IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:	)	CASE NO. BK04-41973
	)	
DONALD FRANK and	)	
SABINA N. FRANK,	)	CH. 7
	)	
Debtor(s).	)	

MEMORANDUM

Hearing was held on October 13, 2004, in Lincoln, Nebraska, regarding Filing No. 7, Motion to Dismiss Case Under 11 U.S.C. § 707(b) for Substantial Abuse, filed by the U.S. Trustee, and Filing No. 11, Objection, filed by the debtors. Carla J. Alexander appeared for the debtors and Jerry Jensen appeared for the U.S. Trustee. This memorandum contains findings of fact and conclusions of law required by Federal Rule of Bankruptcy Procedure 7052 and Federal Rule of Civil Procedure 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(A).

The debtors have filed a Chapter 7 case and the United States Trustee has filed a motion to dismiss for substantial abuse under 11 U.S.C. § 707(b). The motion is denied.

The debtors' Amended Schedules I and J show total monthly net income of $5,501.37 and monthly expenses of $6,069.70. These expenses exclude any payment on unsecured debt. In other words, these are the expenses the debtors have now and will have following the entry of a discharge in the Chapter 7 case. It is clear from the schedules that the debtors, even after receiving a bankruptcy discharge, do not have sufficient income to cover their monthly expenses.

The United States Trustee, however, suggests that the debtors have more income available to them and should have fewer expenses. It is the position of the United States Trustee that if the income was properly adjusted and the expenses were modified, the debtors would have significant funds available which would enable them to pay creditors outside of bankruptcy or through a Chapter 13 plan. The debtors have scheduled $163,000 in unsecured debt.

The first income adjustment suggested by the United States Trustee relates to the fact that there is withheld from Mr. Frank's paycheck $220.86 per month for a contribution to a 401(k) retirement plan. The second modification concerns the deduction from Mr. Frank's paycheck of $259.60 monthly which is applied to pay down a loan taken out from the 401(k) plan. The loan balance on the petition date was approximately $5,800. The 401(k) plan has a gross balance of approximately $42,000. Requiring Mr. Frank to refrain from making further deposits to his 401(k) plan and to stop making payments on the 401(k) loan arguably would provide the debtors with an additional $480 per month. Significantly, however, adding those additional funds to the income stream is still insufficient to enable the debtors to pay their monthly expenses.

In addition to the fact that bringing the 401(k) deposit and loan payment back into the income stream will not enable the debtors to pay any additional funds to unsecured creditors, there are other reasons for not requiring the debtors to stop making the payments. The 401(k) plan is an employer-sponsored plan. Mr. Frank, as a manager, is expected by his employer to participate in the 401(k) plan. The company contributes company stock to Mr. Frank's 401(k) plan account in a "matching" program. If he is not permitted to continue making monthly payments to the 401(k) plan for the duration of a hypothetical Chapter 13 plan, he will lose the benefit of the growth in the plan which accrues as a result of his contributions and those of the company. He is 48 years old and, other than Social Security, has no other retirement plan and no savings. The 401(k) plan is not highly funded, but the funds in it certainly are necessary for the long-term support of Mr. and Mrs. Frank.

If the debtors are not permitted to pay the 401(k) plan loan, they will incur a 10 percent penalty plus taxes on the outstanding balance of $5,800. The loan was taken out to pay income taxes owed by the debtors. It makes little sense to force the debtors to incur additional income taxes and penalties so the unsecured creditors can receive minimal payments. The financial harm to the debtors which would be caused by forcing them to quit paying the loan is significantly greater than the financial benefit which would accrue to the creditors outside of bankruptcy or in a Chapter 13 case.

Mr. Frank received a bonus in the gross amount of $13,000 for meeting certain company goals in 2003. The Franks netted approximately $8,000 after taxes, and they used all of it to bring their mortgages current. It is the position of the United States Trustee that if the debtors were in a Chapter 13 case and received a bonus in one or more years during the operation of the plan, the bonus money could be directly distributed to unsecured creditors as disposable income. However, Mr. Frank testified through affidavit that bonuses were not regularly granted and that he could never count on receiving a bonus. Therefore, even though in theory there may be some bonus money available for distribution to unsecured creditors in the future, there is no real reason to anticipate such funds being available. There is also no reason to require the debtors to be in a Chapter 13 plan solely in anticipation of bonuses being awarded.

On the expense side, the United States Trustee suggests that the debtors pay too much for their housing. The debtors own a three-bedroom home which they purchased in 1998 for $237,500. Its estimated value is $249,900. The assessor values the property for tax purposes at $227,605. The debtors explained that they purchased the house for a number of relatively unique reasons. First, Mr. Frank is a manager of a local department store in Kearney, Nebraska. His employer expects him, as manager, to live in a suitable house to entertain throughout the year and to remain active in the community. He has been employed with the company for twenty-six years.

In addition to the job-related reason for purchasing the house, the house is important to the health of Mrs. Frank. She suffers from asthma and allergies. The house has no carpet, which allows for more thorough cleaning. The bare pine floors do not retain allergens like carpeted floors. That type of floor reduces the aggravation of her asthma and allergies. The house has all electric heat, well-sealed from outside allergens, and does not have mold or mildew. She takes seven medications for her health condition, and her trips to the hospital and emergency room have decreased since moving into the house.

The first mortgage on the house was, on the petition date, $152,257.88. The monthly payment on that obligation is $1,435.44. However, the debtors have a second mortgage in the amount of $88,642. They pay $1,067.44 per month on that debt. The second mortgage debt was incurred in 2001. At that time, the debtors were in some financial distress and used the proceeds to pay down or consolidate other debts.

The United States Trustee argues that the debtors pay too much for housing and that if they would reduce their housing expenses to what the Internal Revenue Service considers "reasonable" for their area of the state, they would have more than $1,500 per month of available disposable income to distribute to unsecured creditors. The suggestion is that the debtors should not live in such an expensive house and therefore the "excessive" housing costs should be treated as disposable income for purposes of determining the debtors' income when constructing a hypothetical Chapter 13 plan. Of course, such a suggestion assumes that debtors in bankruptcy would be able to sell their house, pay the mortgages in full, and then purchase or rent an equivalent house that would provide Mr. Frank with the type of housing expected of him by his company and would provide Mrs. Frank the type of housing that would give her the health benefits the current home provides. There is no evidence to support the position of the United States Trustee on this issue.

The United States Court of Appeals for the Eighth Circuit has had many opportunities to discuss the application of 11 U.S.C. § 707(b). The first case which dealt with the issue is In re Walton, 866 F.2d 981 (8th Cir. 1989). In that case, the circuit court determined that it was proper for a bankruptcy court to consider the debtor's future income when applying the "substantial abuse" language of Section 707(b). Mr. Walton had a monthly income surplus of $497 which would yield a yearly surplus of $5,964. His unsecured debts totaled $26,484. Over a three-year period he could pay two-thirds of his debt and in five years he could pay one hundred percent of his debt. Under those circumstances, the court affirmed the district court which had affirmed the bankruptcy court decision to dismiss the case for substantial abuse. Then, in 1992, the circuit court, in United States Trustee v. Harris, 960 F.2d 74 (8th Cir. 1992), reaffirmed the concept that the ability to fund a Chapter 13 plan can be a sufficient reason to dismiss a Chapter 7 petition under Section 707(b). In that case, the court found that the debtors had sufficient disposable income to pay 156 percent of their unsecured debt over three years. To allow the debtors under those circumstances to obtain a Chapter 7 discharge would be "substantial abuse." In that same year, the circuit court, in Fonder v. United States, 974 F.2d 996 (8th Cir. 1992), found that the debtor could pay at least 89 percent of his unsecured debt in a three-year period and more than 100 percent in a five-year period, thus giving the bankruptcy court sufficient reason to dismiss for substantial abuse.

In Walton, 866 F.2d at 983, the circuit court acknowledged that in addition to the ability to fund a Chapter 13 plan, the bankruptcy court may take the petitioner's good faith and unique hardships into consideration under Section 707(b).

More recently, the court had another opportunity to consider the issue of "substantial abuse" in the case of Stuart v. Koch (In re Koch), 109 F.3d 1285 (8th Cir. 1997). In that case, the circuit court once again reiterated its determination in Walton that a Chapter 7 debtor's ability to fund a Chapter 13 plan is the primary factor to be considered in determining whether granting relief would be substantial abuse. The substance of the Koch decision is that in order to determine whether there has been substantial abuse, the bankruptcy court must evaluate debtor's financial condition in a hypothetical Chapter 13 proceeding. Acknowledging that a Chapter 13 case is intended to allow a debtor to preserve pre-petition assets through payment over a three- to five-year period using the debtor's regular income, the court found that the term "regular income" must include revenues from exempt sources such as disability and Social Security benefits. The court, notably, indicated that there was no requirement in a Chapter 13 plan calculation that debtors must assume that their house should be sold in order to provide revenue to fund the plan. Koch, 109 F.3d at 1288 n.3.

There is no Eighth Circuit case interpreting "substantial abuse" as used in 11 U.S.C. § 707(b) that requires a debtor to give up a home so a creditor can receive payment from the proceeds of the home or from funds made available by the sale of the home and the purchase or rental of a less expensive home. The very purpose of Chapter 13 is to permit debtors to keep their home.

In each case, the bankruptcy judge must evaluate the reasonableness of the expenses of the debtor when attempting to determine if the debtor is able to fund a Chapter 13 plan. Although the court is not required to accept the debtor's actual expenses as "reasonable," the court must necessarily consider the factors that cause the expenses to be what they are. In this case, the debtors have high housing costs because they have had years of financial difficulties, some of which were caused by medical expenses incurred on behalf of Mrs. Frank and others which were incurred on behalf of their child. There is evidence in the record, which does not need to be spread upon these pages, that they have a child with serious medical difficulties and they have in the past and currently are incurring expenses to care for the child. They did not take out a second mortgage for the purpose of gambling or purchasing fancy cars. They drive a 1997 Ford pickup and a 1987 Buick. They borrowed money from their 401(k) plan to pay income taxes. They are 48 years old, and although they enjoy a relatively high monthly income, they have no savings, a small retirement fund, high housing expenses, and no money to fund a Chapter 13 plan.

Taking the good faith and unique hardships of these debtors into consideration as allowed by the court in In re Walton, I find that these debtors do not have the ability to fund a Chapter 13 plan and allowing them to obtain a Chapter 7 discharge is not "substantial abuse" as that term is used in 11 U.S.C. § 707(b). The motion to dismiss is denied. Separate order will be entered.

DATED this 18th day of October, 2004.

BY THE COURT:

/s/ Timothy J. Mahoney
Chief Judge

Notice given by the Court to:
Carla J. Alexander
*Jerry Jensen

*Movant is responsible for giving notice of this order to all other parties not listed above if required by rule or statute.

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ORDER

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IT IS ORDERED that the U.S. Trustee's Motion to Dismiss Case Under 11 U.S.C. § 707(b) for Substantial Abuse, Filing No. 7, is denied. See Memorandum entered contemporaneously herewith.

DATED this 18th day of October, 2004.

BY THE COURT:

/s/ Timothy J. Mahoney
Chief Judge

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