UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE

In re:

THEODORE MARVIN SWINGLE
OLIVIA DEL SWINGLE

Debtors

No. 98-12948
Chapter 7

MEMORANDUM

Appearances: Mark T. Young, Mark T. Young & Associates, Chattanooga, Tennessee, Attorney for Debtors

Gary E. Lester, Mayfield & Lester, Chattanooga, Tennessee, Attorneys for Tennessee Valley Federal Credit Union

John M. Hull, Foster, Foster, Allen & Durrence, Chattanooga, Tennessee, Attorneys for William M. Foster, Trustee

HONORABLE R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE

The debtors, Mr. and Mrs. Swingle, filed a joint petition commencing this Chapter 7 bankruptcy case. Tennessee Valley Federal Credit Union ("Credit Union") has filed a motion to dismiss the case for cause. 11 U.S.C. § 707(a). As cause for dismissal, the Credit Union alleges the debtors filed their bankruptcy petition in bad faith. The Credit Union contends the debtors want to continue lavish and excessive spending for their own benefit while paying nothing to their unsecured creditors; in other words, the debtors allegedly filed in bad faith because they would be able to pay a portion of their unsecured debts in the future if they reduced their expenses to those reasonably necessary for their support.

The facts come primarily from the schedules filed by the debtors in their bankruptcy case, but Mr. Swingle also testified at the hearing on the motion to dismiss.

The schedules list the following property subject to secured debts:

Property	**Owner**	**Value**	**Secured Debt**
House & lot (residence)	Mr. Swingle	$105,000	$89,250
1994 Toyota Celica	Joint	$9,425	$9,735
1994 Plymouth Voyager	Mrs. Swingle	$8,175	$7,893
Television	Joint	$800	$2,135
Furniture	Mr. Swingle	$1,500	$2,744

In their statement of intent, the debtors propose to reaffirm these debts.

Mr. Swingle claimed a $5,000 homestead exemption in the house and lot. The schedules list two Individual Retirement Accounts totaling $35,000. Both are claimed as exempt. No objection has been filed to the debtors' claim of exemptions.

The schedules reveal that Mr. Swingle's unsecured debts total about $101,000. This includes about $4,500 on student loans for one of this daughters. The remainder of about $96,500 appears to be credit card debt. Mr. Swingle testified that the schedules omit two student loan debts that he incurred for his youngest daughter when she was 20 or 21 years old. She is now 25.

The schedules list one unsecured debt owed solely by Mrs. Swingle, a credit card debt of about $4,600.

The schedules list two joint debts, one to J. C. Penney and the other to Citizens Savings and Loan Association. They total about $900.

The schedule of current income originally listed Mr. Swingle's income as wages, salary or commissions, but it did not show any payroll deductions for taxes and social security. The schedule was amended to show Mr. Swingle's income as regular income from the operation of a business.

The amount is given as $5,038 per month. In its post-trial brief, the Credit Union referred to this amount as net income. The court disagrees. The amount stated appears to be gross income without subtracting federal withholding taxes. The schedule

of current income calls for the debtor to list gross monthly income before the deduction of income tax and social security withholding. The schedule of expenses asks for taxes that are not withheld from earnings or paid as part of a mortgage payment. Mr. Swingle testified that he pays estimated federal taxes and that his accountant has estimated them to be $4,000 per quarter. He also testified that he pays real property tax directly instead of paying it as part of his mortgage payment. The schedule of current expenses lists this tax expense as $1,410 per month. This amount is consistent Mr. Swingle's testimony regarding payment of estimated federal withholding taxes and real property taxes. The court can not say that the estimated federal tax of $4,000 per quarter is obviously more than Mr. Swingle would pay on income of about $60,000 per year. Thus, it appears Mr. Swingle's income of $5,038 per month is income before payment of federal withholding taxes.

The evidence, however, is confusing because of one exchange between Mr. Swingle and the Credit Union's lawyer. The lawyer apparently asked Mr. Swingle about gross income from his business, and Mr. Swingle said he did not have the information with him. The lawyer then questioned him about his business expenses. This leads the court to conclude that the Credit Union's lawyer and Mr. Swingle were thinking of gross revenues, not gross income, from Mr. Swingle's business.

Mrs. Swingle's net income from her wages or salary is listed as about $1,200 per month.

The Credit Union's objection has focused on four expense items as evidence of excessive or lavish spending by the debtors. The schedule of expenses lists them as follows:

Food	$550 per month
Life insurance premiums	$737 per month
Christmas and birthdays	$125 per month
Vacations	$200 per month.

With regard to the life insurance premiums, Mr. Swingle testified as follows. The listed amount includes a disability insurance premium of $349 per month on a policy that will pay $4,000 per month. The balance of the amount goes for life insurance premiums on several policies on his life. Apparently each of his daughters is the beneficiary of a policy insuring him for $100,000, and his wife is the beneficiary of other policies insuring him for $550,000.

Mr. Swingle explained his financial circumstances as follows. When he graduated from medical school in 1984, he didn't have any money. He had two children to support and went through a divorce in 1984 or 1985. He did not have the time to do a residency and has never obtained a license to practice medicine. He does physical examinations for insurance companies, which is allowed by Tennessee law. He re-married. He also bought a small house. His stepdaughter and her two children moved in with him and his wife. She did not receive any child support, and they helped to support her and the children. At this time, his two daughters were in college. His step-daughter

and children moved out a few weeks before the hearing, but he and his wife continue to help support them. He tried to re-work his finances but was unsuccessful.

DISCUSSION

Bankruptcy Code § 707(a) allows the court to dismiss a Chapter 7 bankruptcy case for cause. Section 707(a) lists several causes for dismissal but not bad faith. 11 U.S.C. § 707(a). The Sixth Circuit has held that the list does not state the only causes for dismissal, and bad faith is also a cause for dismissal. 11 U.S.C. § 707(a); *Industrial Insurance Services, Inc. v. Zick (In re Zick)*, 931 F.2d 1124 (6th Cir. 1991).

The Credit Union contends the debtors have filed in bad faith because they have the ability to pay a portion of their unsecured debts from future income that is not reasonably necessary for their support or the support of their dependents.

The "reasonably necessary" standard is derived from Chapter 13. An unsecured creditor can object to confirmation of a proposed Chapter 13 plan on the ground that it does not provide for the debtor to pay all his disposable income into the plan for a three year period. 11 U.S.C. § 1325(b)(1)(B). Disposable income is measured by deducting from the income received by the debtor only the expenses that are reasonably necessary for the support of the debtor and dependents. 11 U.S.C. § 1325(b)(2)(A). There is an additional restriction on calculating the income of a debtor who operates a business; the business's income is calculated by deducting only expenses that are necessary to the continuation, preservation, and operation of the business. 11 U.S.C. §

1325(b)(2)(B). In summary, to meet the disposable income test, a Chapter 13 debtor may be required to reduce (1) personal expenses that are not reasonably necessary for support of the debtor and dependents, and (2) if the debtor is engaged in business, expenses of the business that are not necessary to its continuation, preservation, or operation.

The Credit Union's argument on this point is not necessarily limited to debtors who are eligible for Chapter 13 or could propose a confirmable plan. The theory is simpler: the court should consider the debtors' ability to pay unsecured debts in the future if they engage in some "good, old-fashioned belt tightening." *In re Krohn*, 886 F.2d 123, 128 (6th Cir. 1989).

The Credit Union's argument raises a question regarding the relationship between the dismissal for cause under § 707(a) and dismissal on the ground of "substantial abuse" under § 707(b). 11 U.S.C. § 707(b).

The substantial abuse standard in § 707(b) applies only in Chapter 7 cases and only to an individual debtor whose debts are primarily consumer debts. It allows the court to dismiss a case if granting relief would be a "substantial abuse" of the provisions of Chapter 7. Only the court or the United States Trustee can raise the question of substantial abuse. A creditor can not move to dismiss a case for substantial abuse. 11 U.S.C. §§ 707(b), 109(8) & 103(b).

The debtors contend the Credit Union's motion to dismiss for bad faith should be denied because it is equivalent to a motion to dismiss for substantial abuse, and § 707(b) does not allow a creditor to obtain dismissal for substantial abuse.

This problem occurs only when the debtor owes primarily consumer debts. Section 707(b)'s prohibition on creditor action appears to mean the court can not allow a creditor to obtain dismissal for cause under § 707(a), on the ground of bad faith, *if* bad faith means the same thing as substantial abuse.

This raises the question of whether bad faith is the same thing as substantial abuse. The Sixth Circuit dealt with proof of substantial abuse in *In re Krohn*, 886 F.2d 123 (6th Cir. 1989). The court held that the substantial abuse standard was added to the bankruptcy law to curb the use of Chapter 7 by dishonest or non-needy debtors. *Krohn*, 886 F.2d 123, 126-27.

As to honesty, the court did not attempt to set out all the factors that might be relevant. It did say the courts should consider the debtor's good faith and candor in filing the schedules in the bankruptcy case, whether he made eve of bankruptcy purchases, and whether he was forced into bankruptcy by unforeseen or catastrophic event. *Krohn*, 886 F.2d 123, 126.

As to neediness, the court said:

> Among the factors to be considered in determining whether a debtor is needy is his ability to repay his debts out of future earnings. [Citation omitted.] That factor alone may be sufficient to warrant dismissal. For example, a court would not

> be justified in concluding that a debtor is needy and worthy of discharge, where his disposable income permits liquidation of his consumer debts with relative ease. Other factors relevant to need include whether the debtor enjoys a stable source of future income, whether he is eligible for adjustment of his debts through Chapter 13 of the Bankruptcy Code, whether there are state remedies with the potential to ease his financial predicament, the degree of relief obtainable through private negotiations, and whether his expenses can be reduced significantly without depriving him of adequate food, clothing shelter and other necessities.

Krohn, 886 F.2d 123, 126-27.

The Sixth Circuit considered bad faith as a ground for dismissal in the *Zick* case. *Industrial Insurance Services, Inc. v. Zick (In re Zick)*, 931 F.2d 1124 (6th Cir. 1991). Describing dismissal on the ground of bad faith, the court said:

> It should be confined carefully and is generally utilized only in those egregious cases that entail concealed or misrepresented assets and/or sources of income, and excessive and continued expenditures, lavish lifestyle, and intention to avoid a large single debt based on conduct akin to fraud, misconduct, or gross negligence.

Zick, 931 F.2d 1124, 1129.

This statement suggests that bad faith requires proof of more than ability to pay a portion of unsecured debts in the future, after eliminating expenses that are not reasonably necessary. The facts in *Zick* support this conclusion. The debtor had substantial income that could be used to pay a large unsecured debt that was essentially the only unsecured debt. But there were other aggravating circumstances, primarily regarding the origin of the debt. The debt arose from the debtor's intentional breach of a

non-competition agreement with his former employer. The debtor received a substantial income from the business he conducted in breach of the agreement. Furthermore, the former employer's claim was the only unsuspicious unsecured debt. The other scheduled debts were to the debtor's mother, his wife, and his attorneys. Finally, the debtor transferred property shortly before bankruptcy that may have been intended to hinder the former employer's collection attempts. The court concluded that the case was correctly dismissed as having been filed in bad faith.

The court included in its opinion one quotation from *Krohn*, which might be taken as suggesting that bad faith is the same thing as substantial abuse.

> We believe the following language from *In re Krohn* . . . while dealing with § 707(b) of the Code is instructive also as to § 707(a):
>
> > Those courts which have reviewed the legislative history, have generally concluded that, in seeking to curb "substantial abuse," Congress meant to deny Chapter 7 relief to the dishonest or non-needy debtor.
> > . . . .
> >
> > The goals of bankruptcy are to provide an honest debtor with a fresh start and to provide for an equitable distribution to creditors. The debtor herein, although he has minimal assets, appears to be seeking a "head start" with no attempt to deal with creditors on an equitable basis.
>
> 886 F.2d at 126, 127-28.

Zick, 931 F.2d 1124, 1128.

An earlier part of the opinion suggests, however, that bad faith can not be based solely on the debtor's ability to repay. The Sixth Circuit described the lower court opinions as finding bad faith on the basis of (1) the debtor's manipulations which reduced the creditors in this case to one; (2) the debtor's failure to make significant lifestyle adjustments or efforts to repay; (3) the fact that the petition was filed clearly in response to IIS's obtaining a mediation award; and (4) the unfairness of the debtor's use of Chapter 7 under the facts of this case. *Zick*, 931 F.2d 1124, 1128.

Likewise, the *Krohn* opinion suggests that substantial abuse added something to the law — that it added the power to dismiss a case when the facts do not show bad faith:

> Section 707(b) introduces an additional restraint upon a debtor's ability to attain Chapter 7 relief. *Walton*, 866 F.2d at 983 (§ 707(b) is more than a needless duplication of the "other provisions of the Code that have always required petitions to be filed in good faith"). "[D]ismissal for substantial abuse is intended to 'uphold [ ] creditors' interests in obtaining repayment where such repayment wold not be a burden.'" *In re Kelley*, 841 F.2d 908, 914 (9th Cir. 1988).

Krohn, 886 F.2d 123, 126.

In the *Walton* case, referred to in the quotation, the Eighth Circuit held that the case could be dismissed for substantial abuse solely on the basis of the debtor's ability to pay because substantial abuse was not limited to bad faith.

This reasoning leads to different methods of explaining the relationship between substantial abuse and bad faith. The court might say that bad faith is a narrower

ground for dismissal than substantial abuse. *First USA v. LaManna (In re LaManna)*, 153 F.3d 1 (1st Cir. 1998). Conversely, proof of "bad faith" requires more or different evidence than proof of substantial abuse. This seems to be clear in one respect. Proof of the ability to pay in the future can not by itself prove bad faith, but it can prove substantial abuse. *In re Khan*, 172 B.R. 613 (Bankr. D. Minn. 1994); *In re Bridges*, 135 B.R. 36 (Bankr. E. D. Ky. 1991).

Another explanation may be more helpful. Bad faith cases can be viewed as a subset of substantial abuse cases. If a creditor proves bad faith, it necessarily proves substantial abuse. Thus, the same facts that prove substantial abuse *may* also prove bad faith, with one exception: the ability to pay by itself can prove substantial abuse but not bad faith. *In re Barnes*, 158 B.R. 105 (Bankr. W. D. Tenn. 1993).

Viewed from this perspective, the question is whether § 707(b) was intended to prevent a creditor from obtaining dismissal for bad faith by subsuming bad faith into substantial abuse and prohibiting creditors from obtaining dismissal for substantial abuse. The court thinks not.

In effect, the Sixth Circuit's opinion in *Zick* has given a negative answer to this question. The Sixth Circuit recognized the right of a creditor to obtain dismissal on the ground of bad faith. The Eighth Circuit has also allowed a creditor to obtain dismissal on the ground of bad faith. Though the court criticized the use of "bad faith" to describe the

ground of dismissal, it dismissed the case based on facts similar to those in *Zick*. *Huckfeldt v. Huckfeldt (In re Huckfeldt)*, 39 F.3d 829 (8th Cir. 1994).

The court concludes that Congress intended the substantial abuse standard to provide grounds for dismissal other than traditional grounds that can be collected under the heading of "bad faith." In particular, substantial abuse added the debtor's ability to pay in the future as a sufficient ground by itself for dismissal. Congress did not intend to take away from creditors the right to obtain dismissal on the ground of bad faith simply because proof of bad faith will necessarily prove substantial abuse.

The final question is whether the facts of this case show bad faith. This is not a case in which the debtors have incurred one large debt as a result of wrongful conduct and are seeking to discharge it even though they have income that would allow substantial payments over time. *See, e.g., Industrial Insurance Services, Inc. v. Zick (In re Zick)*, 931 F.2d 1124 (6th Cir. 1991); *In re Spagnolia,* 199 B.R. 362 (Bankr. W. D. Ky. 1995).

The *Huckfeldt* case involved a clear misuse of the bankruptcy process. The main creditor was the debtor's ex-wife. He filed the bankruptcy to avoid the effect of the divorce decree and to force her into bankruptcy. The debtor had the ability to pay a substantial amount over time but had intentionally reduced his income. The court held that the case was properly dismissed as having been filed in bad faith. The debtor filed it for a non-bankruptcy purpose — to prevent the divorce decree from having effect — not for

the purpose of a just liquidation.[1] *Huckfeldt*, 39 F.3d 829, 832. The facts of this case do not reveal misuse of the bankruptcy process for a non-bankruptcy purpose.

The facts of this case are similar to the facts that led to dismissal in another case on both grounds, bad faith and substantial abuse. *In re Barnes*, 158 B.R. 105 (Bankr. W. D. Tenn. 1993). But the facts of that case were more egregious — especially the debtors' spending spree shortly before filing. The court also emphasized that the debtors were attempting to favor some creditors over others even though all the debts arose from the same home improvement project shortly before the bankruptcy. There were also problems with the debtors' schedules.

The courts have referred to excessive spending and lavish lifestyle as evidence of bad faith. The evidence does not show exactly how or why the debtors incurred the large amount of credit card debt they owe. The court will not assume they simply lived high with no regard to their creditors. Mr. Swingle's testimony does not suggest that. The debts may have built up over a fairly long period of time. Credit card debts can build rapidly in light of the interest rates often charged on the unpaid balance.

The debtors obviously have a strong urge to financial discipline when it comes to protecting themselves and Mr. Swingle's daughters. They have kept up

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[1] The court discussed the reasoning of the *Khan* case that ability to pay should have no bearing on the question of bad faith. *Huckfeldt*, 39 F.3d 829, 832, *citing In re Khan*, 172 B.R. 613 (Bankr. D. Minn. 1994). But ability to pay was obviously given weight in the decisions by the bankruptcy court and the court of appeals. Indeed, the court suspects that ability to pay can not be totally ignored. It is likely to be a relevant fact in determining bad faith even under traditional rules that allow the court to dismiss a case for fraud on the court or misuse of the process.

payments on secured debts. They have dutifully paid insurance premiums to protect themselves and Mr. Swingle's daughters. They have set aside money in individual retirement accounts. They have accomplished these goals while accumulating a large amount of unsecured credit card debt.

The debtors also scheduled $2,400 per year for vacations and $1,500 per year for Christmas and birthday gifts. Mr. Swingle was not questioned about these amounts, but they are significantly large compared to the debtors' income.

Nevertheless, the court thinks the facts are not sufficient to show bad faith. In this regard, the Credit Union's focus has been somewhat misdirected. Its claim of bad faith is based on the debtor's ability to pay in the future if they reduce some expenses. Ability to pay in the future can be cause for dismissal on the ground of substantial abuse under § 707(b), but by itself, it does not prove bad faith as a ground for dismissal under § 707(a).

The cases dealing with bad faith, however, reveal a great concern with the debtor's pre-petition conduct. Whether the debtor filed in bad faith depends generally on the purpose and effect of the bankruptcy filing in light of the debtor's pre-petition conduct. Of course, the debtor's financial prospects after bankruptcy can hardly be ignored as a continuation of the same wrongful behavior or intent to abuse the bankruptcy process.

The court has taken into account the debtors' pre-petition conduct. The debtors took care of themselves and Mr. Swingle's daughters ahead of the credit card

issuers. Such conduct is common, if not expected. From the debtors' viewpoint, it was the wise course of action. It was a businesslike decision such as the court has seen in numerous business cases. Debtors should be allowed some leeway in taking care of themselves and family ahead of paying creditors without being held to have filed in bad faith.

The facts do not show the debtors were experiencing *la dolce vita* at the expense of the credit card issuers while having a contemptuous disregard for payment of the credit card debts. The debtors could have paid a portion of their credit card debts if they had budgeted differently. If forced into a Chapter 13 case, they could pay a portion of the credit card debts. But the debtors are not wealthy people with the obvious ability to pay, and the desire simply to avoid it. They appear to be honest debtors in need of bankruptcy relief. In summary, this is a common kind of case. It is not an egregious case that should be dismissed on the ground of bad faith. *Zick*, 931 F.2d 1124, 1129.

The court will enter an order accordingly.

This Memorandum constitutes findings of fact and conclusions of law as required by *Fed. R. Bankr. P.* 7052.

ENTER:

BY THE COURT

entered November 20, 1998

R. THOMAS STINNETT
UNITED STATES BANKRUPTCY JUDGE

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF TENNESSEE

In re:

THEODORE MARVIN SWINGLE
OLIVIA DEL SWINGLE

Debtors

No. 98-12948
Chapter 7

ORDER

In accordance with the Memorandum Opinion entered this date,

It is ORDERED that the Motion to Dismiss filed by Tennessee Valley Federal Credit Union is DENIED.

ENTER:

BY THE COURT

entered November 20, 1998

R. THOMAS STINNETT
U.S. BANKRUPTCY JUDGE