CONSUMER BANKRUPTCY REFORM AND 11 U.S.C. § 707(b): A CASE-BASED ANALYSIS

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I. INTRODUCTION

The dark cloud[1] of consumer bankruptcy reform seems to have been long-looming on the horizon.[2] Indeed, each Congress since 1997 has considered specific proposals aimed at transforming consumer bankruptcy into a needs-based regime.[3] The current effort is the Bankruptcy Abuse Prevention and Consumer

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[1] *See* Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5 (1995) (quoting CHARLES WARREN, BANKRUPTCY IN UNITED STATES HISTORY 1 (1935)) ("Bankruptcy is a gloomy and depressing subject.").

[2] *See* Charles Jordan Tabb, *A Century of Regress or Progress? A Political History of Bankruptcy Legislation in 1898 and 1998*, 15 BANKR. DEV. J. 343, 345 (1999) ("[B]ankruptcy reform has been pushed by the consumer credit industry almost from the day the ink was dry on President Jimmy Carter's signature on the Bankruptcy Reform Act of 1978."). Indeed, proposals aimed at forcing more debtors into repayment plans rather than liquidation/discharge have been proposed in earnest since as early as the 1930's. In 1932, conditional discharge (discharge conditioned on payments to creditors from future income) was proposed and rejected as "[u]n-American." Richard E. Coulson, *Consumer Abuse of Bankruptcy: An Evolving Philosophy of Debtor Qualification for Bankruptcy Discharge*, 62 ALB. L. REV. 467, 500 (1998) (citing Vern Countryman, *A History of American Banking Law*, 81 COM. L.J. 226, 231 (1976)).

[3] *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2001, H.R. 333, 107th Cong. (2001); Bankruptcy Reform Act of 2001, S. 420, 107th Cong. (2001); The Bankruptcy Reform Act of 2000, S. 3186, 106th Cong. (2000); H.R. 2415, 106th Cong. (2000); Bankruptcy Reform Act of 1999, H.R. 833, 106th Cong. (1999); A Bill to Amend Title 11 of the U.S. Code to Modify the Application of Chapter 7 Relating to Liquidation Cases, H.R. 333, 106th Cong. (1999); Consumer Bankruptcy Reform Act of 1998, H.R. 3150, 105th Cong. (1998); Consumer Lenders and Borrowers Bankruptcy Accountability Act of 1998, H.R. 3146, 105th Cong. (1998); Consumer Bankruptcy Reform Act of 1997, S. 1301, 105th Cong. (1998); Responsible Borrower Protection Bankruptcy Act of 1997, H.R. 2500, 105th Cong. (1997).

Protection Act of 2003.[4] Relevant substantive aspects of this bill, which was approved by the House of Representatives on March 19, 2003,[5] are identical to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2001.[6] This Article therefore refers to this proposed legislation collectively as "the Reform Act."

As is true for many of the bankruptcy reform proposals Congress has considered in recent years, the Reform Act has as its centerpiece the concept of "means testing."[7] This would exclude debtors above a very low-income threshold

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[4] H.R. 975, 108th Cong. (2003).

[5] Carl Hulse, *House Votes to Make it Harder to Seek Bankruptcy*, N.Y. TIMES, Mar. 20, 2003, at A28.

[6] The 2001 reform legislation had wide bipartisan support. Substantially similar bills were approved by the House of Representatives as H.R. 333 and the Senate as S. 420. Originally scheduled for conference consideration on September 12, 2001, bankruptcy reform was placed on the "back burner" immediately following the terrorist attacks on the World Trade Center on September 11, 2001, with Congress focusing instead on emergency terrorism-related measures. *See* Charles Jordan Tabb, *The Death of Consumer Bankruptcy in the United States?*, 18 BANKR. DEV. J. 1, 2-4 (2001); Rhonda McMillion, *Unfinished Business: Congress Returns Attention to Patients' Rights, Bankruptcy Reform*, A.B.A. J., Jan. 2002, at 74. *See also Bankruptcy Reform Watch Resumes*, CONSUMER BANKR. NEWS, Feb. 7, 2002, at 2 (predicting that widespread economic impact of Enron's bankruptcy filing may also affect whether Congress pushes for personal bankruptcy reforms at this time).

When the 2001 legislation was again considered in the spring of 2002, the conference committee resolved differences between the House and Senate versions of the legislation concerning the homestead exemption. *See* Philip Shenon, *Congress Panel Agrees to Limit Home Shield in Bankruptcy*, N.Y. TIMES, Apr. 24, 2002, at C1. However, by then the legislation had encountered severe opposition by congressional conservatives to a late amendment inserted by Sen. Charles E. Schumer (D-NY) that while making no specific reference to abortion clinics, would have the effect of prohibiting anti-abortion protesters from discharging in bankruptcy any debts incurred as a result of court fines or judgments arising out of violent protests at such clinics. *See* Phillip Shenon, *Bankruptcy Talks Collapse on Abortion Issue*, N.Y. TIMES, May 10, 2002, at A24; Phillip Shenon, *Abortion Issue Holds Up Bill On Bankruptcy*, N.Y. TIMES, Apr. 30, 2002, at A1. Ultimately, Congressional conferees were unable to reach a compromise, and the bill failed to get out of committee prior to the 107th Congress adjourning in late July 2002. *See* Phillip Shenon, *Vote on Bankruptcy Bill Is Stalled by Abortion Provision*, N.Y. TIMES, July 30, 2002, at C3.

On February 27, 2003, Rep. James F. Sensenbrenner Jr., R-Wis, introduced H.R. 975, which is the 2001 Reform Act (H.R. 333) without the Schumer amendment. *Bankruptcy Reform Bill Introduced*, CONSUMER BANKRUPTCY NEWS, Mar. 20, 2003. However, it is likely that the Schumer amendment will be reattached to the legislation in the Senate. *See* Hulse, *supra* note 5.

[7] In addition to limiting access to chapter 7 by way of "means testing," the other primary changes that would be effectuated by this legislation include new paperwork requirements for bankruptcy filers, the elimination of "strip-down" (bifurcation of undersecured debts) in chapter 13, and the amendment of the Truth in Lending Act to

from chapter 7 and require them to file for bankruptcy under chapter 13 instead—thus requiring them to devote as much of their future income to repayment of creditors as possible.[8] Means testing has been called the most contentious of the reforms suggested for reducing the recent "precipitous increase and costs of bankruptcy filings."[9]

The Reform Act's means test, if passed into law, would replace the current standard for dismissing chapter 7 cases. Currently, 11 U.S.C. § 707(b), enacted as part of the 1984 Bankruptcy Reform Act, eliminates so-called "can-pay" filers where they are guilty of "substantial abuse."[10] After analyzing the debtor's schedules (setting forth his or her outstanding debts, monthly expenses, and monthly income), if the bankruptcy trustee believes the debtor is in abuse of the system, the trustee brings a motion to dismiss the bankruptcy case for "substantial abuse."[11] The bankruptcy judge must then decide whether to convert the case to a chapter 13 consumer debt adjustment or dismiss it altogether, denying the debtor any bankruptcy relief.

The goal of this Article is to demonstrate that existing judicially formulated "substantial abuse" tests under section 707(b) of the Bankruptcy Code serve more effectively and fairly to identify and dismiss undeserving filers than would proposed means testing, and that Congress should, therefore, reject means testing as the basis of any consumer bankruptcy reform proposal.[12]

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require additional disclosures by consumer creditors. *See* Zachary Price, *The Bankruptcy Abuse Prevention and Consumer Protection Act*, 39 HARV. J. ON LEGIS. 237, 242 (2002) (referring to 2001-2002 Reform Act).

[8] The specific means testing proposed in the Reform Act compares the debtor's monthly disposable income, as computed by a formula, to the actual amount of unsecured debt owed. If the debtor can afford to pay the lesser of twenty-five percent of his debt or $167 per month, the debtor would automatically be considered in abuse of the bankruptcy system, regardless of the debtor's circumstances. Any debtor who thus "abused" the bankruptcy system will not be granted a chapter 7 discharge of debts. Instead, such a debtor will be limited to filing under chapter 13 and repayment of debts over a five-year period. For a more extended discussion of this formula, see *infra* Part IV.

[9] Edith H. Jones & Todd J. Zywicki, *It's Time for Means Testing*, 1999 B.Y.U. L. REV. 177, 178 (1999).

[10] The term "can-pay" debtor, signifying a debtor who has the apparent "means" to pay creditors out of future income, seems to have originated in 1998. *See* Marianne B. Culhane & Michaela M. White, *Taking the New Consumer Bankruptcy Model for a Test Drive: Means-Testing Real Chapter 7 Debtors*, 7 AM. BANKR. INST. L. REV. 27, 28 (1999) (citing Elizabeth Warren, *The Bankruptcy Crisis*, 73 IND. L. REV. 1079, 1090 n.48 (1998) (introducing the idea of "the unpaid nonhousing, nonpriority debt of the 'can pay' debtors").

[11] *See, e.g.*, Jean Braucher, *Means Testing Consumer Bankruptcy: The Problem of Means*, 7 FORDHAM J. CORP. & FIN. L. 407, 431-32 (2002) (describing trustees as using "rules of thumb" for determining whether such a motion should be brought).

[12] Alternative to means testing have been proposed that are perhaps better calculated to achieve fairer composition of debtors' debts rather than eliminating some debtors from the

Part II introduces the relevant history of the consumer bankruptcy system as a whole, with a primary focus on chapter 7 discharge. In addition, this Part examines the history of bankruptcy jurisprudence, focusing on the underpinnings of the "second chance" concept that permits absolution of debt.

Part III first presents a thorough dissection of section 707(b) of the Bankruptcy Code, exploring the evolution of its language and its judicial interpretation over the years. As the Code fails to define the term "substantial abuse," courts have enjoyed significant latitude in its construction and discretion in their decisions when presented with section 707(b) dismissal motions. This Part also includes wide-ranging and in-depth analysis of both historical and current court cases tracing this Bankruptcy Code provision from its origin to the present, including a detailed discussion of the two primary judicial tests that evolved from section 707(b) and the impact they have had on "substantial abuse" law to the present. This discussion includes an analysis of the types and extent of judicial discretion inherent in the determination of substantial abuse under current law, regardless of the legal test under which the motion to dismiss a debtor's case is determined.

Part IV of this Article then briefly describes the proposed Reform Act, while Part V explains and evaluates its means test and briefly presents some of the primary arguments generally made against the new legislation—both economic and social. The authors also posit additional substantive arguments against the Reform Act's means test, highlighting the extent and desirability of judicial discretion in so-called "abuse" cases and discussing the longstanding historical intent of the bankruptcy laws to favor the debtor rather than the creditor. Finally, the authors argue that section 707(b) is more in line with the intent of the drafters of the Constitution and the legislative history of the United States than is a strict means test that allows for no judicial inquiry into particular circumstances.

Taken together with considerations from caselaw, these factors permit the conclusion, in Part VI, that Bankruptcy Code section 707(b)—the current law—and its coherent yet dynamic body of judicial interpretations should remain the standard for deciding whether personal bankruptcies should be dismissed for

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system altogether. *See, e.g.*, Jean Braucher and Charles W. Mooney, *Means Measurement Rather than Means Testing: Using the Tax System to Collect from Can-pay Consumer Debtors after Bankruptcy*, 2003 ABI JNL. LEXIS 6 (Feb. 1, 2003); Michael D. Bruckman, Note, *The Thickening Fog of "Substantial Abuse:" Can 707(a) Help Clear the Air?*, 2 AM. BANKR. INST. L. REV. 193, 201-02 (1994) (proposing a two-thirds repayment of unsecured debt within three years which could be rebutted if the debtor produces evidence of an unforeseen catastrophe that would affect future earnings); Jean Braucher, *Increasing Uniformity in Consumer Bankruptcy: Means Testing as a Distraction and the National Bankruptcy Review Commission's Proposals as a Starting Point*, 6 AM. BANKR. INST. L. REV. 1, 19-23 (1998) (suggesting either making chapter 13 repayment plans a sliding percentage of income, or making chapter 13 more attractive to debtors so that they voluntarily and more successfully complete their plans); National Bankruptcy Review Commission, *Final Report: Bankruptcy The Next Twenty Years*, Oct. 20, 1997, at 262-73, (proposing income-based repayment plans in chapter 13). Discussion of these proposals is outside the scope of this Article.

abuse of the system.

II. Historical Background of the Bankruptcy Code

A. Genesis

In medieval Italy, when a merchant fraudulently failed to pay his debts, it was the practice to destroy his trading bench.[13] Thus, the English word "bankruptcy" comes from *banqueroute*, the French word derived from the Italian *banca rotta*, or "broken bench."[14] Before the 20th Century, bankruptcy rules and practice favored the creditor and were very harsh toward the bankrupt. The focus was on recovering the investments of the creditors, and almost all early bankruptcies were involuntary.[15] In England, the first bankruptcy act was passed in 1542 under Henry VIII.[16] The law considered bankrupts criminals and subjected them to punishment ranging from incarceration in debtors prisons to death.[17]

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[13] *See* Vern Countryman, *Bankruptcy and the Individual Debtor - And a Modest Proposal to Return to the Seventeenth Century*, 32 CATH. U. L. REV. 809, 810 (1983). *See also* KAREN GROSS, FAILURE AND FORGIVENESS - REBALANCING THE BANKRUPTCY SYSTEM 91 n.3 (1997) and authorities cited therein.

[14] Countryman, *supra* note 13, at 810 (citing Max Radin, *The Nature of Bankruptcy*, 89 U. PA. L. REV. 1 (1940)).

[15] Debt collection laws permitting the recovery of the debts owed existed in early Rome. Under this practice, the merchant-debtor's "market-place bench was either broken or removed as a declaration of his bankruptcy." Steve Rhode, *Bankruptcy*, *in* THE HISTORY OF CREDIT AND DEBT, *available at* http://myvesta.org/history/history_bankruptcy.htm (last visited Feb. 7, 2003). The creditors or a magistrate would appoint a trustee, and the debtor's property was then auctioned off to the highest bidder. *See id.*

[16] F. REGIS NOEL, A HISTORY OF THE BANKRUPTCY LAW 23 (1919).

[17] *See id.* at 24. Using various ancient writs, judgment creditors could have a debtor imprisoned, "sold into slavery, or even cut . . . into pieces proportionate to each creditor's claim." Becky A. Vogt, Note, State v. Allison: *Imprisonment for Debt in South Dakota*, 46 S.D. L. REV. 334, 335 (2001) (citing WILLIAM W. BUCKLAND, A TEXTBOOK OF ROMAN LAW 618-20 (3d ed. 1963)). *See also* Carl Felsenfeld, *Denial of Discharge for Substantial Abuse: Refining - Not Changing - Bankruptcy Law*, 67 FORDHAM L. REV. 1369, 1374 (1999) (describing penalties found in Roman Twelve Tables of 451-450 B.C.); Charles Jordan Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 AM. BANKR. L.J. 325, 329-44 (1991) (describing the evolution of English bankruptcy law and noting that the death penalty for debtors persisted in the Statute of 5 George 2, Chapter 30, the law in effect at the time of the American Revolution and the enactment of the first U.S. bankruptcy law in 1800).

Other penalties, more in the nature of "self help," have been used throughout history as well. *See id.* at 369 (quoting NOEL, *supra* note 16, at 13-14) ("Extreme cases are recorded in which a debt was satisfied by the creditor violating with impunity the chastity of the debtor's wife."). *See also* Countryman, *supra* note 13, at 810 (quoting Max Radin, *Debt*, *in* 5 ENCYCLOPEDIA OF THE SOCIAL SCIENCES 32, 34 (Edwin R. A. Seligman ed., 1931))

Many Europeans first came to the United States either to work off their debts or to escape the debtors prison system.[18] Recognizing a long-established need for an orderly debt settlement process, the original framers of the Constitution gave Congress the Article I power to establish "uniform laws" of bankruptcy.[19] In the United States, early federal bankruptcy laws were typically temporary responses to bad economic conditions.[20] Today's Bankruptcy Code, in fact, evolved from the Bankruptcy Act of 1898, the first truly comprehensive set of bankruptcy laws enacted in America.[21]

Much bankruptcy legislation was written during the economic upheaval of the Great Depression. The Bankruptcy Act of 1933 and the Bankruptcy Act of 1934 were the two most significant reforms.[22] In March 1933, Congress enacted provisions for individual and farmer rehabilitation, as well as the first codification of railroad reorganization. A year later, it codified large-scale corporate reorganization for the first time.[23] Enacted amidst the worst economic crisis in U.S. history, these laws gave both individuals and companies relief from debts they could not afford to repay, in the hope that debtors would become financially solvent again.

The next major event in bankruptcy history was the enactment of the Bankruptcy Code in 1978, replacing the 1898 Act.[24] The Bankruptcy Reform Act

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("[A]bundant traces in Rome, as in Europe until recent times, of an ancient custom of seizing the corpse of a defaulting debtor as a means of enforcing payment from his heirs").

[18] The gradual abolition of debtors prisons in America began on the state level in 1821 in Kentucky. Several states had joined the movement when, in 1839, the federal government "abolished imprisonment for debt of all persons in Federal Courts in States which had so acted." David A. Moss & Gibbs A. Johnson, *The Rise of Consumer Bankruptcy: Evolution, Revolution, or Both?*, 73 AM. BANKR. L.J. 311, 313 n.13 (1999) (citing WARREN, *supra* note 1, at 52; PETER J. COLEMAN, DEBTORS AND CREDITORS IN AMERICA: INSOLVENCY, IMPRISONMENT FOR DEBT, AND BANKRUPTCY 1607-1900 256-57 (1974)).

[19] *See* U.S. CONST. art. I, § 8, cl. 4.

[20] *See generally* Tabb, *supra* note 1, at 13-32. This held true until the 20th Century. "The 1978 Act is unique in the history of the nation's bankruptcy legislation in that it was the first major enactment that was not enacted as a response to a severe economic depression." *Id.* at 32.

[21] *See, e.g.*, Tabb, *supra* note 1, at 23-26; Ann Haberfelde, Note, *A Reexamination of the Non-Dischargeability of Criminal Restitution Obligations in Chapter 13 Bankruptcies*, 43 HASTINGS L.J. 1517, 1525-27 (1992) (discussing evolution of bankruptcy law, including abolition of debtors prison).

[22] *See* DAVID A. SKEEL, DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 73-74 (2001).

[23] *See id.* at 74.

[24] *See* Tabb, *supra* note 1, at 32. Both before and after 1978, creditors (in particular the consumer credit industry after about 1960) have pushed for some type of compulsory wage-earner bankruptcy proceeding. Congress, however, has consistently rejected reform plans that deny chapter 7 relief to those with earning potential, considering these proposals to be variously "unwise, unsound, unworkable, and possibly unconstitutional." Tabb,

of 1978 substantially revamped bankruptcy practices.[25] First, it created chapter 11, a strong business reorganization chapter.[26] Similarly, it replaced the old chapter XIII with a more powerful personal debt adjustment provision.[27] In general, the Reform Act of 1978 made it easier for both businesses and individuals to file for bankruptcy protection and to reorganize.

Modern bankruptcy law and practice in the United States emphasize rehabilitating, or reorganizing, the debts of debtors in distress. But the ultimate discharge of debts has been a prominent feature of bankruptcy policy from the outset. Throughout the evolution of the Code, Congress has routinely rewritten and modified various sections addressing the prerequisites for, as well as identifying the kinds of debt excluded from, dischargeability.[28]

B. Two Different Types of Personal Bankruptcy

There are two types of bankruptcies available to consumer debtors under the Bankruptcy Code: chapter 7 liquidation, also known as "straight bankruptcy," and chapter 13 rehabilitation.[29]

Chapter 13 bankruptcies adjust and reorganize the debtor's debt. This chapter was originally intended for those individuals who did not want the stigma of a straight bankruptcy on their credit record, or who believed that repayment of creditors over time was the "right" thing to do.[30] Chapter 13 filing has always

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supra note 6, at 9.

[25] The Bankruptcy Reform Act of 1978 established U.S. Bankruptcy Courts in each federal judicial district and made the new panels courts of record with their own clerks and other staff. This act also revised and codified Title 11 of the U.S. Code, which contained the substantive and procedural laws of bankruptcy. *See generally*, Eric A. Posner, *The Political Economy of the Bankruptcy Reform Act of 1978*, 96 U. MICH. L. REV. 47, 48 (1996).

[26] This replaced old chapters X and XI, created by the 1938 Act. *See id.* at 64; Tabb, *supra* note 1, at 38.

[27] Authors of the 1978 Act hoped that more people would use the new chapter 13 provisions and repay their creditors over a multi-year period. Congress considered making chapter 13 mandatory for all filers, but ultimately chose to make it voluntary. *See* Tabb, *supra* note 1, at 35.

[28] *See generally* Tabb, *supra* note 17, at 344-69. *See also* Jeffrey Priebe, Note, Field v. Mans *and* In re Keim*: Excepting Debts from Bankruptcy Discharge and the Difference Between "Experienced Horsemen" and "Reasonable Men,"* 54 ARK. L. REV. 99, 103-04 (2001), and statutory authorities cited therein.

[29] For a more extended discussion of the relevant differences between chapter 7 "liquidation" and chapter 13 "rehabilitation," see Rocco Debitetto, Comment, *Bankruptcy Reform in Light of Increased Consumer Filings: Means-Testing Employed to Prevent Long-Run Economic Impacts on Consumers and to Cure Debtor Abuse under the Current Bankruptcy Code*, 69 U. CIN. L. REV. 641, 651-55 (2001).

[30] *See* JANE P. MALLOR, ET AL., BUSINESS LAW AND THE REGULATORY ENVIRONMENT

been on a voluntary basis only.[31] Debtors who qualify for chapter 13 relief[32] devise a repayment plan based on their available disposable income.[33] Under this plan, the debtor typically repays creditors a portion of what they are owed according to a three- to five-year payment schedule. The trustee, any unsecured creditors, and the bankruptcy judge must approve the chapter 13 plan. Neither the creditors nor the judge will do so unless it is quite rigorous, requiring the debtor to commit nearly all his disposable income to repayment of debts. If the debtor is successful in completing the court-approved chapter 13 payment schedule, the debtor's remaining debt is discharged.[34]

Unlike the chapter 13 bankruptcy program, chapter 7 of the Code is available to any consumer who alleges in his or her petition that he or she cannot pay debts as they become due.[35] A chapter 7 proceeding is usually commenced voluntarily by the debtor, but may also be initiated by creditors.[36] After the petition for relief is filed, the United States Trustee's office appoints a disinterested party to serve as the "trustee" or administrator of the case.[37] Included in the trustee's duties are collection and distribution of the debtor's property and the obligation to procure as much money as possible for creditors, particularly those who are unsecured.[38] After collecting the property of the bankruptcy estate, the trustee liquidates the debtor's assets and distributes the proceeds according to a statutorily-prescribed

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640 (11th ed., 2001). Another benefit of chapter 13 bankruptcy is that the debtor is permitted to retain more of his or her personal property than is exempted under chapter 7. *See id.*

[31] *See* Tabb, *supra* note 1, at 35.

[32] In 2001, to qualify for chapter 13 debt adjustment, the debtor's unsecured debt had to be less than $269,250 and the debtor's secured debt had to be less than $807,750. MALLOR, *supra* note 30, at 640.

[33] In making the determination whether a particular debtor qualifies for the relief a chapter 13 bankruptcy affords, courts consider whether an individual qualifies as a "debtor" under 11 U.S.C. § 109(e) (2000). Another factor considered is whether the plan proposed by the debtor is feasible, that is whether the debtor will be able to make all payments under the plan and otherwise comply with it, as prescribed by 11 U.S.C. § 1325(a)(6) (2000). Courts analyze a debtor's ability to pay debts based on the amount of the debtor's disposable income, as defined in 11 U.S.C. § 1325 (b)(2) (2000).

[34] Even if the debtor does not fully complete payments under his chapter 13 plan, the judge will generally discharge the debt if she is satisfied that the failure to pay was beyond the debtor's control. If the reasons for the debtor's failure to pay according to the plan are unacceptable, the debtor's chapter 13 proceeding is dismissed and he may proceed under chapter 7. *See* MALLOR, *supra* note 30, at 644.

[35] *See id.* at 621.

[36] *See id.*

[37] *See* 11 U.S.C. § 701(a)(1) (2000).

[38] By definition an unsecured creditor is a person or company that lends money to a debtor without requiring the debtor to provide any security (collateral) to protect the payment of the debt. *See* MALLOR, *supra* note 30, at 567.

hierarchy of creditors. Once the creditors have been paid,[39] the debtor generally receives an immediate and unconditional discharge of any further personal liability on the scheduled debts.[40]

Granting debtors in financial distress an unconditional discharge has been a central feature of the American bankruptcy laws since the Bankruptcy Act of 1898.[41] The social and economic rationale behind the unconditional discharge was explained by Congress more than 100 years ago:

> When an honest man is hopelessly down financially, nothing is gained for the public by keeping him down, but, on the contrary, the public good will be promoted by having his assets distributed ratably as far as they will go among his creditors and letting him start anew.[42]

This policy is a cornerstone of the U.S. bankruptcy system. Despite numerous assaults over the years, the concept of unconditional discharge of personal debts has persevered from the inception of the Code to the present. When Congress establishes bankruptcy laws, it must balance the needs of creditors and debtors.[43] But with respect to discharge, the presumption is and always has been in favor of the debtor, because society does not benefit from having its citizens hopelessly mired in debt.[44]

C. Perceived Abuses

From the beginning, there have been debtors looking for a "head start" instead of a "fresh start."[45] Because of these abuses, the concept of need-based bankruptcy relief has long been debated in the United States. In 1932, President Herbert Hoover recommended the following to Congress:

> The discretion of the courts in granting or refusing discharges should be broadened, and they should be authorized to postpone discharges for a time and require bankrupts, during the period of suspension, to make some

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[39] Many creditors end up getting paid only a few cents on the dollar. One commentator estimates that seventy-five percent of chapter 7 cases today are "no-asset" cases, in which unsecured creditors are paid no bankruptcy dividend. *See* SKEEL, *supra* note 22, at 7.

[40] *See* Felsenfeld, *supra* note 17 at 364 (noting that the Bankruptcy Act of 1898 eliminated the "long-standing requirement of either creditor consent or a minimum dividend as a prerequisite to obtaining a discharge").

[41] *See id.*

[42] HOUSE COMM. ON THE JUDICIARY, BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2001, H.R. REP. NO. 107-3, at 6 (2001) (quoting H.R. REP. NO. 55-65, at 43 (1897)).

[43] Over the years, various exceptions to dischargeability have been enacted to address specific abuses that prejudice creditors. *See infra* notes 47 and 51.

[44] *See* Tabb, *supra* note 17, at 364-65.

[45] *See In re* Carlton, 211 B.R. 468, 477 (Bankr. W.D.N.Y. 1997) (quoting Robert M. Thompson, Comment, *Consumer Bankruptcy & Substantial Abuse and Section 707 of the Bankruptcy Code*, 55 MO. L. REV. 247, 264-65 (1990)).

satisfaction out of after-acquired property as a condition to the granting of a full discharge.[46]

Even though Congress rejected the idea of repayment from future income at that time, President Hoover's recommendation was significant. Courts thereafter began to look at future income as a means for debtors to repay their creditors. Thus, the practice of moving debtors who had enough income to pay their creditors with future wages out of chapter 7 and into chapter 13 evolved, perhaps as a response to alleged abuses.[47]

III. DISMISSAL OF A CHAPTER 7 BANKRUPTCY PETITION FOR "SUBSTANTIAL ABUSE"

A. Enactment of 11 U.S.C. § 707(b)

The Bankruptcy Code of 1978 provided that a chapter 7 case could be dismissed for "cause."[48] A subsequent amendment permitted the court to dismiss a chapter 7 debtor only for "substantial abuse."[49] The relevant language of the Bankruptcy Amendments and Federal Judgeship Act of 1984 provides:

> After notice and a hearing, the court, on its own motion, 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.[50]

This important provision, codified as 11 U.S.C. § 707(b), was added in 1984 "as a part of a package of consumer credit amendments designed to reduce perceived abuses in the use of chapter 7."[51] Section 707(b) has always been

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[46] H.R. REP. No. 107-3, *supra* note 42, at 7 (quoting President's Special Message to the Congress on Reform of Judicial Procedure, 69 PUB. PAPERS 83, 90 (Feb. 29, 1932)).

[47] It has been held that the bankruptcy court's equating "substantial abuse" with the eligibility to fund a chapter 13 plan "does not create *de facto* involuntary Chapter 13 bankruptcy." *In re* Heller, 160 B.R. 655, 660 (Bankr. D. Kan. 1993). *See also In re* Krohn, 886 F.2d 123, 127 (6th Cir. 1989) ("There is no constitutional right to bankruptcy discharge," and "Congress, within the limits set by the Constitution, is free to deny access to bankruptcy as it sees fit.").

[48] *See* 26 U.S.C. § 1478 (1978). Cases decided under this section, now codified at 11 U.S.C. § 707(a) (2000), are outside the scope of this Article.

[49] Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984).

[50] 11 U.S.C. § 707(b) (2000).

[51] H.R. REP. No. 107-3, *supra* note 42, at 7 (quoting 6 LAWRENCE P. KING ET AL., COLLIER ON BANKRUPTCY ¶ 707.LH[2], at 707-30 (15th ed. rev. 2000)). *See generally* S. REP. No. 97-446 (1982); *In re* Green, 934 F.2d 568, 570 (4th Cir. 1991) (noting that section 707(b) was enacted in response to pressure from the consumer credit industry).

intended, at least in part, to balance the interests of a debtor who cannot pay his debts as they come due against a creditor's interest in obtaining repayment of at least a portion of the debts if such repayment would not be a burden.[52] Another stated purpose of this bill was to help citizens of middle and lower incomes receive needed consumer credit. This was done by "closing prior loopholes such as stacking state and federal exemptions, discharge of consumer debts by debtors with prospects of substantial future income, and other perceived abuses of the personal liquidation provisions, thereby restoring the confidence of the business community in applicants for consumer credit."[53]

In 1986, section 707(b) was further amended to allow the bankruptcy trustee to move for a "substantial abuse" dismissal.[54] From that point forward, the court could consider dismissal either at the prompting of the trustee or on the court's own motion, if the bankruptcy judge assigned to the case believed the debtor did not deserve relief.

B. Interpretation of Language of Section 707(b)

1. Defining "Consumer Debt"

Under section 707(b), bankruptcy judges are authorized to dismiss the chapter 7 petition of a debtor whose debts are primarily consumer debt if granting relief would constitute substantial abuse. The critical components of section 707(b)—"primarily consumer debt" and "substantial abuse"—were not, however, defined in the statute. Understandably, the section's precise terms have been the focus of many published opinions.[55]

The first requirement is that the debtor be an individual, and that the debtor's debts be of the "consumer" type.[56] The Code defines consumer debt as "debt incurred by an individual primarily for a personal, family, or household purpose."[57] Furthermore, courts have held that consumer debts are not limited

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[52] *See* S. REP. NO. 98-65, at 53, 54 (1983). As such, it was intended to "steer debtors [from chapter 7] into chapter 13." Tabb, *supra* note 17, 370 n.363.

[53] *In re* Grant, 51 B.R. 385 (Bankr. N.D. Ohio 1985) (citing 130 CONG. REC. H1810 (daily ed. Mar. 21, 1984)).

[54] *See* Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986, Pub. L. No. 99-554, 100 Stat. 3008 (1986).

[55] The bankruptcy courts have assumed responsibility for construing the section's undefined terms. *See, e.g., In re* Bryant, 47 B.R. 21, 26 (Bankr. W.D.N.C. 1984) ("[I]t is my firm impression that Congress intended to leave the definition of ["primarily consumer debts"] to the Bankruptcy Judge who has the case file before him and who can make the decision in light of all the facts and circumstances presented.").

[56] Section 707(b) is inapplicable if the court finds that the debtor is not "an individual . . . whose debts are primarily consumer debts." *See, e.g., In re* Almendinger, 56 B.R. 97, 99 (Bankr. N.D. Ohio 1985).

[57] 11 U.S.C. § 701(8) (2000); *In re* Wegner, 91 B.R. 854, 857 (Bankr. D. Minn.

only to "obligations willingly entered into" by a debtor, but also include all "debts a person would ordinarily expect to incur in his daily affairs other than business expenses."[58] In determining whether a particular debt is consumer debt for the purpose of section 707(b), a court will look at the purpose for which the debt was incurred. For example, "[i]f the credit transaction involves a profit motive, then it is not a consumer debt. On the other hand, if a debt does not involve a business transaction or potential profit motive, then the debt is ordinarily considered a consumer debt."[59]

2. What is "Primarily" Consumer Debt?

Debtors subject to dismissal for substantial abuse under section 707(b) are those whose debts are "primarily consumer debts." Courts have held that the number of the debtors' individual consumer debts is helpful in determining if his debt is "primarily" consumer debt.[60] However, the court ultimately will give more weight to the proportion of the debt that is consumer debt than to the number of such debts.[61] Accordingly, "where the total amount of the consumer debt is substantially less than the total amount of non-consumer debt, the debts cannot be considered primarily consumer debts, even if there is a greater number of consumer debts."[62] As articulated by another court, when more than half of the dollar amount owed is consumer debt, the statutory threshold is passed.[63] This is important because it limits the scope of section 707(b)'s substantial abuse provision. Though a debtor may have numerous consumer debts, if the total dollar amount is insubstantial compared to that of his non-consumer debt, his case cannot be dismissed for "substantial abuse" under section 707(b).

3. Dismissal at the Suggestion of an Interested Party

The language of section 707(b) precludes "substantial abuse" motions brought

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1998).

[58] *In re* Walton, 69 B.R. 150, 153 (Bankr. E.D. Mo. 1986).

[59] *In re* Palmer, 117 B.R. 443, 446 (Bankr. N.D. Iowa 1990); *see also In re* Restea, 76 B.R. 728, 734 (Bankr. D. S.D. 1987).

[60] *See, e.g., In re* Johnson, 115 B.R. 159, 162 (Bankr. S.D. Ill. 1990) (holding that the term "primarily," for purposes of 11 U.S.C. § 707(b), "should be evaluated in terms of both the dollar amount and number of consumer debts"); *see also Bryant*, 47 B.R. at 26 ("[W]ith regard to number, at least twelve of the Debtor's fifteen or sixteen obligations are consumer debts, and in this respect, also, his case is one involving primarily consumer debts.").

[61] *See In re* Bell, 65 B.R. 575, 577 (Bankr. E.D. Mich. 1986).

[62] *Id.*

[63] *See In re* Kelly, 841 F.2d 908, 913 (9th Cir. 1988) (citing WEBSTER'S NINTH COLLEGIATE DICTIONARY 934 (1984)); *see also In re* Stewart, 175 F.3d 796, 808 (10th Cir. 1999) (describing the term "primarily" at section 707(b) as meaning "consumer debt exceeding [fifty percent] of total debt").

by interested parties, providing instead that a dismissal motion may be filed only by the trustee or by the court *sua sponte*,[64] but not by an interested party.[65] This prevents creditors from trying to intimidate debtors into filing under chapter 13 or otherwise placing an undue burden upon them.[66] Despite the fact that most courts interpret section 707(b) to allow dismissal motions only by the court or the trustee, a few courts have interpreted this portion of the statute differently, permitting creditors to raise the "substantial abuse" argument indirectly.[67]

4. Defining "Substantial Abuse"

The fact that the term "substantial abuse" is not defined in the express language of section 707(b) has left ample room for judicial interpretation. In construing this key concept, courts consider the ability of a debtor to repay a substantial portion of his debts, as well as the effects upon the debtor and the debtor's creditors, in deciding whether relief should be granted.[68] Courts generally also bear in mind that the aim of the Bankruptcy Code is to provide a fresh start for

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[64] The term "*sua sponte*" refers to something initiated by the court's "own will or motion," *i.e.*, judicial action taken "without prompting or suggestion." BLACK'S LAW DICTIONARY 1437 (7th ed. 1999).

[65] *See* 11 U.S.C § 707(b) (2000). *See, e.g., In re* Keniston, 85 B.R. 202, 204, 223 (Bankr. D. N.H. 1988) (considering a *sua sponte* motion to dismiss for substantial abuse); *Restea*, 76 B.R. at 732-34 (discussing "party in interest").

[66] Creditors are left with section 707(a) as a possible basis for seeking dismissal of a debtor's petition. Unlike section 707(b), section 707(a) contemplates dismissal "for cause." Cause under the latter section includes: (1) unreasonable delay by the debtor that is prejudicial to creditors; (2) nonpayment by the debtor of fees or charges; and (3) failure by the debtor to file required information, such as schedules, either along with its petition or within a specified period afterwards. These grounds are not exclusive. *See, e.g., In re* Goulding, 79 B.R. 874, 875 (Bankr. W.D. Mo. 1987).

[67] It is noteworthy that the language of section 707(b) bars the court's dismissal of a debtor's chapter 7 petition "at the request or suggestion of any party in interest." It does not prohibit the trustee from making a motion at the suggestion of a creditor, or the court from considering such a motion. The phrase "but not at the request or suggestion of any party in interest" has been interpreted to modify what the court can do, since "the court" is the subject of the sentence. Section 707(b) imposes no such limitations on the trustee. Thus, courts have ruled that a trustee can file a section 707(b) motion to dismiss for substantial abuse at the suggestion of a creditor. *See In re* Clark, 927 F.2d 793 (4th Cir. 1991). *See also In re* Kornfield, 164 F.3d 778 (2d Cir. 1999) (providing that so as long as a U.S. trustee uses independent judgment, the trustee may bring a motion for dismissal for substantial abuse based on information obtained from the party in interest); *In re* Hudson, 56 B.R. 415, 420 (Bankr. N.D. Ohio 1986) (stating that unless the party or its counsel "flagrantly, intentionally, or repeatedly violates the limitations under § 707(b)," the court is not necessarily precluded from dismissing the case, despite the fact that a party in interest brought to light information that subjects the case to close scrutiny under that section).

[68] *See, e.g., In re* White, 49 B.R. 869 (Bankr. W.D.N.C. 1985).

the debtor while providing equity to and among his creditors as well as limiting the relief that the bankruptcy system affords.[69]

Over the years various interpretations have surfaced with similar results. One court resorted to the dictionary definition of the word "abuse," which is "[t]o make excessive or improper use of a thing, or to employ it in a manner contrary to the natural or legal rules for its use; to make an extravagant or excessive use, as to abuse one's authority."[70] This is the generally accepted meaning of abuse in the 707(b) context. The modifier "substantial" as used in section 707(b) has been taken to mean simply that the abuse "must be real, and not seeming or imaginary."[71] It is not likely intended to distinguish between degrees of abuse. Thus, it has been held that dismissal of a chapter 7 petition is appropriate when a bankruptcy court determines that any abuse is involved.[72]

Irrespective of the precise definition given to the term "substantial abuse," it is generally held that section 707(b) was intended to deny relief to dishonest or non-needy debtors.[73] If a debtor does not "need" the chapter 7 discharge, then the court can fairly say that the debtor's receiving a discharge constitutes substantial abuse.[74]

5. Presumption in Favor of the Debtor

Last, and probably most important to the debtor, is the fact that the statute expressly incorporates a presumption *against* a finding of abuse.[75] Congress intended that this portion of section 707(b) provide the "honest but unfortunate debtor"[76] with a chance to become solvent again.[77] This is accomplished by granting the debtor a full unconditional discharge unless the trustee proves to the court that the debtor abused the system.

C. *"Ability to Pay" Test*

1. "Ability to Pay" Consumer Debt is Based on Debtor's Disposable Income

When presented with a section 707(b) motion, courts typically begin with an

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[69] *See id.*

[70] *Keniston*, 85 B.R. at 206 (citing BLACK'S LAW DICTIONARY 11 (5th ed. 1979)).

[71] *Id. See In re* Edwards, 50 B.R. 933, 936 (Bankr. S.D.N.Y. 1985).

[72] *See Keniston*, 85 B.R. at 206.

[73] *See, e.g.*, *Krohn*, 886 F.2d at 126; *Walton*, 866 F.2d at 983; *Johnson*, 115 B.R. at 162; *In re* Martin, 107 B.R. 247, 248 (Bankr. D. Ak. 1989).

[74] *See* Section D *infra* (discussing various tests that have arisen to determine whether a debtor is needy and, therefore, whether the debtor may be guilty of substantial abuse under section 707(b)).

[75] *See* 11 U.S.C. § 707(b) (2000).

[76] Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).

[77] *See* Tabb, *supra* note 17, at 364-65.

analysis of the debtor's "ability to pay" his debts.[78] The debtor's "ability to pay" consumer debt is usually measured by assessing the amount of disposable income a debtor can use to pay unsecured creditors under a hypothetical three to five-year chapter 13 plan.[79] Every debtor must file a Statement of Income and Expenses with his bankruptcy petition. From this statement, the trustee and the court can determine a debtor's disposable income. "Disposable income" is defined as "that which is not to be expended for the maintenance or support of the debtor or a dependent of the debtor."[80] In more simple terms, disposable income is calculated by subtracting a debtor's total monthly maintenance and support expenses from his gross monthly income. The remaining amount of free cash is the debtor's monthly disposable income. The following Sections discuss substantial abuse dismissals based on excess disposable income, also known as the debtor's "ability to pay."

2. Ninth Circuit Rulings

In the Ninth Circuit Court of Appeals, the principal factor to be considered in determining whether substantial abuse exists is the debtor's ability to pay. *In re Kelly* is the leading case setting out the ability to pay test.[81] In *Kelly*, the debtors had disposable income sufficient to fund ninety-nine percent of a chapter 13 plan.[82] The Ninth Circuit ruled that since the Kellys had not made a reasonable effort to pay their debts, and that they would not be overly burdened financially if they had, allowing them to discharge their debts would be a substantial abuse of the bankruptcy laws. Thus, based solely on the Kellys' ability to pay, the court dismissed their chapter 7 petition.[83]

Though the Ninth Circuit in *Kelly* recites that the debtor's ability to pay is the "primary" factor (presumably of several) to be considered when presented with a substantial abuse motion, the court nonetheless adopted the *per se* rule used by several courts at the time. Under the *per se* rule, the debtor's ability to pay debts under a hypothetical chapter 13 repayment plan, standing alone, warrants dismissal under section 707(b).[84]

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[78] *See infra* Section C, Part 2.

[79] *See, e.g., In re* Koch, 109 F.3d 1285, 1288 (8th Cir. 1997).

[80] 11 U.S.C. § 1325(b)(2)(A) (2000).

[81] 841 F.2d 908 (9th Cir. 1988).

[82] The Kellys clearly were able to repay their debts. They admitted to an excess of income over expenses in the amount of some $440 per month, and the bankruptcy judge found that half of their claimed $500 per month expenditure for "recreation" was excessive. Combining these two figures, the court found that the Kellys could repay, out of disposable income, approximately ninety-nine percent of their unsecured debt in only three years. *See id.* at 915.

[83] *See id.* at 914-15.

[84] *See In re* Cord, 68 B.R. 5, 7 (Bankr. W.D. Mo. 1986); *In re* Gaukler, 63 B.R. 224, 225 (Bankr. D. N.D. 1986); *In re* Kress, 57 B.R. 874, 878 (Bankr. D. N.D. 1985); *Hudson*, 56 B.R. at 419; *Grant*, 51 B.R. at 391; *Edwards*, 50 B.R. at 936-37; *White*, 49

3. Eighth Circuit Rulings

When presented with motions to dismiss pursuant to section 707(b), the Eighth Circuit Court of Appeals also uses the *per se* test.[85] The leading case in that circuit, *In re Walton*, involved discrepancies in the debtor's income and expenditure schedules. The court determined that Walton's monthly income exceeded his monthly expenses by $218 and that this surplus could be used to pay off a substantial portion of his debt under a three-year chapter 13 reorganization plan.[86] According to the *Walton* court, when a debtor has the ability to pay or has made a bad faith filing, the statutory presumption in favor of the debtor is adequately rebutted.[87] Given his ability to pay, Walton's chapter 7 petition was therefore dismissed under section 707(b).[88]

In 1992, the Eighth Circuit gave further support to the *per se* rule when it affirmed the district court's reversal of a South Dakota bankruptcy court's ruling in *In re Harris*.[89] In *Harris*, the bankruptcy court had denied the trustee's section 707(b) motion, requiring two conditions for a finding of "substantial abuse." In addition to a finding that a significant portion of the unsecured debt could be paid over three to five years, the bankruptcy court had required a finding of "egregious behavior," which may include repeated bankruptcy filings evidencing a lack of good faith, fraud, impropriety, or evidence of misconduct.[90]

On appeal, the Eighth Circuit disapproved of this analysis, ruling that egregious behavior need not be proven. Instead, "the [Harris] district court . . . correctly interpreted *Walton* as contemplating that 'the ability to fund a chapter 13 plan can be sufficient reason to dismiss a chapter 7 petition under § 707(b).'"[91] As the district court had found that the Harrises could afford to fund 156% of their unsecured debts in a hypothetical chapter 13 plan, the Eighth Circuit upheld the district court's dismissal of the Harris bankruptcy based on substantial abuse.[92]

B.R. at 874. *See also Bryant*, 47 B.R. at 24-26.

[85] *See Walton*, 866 F.2d 981; *see also In re* Fonder, 974 F.2d 996 (8th Cir. 1992).

[86] *See Walton*, 866 F.2d at 985.

[87] A debtor who makes misrepresentations in his Income and Expense Statement may be found to be a bad faith filer. Debtors in this category usually overestimate their expenses and underestimate their income. Dismissal for bad faith filing is contemplated by section 707(a). However, if a judge dismisses a case pursuant to section 707(a), the debtor can fix the discrepancies in his Income and Expense Statement and refile the chapter 7 petition. On the other hand, if the judge believes a debtor's bad faith filing constitutes substantial abuse of the system, the debtor will not be given a chance to correct errors; instead, the debtor will be barred from obtaining a fresh start. When a debtor's case is dismissed under section 707(b), the debtor cannot refile under chapter 7.

[88] *See Walton*, 866 F.2d at 985.

[89] *See* United States Trustee v. Harris, 960 F.2d 74 (8th Cir. 1992).

[90] *See id.* at 75; *see also In re* Harris, 125 B.R. 254 (Bankr. D .S.D. 1991).

[91] *Harris*, 960 F.2d at 77.

[92] *See id.* at 78.

D. "Totality of the Circumstances" Test

1. Majority Rejects *Per Se* Rule

As we have seen, the Eighth and Ninth Circuit Courts of Appeal have fairly strictly interpreted section 707(b) to permit dismissal of a debtor's case when ability to pay is present. The other circuits, however, have adopted a broader and wider-ranging test to determine whether a debtor is in abuse of the system. The First, Second, Fourth, Sixth, Seventh, and Tenth Circuits have all rejected the *per se* rule,[93] instead employing what is known as the "totality of the circumstances" test.[94] The consensus in this majority of circuits is that the section 707(b) substantial abuse determination should be made on a case-by-case basis, in light of the totality of the individual debtor's circumstances.[95] Put otherwise, these circuits have concluded that a mechanical economic test is inappropriate.[96]

A Minnesota bankruptcy court cogently set out the argument against the*per se* rule:

> Substantial abuse, in the context of § 707(b), requires some evidence of misconduct, impropriety, or lack of good faith by chapter 7 debtors and, while it may be evidence of substantial abuse, the fact that debtors have substantial net disposable income is, in and of itself, insufficient to establish substantial abuse; in determining whether substantial abuse exists, the court should examine the totality of facts and circumstances surrounding debtors'

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[93] *See In re* Lamana, 153 F.3d 1 (1st Cir. 1998); *Kornfield*, 164 F.3d at 778; *In re* Green, 934 F.2d 568, 572 (4th Cir. 1991); *Krohn*, 886 F.2d at 126; *In re* Ontiveros, 198 B.R. 284 (7th Cir. 1996); *Stewart*, 175 F.3d at 796.

[94] The concept of the "totality of the circumstances" is also used in other areas of the law. For example, the U.S. Supreme Court ruled recently, based on the "totality of the circumstances," that a detaining officer had probable cause to search a defendant's vehicle. *See* United States v. Arvizu, 122 U.S. 744 (2002).

[95] Apparently, the use of the phrase "totality of the circumstances" in the context of section 707(b) jurisprudence was coined in the case of *In re* White, 49 B.R. 869 (Bankr. W.D.N.C. 1985) (holding that to determine whether substantial abuse exists, a court "must look at the totality of the circumstances, including the effects upon the petitioner and his creditors should relief under chapter 7 be granted, or alternatively, denied."). *See also In re* May, 261 B.R. 770 (Bankr. M.D. Fla. 2001) (stating that having income in excess of necessary expenses is not, by itself, sufficient to support a finding of substantial abuse of chapter 7, and the bankruptcy court should engage in a "totality of the circumstances" analysis in determining whether a discharge would be a substantial abuse of chapter 7); *In re* Hayes, 270 B.R. 183 (Bankr. S.D.N.Y. 2001); *In re* Blair, 226 B.R. 502 (Bankr. D. Me. 1998); *In re* Snow, 185 B.R. 397 (Bankr. D. Mass. 1995); *In re* Farrell, 150 B.R. 116 (Bankr. N.J. 1992); *In re* Pilgrim, 135 B.R. 314 (Bankr. C.D. Ill. 1992); *Johnson*, 115 B.R. 159; *In re* Braley, 103 B.R. 758 (Bankr. E.D. Va. 1989); *Keniston*, 85 B.R. at 202; *In re* Strong, 84 B.R. 541 (Bankr. N.D. Ind. 1988); *In re* Peluso, 72 B.R. 732 (Bankr. N.D.N.Y. 1987); *Gaukler*, 63 B.R. 224; *Grant*, 51 B.R. at 385.

[96] *See In re* Wilkes, 114 B.R. 551 (Bankr. W.D. Tenn. 1989).

affairs and events leading to bankruptcy in light of the statutory presumption in favor of the relief sought by debtors.[97]

2. The Seminal Circuit Court Case

The Fourth Circuit Court of Appeals, in *In re Green*, was the first appellate court to adopt a six-prong totality of the circumstances test to judge whether a debtor was in substantial abuse of chapter 7.[98] In *Green*, the Fourth Circuit agreed that a debtor's ability to pay pre-petition debts is the primary factor indicative of section 707(b) abuse, but it also required other factors (the "Green Factors") to be considered, including: (1) whether the debtor experienced sudden illness, calamity, disability, or unemployment; (2) whether the debtor made consumer purchases on the eve of bankruptcy that far exceeded what debtor could repay; (3) whether the debtor's personal budget is unreasonable or excessive; (4) whether the schedules and statements of financial affairs accurately depict the debtor's financial condition; and/or (5) whether the debtor filed in good faith.[99]

The rationale employed in *Green* was simply that the "totality of circumstances" approach was consistent with section 707(b)'s presumption in favor of granting the requested discharge.[100]

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[97] *In re Wegner*, 91 B.R. at 854 (emphasis added).

[98] *See* 934 F.2d 568 (4th Cir. 1991).

[99] *See id.* at 572-73. This test actually has its origins in the ruling from *In re Bryant*, where the court formulated a three-prong test consisting of the following circumstances: (1) the debtor did not suffer financial difficulty due to calamity, sickness, or unemployment; (2) the debtor disregarded the debtor's duty under section 522 to truthfully list all of the debtor's obligations, monthly expenses, and to accurately disclose the debtor's general financial position to the court; (3) the debtor exhibited bad faith by greatly overstating monthly expenses with the intention of misrepresenting the debtor's financial picture. *See Bryant*, 47 B.R. at 24.

The *Bryant* test was later extended to include: (4) whether the schedules and statements of financial affairs accurately depict debtor's financial condition; and (5) whether the debtor filed in good faith. *See, e.g., Kress*, 57 B.R. at 877-87. Some courts have extended the test so as to hold that "the ability to repay" factor must be coupled with other factors in order to support a finding of substantial abuse. *See In re* Deaton, 65 B.R. 663, 665 (Bankr. S.D. Ohio 1986) (finding that the debtor's ability to fund a chapter 13 plan must be coupled with other factors to support a finding of substantial abuse); *In re* Shands, 63 B.R. 121, 124 (Bankr. E.D. Mich. 1985) (holding that the ability to pay 100% of debt within three years, when coupled with some egregious circumstance, is sufficient to deny chapter 7 relief).

[100] *See Green*, 934 F.2d at 573.

3. Totality of the Circumstances Analysis in Action: A Look at the *Green* Factors

i. Sudden Illness, Calamity, Disability, or Unemployment

Judges in the majority of circuits and bankruptcy trial courts may grant a debtor a chapter 7 discharge even where a chapter 13 plan could be funded, if the "totality" of the debtor's "circumstances" demonstrate that discharge is nonetheless appropriate. The relevant circumstances include the *Green* Factors set forth above.

The first of these is "sudden illness, calamity, disability, or unemployment." Unemployment was the primary consideration in an Illinois bankruptcy case in which the debtor was unexpectedly laid off from work.[101] He thereafter fell behind in his ability to pay his creditors and, upon returning to work, sought a fresh start by initiating a chapter 7 proceeding. The Illinois court refused to dismiss his case pursuant to section 707(b) because the debtor's sudden unemployment, which is a major mitigating factor under the totality of the circumstances test, had caused his indebtedness.[102]

Similarly, the debtor's illness constituted a partial basis for the court's refusal to dismiss the debtor's chapter 7 case in *In re Norvell*.[103] On paper, Mrs. Norvell could afford to pay a substantial amount of her debt under a chapter 13 plan. But upon consideration of her circumstances, the court found that most of Mrs. Norvell's disposable income came from working overtime hours and double shifts and that her ability to work was both irregular and seasonal.[104] Due to her deteriorating health, which was found to be a direct result of hard work, the debtor claimed she would not be capable of working such a substantial number of hours in the future.[105] Based on this testimony, an Ohio court found that Mrs. Norvell's "conduct and debt posture" did not mandate dismissal.[106] Accordingly, the section 707(b) motion was denied.

Under the "totality of the circumstances" test, courts also consider the financial burden placed on the debtors if their chapter 7 cases were dismissed or converted

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[101] *See Pilgrim*, 135 B.R. 314.

[102] *See id.* This Illinois court ruled in a similar manner on at least two other occasions. The debtors in each of the following cases had the so-called "ability to pay" their creditors, but, based on the totality of the circumstances, their cases were not dismissed for substantial abuse. *See In re* Fortune, 130 B.R. 525 (Bankr. C.D. Ill. 1991) (holding that despite the fact the debtor could pay 100% of debt in thirty-three months, no substantial abuse under totality of the circumstances analysis); *In re* Hammer, 124 B.R. 287 (Bankr. C.D. Ill. 1991) (stating that while debtor could repay 100% in eighteen months, the case did not "shock the conscience of the court").

[103] 157 B.R. 14, 17 (Bankr. N.D. Ohio 1993).

[104] *See id.*

[105] *See id.*

[106] *See id.*

into chapter 13 cases. For example, the *In re Wilkes* court determined that the debtor would have been unduly burdened if she were not allowed to discharge her debts under chapter 7.[107] Though her schedules revealed that Ms. Wilkes had the ability to repay a portion of her debt, the court found thather disposable income was minimal and would be subject to instant depletion if she or her child became ill or if her household expenses increased even slightly.[108] Because Ms. Wilkes lived on a limited income, and because the court did not find excessive or unreasonable expenses in her budget, the substantial abuse motion was denied.[109] Hence, the *Wilkes* court defined "calamity" as a single unbudgeted expense that would have sent Ms. Wilkes spiraling back into debt. Utilizing the discretion inherent in the "totality of the circumstances" analysis, the judge was able to grant chapter 7 relief to an unfortunate debtor like Ms. Wilkes despite her apparent ability to pay.

ii. Debtor Lived Beyond His Means

While some of the *Green* Factors mitigate in the debtor's favor, others have just the opposite effect. In the typical case involving living beyond one's means, the court identifies conduct or lifestyle choices that reflect a disregard for the creditors' right to be repaid. The case of *In re Newsom* is illustrative.[110] In *Newsom*, the debtors' chapter 7 petition was dismissed for substantial abuse where the totality of their circumstances evidenced not only an ability to pay between forty-seven percent and eighty percent of their debts in a three- to five-year hypothetical chapter 13 repayment plan, but also an irresponsible use of credit. Pivotal to the court's "totality of the circumstances" findings were the following facts:

> [The debtors], already aware of their financial limitations and already faced with financial difficulties, went ahead and rang up at least $11,500.00 of consumer debt in 1986—an amount equal to [thirty percent] of their combined annual net income and which was incurred at a time when they already had unsecured obligations of over $9,000.00. Even worse, they apparently purchased a second vehicle during this time period![111]

Similarly, eve of bankruptcy purchases drove the dismissal in a recent West Virginia case.[112] In that case, the debtor purchased a brand new truck after filing his petition for bankruptcy.[113] This conduct fell squarely within the second factor

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[107] *See* 114 B.R. 551, 555-56 (Bankr. W.D. Tenn. 1989).

[108] *See id.* at 556.

[109] *See id.*

[110] 69 B.R. 801 (Bankr. D. N.D. 1987).

[111] *Id.* at 804-05.

[112] *See In re* Rodriguez, 228 B.R. 601 (Bankr. W.D. Va. 1999).

[113] *Id.* at 604. The purchase of the new truck directly increased the debtor's monthly transportation-related expenses by $220.50. According to the chapter 7 trustee's testimony in the case, the debt added by this purchase amounted to more than three times the debtor's

of the *Green* totality of the circumstances test: "whether the debtor incurred cash advances or made consumer purchases far in excess of his ability to repay."[114] The court felt that buying a new vehicle while attempting to seek chapter 7 relief also constituted "bad faith," the fifth *Green* Factor.[115] Because the debtor could have paid his creditors in full in only ten months had he not purchased the truck (and he planned to continue voluntary contributions of $286.39 per month to his 401(k) plan)[116] the judge ruled that the debtor's case constituted "the kind of egregious abuse that § 707(b) was intended to prevent."[117]

In these cases, the court is able to use the flexibility of the "totality of the circumstances" test to dismiss a debtor who has committed substantial abuse, even if he appears incapable of repayment under the simple "ability to pay" analysis.

iii. Bad Faith

Another *Green* Factor considered in connection with the totality of the circumstances test is "whether the debtor filed in good faith."[118] Bad faith, where found, has resulted in a section 707(b) dismissal even where a debtor is so hopelessly engulfed in debt that the debtor unquestionably lacks the ability to repay his creditors. For example, a debtor-couple in New York managed to accumulate $336,328.15 in unsecured debt on fifty-nine different credit cards![119] While much of this was incurred to remodel their home, a substantial portion was also the result of considerable cash advances obtained solely to make minimum payments on other cards. At the time of the petition, the annual interest accruing on the debt alone was over $60,000, nearly $10,000 more than the family's annual gross income.[120] In that case, the debtors had no income above expenditures, they did not make any "eve of bankruptcy" purchases, and the total amount of their debt made them ineligible for relief under chapter 13.[121] The court nonetheless held that "when bankruptcy represents a mere step in a process

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other pre-petition debt and increased his liabilities by approximately $19,000. *See id.*

[114] *Green*, 934 F.2d at 572.

[115] *See Rodriguez*, 228 B.R. at 605.

[116] *See also In re* Norris, 225 B.R. 329, 333 (Bankr. E.D. Va. 1998) (voluntary pension plan payments may be unreasonable given debtor's financial condition); *In re* Shands, 63 B.R. 121, 123 (E.D. Mich. 1985) (finding that debtor's ability to fund voluntary contributions to pension plan indicated ability to pay at least that much to creditors).

[117] *Rodriquez*, 228 B.R. at 605.

[118] *See supra* notes 98-117 and accompanying text.

[119] *See In re* Wolniewicz, 224 B.R. 302, 303 (Bankr. W.D.N.Y. 1998). While the court chastised the credit card companies for continuing to increase the debtors' credit lines and for continuing to issue additional cards by way of mailed solicitations, the court recognized that section 707(b) does not focus on the creditors' activities, but instead on the debtors' worthiness for chapter 7 relief. *See id.* at 305.

[120] *See id.*

[121] *See id.*

and the debtor has designed to avoid obligations, the filing of a bankruptcy petition loses the character of a solution, and instead becomes part of the underlying problem. In such circumstances, the use of bankruptcy develops into an exercise of abuse."[122] Thus, the debtors were denied relief despite their clear inability to pay.

4. Judicial Discretion is a Balanced Approach

The foregoing discussion of the totality of the circumstances test reveals that it is quite even-handed. As it did in the *Green* case, the totality of the circumstances test gives bankruptcy judges needed discretion to grant chapter 7 relief despite an ability to pay where the debtor deserves a fresh start.[123] Equally critical, the totality of the circumstances test permits the dismissal of cases involving unworthy debtors, even where such debtors have no ability to pay. Indeed, the totality of a debtor's circumstances may identify him as a candidate for section 707(b) dismissal even where the debtor might have otherwise been viewed as "needy."[124]

Using the current totality of the circumstances test, judges are free to use their discretion when deciding motions seeking dismissal based on substantial abuse. This is essential because a mechanistic rule such as the proposed means testing does not take into consideration the human side of the law. Judges are in the best position to ascertain debtors' ability to pay and to weigh any other subjective factors that may assist in identifying debtors who are trying to unscrupulously shield themselves from their debt and to separate them from the debtors who are truly worthy of a fresh start. As such, the judge is the appropriate intermediary between the creditors and the debtor and is best positioned to decide the issue of "substantial abuse."

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[122] *Id.* at 306. *See also In re* Smith, 229 B.R. 895 (Bankr. S.D. Ga. 1997) (allowing debtors chapter 7 relief would constitute substantial abuse of the bankruptcy process where the debtors filed a petition in bad faith, suffered no calamity that precipitated filing, and filing resulted from excesses).

[123] *See, e.g.*, *In re* Higuera, 199 B.R. 196, 201 (Bankr. W.D. Okla. 1996); *In re* Butts, 148 B.R. 878, 880 (Bankr. N.D. Ind. 1992); *Fortune*, 130 B.R. at 526; *In re* Hammer, 124 B.R. 287, 289 (Bankr. C.D. Ill. 1991); Keniston, 85 B.R. at 223; *Deaton*, 65 B.R. at 664 (Bankr. S.D. Ohio 1986).

[124] *See In re* Uddin, 196 B.R. 19 (Bankr. S.D.N.Y. 1996). In *Uddin*, the debtor owed over $170,000 in unsecured debt due to his excessive purchases and gambling losses. *See id.* at 23. Deeming this "blatant abuse of consumer credit," the court found dismissal of the chapter 7 case to be warranted. *Id.* at 24. According to the court, chapter 7 relief is inappropriate for a debtor "attempting to lead the life of Riley while his creditors suffer on his behalf." *Id.* (citing *Bryant*, 47 B.R. at 26).

E. Judges' Discretion in Cases Involving the Ability to Pay Test

i. Adjustment of Debtors' Disposable Income

While it may appear that the *per se* test of the Eighth and Ninth Circuits is far less flexible than the totality of the circumstances test used in the majority of circuits, interestingly judges in the Eighth and Ninth Circuits also exercise discretion with regard to what constitutes abuse.[125] Even in *Kelly*, the Ninth Circuit recognized the possibility that despite an inability to repay debts, a debtor may be dismissed from the system for substantial abuse.[126]

Subsequently, a California court following *Kelly* ruled that if a debtor appears to lack the ability to pay, the court may look at other factors such as credit card abuse and eve of bankruptcy purchases to "adjust" the debtor's ability to pay.[127] For example, if the debtor purchases a new Rolex on credit just before filing for bankruptcy protection, the debtor's disposable income going forward has to support a much higher total debt. In such circumstances, the court can and will

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[125] *See Martin*, 107 B.R. 247. The *Martin* court strayed from the strict mechanical ability to pay test when it denied a trustee's motion to dismiss a case pursuant to section 707(b). This Alaska bankruptcy court ruled that even though a feasible chapter 13 plan could be devised, the realistic future for the Martins looked difficult. The Martins had moved to Alaska to go into business with their cousin. Shortly after their arrival, the business failed; both of the Martins were left unemployed. They then moved to a very remote town in Alaska where Mrs. Martin found work as a teacher. In that town, the cost of clothing and food, if available, was very high. The Martins had to travel regularly to a relatively larger community to obtain relief from the cultural shock, for medical and dental attention, and to shop at more reasonable prices. Due to the fact that the Martins had been accumulating interest on their credit card debt for two years, their unsecured debt amounted to $23,000. With Mrs. Martin's new-found work, the debtors could afford to pay off their debt completely in three years. According to the Alaska court, however, the debtors should not be pushed to the edge of financial survival because a plan looked feasible on a cold financial statement. Hence, notwithstanding *Kelly*, the Alaska court refused to find the Martins to be in substantial abuse, even though their ability to pay could be demonstrated on paper.

[126] *See Kelly*, 841 F.2d at 915 (noting in *dicta* that "this is not to say that inability to pay will shield a debtor from section 707(b) dismissal where bad faith is otherwise shown").

[127] See *In re* Motaharnia, 215 B.R. 63 (Bankr. C.D. Cal. 1997). In adhering to the policy rationale behind section 707(b) as well as upholding the underlying principles of our bankruptcy system, the court held in *Motaharnia* that if a debtor will have enough excess income to allow him or her to repay debts, dismissal is warranted. If the evidence suggests, however, that the debtor is unable to meet a meaningful part of the debtor's financial obligations, the court also may consider "other relevant indicia of the debtor's honesty and good faith and whether there are lesser effective remedies to protect the creditor-body and/or the bankruptcy system from the effects of debtor's bad faith dealings." *Id.* at 73.

adjust the debtor's ability to pay figure, calculating it based on the debtor's total debt *without* the additional Rolex debt.[128] This example illustrates how even in the stricter ability-to-pay courts, circumstantial factors personal to the individual debtor influence the courts' section 707(b) analysis. While other factors influence the court's analysis when the debtor is dismissed from the bankruptcy system, the dismissal is still nominally because of his ability to pay. Rather than expressly adopting a totality of the circumstances test, however, these courts simply engage in a legal fiction that permits the individual debtor's environmental factors to support the conclusion that the debtor would have the ability to repay creditors had the debtor not been so financially reckless.

ii. Amount of Debt Paid v. Percentage Paid

There is another way in which the ability-to-pay courts exercise significant discretion, bearing on the outcome of the substantial abuse motion. Both the Eighth and Ninth Circuit courts have recently ruled that the percentage of debt that a debtor can afford to repay is unimportant if the amount paid is substantial. In earlier ability-to-pay cases, courts dismissed debtors when a chapter 13 plan could be fully funded with the debtor's (sometimes adjusted) disposable income. In *In re Gomes*, the Ninth Circuit Bankruptcy Appellate Panel ("BAP") affirmed a bankruptcy court's dismissal under section 707(b) after finding that the debtor had $1,287.90 per month in disposable income, with which he could repay forty-three percent of his debts within thirty-six months.[129] According to the BAP, the debtor's $1,287.90 monthly disposable income was "no small sum."[130] Therefore, even though his ability to pay expressed as a percentage of his total debt was far less than that involved in the *Kelly* case, the substantial dollar amount Gomes could pay was sufficient reason to dismiss him under section 707(b).

The Eighth Circuit has also dismissed cases in which the debtor did not have the ability to fully fund a hypothetical chapter 13 plan. Applying the *Walton* decision,[131] a panel of the Eighth Circuit in *In re Fonder*[132] held that substantial abuse is primarily determined by the debtor's ability to fund a chapter 13 plan, observing that most bankruptcy courts equate the ability to fund this plan with the ability to repay at least fifty percent of unsecured debts in three to five years.[133]

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[128] In considering the excessive credit card expenditure, the court will add back the cost of the Rolex, in this hypothetical example, to show the debtor's ability to pay. *See, e.g.*, *In re* Mills, 246 B.R. 395 (Bankr. S.D. Cal. 2000). The trustee in that case did not allege that the debtors were able to repay their debts. The trustee instead argued that the debtors' credit card abuse merited a finding of substantial abuse. *Id.* at 404.

[129] *In re* Gomes, 220 B.R. 84 (Bankr. 9th Cir. 1998).

[130] *Id.* at 88.

[131] *In re* Walton, 866 F.2d 981, 981 (8th Cir. 1989).

[132] 974 F.2d 996 (8th Cir. 1992).

[133] *See id.* at 996-98.

Since Mr. Fonder overstated his expenses and understated his income, and after these adjustments were made he could fund seventy-nine percent of his debt, his case was promptly removed from the court for substantial abuse.[134]

Other courts have extended the *Fonder* rule, dismissing cases from chapter 7 where the percentage of debt that could be repaid was less than fifty percent.[135] Taking a logical next step, a Nebraska bankruptcy court suggested that judges should focus on whether the debtor could make "substantial payments" to creditors over the life of a three-year chapter 13 plan, rather than on the percentage of overall debt that could be repaid.[136] In that case, the court ruled that substantial abuse exists where the chapter 7 debtor can afford to make chapter 13 monthly payments of $300, regardless of whether such payments would pay back ten percent or eighty percent of the debtor's unsecured debt.[137] Because the debtor would be able to pay his creditors $10,800 over the course of a three-year chapter 13 plan—a significant sum of money—the court found substantial abuse of chapter 7 and dismissed the petition.[138]

In *Kelly* and *Harris*, the bankruptcy petitions were dismissed because the debtors could afford to repay 100% of their outstanding debt. In *Fonder*, the ability to pay eighty-nine percent was sufficient to dismiss the case.[139] The Ninth Circuit BAP removed Gomes for his ability to fund a mere forty-three percent of his debt. And, a look at the most recent *per se* rule cases shows just how far the

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[134] *See id.* at 998; *see also In re* Nelson, 223 B.R. 349 (Bankr. D. Iowa 1998) (finding that the ability to pay 79.9% of unsecured credit in a chapter 13 case in three years constitutes substantial abuse of chapter 7).

[135] *See, e.g.*, *In re* Lampkin, 221 B.R. 390 (Bankr. W.D. Tex. 1998) (dismissing a chapter 7 petition for substantial abuse granted where twenty-five percent of debtor's net income was available to repay debts, even after allowing him highly questionable monthly deductions for vacations and recreation, and over three years the resulting dividend to scheduled unsecured creditors would be close to forty percent); *In re* Gyurci, 95 B.R. 639 (Bankr. D. Minn. 1989) (dismissing debtor's petition where repayment of forty to fifty percent of outstanding debt over a three year period in chapter 13 was feasible); *In re* Newsom, 69 B.R. 801 (Bankr. D. N.D. 1987) (stating that the ability to repay substantial portion of unsecured debt does not require ability to pay back 100%, only that payback be significant and there be a likelihood of sufficient future income to maintain such payback).

[136] *See In re* Coleman, 231 B.R. 760, 762 (Bankr. D. Neb. 1999). Suppose, for example, that two debtors file for chapter 7 bankruptcy relief, and each can afford to repay $20,000 of his debt under a three-year chapter 13 plan. The difference between them is that the $20,000 equates to only thirty percent of the debt owed by Debtor A while it amounts to eighty-five percent of what is owed by Debtor B. If courts look only at the actual percentage of debt owed, then only Debtor B would likely be discharged for substantial abuse of the system. Using the precedents set by the Eighth and Ninth Circuits, however, both of the debtors would be dismissed for substantial abuse under section 707(b) based on their ability to pay a substantial portion of their debts in a chapter 13 plan.

[137] *See id.*

[138] *See id.* at 761.

[139] *See* 974 F.2d at 998.

rule has been extended since *Kelly*. In *In re Beckel*, for example, the Beckels admitted that they could pay $400-500 per month toward their debts, resulting in an ability to pay back approximately $18,000 over three years.[140] While this equated to as little as thirty percent of the unsecured claims against them, the court ruled that the debtors' ability to pay was not insubstantial and, therefore, granting them chapter 7 relief would constitute substantial abuse of the Bankruptcy Code.[141]

iii. Substantial Discretion is Exercised in Ability to Pay Courts

Thus, even the courts that have formally eschewed the totality of the circumstances analysis have nonetheless exercised similar types of discretion in ruling on section 707(b) motions. Judges in both the Eighth and Ninth Circuits have ruled that even in the absence of an ability to pay, a debtor can still be removed from the system because of other important factors such as credit card abuse, eve of bankruptcy purchases, and bad faith filing.

Moreover, no *per se* court has established a hard and fast percentage or other bright line number to be applied mechanically to the debtor's finances so as to determine who is in abuse of the system.[142] Instead, similar to the courts that employ the totality of the circumstances test, the ability to pay courts have made section 707(b) rulings on a case-by-case basis. This means that even in the apparently harsher ability-to-pay courts, a debtor's dismissal hinges on his individual circumstances, and the court is empowered to make the appropriate *ad hoc* decision in each individual case in which substantial abuse is alleged.

IV. THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2003

A. Introduction of a New Test

After years of interpretation and countless court cases, each sentence of section 707(b) has been dissected, explored, interpreted, and reinterpreted. Yet,

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[140] *See* 268 B.R. 179, 181 (Bankr. N.D. Iowa 2001).

[141] *See id.* at 185.

[142] *See, e.g., Fonder*, 974 F.2d at 1000 (finding that an ability to repay eighty-nine percent of unsecured debt in three years or 100% in five years constitutes abuse); *Harris*, 960 F.2d at 77 (stating that an ability to repay 100% of unsecured debt in three years constitutes abuse); *Walton*, 866 F.2d at 985 (finding that an ability to fund a chapter 13 plan where debtor would repay sixty-seven percent of unsecured debt in three years or 100% of unsecured debt in 5 years constitutes abuse); *In re* Struggs, 71 B.R. 96 (Bankr. E.D. Mich. 1987) (holding that if a debtor can repay a meaningful part of his debt in a chapter 13 plan, his chapter 7 petition should be dismissed); *Edwards*, 50 B.R. at 933 (discharging debtors' chapter 7 claims but enunciating the rule that the ability to pay back 100% in three years *per se* constitutes substantial abuse),

regardless of the specific test used by a particular court presented with a section 707(b) dismissal motion, all courts have the discretion to grant relief to sympathetic debtors and to deny relief to those that appear to be in abuse of the system. Now after nineteen years of refinement of the substantial abuse doctrine, Congress is considering amendment of section 707(b) to establish a different test for so-called "abuse." The Reform Act proposes to "improve bankruptcy laws and practices by restoring personal responsibility and integrity in the bankruptcy system and by ensuring that the system was fair for both debtors and creditors."[143] Specifically by employing a mechanical threshold "means" test, the Reform Act purports to screen can-pay debtors from the system.

B. The Language of the "Means" Test

The relevant language of the Reform Act, found in section 102(a)-(d) thereof, would have established new "substantial abuse" parameters. If passed, section 102(a) of the Act would have replaced the current law's presumption in favor of the debtor with a mandatory *presumption of abuse*, triggered under certain conditions.[144] Section 102(a) also would have allowed any interested party, including creditors, the U.S. Trustee, and the judge, to assert the presumption as to debtors whose income exceeds a defined state median. Rather than the judicially-developed ability to pay and totality of the circumstances tests, a "means" test would determine the extent of a debtor's ability to repay general unsecured claims. Under this proposal, the debtor's "current monthly income" is his ability or "means" available to pay creditors.[145] Simplified, current monthly income is derived by subtracting monthly expendıtures from a debtor's gross monthly income. The allowed deductions for monthly expenditures consist of food, clothing, personal care, transportation, housing, and entertainment.[146]

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[143] H.R. REP. No. 107-3, *supra* note 42, at pt. 1 (discussing H.R. 333).

[144] *See* H.R. 975, 108th Cong. § 102 (2003); H.R. 333, 107th Cong. § 102 (2001); S. 420, 107th Cong. § 102 (2001).

[145] *Id.* (defining "current monthly income" as the average monthly income from all sources that the debtor receives (or, in a joint case, the debtor and spouse receive), without regard to whether it is taxable income, in the six-month period preceding the date of determination. It includes any amount paid on a regular basis by any entity (other than the debtor or, in a joint case, the debtor and spouse) to the household expenses of the debtor or the debtor's dependents and, in a joint case, the debtor's spouse, if not otherwise a dependent. It excludes Social Security Act benefits and payments to victims of war crimes or crimes against humanity on account of their status as victims of such crimes.).

[146] The allowable expense deductions incorporate "stringent IRS collections guidelines on living expenses as the basis for determining ability to pay, even though the IRS has found that its expense guidelines are often not realistic." Braucher, *supra* note 11, at 410. *See also* Culhane & White, *supra* note 10, at 41-49 (noting the IRS's Collection Financial Standards may understate debtors' actual and reasonable expenses); Gary Klein, *Impact of Pending Bankruptcy Legislation on Low-Income Debtors*, 19 AM. BANKR. INST. J. 34, 35 (2000) (noting that the IRS standards were developed to serve as discretionary guides

Under the Reform Act's means test, "substantial abuse" would be presumed where the debtor's current monthly income exceeds either of the following two trigger points. First, if the debtor has at least $166.67 in current monthly income, then regardless of how much money a debtor owes, he cannot discharge his debts in a chapter 7 proceeding.[147] Second, if the debtor has at least $100 in current monthly income and can afford to repay twenty-five percent of his debts in a five-year repayment plan, he is in abuse of the system.[148] This means that under the Reform Act, a debtor with as little as $100 in current monthly income would be presumed to be in abuse of the bankruptcy system if he or she has general, unsecured consumer debt of $24,000 or less. If he has $150 in monthly income, his case would be dismissed if he owed $36,000 or less.[149]

To be fair, the presumption against the debtor is rebuttable. A debtor who can afford to do so[150] may swear to and document "special circumstances" that would decrease his income or increase his expenses so as to bring his current monthly income figure below the trigger points. This would require the debtor to file a motion, which could be challenged by the trustee or any creditor, with the burden of proof falling on the debtor.[151]

V. WHY MEANS TESTING IS NOT THE ANSWER

Congress has apparently been persuaded to believe that dishonest debtors are running amok,[152] perhaps because personal bankruptcy has lost its stigma.[153] On

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rather than absolute requirements, and that the guides are subject to multiple exceptions, rendering them inappropriate for a statutory test). For a detailed discussion of the precise means testing mechanism contained in the proposed legislation, see Braucher, *supra* note 11, at 434-39.

[147] *See* H.R. 333, § 102; S. 420, § 102.

[148] *See id.*

[149] *See, e.g.*, Braucher, *supra* note 11, at 445-46.

[150] *See* Jean Braucher, *Counseling Consumer Debtors to Make Their Own Informed Choices - A Question of Professional Responsibility*, 5 AM. BANKR. INST. L. REV. 165, 181-82, 185-86 (1997) (arguing that the economics of flat fee practice along with debtors' lawyers tendency to acquiesce in local legal culture make them too unwilling to take aggressive positions on behalf of their clients, so as to avoid engaging in litigation or prolonged negotiation in consumer bankruptcy cases).

[151] This "special circumstances" filing may appear to give a bankruptcy judge some discretion. However, without the use of the favorable "totality of the circumstances" factors, a judge would be hard-pressed to keep a debtor in a chapter 7 proceeding if that debtor's disposable income exceeds the trigger points.

[152] *See infra* notes 154-166.

[153] *See* A. Mechele Dickerson, *Bankruptcy Reform: Does the End Justify the Means?*, 75 AM. BANKR. L.J. 243, 262-63 (2001) (discussing social stigma in the context of comparison of bankruptcy discharge to federal entitlement programs). *Cf.* Zachary Price, Comment, *The Bankruptcy Abuse Prevention and Consumer Protection Act*, 39 HARV. J. ON LEGIS. 237 (2002) (stating that research indicates about fifteen times as many American households could benefit from bankruptcy as actually file) (citing Michelle J. White, *Why*

the surface, the Reform Act does seem to be a way to eliminate abusive filers from the system. But is there really an abuse crisis? Assuming so, would the means test proposal actually accomplish what its proponents desire? And if so, are its costs justified? Is this means testing proposal consistent with public policy? These critical questions are explored below.

A. Is there a Bankruptcy Crisis?

There is substantial dispute as to whether the nation really is in the midst of a bankruptcy crisis. Nearly every treatment of bankruptcy reform starts with the undeniable statement that personal bankruptcy filings are way up.[154] Consequently some have drawn the facile conclusion that the high number of personal bankruptcies—more than one million filings annually—is caused by increased abuse and, therefore, that reform is vital.[155] However, most thoughtful, neutral observers agree that the current high level of consumer bankruptcy filings is unlikely caused by increasing levels of abusive filings,[156] but instead is due to any number of other economic and non-economic factors, including the credit card interest rate deregulation of the 1980's,[157] increased availability of consumer

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Don't More Households File for Bankruptcy?, 14 J.L. ECON. & ORG. 205 (1998).

[154] *See* Moss & Johnson, *supra* note 18, at 349 (noting that when considering whether there is a bankruptcy crisis at all, the focus should not be on "whether the number of bankruptcy filings is too high. Even when the number was one-twentieth of its current level, critics insisted that consumer filings were out of control.").

[155] *See* Elizabeth Warren, *The Bankruptcy Crisis*, 73 IND. L.J. 1079, 1080, 1089 (1998) (referring to the connection between one-million-plus filings and consumer abuse as "assumed," a hypothesis that is contrary to available data); Tabb, *supra* note 6, at 13-14 ("Reform advocates then take the leap of faith that debtors are causing the crisis - that debtors are abusing the law by taking out too much credit, living the high life, and sliding down the easy path of discharge when they could repay a significant portion of their debts. This portrait is exaggerated and factually unsupported . . . the abuse mantra is a canard."). *See also* Hon. David F. Snow, *The Dischargeability of Credit Card Debt: New Developments and the Need for a New Direction*, 72 AM. BANKR. L.J. 63, 65 (1998) (reporting widespread perception among bankruptcy judges that "defaults on credit card debt are the principal single cause for the upsurge in consumer filings").

[156] *See generally* National Bankruptcy Review Commission, *supra* note 12, at 83 n.124 (stating that the increase in number of bankruptcy filings is not attributable to wealthier people seeking bankruptcy protection; debtors in the 1990s were in as much or more financial trouble as debtors of early 1980s); *see also* TERESA A. SULLIVAN et al., THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT 71, Table 2.5 (2000) (reporting increases in median debt-to-income ratio between 1981 and 1997).

[157] *See* Lawrence M. Ausubel, *Credit Card Defaults, Credit Card Profits, and Bankruptcy*, 71 AM. BANKR. L.J. 249 (1997); *see also* Warren, *supra* note 155, at 1083 (citing FDIC research drawing the same correlation).

The Supreme Court case that "deregulated" credit card interest rates was Marquette Nat'l Bank of Minneapolis v. First Omaha Serv. Corp., 439 U.S. 299 (1978) (interpreting the hundred-year-old National Bank Act to permit national banks to charge interest rate credit at lower income levels[158] (due to highly profitable returns for consumer credit card issuers and successful yet unrelenting solicitations by mail);[159] an unusually prosperous economy for the last few decades (resulting in increased spending and higher consumer debt levels),[160] attorney advertising;[161] and a variety of social instabilities such as corporate downsizing (resulting in unemployment in employee ranks heretofore untouched by job loss), the increase in divorces (causing duplicative living expenses), and lack of affordable medical insurance,[162] as well as the possibility of a decline in the perceived stigma associated with bankruptcy.[163]

The real crisis, according to noted bankruptcy scholar Professor Elizabeth Warren, is "that this many families are overextended."[164] Indeed, neither the unbiased empirical nor available anecdotal evidence reveals widespread abuse by high wage earners who could relatively effortlessly repay their creditors rather than seeking discharge.[165] One widely cited academic study found that 96.4% of debtors in chapter 7 belonged there.[166] Other neutral commentators have come to

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allowed in states in which they are located and also to charge those same rates to customers in states with lower usury limits).

[158] *See* Ausubel, *supra* note 157, at 249.

[159] *See id.* at 250-51 (calling profitability of credit card lending "extranormal"); *see also* Paul J. Lim & Matthew Benjamin, *Digging Your Way Out of Debt*, U.S. NEWS & WORLD REP., Mar. 19, 2001, at 57 (reporting that credit card issuers mailed 3.3 billion solicitations in 2000, up from 2.8 billion in 1999).

[160] *See* Timothy L. O'Brien, *Giving Credit Where Debt Is Due*, N.Y. TIMES, Dec. 14, 1997, at 14 (noting installment credit is up fifty percent from the previous four years, that the average credit card holder has four cards and about $4,000 in high-interest debt, and that lenders are targeting consumers who are least creditworthy in their marketing).

[161] *See* Braucher, *supra* note 12, at 5.

[162] *See id.*

[163] *See, e.g.*, William C. Whitford, *The Ideal of Individualized Justice: Consumer Bankruptcy as Consumer Protection, and Consumer Protection in Consumer Bankruptcy*, 68 AM. BANKR. L.J. 397, 399 (1994). *Cf.* Moss & Johnson, *supra* note 18 (stating that shifts in the volume and distribution of consumer credit rather than declining stigma are the most likely sources of the recent surge in consumer filings).

[164] Warren, *supra* note 155, at 1101.

[165] *See* Culhane & White, *supra* note 10, at 31 (stating that an empirical study funded by a grant from the non-profit American Bankruptcy Institute Endowment found only 3.55% of debtors were "can-pays"); Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501, 537 (1993) (stating that in an empirical study most debtors' lawyers reported that they had never or rarely seen a substantial abuse challenge, and that chapter 7 trustees reported that while they looked for excess income over reasonable expenses, they rarely found it).

[166] *See* Culhane & White, *supra* note 10, at 31 (methodically applying H.R. 3150, a means testing proposal similar to that offered by the Reform Act, to a sample of 1000 actual chapter 7 debtors); *see also* Gordon Bermant & Ed Flynn, *Incomes, Debts, and Repayment Capacities of Recently Discharged Chapter 7 Debtors*, Jan. 1999, *available at* http://www.abiworld.org/legis/reform/eoust-99jan.html (concluding that "only a small

the same conclusion.[167] Moreover, scholars have also found that the percentage of debtors who could pay but use bankruptcy as a means not to do so may actually be decreasing rather than increasing, even without bankruptcy reform![168]

B. Behind the Curtain in Oz: What's Really Driving Bankruptcy Reform

1. Money Talks

In fact, it appears that much of the uproar about chapter 7 abuse stems from persistent and intense lobbying by the consumer credit industry, which funneled more than $9 million in campaign contributions into the last national election alone.[169] To bolster its lobbying efforts in recent years, the credit industry has funded numerous "studies" since the beginning of the early 1980's, before the 1984 amendments were enacted.[170] Just in the last five years, major credit card issuers have commissioned at least five such studies, intent on proving that chapter 7 debtors have the ability to pay a significant portion of their outstanding consumer debt.[171] While the assumptions underlying these reports have been

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percentage of current chapter 7 debtors have income sufficient to repay any portion of their unsecured debts.").

[167] Indeed, even the credit industry funded studies reported that at least eighty-five percent of chapter 7 debtors have too little income after necessary expenses to repay unsecured debt. *See* Culhane & White, *supra* note 10, at 32, and authorities cited therein at n.22 ("All the empirical studies to date agree on one point; the vast majority of chapter 7 debtors belong in that chapter.").

[168] *See* William C. Whitford, *Changing Definitions of Fresh Start in U.S. Bankruptcy Law*, 20 J. CONSUMER POL'Y 179, 192 (1997) (citing Theresa Sullivan et al., *Consumer Debtors Ten Years Later: A Financial Comparison of Consumer Bankrupts 1981-1991*, 68 AM. BANKR. L.J. 128, 130 (1994)).

[169] According to the Center for Responsive Politics, a non-profit watchdog agency in Washington, D.C., credit card issuers gave a combined $9.3 million in the last national election. The Center's research reveals that MBNA America Bank, one of the nation's biggest credit-card lenders, gave more than $3 million to national candidates in 2000 and ranked as President Bush's biggest corporate donor. At the same time, members of the National Consumer Bankruptcy Coalition—a conservative group seeking bankruptcy reform—contributed $5 million to national parties and candidates in 2000, an increase of about forty percent from the 1996 election. *See College Students Learn Credit Card Basics the Hard Way; Schools Strike Deals with Companies as Students end up Buried in Debt*, MIL. J., Sept. 16, 2001. *See also Votes in Congress*, STAR TRIB., Dec. 8, 2000, at 6A.

For a more complete description of the political process and credit card lobbying efforts surrounding consumer bankruptcy reform efforts in 1998, see Tabb, *supra* note 2, at 346-53.

[170] *See* Warren, *supra* note 155, at 1088-89.

[171] *See* Culhane & White, *supra* note 10, at 29 (cataloguing the various studies funded by VISA/USA, Inc. between 1996 and 1998 alone); *see also* Warren, *supra* note 155, at

severely criticized—their results questioned by both academics and governmental agencies[172]—it appears that these "studies" have succeeded in convincing at least some that bankruptcy law reform is the answer to the rising level of consumer bankruptcies and putative bankruptcy abuse.[173]

2. Popular Misconceptions about Bankruptcy Abuse

Another source of popular overreaction about bankruptcy system abuse is a few highly publicized cases of unworthy debtors who have successfully gamed the system. Some examples include: former Texas governor John Connally, who kept a 200-acre ranch, large home, and swimming pool despite his personal bankruptcy filing;[174] the erstwhile corporate raider, Paul A. Bilzerian, who in January 2001 declared bankruptcy for the second time in Florida, but who continued to maintain a $5 million, 37,000 square foot, 11-bedroom estate in the Tampa area;[175] and the movie actor, Burt Reynolds, who declared bankruptcy in 1996, claiming more than $10 million in debt, but keeping his $2.5 million home while his unsecured creditors received 20 cents on the dollar.[176]

1092-93.

[172] *See* Culhane & White, *supra* note 10, at 31; Warren, *supra* note 155, at 1085-87, 1090-93 (discussing deficiencies in the VISA study published in 1996).

[173] The credit industry issued press releases in 1997 indicated, based on a Purdue University study the industry both commissioned and funded, that some forty percent of chapter 7 debtors could afford to repay some of their debt. Apparently this self-serving statistic, picked up "as fact" by such popular press as Newsweek and the Los Angeles Times, eventually found its way into an Op-Ed piece in the Washington Times by former Sen. Lloyd Bentsen, and was later cited by Rep. Gekas in introducing the 1997 reform bill incorporating means testing. *See* Warren, *supra* note 155, at 1089-90 and sources cited therein at nn.43-47. While both the Congressional Budget Office and the General Accounting Office reviewed the study, finding problems with study design, many unfounded assumptions, and overstatements regarding debtors' repayment capacity, by then the chapter 7 bankruptcy reform train had already left the station. *See id.* at 1091.

[174] *See* Christine Dugas, *Should Debtors Be Able to Keep Homes?* USA TODAY, June 26, 2000, at 10B.

[175] *See id.*; *see also* Eliot Kleinberg, *Reynolds Gets Out From Under Bankruptcy*, PALM BEACH POST, Oct. 8, 1998, at 1B.

[176] *See* Dugas, *supra* note 174, at 10B; *see also* Larry Rohter, *Rich Debtors Finding Shelter Under a Populist Florida Law*, N.Y. TIMES, July 25, 1993, at A1. Another Florida case involved Marvin Warner, former ambassador to Switzerland and the owner of a failed Ohio savings and loan. Warner paid off only a fraction of $300 million in creditor claims while keeping his multi-million-dollar horse ranch near Ocala, Florida. *See id.* Notably, debtor O.J. Simpson recently moved to Florida, presumably to take advantage of the homestead exemption boon. *See O.J. Simpson Buys Home in Miami*, ST. PETERSBURG TIMES, Sept. 25, 2000, at 2B. More recently, even while faced with the prospect of an eventual personal bankruptcy, Scott D. Sullivan, indicted former CFO of the spectacularly failed public company WorldCom, continues to oversee construction of his $15 million "mega-mansion" in Boca Raton, Florida. Because of the unlimited state homestead

The Reform Act's means test would not eliminate these patently abusive debtors from the bankruptcy system. As it turns out, the injustice in these cases is enabled by an unlimited homestead exemption in a number of states, most notably Florida and Texas.[177] No part of the Reform Act creates a uniform general cap on state homestead exemptions, which are entirely the province of the fifty individual state legislatures.[178] This means that debtors with expensive homes could continue to shelter assets in them even if means testing, such as that proposed with the Reform Act, becomes law.

C. Other Macro-Defects in the Reform Act's Means Testing

Not only does the Reform Act fail to eliminate the perceived abuse that is in actuality rooted in the homestead exemption "loophole," but it contains other basic flaws.[179]

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exemption, no creditor of Sullivan's will be able to touch either the land or the 24,000 square foot home, which allegedly will include an 18-seat movie theater and a private art gallery. *See* Andrew Ross Sorkin, *Life Without a Jet, and Other Laments*, N.Y. TIMES, Dec. 15, 2002, § 3, at 1.

[177] The other states with unlimited homestead exemptions are Arkansas, Iowa, and Kansas. One commentator called this the "800-pound gorilla of loopholes" in the Reform Act's means test. Tabb, *supra* note 6, at 42. For a lengthier discussion of homestead exemptions, see Robert E. Shapiro & Richard J. Hunter, *Renewing the Debate on Bankruptcy Reform: Lessons of 2001-2002*, 35 BUS. L. REV. 125, 125-26 n.1 (2002).

[178] The 2001 Senate version of the Reform Act capped the general homestead exemption at $125,000. That provision, however, was all but eliminated in conference committee. *See* Philip Shenon, *Congress Panel Agrees to Limited Home Shield in Bankruptcy*, N.Y. TIMES, Apr. 24, 2002, at C1 (reporting that a conference committee eliminated the general $125,000 homestead cap from the legislation, retaining it for only some debtors—such as convicted felons or those with debts arising under securities laws—and also removed the homestead exemption for anyone who had not lived in a state for at least forty months). Obviously, this leaves untouched the use of unlimited state homestead exemptions for debtors not in the specified categories and those who have not moved in forty months). It is noteworthy that the provision concerning those with debts arising out of the securities laws is likely intended to deal with the possibility that former Enron executives might file for bankruptcy in Texas and take advantage of that state's unlimited homestead exemption.

[179] This Section addresses basic or "macro" flaws rather than the many "micro" or specific critiques of the calculations, figures, and precise procedures involved in this particular means testing proposal that have been advanced, many of which are detailed in H.R. REP. NO. 107-3, *supra* note 42. For example, there are numerous, significant flaws in the manner in which state median income is calculated. First, the median income figure required under the Reform Act was outdated and understated. The bill based household income on the most recent Census Bureau figures available as of January 1 of the given year. *See* H.R. 975 § 102. But as of January 1, census information is available for only the second year prior to that date. Therefore, for example, during 2001 census figures are available only for 1999. In times of inflation, this two-year lag could result in a significant increase in the number of debtors subject to motions to dismiss or convert their cases

1. New Dam, New Leaks

Like any new legislation, the Reform Act provides no guarantee that crafty debtors will not circumvent its means test and still obtain a discharge. For example, a debtor could simply take on more debt pre-filing to reduce the total amount of disposable income available to fund the hypothetical chapter 13 plan.[180] In this vein, noted bankruptcy historian, Charles Jordan Tabb, recently suggested rather cynically:

> The smart move for a debtor is to buy a Mercedes on credit shortly before filing. The debtor can then keep the Mercedes, make payments to the Mercedes secured creditor, and deduct all Mercedes payments from income in computing the means test. Mercedes-debtor thus might well be able to obtain access to chapter 7 and to the discharge available thereunder, whereas

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because they are alleged to earn more than the outdated median income figure being used. *See* H.R. REP. No. 107-3, *supra* note 42, at pt. 1. The fact that Census Bureau information is published only once a decade creates a potentially more serious problem, namely that median income figures being used to calculate a debtor's "ability to pay" may be as much as ten years out of date. *See id.*

Another glaring shortcoming of the Reform Act's median income formula is that it measures a debtor's income based upon the debtor's earnings in the six months prior to the bankruptcy filing. *See* H.R. 975 § 102. This might mean that if, for example, a debtor lost a higher paying job in the third month prior to filing and has been working at a low-wage job ever since, the three months' income from the higher paying job would be included in the future income calculation applicable throughout the hypothetical chapter 13 repayment period. In addition, if such a debtor received help from a family member, even a single cash advance, these funds also would be included as part of the debtor's regular monthly income during the six months in question. Thus the Reform Act would have required debtors to repay debts out of income that no longer exists. H.R. REP. No. 107-3, *supra* note 42, at pt. 1.

Finally, as many commentators have pointed out, the expense figures permitted under the Reform Act in many cases do not conform to reality. For example, the automobile expense allowed for debtors living in the San Francisco Bay area is $373 per month total, even though most families could barely cover the cost of automobile insurance, not to mention car payments, fuel, and necessary tolls using this figure. *See Bankruptcy Reform Act of 1998: Hearing on H.R. 3150 Before the House Subcomm. on Commercial and Admin. Law*, 105th Cong. (1998) (written statement of the Hon. R. Newsome, U.S. Bankruptcy Judge, N.D. Cal.).

For a more thorough and thoughtful discussion of the "devil in the details" of the Reform Act, see Tabb, *supra* note 6, at 20-27 (addressing flaws in the means test's treatment or calculations for income, expense deductions, secured credit, priority claims, and miscellaneous expenses); Braucher, *supra* note 11, at 434-39; *see generally* Culhane & White, *supra* note 10.

[180] *See, e.g.*, Hon. Eugene R. Wedoff, *An Analysis of H.R. 2500 and S. 1301, available at* http://www.abiworld.org/legis/bills/97hr2500.html (last visited Mar. 19, 2003).

a Chevrolet-debtor would not.[181]

And if a particular debtor is not inclined to buy a luxury car pre-petition, another simple way of outmaneuvering the Reform Act's means test is available:

> A debtor who spends $1,500 a year on private school can eat up $7,500 (per minor child!) over the sixty-month means test period of otherwise available net income. Sending Junior to First Baptist Academy rather than P.S. 100 could be the difference in whether the debtor is entitled to obtain an immediate discharge in a chapter 7 or not.[182]

According to Professor Tabb, among others, the Reform Act's means test invites manipulation particularly by those at whom the Reform Act is allegedly directed—the more sophisticated consumers with higher incomes, the "wealthy, well-informed debtors."[183]

2. Dollars and Sense

Presumably there are two reasons society would endeavor to eliminate all opportunistic behavior from the consumer bankruptcy system. First, abuse of a system designed as a social safety net is just plain wrong. Second, elimination or further reduction of any abuse in the system could result in a higher level of repayment to unsecured creditors. Of these two reasons, the first is perhaps only aspiratory, but the latter is economic and more concrete. Assuming the goal of reducing the level of default and/or consumer debt charge-offs is a worthy one, the Reform Act passes muster only if it accomplishes that goal in some meaningful way, without excessive cost.

Two types of costs are associated with the Reform Act's means testing: administrative costs and social costs. First, significant implementation costs, as estimated by the Congressional Budget Office, included $260 million in new administrative expenses and another $18 million for the additional judges necessary to handle the burden of means testing and associated litigation in the first five years alone; these estimates did not include private sector costs.[184] To be justified at all these costs must exceed the additional recovery by unsecured

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[181] Tabb, *supra* note 6, at 42. *See also* Braucher, *supra* note 11, at 446 ("It is odd that legislation supposedly designed to catch abuse makes it easier to qualify for bankruptcy [discharge] by buying a new car.").

[182] Tabb, *supra* note 6, at 29. Further, the Religious Liberty and Charitable Donation Protection Act of 1998 permits chapter 7 and 13 debtors to donate fifteen percent of their annual gross income to qualified churches and charities. For most debtors, the inclusion of this deduction in their schedules will reduce projected monthly net income to nothing, enabling them to avoid chapter 13. *See* Culhane & White, *supra* note 10, at 49.

[183] *Id.* at 29, 42.

[184] *See* Congressional Budget Office Cost Estimate, *S. 420: Bankruptcy Reform Act of 2001* as reported by the Senate Committee on the Judiciary on Mar. 1, 2001 *available at* http://www.cbo.gov/showdoc.cfm?index=2738&sequence=0 (last visited Mar. 19, 2003).

creditors,[185] which has been estimated to improve with means testing by, at most, $930 million annually.[186] While these numbers are large—easily exceeding the implementation costs—what must be borne in mind is that the costs fall on taxpayers and the benefits accrue to consumer credit institutions. Not only is there serious doubt as to whether credit card companies deserve this boost in revenues,[187] but there is also little likelihood that any portion of the savings associated with fewer bad debt write-offs will trickle down to the consumer.[188]

Social costs are more difficult to pin down. Constricting access to chapter 7 discharge may quell entrepreneurship and, thus, threaten our capitalist system.[189] What is worse, the proposed reforms effectively "throw the baby out with the bathwater." In attempting to choke off abusive behavior, means testing is likely to squeeze hardest those that are most deserving of bankruptcy relief.[190]

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[185] *See* Braucher, *supra* note 12, at 2 (stating that means testing might increase uniformity of application of bankruptcy laws, but would do so "at the expense of raising the price of access to the bankruptcy system, disproportionately excluding the worst off").

[186] This number, derived from the VISA International report, assumes successful completion of five-year chapter 13 plans by all debtors who are forced out of liquidation and into rehabilitation by means testing. This is an outrageously unrealistic assumption. *See infra* notes 190-193 and accompanying text.

[187] The credit card issuers appear to be guilty of both setting the fire and then calling the fire department. Courts and commentators alike have chastised creditors for their loose lending practices. *See In re* Wolniewicz, 225 B.R. 302, 305 (Bankr. W.D.N.Y. 1998) (discussing substantial abuse in case involving debtor with fifty-nine credit cards); *In re* Chinchilla, 202 B.R. 1010, 1015-16 (S.D. Fla. 1996) (describing lender's nondischargeability claim against a bankrupt customer that the lender targeted for solicitation because of his overextended or otherwise not creditworthy position as "institutional hypocrisy"). *See also* Ausubel, *supra* note 157, at 266 ("[P]reapproved credit cards are being offered to consumers whose financial condition has already so sufficiently deteriorated that the proposed rule would make bankruptcy protection from further debts inaccessible."); Moss & Johnson, *supra* note 18, at 332-37 (opining that credit card lending practices are at fault for increasing bankruptcy filings).

[188] *See* H.R. REP. No. 107-3, *supra* note 42, at 458-59 ("Instead the evidence shows that credit card companies . . . tend to maintain high interest rates, even when their own cost of credit declines.").

[189] *See generally*, John M. Czarnetzky, *The Individual and Failure: A Theory of the Bankruptcy Discharge*, 32 ARIZ. ST. L.J. 393, 464 (2000) (advocating an "entrepreneurial hypothesis" of discharge—*i.e.*, that discharge is a part of the institutional framework vital to fostering entrepreneurship in the market and concluding that "reform proposals . . . might work a real harm on the market system by removing one of the institutional conditions necessary for entrepreneurship."). *See also* GROSS, *supra* note 13, at 100-02 (stating that rehabilitating debtors, through either liquidation or debt adjustment, makes economic sense since it encourages risk taking and, therefore, promotes economic growth).

[190] *See, e.g.*, Dickerson, *supra* note 153, at 266 (stating that the Reform Act appears "designed to prevent all opportunistic behavior even if the reformed system prevents some truly deserving debtors from discharging their debts"); Braucher, *supra* note 11, at 430 (existing reform proposals "would burden even the worst off, while leaving some

3. "Involuntary" Chapter 13 is Bad Economic and Social Policy

The intended effect of the Reform Act is to thrust more debtors into chapter 13.[191] Heretofore, chapter 13 has been reserved for those who willingly chose it over chapter 7. With means testing like that proposed in the Reform Act, chapter 7 would be unavailable to many needy debtors, and chapter 13 would be their only opportunity for any debt relief (and a much more difficult one at that). Many have called this the equivalent of involuntary chapter 13 rehabilitation.[192]

Government and academic studies have consistently shown that only about thirty percent of chapter 13 debtors successfully complete their planned three-year repayment.[193] The lengthier plan period contemplated by the Reform Act will undoubtedly increase the failure rate.[194] Thus, it is far from clear that more debt would be repaid under the current means testing proposal. Economists and legal scholars alike have shown that the ultimate effects of such a system run counter to Congress's stated policy objectives for this legislation.[195]

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inequities and potential abuse in place, and risk bringing the system to its knees with new, often pointless paperwork").

[191] Given its current failure rate, too many debtors may be "electing" chapter 13 improperly. *See* Jean Braucher, *Counseling Consumer Debtors to Make Their Own Informed Choices - A Question of Professional Responsibility*, 5 AM. BANKR. INST. L. REV. 165, 181-82, 185-86 (1997).

[192] *See, e.g.*, H.R. REP. NO. 95-595, at 380 (1977); S. REP. NO. 95-989, at 94 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5880 (stating that "the ability of the debtor to repay his debts in whole or in part" would not be an "adequate cause for dismissal" under proposed "abuse" section, because that would in essence "enact a non-uniform mandatory chapter 13" filing). It is noteworthy that not all commentators view this outcome entirely negatively. *See* John C. McCoid, II, *Discharge: The Most Important Development in Bankruptcy History*, 70 AM. BANKR. L.J. 163, 191 (1996) (requiring chapter 13 rehabilitation for debtors who have disposable future income is consistent with the composition outcome theory of bankruptcy, in that such a requirement "simply seeks to improve the fairness of the composition's division of assets").

[193] *See* Culhane & White, *supra* note 10, at 60 n.173 (citing U.S. General Accounting Office, *Personal Bankruptcy, The Credit Research Center and Ernst & Young Reports on Debtors' Ability to Pay: Testimony Before the Subcomm. on Commercial and Administrative Law, Comm. on the Judiciary of the House of Representatives*, 105th Cong., at 7 (1998)); National Bankruptcy Review Commission, *supra* note 12, at 90-91 (finding that completion rate is thirty-two percent). *See also* Scott F. Norberg, *Consumer Bankruptcy's New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13*, 7 AM. BANKR. INST. L. REV. 415, 439-41 (1999) ("Consistent with other studies reporting the success rate for chapter 13 debtors, this study has found that approximately one-third of the chapter 13 filers completed a plan and obtained a discharge." (internal citations omitted)); William C. Whitford, *Has the Time Come to Repeal Chapter 13?*, 65 IND. L.J. 85, 92-93 (1989) (discussing high failure rate and consequences of plan failure).

[194] *See, e.g.*, Braucher, *supra* note 12, at 10-11.

[195] *See, e.g.*, Ausubel, *supra* note 157, at 264-65, 269 (stating that economic analysis

More fundamentally, it is even doubtful that chapter 13 is a successful method for collection by unsecured creditors. Indeed, one academic study revealed that ninety percent of payments made by chapter 13 debtors (other than to lawyers) went to secured creditors; that "unsecured creditors in more than [seventy-five percent] of the cases collected less than the typical chapter 13 debtor's attorney's fee;" and that the higher costs of administering chapter 13 plans eat up much of the overall recovery to creditors.[196] Portions of the Reform Act other than its means testing component favor secured creditors and will reduce recovery to unsecured creditors—the backers of the bill—even further.[197]

There is also a compelling argument against the notion of "forced" chapter 13 that is based on its likely negative social effects.[198] The United States is unique in providing for a relatively unqualified fresh start, unfettered by creditor approval or needs-based considerations. This is a fitting part of the "American Dream" and our rugged individualist, entrepreneurial culture.[199] As noted earlier,

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proves restrictions on dischargeability of credit card debt will result in even higher numbers of overextended consumers and credit card delinquency); Hung-Jen Wang & Michelle J. White, *An Optimal Personal Bankruptcy Procedure and Proposed Reforms*, 29 J. LEGAL STUD. 255, 256 (2000) (stating that means testing would "give some debtors who file for bankruptcy a strong incentive to quit their jobs").

Likewise, bankruptcy scholars have found that prior attempts at pro-creditor legislation have had counterintuitive results. *See, e.g.*, Braucher, *supra* note 12, at 8 (noting that restricting access to bankruptcy, while not particularly successful in netting abusers out of the system, will result in a growth in the consumer credit industry).

[196] Norberg, *supra* note 193, at 418, 429-31 (casting heavy doubt on the efficacy of chapter 13 as a successful debt collection procedure for unsecured creditors). *See also* Bermant & Flynn, *supra* note 166 (noting that the average 1998 yield per chapter 13 debtor to the debtor's unsecured creditors *collectively* was $540, or $45 per month).

[197] *See* Norberg, *supra* note 193, at 439 ("By forbidding strip down of debts incurred within five years before bankruptcy and secured by personal property, secured creditors will collect much greater amounts at the expense of unsecured creditors.").

[198] This Article does not venture into the sphere of the negative psychological impact of denying bankruptcy relief to desperate deserving debtors nor the psychologically salutatory effects of forgiveness on creditors and a society that treats its weakest members humanely. For a discussion of the intangible value of such things as forgiveness, dignity, and rehabilitation, see GROSS, *supra* note 13, at 100-03, 119.

[199] Discussing the invalidity of assignments of future wages after a discharge in bankruptcy some seventy years ago, the United States Supreme Court set out the argument against court ordered/assisted repayment of creditors out of future income:

> When a person assigns future wages, he, in effect, pledges his future earning power. 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. Pauperism may be the necessary result of either. The amount of the indebtedness, or the proportion of wages assigned, may here be

entrepreneurship is fostered by a society that protects those who take risks and fail. The concept of discharge is also indicative of a humane society, one that protects its weak or foolhardy.[200] Other countries without a similar bankruptcy system provide for their own with a "generous social safety net."[201] The inevitable result of the proposed radical changes—dubbed "reform"—is to force many worthy debtors into unsuccessful chapter 13 plans, in effect denying them any bankruptcy relief at all.[202] Such a system would indeed be mean-spirited, providing neither the social security common to many Western European countries, nor the privilege of expunging debts that has been a consistent feature of United States bankruptcy law for the last century.[203] Worse yet, a forced chapter 13 plan may be so daunting to some debtors as to force them underground to "gain a 'fresh start' somewhere else."[204]

D. Public Policy Favors Judicial Discretion Rather than a Mechanical Means Test

1. Basic Fairness: Should "Circumstances" Work Only Against the Debtor?

Means testing of the type proposed by the Reform Act pigeonholes bankruptcy filers into one common category of abuse if they fail the means test. The problem

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> small, but the principle, once established, will equally apply where both are very great. 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.

Local Loan Co. v. Hunt, 292 U.S. 234, 245 (1934).

[200] *See* Felsenfeld, *supra* note 17, at 1378 ("American society renounced debtors' prison for a kinder, gentler approach in which the troubled debtor is considered 'one of us.' This approach reflects empathy for the debtor, engendered by the realization that any of us could experience financial difficulty or failure due to circumstances beyond our control (e.g., illness, accident, job loss).").

[201] Price, *supra* note 7, at 253.

[202] *See* Norberg, *supra* note 193, at 451 (concluding that "the real impact of mean-testing may be to deny debtors [any] bankruptcy relief").

[203] *See* Price, *supra* note 7, at 253.

[204] Brenda Anthony, Comment, *"Substantial Abuse" Under Section 707(b) of the Bankruptcy Code: American Consumers Learn Declaring Bankruptcy May Cease to Be a Way Out*, 67 U. CIN. L. REV. 535, 562 (1999). *See* Jack F. Williams, *Ruminating on the Proposed Bankruptcy Bill*, AM. BANKR. INST. J., July/Aug. 2001, at 6 (predicting that the Reform Act might force debtors to simply disappear and avoid repayment without benefit of bankruptcy). *See also* Karen Gross, *Preserving a Fresh Start for the Individual Debtor: The Case for Narrow Construction of the Consumer Credit Amendments*, 135 U. PA. L. REV. 59, 150 (1986).

with this is that personal debts are not "one-size-fits-all." Individual debtors' circumstances do differ from one to another.[205] It is difficult if not impossible to draw up a set of exact factors that work fairly and efficiently for all consumers.

For nearly two decades the standard practice has been to review so-called abuse under section 707(b) on a case-by-case basis, using the flexible judicially-devised tests that evenhandedly allow review of both aggravating and mitigating circumstances. On the one hand, a judge can use his or her discretion to dismiss a chapter 7 petition even in the face of obvious financial incapacity;[206] and on the other hand, he or she can grant chapter 7 relief despite a debtor's apparent ability to repay his creditors.[207]

The Reform Act does not replace section 707(b) altogether. But its effect will be to limit the use of any "totality of the circumstances"-type analysis to the debtor's detriment.[208] This is hardly fair, considering only aggravating factors and eliminating judges' discretion to consider any circumstances that mitigate in favor of a fresh start for the honest but unfortunate debtor. If a court is to consider a debtor's individual circumstances, it should consider all such circumstances, not just those that would add to the number of dismissals. Under the Reform Act's negative presumption, the totality of a debtor's circumstances inappropriately and one-sidedly becomes just another high hurdle a debtor must clear to avoid dismissal for "abuse."

2. Section 707(b) More Effectively Detects and Deals With Abusers

Assuming the need to do something by statute to eliminate the non-needy debtor from the system,[209] the Reform Act incorporates injustices in the way it

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[205] Indeed, as the well-respected bankruptcy scholar Elizabeth Warren comments, due to these variations in circumstance the concept of abuse itself is "slippery." *See* Elizabeth Warren, *The Bankruptcy Crisis*, 73 IND. L.J. 1079, 1087 (1998) ("One person's example of abuse may be another person's legitimate use of the system. Filing bankruptcy on the eve of a home mortgage foreclosure is, in the eyes of some, an abusive use of bankruptcy and, in the eyes of others, a legitimate use of a statutory provision designed to halt debt collection."). *See also infra* note 207.

[206] *See supra* notes 108-119.

[207] *See supra* notes 101-108.

[208] Once a debtor has proven that his income is below the trigger points of the means test, he may still be dismissed if the totality of his financial circumstances indicate abuse (or if he has filed his petition in bad faith). *See* H.R. 975, 108th Cong. § 102 (2003).

[209] *See, e.g.*, Dickerson, *supra* note 153, at 245, 272-76 (noting that means testing as a threshold to chapter 7 is not inconsistent with types of restrictions imposed on recipients of other nonentitlement public benefits); Felsenfeld, *supra* note 17, at 1391 (noting means testing is consistent with author's view of current judicial policy, which while giving "lip service" to the totality of a debtor's circumstances, results in dismissal of nearly all cases where an ability to pay is demonstrated).

Other commentators question the very premise that legislation is needed to correct the supposed abuse crisis. *See, e.g.*, Tabb, *supra* note 6, at 13-14 (calling reformers' portrait evaluated that neediness.[210] One noted scholar developed a convincing hypothetical:

> Consider an elderly woman living in Florida who returned to the workforce several years after her husband became ill and died. She makes $30,000 annually as a secretary, and she has not taken a vacation in several years. She rents a one-bedroom apartment and owes $60,000, much of which stems from medical bills for the care of her late husband. Most of the remaining debt consists of unpaid credit card bills, most of it spent on household goods and groceries. She is behind in her payments, collection agencies call at home and at work, and they are threatening to garnish her wages.
>
> Then consider a 45-year-old businessman, also living in Florida. He works for a large corporation and makes $95,000 a year. He previously had his own business, but it failed. Though single, he lives in a 5-bedroom house worth $500,000. He owes $60,000 on his 10 credit cards, which he used to pay for vacations, clothes, and meals in restaurants. In addition, he is personally liable for $200,000 in debt from his failed business venture.[211]

Under the means testing proposal incorporated in the Reform Act, "only the businessman would be allowed a fresh start because the widow's use of chapter 7 would be presumed abusive."[212] This ironic result occurs here because the widow's income above expenditures triggers one prong of the means test. And, perversely,[213] if she had run up more debt by taking vacations or spending more money on clothes or meals, her filing would not be abusive under a means test. Instead, means testing would punish her for keeping her debt from exhausting her disposable income. Ultimately, the widow would be eligible for relief under chapter 13 if she committed all of her income for the ensuing five years to the repayment of her debts (apart from monthly living expenses), while the businessman would be eligible for chapter 7 relief, discharged of all of his debt,

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of the problem "exaggerated and factually unsupported").

[210] Various other sources catalog deficiencies in means testing, many of which are applicable to this proposed Reform Act's version. *See, e.g*, Hon. Eugene R. Wedoff, *An Analysis of the Consumer Bankruptcy Provisions of H.R. 3150 Proposed Bankruptcy Reform Legislation (Revised), available at* http://www.abiworld.org/legis/bills/revwedofmar98.html (last visited Mar. 19, 2003) (noting many serious flaws with the means testing calculations as proposed). *See also* Braucher, *supra* note 11, at 433-39.

[211] H.R. REP. NO. 107-3, *supra* note 42, at 337 (statement of Rep. Lee). Professor Douglas Baird of the University of Chicago Law School created this hypothetical for the Reform Act's predecessor bills in the 105th and 106th Congresses, testifying that those proposed bankruptcy reforms would fail to balance competing goals of bankruptcy reform. The case is the same with the Reform Act.

[212] *Id.*

[213] *See* Braucher, *supra* note 11, at 450 ("It is *perverse* to require repayment of debtors because they have incurred less debt than others.") (emphasis added).

and allowed to keep his home.[214] This result is not only counterintuitive, but also manifestly unjust.

Now let us examine the outcomes for these two debtors under existing section 707(b) caselaw. In the majority of jurisdictions the widow would be allowed to discharge her debt, and the businessman would be subject to a finding that he is in abuse of the system.[215] Faced with these two cases, a judge in any state that has adopted the "totality of the circumstances" test would weigh the equities of each debtor's circumstances.[216] Such a court would likely rule that the unforeseen illness and eventual death of the widow's husband exhausted the couple's funds and left her with insurmountable debt and that hers is not a case of living beyond her means or piling up frivolous credit card charges on the eve of bankruptcy.[217] Instead, this elderly woman went back to work to support herself. The facts of the widow's case do not appear to indicate she is a bad faith filer or an unscrupulous debtor trying to shield herself from her financial obligations. In keeping with the fresh start concept, a bankruptcy court would and should exercise its discretion to grant the widow a chapter 7 discharge.

Conversely, by any measure the businessman appears to have lived far beyond his means. He used credit cards not to buy necessities but to enjoy a life of pleasure and relaxation. Despite the fact this debtor would not have enough disposable income to fund a hypothetical chapter 13 plan (*i.e.*, ability to pay), existing section 707(b) jurisprudence would permit a court employing the totality of the circumstances test to find this debtor's filing abusive.[218]

At least from the perspective of this easily contrived hypothetical, the means test does not appear to be as effective as section 707(b) with respect to removing abusive filers from the system. The judicial discretion inherent in the application of section 707(b) allows for necessary flexibility in the system.[219]

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[214] *See* H.R. REP. NO. 107-3, *supra* note 42, at 337.

[215] This is in contrast to Professor Baird's hypothetical, which concludes that both the widow and the businessman would be entitled to a discharge.

[216] *See generally In re* Dickerson, 193 B.R. 67, 71 (Bankr. M.D. Fla. 1996) (applying totality of the circumstances test to deny motion to dismiss chapter 7 filing where U.S. Trustee failed to show that debtors had sufficient future income to repay debtors); *In re* Gentri, 185 B.R. 368, 373 (Bankr. M.D. Fla. 1995) (applying "totality of the circumstances" test to deny motion to dismiss chapter 7 filing where significant post-filing changes in debtor's income caused the record to misrepresent actual financial situation); *In re* Tindall, 184 B.R. 842, 844 (Bankr. M.D. Fla. 1994) (applying totality of the circumstances test to dismiss good faith chapter 7 filling due to unreasonably large reserves in debtor's schedule).

[217] *See supra* notes 109-120 and accompanying text.

[218] *See supra* notes 48-54, 93-100, 116 and accompanying text.

[219] *See* Felsenfeld, *supra* note 17, at 1397-98 (arguing that the exercise of judicial discretion by federal bankruptcy court judges has resulted in an incoherent non-uniform application of section 707(b) and that, at present, there are not enough judges to handle "case by case" analysis of substantial abuse of chapter 7). Means testing will likely require at least as many individual fact-intensive considerations, particularly in light of the

3. Guilty Until Proven Innocent in Bankruptcy Court

Another major problem with the Reform Act's means testing proposal is that it turns the century-old fresh start concept on its head. Existing bankruptcy laws are based upon the fundamental notion that an honest debtor is entitled to a discharge of his debts.[220] Section 102(a) of the Reform Act replaces the current law's presumption in favor of the debtor, instead requiring debtors to *qualify* for chapter 7.[221] It is based on a dishonest debtor assumption: the debtor is "guilty until proven innocent," so to speak. To be sure, the innocent-until-provenguilty doctrine developed in criminal law, where the stakes are highest. Bankruptcy proceedings, of course, are civil. No debtor is *entitled* to a presumption in his favor, unless Congress decrees it so. However, the history of the Bankruptcy Code—with the elimination of the debtor's prisons—suggests that a presumption that the debtor is entitled to a discharge is consistent with American bankruptcy theory.[222]

For nearly a century, Congress has carefully considered and reconsidered our bankruptcy laws, legislating on a deliberate basis. And in the past, Congress has always chosen to preserve an insolvency system that provides a fresh start for honest, hard-working debtors, protects ongoing businesses and jobs, and balances the rights of debtors and creditors. Means testing is a serious reversal of course that loses track of the Bankruptcy Code's roots. It should not be hastily adopted at the expense of our society's neediest individuals.

By definition, bankruptcy involves tension between opposing interests. But the foundation of this country's legal system as a whole suggests that if there has to be an error, it is better to let one guilty man go free then it is to imprison an innocent one. The same should continue to hold true with our bankruptcy laws. It benefits society more as a whole to allow the worthy, along with perhaps a few unworthy, debtors to regain solvency, than it does to "imprison" many to likely unsuccessful five-year repayment plans in an attempt to weed out a few abusers.[223]

VI. CONCLUSION

Let us face the real issue raised by the current bankruptcy reform rhetoric. Rather than calling the problem of increased consumer debt a "bankruptcy tax"[224]

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statutory presumption against the debtor.

[220] *See, e.g.*, Felsenfeld, *supra* note 17, at 1380 (noting that the "concept of consumer discharge is deeply embedded in the Code").

[221] Admittedly, there is no constitutional right to a chapter 7 discharge. *See supra* note 47.

[222] *See infra* Section II.A.

[223] *See* McCoid, *supra* note 192, at 185 (stating that the discharge component of bankruptcy system is "designed to salvage the debtor from insolvency to the general advantage of all").

[224] Congressman Gekas coined the phrase "bankruptcy tax" to describe a credit card industry-generated statistic that divided the total uncollected debt in bankruptcy among

on fiscally responsible Americans, let us frame the issue more accurately and objectively. Credit card companies have extended an extraordinary amount of unsecured credit, enabling not just profligate spending by some, but also much-valued entrepreneurship.[225] The real debate is about who should pay for the losses associated with the inevitable default, which gives rise to both "honest and unfortunate debtors" as well as a few more wily debtors seeking discharge by way of chapter 7 bankruptcy proceedings. Permitting the credit card industry to use the bankruptcy system as its collection mechanism would reward creditors' irresponsibility.[226] This result should be no more palatable to us than the notion that the current bankruptcy system rewards a small percentage of consumer debtors' irresponsibility.

Section 707(b) is a sophisticated and fundamentally fair doctrine that has stood the test of time. The appellate courts seemingly articulate different tests, some framing their decisions in terms of ability to repay and others applying a broader totality of the circumstances test. But these tests are different more in form than in substance. The totality of the circumstances test considers a debtor's repayment potential plus extenuating circumstances. Courts that use the stricter ability to pay test, focusing primarily on a debtor's capacity for repayment, are increasingly looking to other circumstances of the debtor when reaching their substantial abuse decisions. Regardless of which test is used, the nature of a debtor's insurmountable debts and the culpability of the debtor in their creation is inevitably reviewed. This is where justice is done—separating the deserving from the undeserving based on their individual merits.

Means testing almost completely removes the human element from the bankruptcy system and replaces it with an unforgiving mechanical test. Under section 707(b), a judge can look at the debtor's unique circumstances, focusing on *why* the debt exists. With a means test, if a debtor is theoretically[227] able to pay twenty-five percent of his debt over five years or his monthly disposable income exceeds $167, no judicial discretion is allowed, and such a debtor is presumed to be in abuse of the system.[228] But the actual "means" calculations used by the

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taxpaying families. *See* Tabb, *supra* note 2, at 350. *See also* Braucher, *supra* note 12, at 8.

[225] *See* Rodney Ho, *Banking on Plastic: To Finance a Dream, Many Entrepreneurs Binge on Credit Cards*, WALL ST. J., Mar. 9, 1998, at A1 ("Teaser introductory rates . . . and the crush of card offers have made credit cards a convenient no-questions-asked option" for many consumers starting small businesses.).

[226] *See* GROSS, *supra* note 13, at 117-18.

[227] Among other questionable premises, this ability-to-pay number assumes that the debtor's income remains steady, and that it increases at the same rate as his expenses. *See* Culhane & White, *supra* note 10, at 58-59.

[228] Two examples posited by Professor Tabb illustrate the harsh effect of the presumption of abuse:

> Consider first a debtor with debts of only $20,000, income of $2,500 per month, and allowed expenses of $2,400 per month. This debtor would be a presumptive abuser:

Reform Act are not what make means testing most inappropriate. No matter what the threshold means level may be and regardless of how specifically that number is calculated, means testing cannot replace a judge's ability to review debtors' personal circumstances along with their schedules and income and expense statements. Judges—who are in the bankruptcy trenches on a daily basis—are in the best position to show our society's compassion for debtors who have suffered sudden unemployment, sickness, or calamity. They are well equipped to balance a debtor's ability to pay against the totality of his or her circumstances, both good and bad. These same judges are more than capable of flushing out the crafty debtor who is looking for a "head start," abusing the Bankruptcy Code.

The bankruptcy courts should remain the common ground for debtors and creditors to work out untenable debt situations. These courts should not become harsh collection agents for credit card companies. Bankruptcy judges should not be limited to following a set of rigid mathematical rules with very little room for interpretation. They should retain the authority and the necessary discretion to decide the question of substantial abuse without having their hands tied by a mechanical means test. Because section 707(b) has demonstrated its ability to protect those who deserve bankruptcy and to deny those who do not, it should remain the standard for judging substantial abuse.

> she has $100 in net income theoretically available, and thus over sixty months could pay $6,000. Or, as a second example, consider an unusual single debtor with $800,000 in debt, income of $2,970 per month and allowed expenses of $2,800 per month. This second debtor also would be a presumptive abuser - she supposedly could pay $170 per month, for sixty months, for a total of $10,200, thus satisfying prong two of the test. That debtor would thus be denied bankruptcy relief under chapter 7 even though she could pay her creditors just a shade more than one percent of the debt owed.

Tabb, *supra* note 6, at 20. Surely these debtors deserve either presumptive chapter 7 relief or, at the very least, judicial consideration of their individual circumstances.