of the bankruptcy code;

8. The availability of relief under state laws;

9. The availability of relief through private negotiation (arguably a repetition of part of the first factor, but broken out separately here regardless);

10. The good faith of the debtors under the totality of the circumstances.

In applying these *Stewart* factors to the facts before the court in the present case, the Debtors believe that a finding of substantial abuse is not warranted in the present case.

In preparing this memorandum, the Debtors conducted an analysis of their case under chapter 13. This analysis provides, among other things, for a cessation of the 401(k) loan payments, but also provides for the payment of the resulting increased tax liability (roughly estimated to be as high as $16,000), the cramdown of the vehicle and computer loans listed on Schedule D, and provides for the $1,000 child support payment as an ongoing budget item. This analysis shows that with their income as of the filing date, the debtors could have supported a Chapter 13 payment of $1,360.00 per month, which would result in an 18% return to the class of general unsecured creditors over 36 months. As the court has approved plans providing for this level of return in the past, it does appear that substantial abuse could be found, if the ability to repay were the only factor to be considered by the court under the *Stewart* analysis. Absent a conversion to Chapter 13, the budget submitted by the Debtors is reasonable, as they would have to either repay the 401(k) or incur the taxes, penalties and interest associated with a default. The unsecured portion of the vehicle loan is only $2,264, and the Chapter 13 cramdown would not result in a significant benefit to either the debtors or other creditors. Finally, the trustee's assertion that additional $1,000 per month would become available in May, 2005 following the

cessation of child support payments for Mr. [PARTY NAME REDACTED]'s minor daughter, is speculative at best. While the debtors may no longer have this expense, as will be discussed below, because of the question of income stability, there is no guarantee that these funds will be excess income fourteen months after the petition date. The U.S. trustee also fails to state any basis for including such future speculations into a substantial abuse analysis.

There are other factors to be considered, and in looking at the second factor, the debtors have experienced other circumstances which have led to their current financial situation. Both debtors were recently divorced prior to their present marriage, and both have incurred additional expenses and debt as a result. One daughter became pregnant and had no other means of support. Despite the implication inherent in the U.S. trustee's motion, the Debtors object to the idea that their failure to abandon this daughter, though an adult, and their expected grandchild, to their own resources under these circumstances constitutes abuse, substantial or otherwise, or bad faith. Another minor daughter is now living in a separate household in another state, and again the trustee suggests that Mr. [PARTY NAME REDACTED] is abusing the system or acting in bad faith when he incurs expenses on her behalf above and beyond that required of him in the divorce decree. The trustee also objects to the expenses incurred by the debtors in caring for a pet with a significant birth defect. The debtors were unaware of this defect when they purchased the animal, but have made a sincere effort to provide care for the animal, which cannot eat or eliminate without assistance. Reasonable people could disagree as to necessity of the expenses, but they cannot doubt the sincerity and the sacrifices made by the debtors in caring for this pet.

Also, Mr. [PARTY NAME REDACTED] came to a realization that his company's new compensation structure would not allow him to continue to service the level of debt he became obligated for following his divorce. In fact, Mr. [PARTY NAME REDACTED] testified at his 2004 Examination that he had been making significant efforts to deal with this debt load and reduce his expenses for some time prior to the bankruptcy filing, including borrowing against the greater part of his retirement account balance to settle some debts. In short, the debtors have in fact made a sincere effort to deal responsibly with the circumstances in which they find themselves and this effort should weigh against a finding of substantial abuse.

With the regard to the third factor, Mr. [PARTY NAME REDACTED] indicates that his ex-wife incurred a substantial amount of credit card debt that he became responsible for through his divorce decree and his ex-wife's subsequent bankruptcy filing, in which a discharge was granted. In considering this factor the court should take note that a party responsible for incurring the debt in this bankruptcy estate is not before the court, and that a finding of substantial abuse in this case would not deny that person a discharge or serve in any way as a deterrent against future irresponsible behavior. Mr. [PARTY NAME REDACTED] and the present Mrs. [PARTY NAME REDACTED] have incurred very little debt and they do not have an excessive or unreasonable family budget. They drive one automobile between them, and have made efforts to cut their expenses as much as their circumstances will allow.

The schedules and statements filed in this case accurately reflect the financial condition of the debtors at the time the case was filed. The motion of the U.S. trustee does point out some

post-petition income changes discovered as a result of a Rule 2004 Examination, but there is no allegation that the debtors have misrepresented their financial condition as of the date the bankruptcy estate was created. Mr. [PARTY NAME REDACTED] is expected to incur expenses, mostly for travel, in relation to his employment. These expenses are not listed on the debtors' schedules because prior to his filing, Mr. [PARTY NAME REDACTED] had attempted to cut out these expenses and oversee his sales area by telephone. This attempt leads us to a discussion of the fourth factor, the expectation of a stable source of income.

Mr. [PARTY NAME REDACTED] is a regional sales manager overseeing a multi-state area. He is expected to travel to various locations around the Western U.S. to meet with employees, suppliers, customers, and other parties related his business. Both he and his employer consider travel and face-to-face contact to be critical to the success of the company, and by mutual agreement and because of the type of industry, believe that those expenses are necessarily incurred by Mr. [PARTY NAME REDACTED] in order to earn his commissions. Only a portion of these expenses are reimbursed, and then only after significant delay. Mr. [PARTY NAME REDACTED] had reached a point prior to the bankruptcy where he was no longer able to obtain the credit necessary to advance these costs, and he was forced to try to eliminate his travel expenses. This attempt has resulted in a reduction of income and the dissatisfaction of his employer, placing his income and possibly his employment in jeopardy. This situation would only be exacerbated with the restrictions imposed on his spending and borrowing under a Chapter 13 plan. Add to this the changes in the company's compensation

structure, as well as a looming buyout, and it becomes clear that the U.S. trustee's assertion regarding stable future income cannot be made without significant qualification.

As for Mrs. [PARTY NAME REDACTED]'s employment, the record shows that she has changed jobs once since the case was filed, and her new employment is with a startup company. Stability of employment is not guaranteed in her case, either.

This discussion also makes clear that the debtors have already reduced expenses to an extent that their ability to provide for necessities is endangered. They only have one car, and while the U.S. trustee alleges that it is a luxury, the facts suggest otherwise. The vehicle is now 4 model years old, and neither the loan balance or monthly payment are excessive or more than what the Debtors would be forced to pay if, under a Chapter 13 plan, they were forced to surrender the vehicle and obtain post-petition financing on another. Mr. [PARTY NAME REDACTED] also borrowed against the entire balance of his 401(k) account to fund a negotiated settlement of a significant debt. The U.S. trustee argues that by structuring that transaction as loan, the debtor has sheltered income from creditors. In fact, the debtors were obligated to repay the withdrawal from the 401(k) in order to avoid significant tax liability, which would have only worsened their financial situation.

Other remaining factors are easily dealt with, and do not necessarily weigh toward a finding of substantial abuse. The debtors would qualify to file under Chapter 13, and the debtors do not have equity in any asset sufficient to fund negotiated settlements outside of bankruptcy.

Finally, the analysis requires consideration of the good faith of the debtors under the totality of the circumstances. The U.S. trustee has suggested that certain aspects of the case suggest bad faith, namely that the debtors are living beyond their means, have incurred debt beyond their ability to pay, have incurred unnecessary expenses for the care their pet and for the assistance of Mr. [PARTY NAME REDACTED]'s daughters, and are retaining extravagant assets. The debtors, by providing additional detail and explanation herein, have refuted those allegations and shown their good faith.

In applying the ten *Stewart* factors, the Debtors believe that the court should not find that substantial abuse exists in the present case.

The U.S. trustee believes that the facts of the present case are "strikingly" similar to the facts of *In re Carlton*, 211 B.R. 468 (Bkrtcy.W.D.N.Y 1997), in which the court held that substantial abuse existed where the debtors contributed to their 401(k) instead of using those funds to pay creditors, voluntarily reduced their work hours post-petition, tried to maintain payments on three vehicles, and were found to have expenses "far and away" in excess of the expenses typical of a family in their area.

The U.S. trustee argues the cases are similar and that substantial abuse exists because the [PARTY NAME REDACTED] and the Carltons both had stable employment, high consumer debt, and high monthly expenses. In fact, the similarities to the *Carlton* case are superficial at best. In the present case, the debtors have both experienced recent divorces and the accompanying expenses, there is a serious question as to the stability of Mr. [PARTY NAME

REDACTED]'s employment, the debtors are proposing to make payments on only one vehicle for two working adults, and there is no allegation that their expenses are in excess of what is typical of a family living in Park City, Utah. The present case is clearly distinguishable from the *Carlton* case, and a similar finding is not warranted.

The *Carlton* case was also decided under what is known as the "hybrid" or "blended" test of substantial abuse rather than the "totality of the circumstances" test in place in the Tenth Circuit. Under the hybrid test, the court first looks at ability to pay, then looks at other factors to see if those factors mitigate against a finding of substantial abuse. Under the totality of the circumstances test, the court must look at all the *Stewart* factors, taking each case on a case-by-case basis and considering the totality of the circumstances of each individual debtor.

The U.S. trustee also has supplied the court with a number of pre-*Stewart* cases from other circuits regarding the issue of support for adult children at the expense of creditors. While those cases do apparently support the assertion of the U.S. trustee, the debtors note that in their case, the "adult" child is only 19 years old, and the cased cited were again all rendered prior to the establishment of the totality of the circumstances test. Even if the court were to adopt these opinions, those holdings only go to one of ten factors the court must consider in this analysis, and the debtor believe that the total weight of the circumstances is against a finding of substantial abuse.

Following the Tenth Circuits decision in *Stewart*, the District of Utah has published two opinions on the question of substantial abuse under Section 707(b). In *In re Dabbas*, 00-21217

GEC, Judge Clark held that substantial abuse existed where the debtor had, at the time of filing, a monthly income of $21,365 and monthly expenses of $15,198, had significant ability to reduce expenses without suffering hardship, and a number of other factors point to an extravagant lifestyle and an ability to pay their debts. In the *Stewart* case, the debtor had both intentionally reduced his income far below his actual earning potential as a medical doctor, had incurred substantial debt, and was arguably acting in bad faith in a number of ways. Both *Dabbas* and *Stewart* involve circumstances where substantial abuse could be easily found even without the guidance of the *Stewart* test. Both cases involved debtors with professional degrees in medicine and high earning potential.

This case, like the case of *In re Snow*, 03-20144 WTT (Local Opinion 439) (no relation to present debtor's counsel), is a much closer question. In *Snow*, the debtors scheduled monthly income of $9,949.62 and expenses of $9,965.57. The expenses of the debtors included significant costs for housing, medical expenses, optional educational expenses of the debtor's minor children, travel expenses occurred in commuting between Salt Lake and Park City, multiple auto loan payments, dining and fast food, apparently high expenses for groceries and household supplies, and the care of two to four horses. There was also some evidence that the income of the debtors exceeded that disclosed on the schedules. Again, the debtor in *Snow* was dentist, with high earning potential.

In the *Snow* case, the court found that substantial abuse existed, and found that of the *Stewart* factors, ability to pay, lack of unique hardship, the existence of at least one instance of a

debt incurred beyond ability to pay, stability of income, ability to reduce expenses, and qualification for chapter 13 relief all weighed in favor of that outcome.

Of the cases discussed herein and presented by the U.S. trustee, the *Snow* case is most like the present case, and yet the present case is easily factually distinguishable. As a result of these factual distinctions, the court may properly reach a different result. The [PARTY NAME REDACTED]'s have not misrepresented their income, nor do they have all of the optional expenses the court believed the Snows could do without. The debtors are not professionals, and while they have relatively high income, it is far from certain that they would be able to maintain that level of income if they experienced a change in employment. In particular, the questionable stability of income and the impact Chapter 13 would have on the debtor's earning ability, together with the lack of an extravagant lifestyle by the present debtors weigh strongly against a finding of substantial abuse.

The *Stewart* court noted that Congress apparently passed Section 707(b) intending to "address the problem of consumer debtors taking *inordinate advantage* of modern easy credit practices, running up consumer debt, and then seeking discharge of that debt." In making that statement, the court referred to *In re Kornfield*, 164 F.3d 778 (2nd Cir. 1999), another case which like *Stewart, Dabbas,* and *Snow* involving debtors with professional degrees and high income potential. The *Kornfield* court stated that Congress added Section 707(b) out of concern "that debtors who could over time *easily* pay their creditors might resort to Chapter 7 to erase their legitimate obligations." (Emphasis added in both quotations).

Again, this is a closer case than those discussed above. In light of that, the Court should take note of three other considerations as it conducts its analysis. The first of these considerations is the discretionary nature of the substantial abuse dismissal. As the court noted in *Snow*, Section 707(b) does not require a dismissal upon a finding of substantial abuse, but rather the code only states that the court "may" dismiss the case upon such a finding. Further, the court must find that the discharge would substantially abuse a provision of Chapter 7, not the bankruptcy code in general or Chapter 13. The Debtors note that the *Stewart* court deleted the very relevant words "of this chapter" out of their recitation of the language of Section 707(b), and failed to address this issue in any meaningful way in their analysis.

The second and third items for consideration are the requirement in Section 707(b) that the debtors receive a presumption in favor of granting their discharge and the use of the word "substantial" as a modifier the Section. These considerations are not widely discussed in the relevant cases, and are ignored completely in the *Stewart* opinion.

The debtors argue that these two considerations may at least provide the court with guidance in the use of and the extent of its discretion in entering a dismissal under Section 707(b), especially in a close case. First, the Debtors are be presumed to be entitled to a discharge. Black's Law Dictionary defines a presumption as "a rule of evidence which has the effect of shifting either the burden of proof or the burden of producing evidence." A rebuttable presumption is further defined as "an ordinary presumption which must, as a matter of law, be made once certain facts have been proved, and which is thus said to establish a *prima facie*

conclusion." Under the provisions of Chapter 7, the Debtor is presumed to be entitled, or has established a *prima facie* case that he is entitled, to a discharge. Parties opposing the discharge must overcome at least the *prima facie* case. The use of the "substantial" modifier gives guidance as to how much evidence the opposing party must provide, especially when coupled with Congressional intent that 707(b) should address debtors who have taken inordinate advantage of the credit system, or who can easily repay their debts. There must be more than just "abuse." Whatever abuse exists must be substantial to warrant a dismissal. In a close case, there may be some reason for believing the debtors have abused the credit system, but the requirement that the abuse be substantial may give guidance to court in exercising its discretion in light of the overall purpose of the bankruptcy code to facilitate the fresh start and financial rehabilitation of the debtor.

In addition to the requirement that abuse be substantial, the substantial abuse must somehow violate the provisions of Chapter 7, not Chapter 13, nor of the rest of the bankruptcy code. Inherent in the argument that an ability to pay constitutes substantial abuse, or should even be taken into consideration in substantial abuse analysis, is the idea that Chapter 7 requires a debtor to pay his debts. Beyond the surrender of non-exempt property for the purposes of liquidation, however, Chapter 7 contains no such requirement. The case law on substantial abuse has essentially ignored this aspect of the provision's plain language, and has given it quite a different meaning. In fact, it is difficult to see how any individual consumer debtor could abuse, substantially or otherwise, the provisions of Chapter 7 other than those set forth in Section 727.

It would not be unreasonable, given the plain language of Section 727 and the silence of the Tenth Circuit on this aspect of the Section, to infer that a substantial abuse dismissal must be based in some way upon a breach of the debtors duties, as enforced through Section 727. No such allegation exists in this case. Seen in this light, the statement of presumption in favor of discharge could even be seen as a prohibition against the kind of interpretation of 707(b) supported by the U.S. trustee and the *Stewart* and *Kornfield* courts, essentially warning interested parties that 707(b) was not intended to be a method of forcing debtors out of Chapter 7. If, as the *Stewart* and *Kornfield* courts hold, Congress intended ability to pay debts to be a basis for denying a Chapter 7 discharge, Congress could and should have clearly said so. Instead it limited substantial abuse review solely to the provisions of Chapter 7.

CONCLUSION

For the reasons set forth above, the Debtors do not believe that a basis exists upon which the Court can make a finding that granting them a discharge constitutes substantial abuse of the provisions of Chapter 7. The weight of the application of the *Stewart* analysis to the facts of the present case does not outweigh the presumption that the Debtors are entitled to a discharge.

WHEREFORE, the Debtors therefore respectfully ask the Court to deny the Motion of the U.S. Trustee to Dismiss this case. In the event the U.S. Trustee's motion is granted, the Debtors ask the Court to allow sufficient opportunity to convert their case to one under another applicable chapter of the bankruptcy code.

DATED: December 16, 2004

David W.M. Snow, P.C.

/S/ David W.M. Snow
David W.M. Snow
Attorney for Debtors