CHAPTER 5
LIQUIDATION BANKRUPTCY

A. INTRODUCTION

A Chapter 7 bankruptcy is the classic "straight" or liquidation bankruptcy. A Trustee in Bankruptcy (TIB) is appointed to gather all the debtor's property, to sell it, and to distribute the proceeds to creditors. At the end of the process, the creditors have their proportional share of whatever the debtor had, and the debtor receives a discharge of the remaining outstanding debts. The creditors can tote up their losses and move on. The debtor can get back to work or start a new business, flat broke and without much in the way of assets, but knowing that the benefits of tomorrow’s hard work will not go to the creditors.

The distribution process in liquidation is governed by section 726. Although the basic principles of bankruptcy distribution are simple, the process can become quite complex. It is therefore useful to set out the basics by way of introduction, then return to it later with more detail. The discussion that follows is necessarily simplified for introductory purposes.

As the TIB prepares to sell each piece of property in which the debtor has an interest, it must first be determined if some other person or company has any interest in that property. For example, such an interest could be that of a co-owner or, more often, a secured party. If another party has a recognized interest, then the TIB must pay that party the part of the proceeds to which it is entitled, with only the remainder available for distribution to creditors generally. In the typical case, the trustee will have to deduct from the sale proceeds the trustee’s own fee and costs of sale, and then the amount of the claim of a secured party and pay that amount to the secured party. Any proceeds in excess of those owed to the secured party go into the general distribution fund. So, for example, if the debtor owned a Toyota Camry, the trustee might seize it, sell the car, take a fee for the sale, and pay off the secured lender. If money remains, it would go into the pool for general unsecured creditors.

The trustee must also consider any valid exemption claimed by the debtor in a particular item of property. Exemptions, which are discussed below, will determine what property of the estate is exempt from sale for the benefit of the creditors and reserved for the debtor's fresh start. If, for example, the debtor had a valid exemption for the car, the trustee might still seize and sell it, and the trustee and the secured creditor would be paid, but the debtor would get the dollar value of the exemption. Only if the car brought more money than all of those would there be anything left to go into the pool for the general unsecured creditors.

Once the proceeds from the sales of all property have been obtained and the secured parties and other entities with property interests have been paid, the TIB distributes the remaining funds among the general creditors. General creditors are in turn divided into three principal groups: "priority creditors," "general, unsecured creditors," and "subordinated creditors." None of these creditors is secured, although some of them
may have been partially secured and are now in line to collect only on that part of their claims that was not satisfied by the proceeds of the sale of their collateral.

If the TIB is pictured as sitting behind a distribution table with piles of money ready for payment, then the statute sets forth specific rules determining who stands where in the line of unsecured creditors gathered in front of the table. Those who are among the first in line are the "priority" creditors. These creditors are entitled to get paid, in full or up to the dollar limits of their statutory priorities, before the other creditors get anything. Even among these priority creditors, some get paid before others. §507(a). At the very back of the line are "subordinated creditors," who are paid last because they have been "equitably subordinated" to everyone else, usually because of some wrongdoing. All the remaining creditors are general, unsecured creditors who get paid after the priority claimants, but before those who are subordinated. (Some of the unsecured creditors have agreed to be subordinated by contract; their special circumstances are discussed later.)

There are also some distinctions among general, unsecured creditors, but ordinarily they are paid pro rata from the remaining funds, in proportion to the amounts owed to each: If there is $10,000 left and the unsecured creditors are collectively owed $100,000, then each one will get 10 percent of its claim (the infamous "10 cents on the dollar" that springs up in thousands of bankruptcy examples).

B. ELIGIBILITY

1. A Change in Philosophy

Chapter 7 liquidation bankruptcy is the baseline, the central idea behind the bankruptcy system—liquidate property, distribute the proceeds, discharge the debts, and leave the debtor with a reason to keep working. At some level, this cycle of debt forgiveness and re-entry into the marketplace is quite extraordinary. Using a largely administrative process, many kinds of legally enforceable obligations simply dissolve. Bankruptcy is a world turned upside down in which a debtor freely admits owing money to many creditors, but payment will never be made.

At the same time, bankruptcy is not very extraordinary at all. Any free market economy will produce both winners and losers. The winners will pay their debts and count their profits, but there must also be some way to deal with the losers. Even if the law provided no bankruptcy system, many of the losers would never pay—they simply don’t have the money. Creditors might press for repayment, and some might get it. Perhaps the biggest creditor would take everything the debtor had left. Perhaps an outlaw creditor would break the debtor’s legs unless some family member paid up. Perhaps corporate insiders would loot the business before the creditors showed up. And perhaps creditors would hound the debtor for decades to come, seizing wages or grabbing business assets, unless the debtor fled to another country or to the underground economy where all transactions are in cash. Bankruptcy substitutes an orderly process under a uniform federal law for these other approaches to collection, with Chapter 7 as the central arbiter between debtors and creditors.
The power of the bankruptcy system and its starting point, Chapter 7 liquidation, is so great that Congress has revisited the question of when debtors should be eligible for bankruptcy relief a number of times. The first bankruptcy laws were available only to “traders,” an early recognition that debt relief was essential to encouraging entrepreneurial undertakings. By the mid-nineteenth century, bankruptcy laws accommodated both troubled businesses and families in financial distress, all following the liquidation model. When repayment schemes were added during the Great Depression, Chapters X, XI, and XII for businesses and Chapter XIII for wage earners, a new choice was born: liquidate or pay creditors over time.

When Congress enacted the 1978 Bankruptcy Code, it kept access to liquidation bankruptcy broad, making it available to both individuals and businesses, with only the smallest exceptions. But Congress wanted more of the people in trouble to repay if they could, so the new law substantially revised Chapter 13 to make it a more workable alternative. In order to attract more users, Congress built incentives into the Chapter 13 option. So, for example, Chapter 13 provided carrots such as a unique opportunity to get current on a home mortgage that was in default, a chance to keep more property, and a discharge that covered certain debts that could not be discharged in Chapter 7. Around the country, a number of bankruptcy judges embraced the new system, working with trustees and attorneys to try to make the Chapter 13 system feasible for people who needed bankruptcy relief and who might eventually discharge many of their debts, but who might be able to make payments along the way.

The changes worked. In a short period of time, Chapter 13 spread from a regional oddity to a nationwide system. By the mid-1980s, about 30 percent of all the families that filed for bankruptcy chose Chapter 13. It appeared that Congress had its wish: a two-level bankruptcy system that provided liquidation for people in the worst financial trouble, but a repayment alternative that a sizeable portion of the debtors would attempt.

But there it stalled out. Chapter 13s were half the filings in some districts, but in other districts Chapter 13 remained a rarity. In twenty years, from 1985 to 2005, the proportion of debtors choosing Chapter 13 changed little. Moreover, data began to emerge that showed that only a third of the debtors who filed for Chapter 13 were able to complete their repayment plans. Two-thirds either converted their cases to Chapter 7 or they dropped out of bankruptcy altogether, with no discharge and facing a mountain of interest that piled up on their debts in the meantime.

At the same time that the proportion of debtors filing for Chapter 13 stabilized at about 30 percent, the total number of bankruptcy filings continued to rise dramatically. From the early 1980s to the early 2000s, the number of bankruptcy filings quadrupled. By 2004, about one in every 75 households across the country filed for bankruptcy. With more than 1.5 million cases filed (and more than 2 million people filing, counting husbands and wives who file jointly), bankruptcy had become far more common than our forebears could have imagined (see Warren and Tyagi, The Two-Income Trap, p. 13). Now in a single year more people file for bankruptcy than are diagnosed with cancer. More declare bankruptcy than graduate from college. And, as a reminder of the fallout from these bankruptcy decisions, we note that more children live through their parents’ bankruptcy than their parents’ divorce.

What does it mean when the number of bankruptcies rises so sharply? Could it be that families are in a lot more financial trouble? Could the rise in the number of families with no health insurance or the increasing instability of American jobs be causing some of the increase? Could a deregulated credit industry that aggressively markets consumer debt and sub-prime mortgage financing bear on the failure of these families? Could more
small businesses be failing, dragging down the entrepreneurs who owned them? Could increased attorney advertising have increased the number of filings? Or could it be that those in modest financial trouble are simply more willing to seek a bankruptcy alternative than they were a generation ago? Or perhaps more people are spending wildly because they know they have a bankruptcy backstop?

Depending on which answer (or answers) is correct, the rise in bankruptcy filings, and particularly the rise in the number of people who choose to discharge their debts through Chapter 7 liquidation, is either a symptom of other serious problems or it is a problem itself. Congress, spurred on by a highly vocal credit industry, decided it was the latter. In their view, the rise in bankruptcy filings was the fault of wildly spending debtors or of debtors who could pay their debts if they really tried.

In 1984, as the rise in bankruptcy filings began to gather steam, the credit industry lobbied Congress for changes in the laws. In response, Congress gave the bankruptcy judges the power to dismiss Chapter 7 cases if the filing involved “substantial abuse.” Over time, a number of debtors were denied access to Chapter 7. Some of those debtors had engaged in bad acts before bankruptcy that made their filings offensive to a sense of fair play. They might meet all the technical requirements for bankruptcy, but they were engaging in criminal activities or cheating their creditors, so the bankruptcy judges tossed them from the system. More often, the debtors who were pushed out were those who had the ability, with a modest amount of sacrifice, to repay their creditors. Debtors who had substantial incomes were told to convert their cases to repayment plans or to leave the bankruptcy system altogether. Published opinions added some flesh to the statutory bone of “substantial abuse” as the trustees and courts monitored which debtors would be eligible for Chapter 7.

Over time, some debtors pushed the boundaries of bankruptcy relief, and some courts pushed back. Notice in the opinion below how the court reshapes the debtors’ budget and requires a minimum three-year repayment plan if the debtors want any bankruptcy relief.

In re SHAW

OPINION BY: Catharine R. Carruthers

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The Debtors, Gregory and Martha Shaw, filed for Chapter 7 bankruptcy on May 27, 2003. The Debtors are a married couple in their early 50s with two grown children, ages 21 and 24. The Debtors assets include a house that they listed on Schedule A with a value of $415,000.00, but testified that they believed it was actually worth less than $400,000.00. The Debtors listed personal property in the amount of $56,265.00. The Debtors have been continuously employed for at least the past five years. The Debtors’ 2001 Federal tax return shows adjusted gross income of $138,554.00, with an increase in 2002 to $157,024.00. At the time of the bankruptcy filing, Mr. Shaw worked for Shelco, Inc., where he has been employed for the past five years, and Mrs. Shaw worked for R.J. Reynolds Tobacco Company. On their bankruptcy schedules, Mrs. Shaw listed monthly income of $3,080.70 and Mr. Shaw listed income of $4,723.41 for a total
combined monthly income, after taxes and other payroll deductions, in the amount of $7,804.11.

Mrs. Shaw has since lost her job, though she will receive severance pay at full salary until April 2004. Mrs. Shaw must now pay for health and dental insurance, which she estimated at $192.00 per month, such that her income should be adjusted down accordingly. Therefore, according to her pay stubs her monthly income is $2,763.89 per month.\textsuperscript{1} Mrs. Shaw stated that she obtained many skills from her employment at R.J. Reynolds Tobacco Company and that she is also a licensed cosmetologist. She intends to seek new employment next month, and will continue to receive severance pay at full salary even if she obtains new employment prior to April. Mr. Shaw recently received a raise, such that his income has increased to $5,126.08 per month after taxes. Therefore, the Debtors combined monthly income, after deductions for payroll taxes and health insurance, is currently $7,889.97.

The Debtors listed net monthly expenses of $7,517.59. The breakdown is as follows:

<table>
<thead>
<tr>
<th>Category</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Home Mortgage</td>
<td>$3,349.28</td>
</tr>
<tr>
<td>Electricity and heat</td>
<td>$200.00</td>
</tr>
<tr>
<td>Cable</td>
<td>$40.00</td>
</tr>
<tr>
<td>Telephone</td>
<td>$95.00</td>
</tr>
<tr>
<td>Water</td>
<td>$16.00</td>
</tr>
<tr>
<td>Internet</td>
<td>$29.95</td>
</tr>
<tr>
<td>Trash service</td>
<td>$16.00</td>
</tr>
<tr>
<td>Home maintenance</td>
<td>$30.00</td>
</tr>
<tr>
<td>Food</td>
<td>$525.00</td>
</tr>
<tr>
<td>Clothing</td>
<td>$75.00</td>
</tr>
<tr>
<td>Laundry</td>
<td>$40.00</td>
</tr>
<tr>
<td>Medical and dental</td>
<td>$75.00</td>
</tr>
<tr>
<td>Transportation</td>
<td>$435.00</td>
</tr>
<tr>
<td>Recreation, newspapers</td>
<td>$14.00</td>
</tr>
<tr>
<td>Charitable contributions</td>
<td>$165.00</td>
</tr>
<tr>
<td>Auto insurance</td>
<td>$227.00</td>
</tr>
<tr>
<td>Life insurance</td>
<td>$41.36</td>
</tr>
<tr>
<td>Property taxes</td>
<td>$50.00</td>
</tr>
<tr>
<td>Auto payments</td>
<td>$944.00</td>
</tr>
<tr>
<td>College expenses for daughter</td>
<td>$1,105.00</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>$100.00</td>
</tr>
<tr>
<td>TOTAL</td>
<td>$7,517.59</td>
</tr>
</tbody>
</table>

At the hearing on this matter, the Debtors testified as to some adjustments to their scheduled budget. First, the Debtors understated their automobile payments on their petition. The Debtors own a 2002 Oldsmobile Bravado with a payment of $598.00, a 2001 Oldsmobile Alero with a payment of $458.00 per month, and lease a 2000 Mitsubishi Montero for $349.00 per month for a total of $1,404.00 per month. Second, the Debtors monthly telephone expense is $220.00, including two cell phones and two

\textsuperscript{1} This monthly figure is based on earnings in the amount of $1,818.50 less $454.24 in taxes paid 26 times a year. The court deducted $192.00 per month for health and dental insurance. Mrs. Shaw also has deductions from her paycheck for a 401(k) loan and a car loan that the court has included in her income.
lines for their home. Finally, the Debtors did take out a student loan for their daughter's college tuition, so their college expenses have dropped to $520.00 per month. Even with these changes, the Debtors' monthly budget appears to remain at approximately $7,500.00 per month.

The Debtors' financial problems have been ongoing for over ten years. Prior to filing for bankruptcy, the Debtors had amassed a substantial amount of both secured and unsecured debt consisting primarily of credit card debt. The Debtors have a first mortgage in the amount of $338,000.00 and a second mortgage in the amount of $60,329.00 on their home. The Debtors total secured debt, including three car loans and two mortgages is $469,074.50. The Debtors also owe $131,476.26 in unsecured credit card debt. The Debtors had at least fifteen credit card accounts including credit accounts with stores such as Dillards, Hecht's, JC Penney's, Sears, Belk and Home Depot.

Despite their consistent income during the last several years, the Debtors have been unable to make a dent in the repayment of their debts and have consistently spent more money than they were able to earn. The Debtors contend that they need a fresh start in a Chapter 7 so that they can retain their home and three vehicles.

DISCUSSION

The court scheduled this matter to determine if dismissal was for substantial abuse under Bankruptcy Code Section 707(b) . . .

The Debtor stipulate that their obligations are "primarily consumer debts" in that they are debts "incurred by an individual primarily for personal, family, or household purposes." 11 U.S.C. §101(8). Congress, however, did not provide a definition for the term "substantial abuse." The Fourth Circuit has adopted a test for substantial abuse that requires that the court look at the "totality of circumstances." In re Green, 934 F.2d 568 (4th Cir. 1991). Under the Green test, an important factor to be considered is whether the debtor has the ability to repay the debt, including consideration of the relation of the debtor's future income to his future necessary expenses. Id. at 572. The court must also examine (1) whether the debtor filed his bankruptcy petition because of sudden illness, calamity, disability, or unemployment; (2) whether the debtor's schedules and statement of current income and expenses reasonably and accurately reflect his true financial condition; (3) whether the debtor incurred cash advances and made consumer purchases in excess of his ability to repay; (4) whether the debtor's proposed family budget is excessive or unreasonable; and (5) whether the petition was filed in good faith. In re Smurthwaite, 149 B.R. 409, 411 (Bankr. N.D.W. Va. 1992).

The facts in this case illustrate that the Debtors can repay a meaningful portion of their unsecured debt over a period of 36 months based upon their projected income and necessary future expenses. Conversely, if the debtors remain in chapter 7, this case will be a no asset case and unsecured creditors will receive nothing. The Debtors' proposed family budget as listed on Schedule J in the amount of $6,312.52 is excessive and unreasonable. While their scheduled budget appears to leave no disposable income, the Debtors' overall expenses can be reduced significantly and still provide the Debtors with adequate food, clothing, shelter and other necessities of life. See In re Engskow, 247 B.R. 314 (Bankr. M.D. Fla. 2000).

The court finds that the Debtors' proposed family budget is excessive and unreasonable within the context of a Chapter 7 bankruptcy. First, the Debtors' mortgage payment expense is clearly unwarranted. The Debtors purchased the home in 1993. At the hearing, the Debtors explained that they needed a large home so that there would be
sufficient space for Mrs. Shaw's mother to live with them and yet not interrupt their children's lives. Mrs. Shaw’s mother passed away in 1998. The Debtors currently pay $3,349.28 to maintain a home with approximately 3200 square feet as well as a finished basement. The Debtors' children are now grown, however, their 24-year-old son lives at home and contributes nothing to the monthly housing payment. If the Debtors wish to take advantage of the protections afforded by the Bankruptcy Code, they simply must obtain less expensive housing. The Debtors could easily reduce their monthly housing expense by $1,000.00 per month and still have over $2,000.00 per month available for housing.

In addition, the court finds that the vehicle lease payments of $349.00 per month and college expenses of $520.00 per month for the Debtors' daughter are not reasonable and necessary expenses under these circumstances. While supporting a daughter in college is an admirable goal, the Debtors propose to do so at the expense of their creditors. Therefore, the Debtors' budget can be further reduced by $869.00 per month. Further reductions can be made by trimming the Debtors' telephone expenses for two home lines and two cell phones and by eliminating the ongoing expenses for the swimming pool. The court finds that the transportation cost, exclusive of car payments and insurance, is unreasonable and excessive. With just these adjustments alone, the Debtors could be able to contribute approximately $2,000.00 per month to a Chapter 13 plan. The Chapter 13 Trustee estimates a dividend of 29% over 36 months.

The Debtors admit that their bankruptcy was not the result of a sudden illness, calamity, disability, or unemployment. These Debtors were not forced into bankruptcy as the result of a tragic event. While the Debtors have experienced some short period of unemployment, their road to financial distress was the result of lifestyle choices they made. Their debts have been accumulating for years. This Green factor weighs in favor of dismissal.

The Debtors admit they have incurred cash advances and consumer purchases beyond their ability to pay such debts. The Shaws have been living beyond their means for years. The Debtors made purchases in anticipation of future bonuses and were unable to pay off those purchases when bonuses were not received or were smaller than expected. For example, Mrs. Shaw testified that she purchased a bedroom suite less than two years ago for approximately $4,000.00 with the expectation that Mr. Shaw would get an anniversary bonus. Mr. Shaw did not receive that bonus. The Debtors also paid for maintenance and repairs on their home through cash advances on credit cards. Mrs. Shaw testified that for years, they managed to keep up with their bills only by relying on bonuses and income tax refunds to catch up payments, and by pushing out payments by consolidating debts or refinancing.

The Debtor contend that they have never incurred debt maliciously or with an intent not to pay, and that their enormous debt has accumulated over a period of years. The fact that the these debts accumulated over a long period of time makes it all the more difficult for the court to understand why the Debtors did not change their spending behavior years ago. According to the Debtors' testimony, they have been struggling to make payments on their debts for years, and yet continued to make expensive decisions, such as purchasing a 2002 Oldsmobile Bravado and a 2001 Oldsmobile Alero, and a $4,000.00 bedroom suite and contributing over $1,000.00 per month towards their daughter's college expenses. Thus, the Debtors have clearly been aware of their inability to pay their ever-increasing debt for years, and continued to incur cash advances and consumer purchases beyond their ability to pay.
This brings the court to the question of whether the Debtors filed the case in good faith. The Debtors have incurred over $130,000.00 in unsecured credit card debt. The Debtors have clearly stated that they are seeking the court to discharge this unsecured debt so they can use their income to make their vehicle and mortgage payments. Clearly the Debtors have been quite forthright and honest, however, the Debtors’ desire to retain their $415,000.00 home and three vehicles, and maintain a lifestyle they cannot afford at the expense of their creditors weighs against a finding of good faith.

Finally, the court notes that the Debtors' schedules are reasonably accurate and the Debtors were credible at the hearing when questioned by counsel and the court. Therefore, the court will find that the errors in the schedules were not made with the intent to mislead any parties and therefore do not weigh in favor of dismissal.

In evaluating all of the Green factors and looking at the totality of the circumstances, the court must take into account that there is a presumption of granting the debtors the relief requested under Chapter 7. Even with this presumption, the court finds that this case should be dismissed for substantial abuse. The Debtors elected to file a Chapter 7 petition to maintain their present lifestyle. They have the ability to repay a substantial portion of the debt with their high income. The Debtors incurred cash advances and made consumer purchases far in excess of their ability to repay and their proposed family budget is both excessive and unreasonable given their current circumstances.

The court concludes that based upon the totality of the circumstances these debtors do not satisfy the criteria to be Chapter 7 debtors. To allow such would be a substantial abuse of the bankruptcy system and goals; and therefore, this Chapter 7 case should be dismissed under 11 U.S.C. §707(b) of the Bankruptcy Code. The Court will delay entry of the Order for ten days to provide the Debtors with an opportunity to consider whether to convert this case to a case under Chapter 13 of the Bankruptcy Code.

With an income about six times higher than the typical debtor filing for bankruptcy, Mr. and Mrs. Shaw are not likely to provoke a great deal of sympathy. Even so, we find ourselves wondering about the creditors that offered all those mortgages, car loans, and new credit cards and that, according to the court, refinanced and consolidated all those debts on multiple occasions. Didn’t anyone notice that the Shaws were just a wee bit overextended?

Despite the courts’ willingness to crack down in cases such as Shaw, most debtors didn’t have high incomes and big expenses to cut back on. Even as the bankruptcy judges and trustees screened the debtors, bankruptcy filings continued to skyrocket. A solid 70 percent of the filers were liquidating their debts in Chapter 7, and the failure rate in Chapter 13 remained high. The credit industry lobbied hard for more changes in the law to make it harder for debtors to get bankruptcy relief, launching a public relations campaign about bankruptcy abuses. Empirical studies, including our own, showed that most people filed for bankruptcy following job losses, serious medical problems, and family break-up, but that did not slow down credit industry lobbying. The debate over why so many people were filing for bankruptcy rapidly intensified.

Historically there were two big deterrents to filing bankruptcy: the risk of losing property and the stigma associated with a public declaration of insolvency. As bankruptcy filings rose, critics claimed that these two determinants were obviously inadequate—otherwise how could anyone explain the rise in bankruptcy filings? Most
debtors had no non-exempt property and, they argued, an increasingly decadent population no longer regarded bankruptcy as shameful. Therefore there was no real cost to filing bankruptcy and no return to creditors. Debtors should be made to pay at least something from future income in exchange for a discharge.

In 2005, nine years after the bill drafted by the credit industry was first introduced, Congress took steps to make bankruptcy less accessible. Instead of keeping the doors to the bankruptcy courthouse open wide for any person in financial trouble, the 2005 Amendments put new mechanisms in place to screen the debtors seeking relief more aggressively than the courts and trustees had done. Only those who could make it past the screens would be permitted to file for Chapter 7 bankruptcy. The rest must adopt a payout plan in Chapter 13 or struggle along outside of bankruptcy without its fresh start.

2. The Presumption of Abuse

The 2005 Amendments follow the basic idea of the 1984 amendments—scrutinize the debtors to see which ones should be denied access to Chapter 7 liquidation because they are abusing the system. As in the 1984 Amendments, Congress embraced the position that only one kind of debtor could engage in abuse: the consumer. For someone whose debts are mostly business debts there is no screening for abuse. §707(b)(1). This means, for example, that someone who runs a small business and is loaded with debts to suppliers, tradespeople, and the like is not subjected to section 707(b). scrutiny. (We note, however, that section 707(a) may still provide a creative court with some chance to review a business petition.) Of course, another small businessperson, with more modest business debts, but a home mortgage and credit card charges run up for family needs, may be barred from Chapter 7. Similarly, the consultant who is self-employed may face a business crisis and file for bankruptcy, but the debts he incurred to support himself will likely be declared “consumer debts,” thus requiring him to run the gauntlet of the means test in order to file for Chapter 7.

One place where the 2005 Amendments part company from earlier efforts to scrutinize debtors who might be abusing the bankruptcy process is in the role of the judges. The 1984 Amendments authorized the judge to dismiss cases on any finding of abuse, leaving what constituted abuse in a particular circumstance to the judge who weighed all the facts and circumstances of the individual case. Instead of leaving discretion with the court, however, the new Chapter 7 screen is semi-automated, employing a fixed formula to determine which debtors should be deemed ineligible.

The test is complex. In the 2005 legislation, it filled two printed, single-spaced pages. Like a big meal that can’t be digested all at once, the new formula is best understood when broken into smaller parts. The first such part appears in 11 U.S.C. §707(b)(1), instructing the courts to dismiss a case or to convert it to a repayment plan in Chapter 13 or Chapter 11 if the Chapter 7 filing constitutes an “abuse.”

The real action, of course, is in the provisions that determine which factors make up “abuse.” Those provisions are in section 707(b)(2)(A), which creates a presumption of abuse based upon a formula. The instruction to the courts is now clear: “the court shall presume abuse exists” according to an intricate formula of income minus expenses. The debtor must also supply extensive documentation for the calculation. The starting point is unambiguous: No more weighing and measuring what constitutes abuse under the highly individualized circumstances of each person who files for bankruptcy relief.
Instead, under the 2005 Amendments, the judges have their marching orders from Congress: Apply the formula to all Chapter 7 filers, then dismiss or convert the cases that the formula identifies as abusive.

Congress left a sliver of judgment with the courts in the next major subsection, 707(b)(2)(B). “Special circumstances,” such as serious medical conditions or service in the armed forces, may justify adjustments to the calculations to determine which debtors are presumed to have abused the bankruptcy system. But the exceptions themselves require extensive documentation and the adjustments to income or expenses must be cranked back into the mechanical formula to determine whether the debtor can overcome the presumption that this bankruptcy filing is abusive. Suffering or distress is not enough; the special circumstances must have an effect on income or expenses that can be quantified and documented.

Although Congress left little room for a court to determine that a filing that failed the formula was not abusive, Congress permitted courts to exercise discretion in the opposite direction. Even a debtor who was deemed “not abusive” under the formula could nonetheless be deemed an abuser by the court in section 707(b)(3). The grounds are “bad faith” and “totality of the circumstances,” a catch-all category for any unworthy debtors not captured by the payment formula.

3. The Formula: Income and Expenses

The key to the reform was to determine which debtors could make any meaningful repayment of their debts—and in the process to define “meaningful.” Congress was obviously dissatisfied with the judges’ efforts since 1984 to determine which debtors could repay. Instead, Congress instituted a formula widely known as the “means test,” a mechanical formula to determine who can and cannot (as a matter of law) repay some debt. Debtors who cannot pass the means test are presumed to abuse the bankruptcy process, and the judges are instructed to dismiss their filings without further ado. The core idea is to define income and expenses and subtract the second from the first. If the difference (the surplus of income over expenses) would pay at least “X” amount of debt, the debtor is barred from Chapter 7, absent special circumstances.

Income

The formula for the means test begins with the debtor’s current monthly income and a threshold test for Chapter 7 eligibility. If the debtor’s income is low enough, the debtor is exempt from the means test and therefore eligible for Chapter 7. Otherwise, the rest of the formula must be worked out to determine eligibility. In general, the threshold test is whether the debtor’s income exceeds the median income for similar families in the state where the debtor filed. If the debtor’s income is equal to or lower than the median, then the debtor has passed through the median-income screen and no presumption bars the way to Chapter 7. If the income is higher than the state median, more calculations await. §707(b)(2)(A). Note it is the median (middle) income that is used, not the mean (average) income, which is pulled way up by really big earners.

What counts as current monthly income is defined in section 101(10A). The court is instructed to calculate the average monthly income for the six months preceding the bankruptcy filing. Income from all sources is included. This means wages, of course,
but it also includes other earnings, such as interest on a checking account, stock dividends, unemployment compensation, income tax refunds, or, in the case of a debtor who runs a small business, revenues and accounts receivable. Income also includes amounts paid by others toward household expenses.

Obviously, the median-income screen is the most crucial step in the process, since data show that many debtors will fall below that threshold (see below). This screen depends upon comparison with state median income figures compiled by the Census Bureau, yet the Bankruptcy Code and Census definitions of income are mismatched in several important ways. For example:

A. Is “income” pre-tax or post-tax? The Bankruptcy Code defines current monthly income as “income received.” This distinction might suggest that the test uses only post-tax income, the take-home pay of the debtor after federal, state, and local taxes, social security, and Medicare have all been deducted. The Census Bureau bases its data collection on pre-tax income.

B. On the other hand, the Census Bureau income does not include sources such as capital gains; money received from the sale of property (unless the recipient was engaged in the business of selling such property); the value of income "in kind" as in food stamps; tax refunds; exchange of money between relatives living in the same household; gifts and lump-sum inheritances, insurance payments, and other types of lump-sum receipts. Some or all of these items are included in the definition of income from the Bankruptcy Code in section 101(10A) for income received.

C. Heading back in the other direction, the Bankruptcy Code excludes Social Security benefits from the calculation of income, even though the Census Bureau includes them.

What if the debtor has other paycheck deductions, such as savings bonds or retirement contributions? Those deductions create assets for the debtor, so they presumably would not be included. What about deductions for health insurance? What about a wage garnishment? It should become increasingly clear that in the flotsam and jetsam of the lives of millions of families, even the simple parts of this means test are going to get pretty complex.

Although the Bankruptcy Code specifically requires a comparison of the debtor’s income with that of the state median, the various definitions of income in the Code make it clear that there can be no apples-to-apples comparison. Instead, Congress has determined that two things that are defined differently should be compared to determine whether the debtor has sufficient income to go on to the next steps of the means test.

The Census Bureau collects data on median incomes by state and by family size, reporting what families actually earn, and Congress instructs the court to use the Bureau’s data, although the language of section 707(b)(7) uses the Census terminology in an odd way, creating additional questions. §101(39A). The reports are available online at www.census.gov/hhes/www/income/statemedfaminc.html. The Bureau does not collect new data annually, but it offers estimates. Whether such estimates meet statutory muster is an open question. When there are no current data, the Code instructs the courts to adjust the most recent census reports for inflation. Even the inflation adjustment presents challenges. Inflation adjustments come from the Consumer Price Index, which is based on expenses—not incomes. The CPI is also national. In any given year, median incomes in a particular region may rise or fall somewhat faster or slower than the national prices for the goods making up the CPI. One place to get data on cost of living adjustments is www.aier.org/cgi-aier/colcalculator.cgi. Because judges will be required to review
thousands of cases to determine whether they pass the means test, data about the current median incomes in the state will likely be posted and revised on a regular basis. The data from our 2001 Consumer Bankruptcy Project study shows that only about 6 percent of the Chapter 7 debtors would have income above their state medians. Although our data were not gathered using all the factors that went into the means test as finally passed, it almost certainly gives a good ceiling on its reach. Among these 6 percent, some will pass the means test because their expenses relative to their incomes leave them with too little money to trigger a presumption of abuse. The Culhane and White study published in 1998 (using a different means test than the one that ended up in the amendments as they finally passed) showed 3 to 4 percent of the debtors above the national median. Thus, as one lawyer put, for the great majority of debtors the problem with the means test is calculating it and litigating it, not living within it.

On the other hand, even if most debtors are below the income threshold, the means test cannot be dismissed as unimportant. The substantial costs it will impose on all Chapter 7 debtors and on their lawyers may reshape bankruptcy practices. Moreover, 6 percent of Chapter 7 individual filers amounts to about 60,000 debtors and their families each year. Furthermore, there are critical public policy implications of the means test. Congress decided to incur enormous public costs to enforce the means test (see above concerning the U.S. Trustee's duties in that regard) despite empirical evidence that it would affect few debtors, because it wanted to reduce Chapter 7 filings. If filings do not drop, will the next step be to adjust the test downward to block more Chapter 7 filings? Or will the data showing that most families are already living below the median income convince Congress that it has misdiagnosed the problem?

Expenses

For debtors who failed the median-income screen, the next step is to determine what expenses the debtor may deduct. Government data show what families actually spend in various categories, but Congress wanted families in bankruptcy to spend less—and produce more for their creditors. Here Congress faced a serious challenge. It wanted to force debtors to tighten their belts and pay if they could, but it also wanted a uniform repayment standard, applicable like a rubber stamp to every family. It found its answer in the IRS. For many years the IRS has negotiated with people who failed to pay their taxes. Instead of simply prosecuting and putting these people in jail or seizing their homes and other property, the IRS would sometimes offer a repayment alternative. If the tax delinquent would pay a certain amount toward past-due taxes, penalties, and interest, then the IRS would delay asset seizure or prosecution and, if the miscreant paid up in full, let the person go. The IRS negotiated around a family budget, leaving some for the taxpayer and taking the rest for the IRS. In order to develop some consistency from office to office and agent to agent on how much money to demand that each tax delinquent pay, the IRS developed a series of guidelines. Those guidelines include expense allowances for the tax delinquents.

The IRS guidelines include what they term National Standards. These National Standards use a sliding scale for various expenses based on income. So, for example, when the IRS negotiates with a woman and child whose household income is just under $10,000 a year, it allows $336 a month to feed the two of them. But a woman and child whose household income is $70,000 a year gets $691 a month for food. Whatever the
differences between the rich and the poor, it is clear that the IRS thinks the rich need to eat better.

Adding further support to the statement that you can find anything on the internet, the current IRS expense allowances are now available online. www.irs.gov/individuals/article/0,,id=96543,00.html. The National Standards cover clothing, food, personal grooming, clothes and laundry, and miscellaneous. The National Standards apply nationwide, except for Alaska and Hawaii, which have their own tables. When they are figuring out what they have to pay to the IRS, taxpayers are allowed to deduct the National Standards amounts allocated for their family size and income level, regardless of what was actually spent. The Bankruptcy Code similarly permits debtors to deduct these amounts without further proof. §707(b)(2)(A)(ii).

The origin of the National Standards is not entirely clear. The IRS website explains that the numbers are based on numbers from the Bureau of Labor Statistics and Consumer Expenditure Survey, but the IRS makes the decision on how much the families can deduct in the various categories. How much hardship should be imposed on the tax delinquents who are avoiding seizure or prosecution is within their province.

One other note about the National Standards is in order. The IRS uses them as a guideline for agents when they negotiate with people who haven’t paid their taxes, not as a hard and fast rule. On its website, the IRS explains:

If the IRS determines that the facts and circumstances of your situation indicates that using the scheduled allowance of necessary expenses is inadequate to provide for basic living expenses, we will allow for your actual expenses. However, you must provide documentation that supports a determination that using national and local expense standards leaves you an inadequate means of providing for basic living expenses.

Because these are guidelines for negotiations, the IRS can revise them as they see fit. This power raises the specter that the IRS—not Congress and the courts—will be developing and changing the basic bankruptcy rules.

In other words, the IRS uses these guidelines as a floor. The IRS then leaves some room for agents to use their discretion to permit people to spend more for their basic living expenses if there seems to be a good reason to do so. The Bankruptcy Code also permits some discretion, but in keeping with the automated nature of the means test, even the discretion is tightly controlled. The 2005 Amendments provide that the court may increase the allowance for food and clothing by up to 5 percent, if the debtor can demonstrate that such expenditures are reasonable and necessary. §707(b)(2)(A)(ii). But for expenses above that 5 percent or for any amounts in categories other than food and clothing, the Bankruptcy Code seems to leave the courts with no discretion to consider how families actually spend their money.

The National Standards cover food and clothes. In addition, the Bankruptcy Code specifies other expenses that can be subtracted from the monthly income. So, for example, the courts are instructed to include deductions for health insurance, disability insurance, and health savings accounts. (§707(b)(2)(A)(ii)(I)); expenses of caring for the elderly (§707(b)(2)(A)(ii)(II)); and private schools, up to $1500 per child per year. §707(b)(2)(A)(ii)(IV). Through another IRS allowable-expense list (“Other Necessary Expenses”), the Bankruptcy Code permits the courts to deduct actual expenses for certain items such as childcare, legal fees, life insurance, union dues, taxes, and several other items already specifically covered by the Bankruptcy Code. The IRS has guidelines for
many of these items. So, for example, the taxpayer may have internet service if it is necessary for the production of income. For a look at the whole list, see www.irs.gov/irm/part5/ch14s01.html#d0e122933.

Finally, under the category of general expenses, the debtor is permitted to deduct any expenses to pay arrearages on “priority debts.” §707(b)(2)(A)(iv). Priority debts are listed in section 507(a), and they will be covered later in this section. The main ones that appear in consumer bankruptcies are alimony, child support, and taxes. This means that if a debtor owes $5000 in past-due child support, for example, the amount of the arrearage, divided by 60 (or $83.33), is deductible from the monthly income.

**Secured Debts**

In addition to buying food and clothes, a big monthly expense for many people is the car (or cars). Although some people will lease a car, and others will use public transportation, many debtors will have substantial payments due on a car loan, plus insurance, maintenance, and gasoline. When it adopted the means test, Congress was concerned that the application of the IRS guidelines for transportation would require many debtors to give up their cars, to the distress of the car lenders. (Without the support of the car lenders, the proposed amendments would likely have never made it into law.) At the urging of the car lenders, Congress made a special provision for lenders who have a security interest in the debtor’s property. These loans—such as car loans—can be deducted in full, no matter how large, along with any payment arrearages. §707(b)(2)(A)(iii). The gasoline, insurance, and maintenance then follow the Local Standards in the IRS tables. §707(b)(2)(A)(ii)(I). Gotta protect those wheels!

Home mortgages present an even greater problem because the IRS housing guidelines make no distinction between ownership expenses and operating costs. If the house payment amount is capped, then the debtor might have to give up the house—and that could mean losses for the mortgage companies. Congress decided that the debtor can deduct the payment to the mortgage lender, whatever it may be. §707(b)(2)(A)(iii). But what to do about the other costs of running a home, such as utilities and maintenance, is unclear. The IRS combines all housing costs—rent, mortgage, and incidentals—in a single allowable amount. There is no way to break out the mortgage costs from the other housing costs. It might make sense to deduct the debtor’s actual expenses, but there is no apparent statutory authority for such a move. Or it might make sense for the debtor to take the higher (or lower) of his actual house payment and expenses or the IRS housing allowance. Once again, however, what makes sense and what is in the statute seem to be at odds. Congress seems to have made it very clear that it wants the courts to turn very square corners on these deductions. In this case, the statute seems to give the debtor both the actual amount of the home mortgage in section 707(b)(2)(A)(iii) and the full Local Standard deduction in section 707(b)(2)(A)(ii)(I). Of course, the IRS may change its numbers again.

While car purchasers and home buyers seem to get a real break, renters are out of luck. The IRS standard deduction for cars makes room for car leases as part of the ownership costs and home or apartment rentals as part of the housing allowance, but the bonus in the Bankruptcy Code for payments on secured debts makes extra allowances for car payments and mortgage payments, but gives no extra bump for car leases and home rentals. In Washington, it seems that those who buy are rewarded far more generously than those who rent.
**Income after Expenses**

Even if a debtor has some surplus after allowed expenses are deducted from income, Chapter 7 might still be available. To do the final calculation, it is necessary to know (a) the total size of the surplus of income over expenses over 60 months (five years); and (b) how much general unsecured nonpriority debt, such as credit cards and medical bills, that the debtor owes. The Bankruptcy Code has one of those confusing less-than/more-than calculations. The translation into English follows.

Abuse is presumed:

1. If the debt is greater than $24,000, and
   - (a) the surplus is at least
     - (i) $10,000 or
     - (ii) 25% of the debt; OR
2. If the debt is $24,000 or less, and the surplus is at least $6,000.

Another way to understand this tangle is to note that if the surplus is less than $100, the debtor passes. If it is between $100 and $166.66 he passes if the surplus is less than 25 percent of his unsecured debt divided by 60. If the surplus is greater than $166.66 he flunks no matter how much he owes. Thus, for example, if a debtor owed $28,000 and the monthly surplus was $120 ($7200 over 60 months), the presumption of abuse would arise, because $7200 is greater than 25 percent of $28,000 ($7000). §707(b)(2)(A)(i)(2).

Whew! A lot of work to shake the money out of the pockets of the people who want to file bankruptcy. With well over a million consumer filings annually we can be sure that both attorneys and courts are struggling to computerize the undertaking. With substantial variations around the country because of the many open legal issues created by the statutory language and the variations presented by each debtor in the classification of non-standard income, expenses, and debts, they will face an extraordinary challenge.

**4. Policing the New Standards**

a. **Procedure**

Two important procedural points should be mentioned. The drafters of the amendments sought to ensure that in processing over a million cases a year, the abuse issue is not overlooked. In every case filed by an individual, the statute requires the debtor to calculate the means test for that case in the form required to be filed under section 521. In turn, the U.S. Trustee’s office is required to look at every case filed by an individual debtor to see if the presumption of abuse is triggered and to file a statement reporting its finding that is sent to every creditor. §704(b)(1). In addition, for an above-median debtor, the office must also file a motion to dismiss or convert the case if presumptive abuse is present or file a statement explaining why it has not done so. At this point, the observer understands more clearly why the Congressional Budget Office estimated that taxpayers will pay over $100 million to carry out the requirements of the new law.

On the other hand, the 2005 Amendments follow the 1984 Amendments in limiting standing to raise the question of abuse. Abuse can be alleged against an above-median debtor by the judge, the U.S. Trustee’s office, or any creditor. §707(b)(1). A creditor cannot raise the abuse issue against a median-or-below debtor under either section.
707(b)(1) (general abuse) or section 707(b)(2) (means test). Only a judge or the U.S. Trustee’s office can raise a claim of general abuse. §707(b)(6). Even those officials cannot raise abuse under the means test under section 707(b)(2)(A)(i) if the debtor’s income is equal to or below the state median.

Also notice the difference in how a spouse’s income is treated. If the couple files jointly, both incomes are included for all purposes, and that is that. If only one files, the non-filing spouse’s income is nonetheless included for purposes of determining whether the debtor is above or below the median income for purposes of continuing the inquiry. §707(b)(7). But if the debtor fails the test—that is, if the debtor and the debtor’s spouse have income above the median—only the debtor’s income and not that of the debtor’s spouse is used for working through the budgets and the means test. §§101(10A); 707(b)(2)(A)(i).

b. Many Roles for Debtors’ Lawyers

Debtors have always had to file a great deal of information with their bankruptcy petitions. Detailed reports on assets, debts, security interests, income, and the like must accompany every petition. The section 707(b)(2) means test adds a new layer of required information about income and expenses—and it requires documentation for much of that income and expenses for six months preceding the filing.

At the same time that Congress required that debtors filing for bankruptcy provide substantially more information, Congress also increased the scrutiny of the information provided. Debtors have always signed their petitions under penalty of perjury, and their attorneys sign as well. We noted in the preceding section that the 2005 Amendments also require the debtor’s attorney to certify that the lawyer has made some investigation of the accuracy of the data. §707(b)(4)(C), (D). In addition, sections 526(a)(4) and 707(b)(4)(A) seem to impose new duties on the attorney regarding the advice the attorney gives the debtor in helping the debtor decide whether to file for Chapter 7.

If a debtor files for Chapter 7 and a court later determines that the debtor was ineligible, the attorney may be litigating with a creditor, the trustee, or even the bankruptcy judge over the advice given. Section 707(b)(4)(A) authorizes the court to award costs and reasonable attorneys fees to a trustee who prevailed on a motion to dismiss the debtor’s Chapter 7 filing as a violation of section 707(b)(2) if the attorney violated Rule 9011 of the Bankruptcy Rules by such filing. Rule 9011 requires that any petition be made only after reasonable inquiry that the allegations have a factual basis, which reinforces the duties of the debtor’s attorney to inquire into the underlying facts. In addition, Rule 9011 requires that legal contentions be warranted by existing law or by non-frivolous extension. The standard for charging debtor’s counsel may be high, but surely many attorneys will notice that if they advise the debtor to file for Chapter 13 instead of Chapter 7, the likelihood of ending up as a defendant in lawsuit will disappear.

What if the creditor or trustee files a motion to dismiss under section 707(b)(2) and loses? In other words, what if the court determines that the debtor was eligible to file? Can the debtor’s attorney then collect costs and attorneys’ fees from the creditor or trustee? Section 707(b)(5) gives the debtor the power to recover (and presumably to collect the money to pay the attorney) if the court finds that the creditor or trustee violated Rule 9011 or brought its motion “solely to coerce the debtor to waive” other rights guaranteed under the Bankruptcy Code. Since the debtor is not the client of the creditor or trustee, we confess to wondering what a creditor or trustee would have to
know in order to violate Rule 9011 and thus be charged with costs and attorneys’ fees. Can trustees and creditors simply say to every debtor, “prove you are eligible to file for Chapter 7 or I will move to dismiss”? If so, we wonder if this “balancing” provision has much real meaning.

Problem Set 7

7.1. Marissa Allegretti comes into your office in Detroit to see you about filing for bankruptcy. She explains that when the accounting firm she worked for closed, she scraped by on $650 a month unemployment for nearly six months, running up a pile of bills. Three months ago, she found another job. With a base pay of $3800 a month and overtime adding up to another $2200 each month, she is catching up on her mortgage payments. Even so, she says that she is struggling with her credit cards and other debt. She doesn’t want to file for bankruptcy, but she isn’t sure if she has any option.

You ask about her personal circumstances, and Marissa explains that she and her ex-husband effectively share custody of their son Jamal. At the divorce ten years ago, Marissa was granted an award of $1000 a month in child support. Her ex hasn’t paid for years, but he buys clothes for the boy and he has been paying the $3000 each semester for tuition at the local Catholic school, and Marissa hasn’t pushed the point.

Can you tell if Marissa is eligible for Chapter 7? See §§101(10A), 707(b)(6), (b)(7). What advice do you give her at this point? Marissa can barely scrape together your standard $800 fee; how aggressive can she afford for you to be?

7.2. Jason and Evie Spitalnik came to see you about filing for bankruptcy. They live near your office in Montgomery County, a suburb of Philadelphia. Jason earns $5,600 a month as an auto mechanic, and Evie’s job as a fourth grade teacher brings in another $4,200. They have three children. The third was born with a serious heart problem. The baby has had three major surgeries, and now lives on a regimen of drugs and monitoring. Even though they have health insurance, the out-of-pocket expenses for medical care for the baby have left Jason and Evie with more than $100,000 in debt. Some of it is medical co-pays and services, supplies and drugs that weren’t covered, and some was ordinary credit card debt they ran up when Evie took a seven-month leave from her job during the surgeries and recuperations and Jason also missed a lot of time from work. By skipping other payments and falling behind on everything else, Jason and Evie have been paying about $600 a month on these bills, but that doesn’t even cover the interest on the credit cards. Every month, the pile of bills gets higher.

You ask Jason and Evie for a list of their monthly expenses. After working for a while with your paralegal, here’s what they identify:

- Home mortgage (principal, interest, taxes & insurance) $1600
- Utilities (water, gas, sewage) 190
- Internet 35
- Satellite television 75
- Ford Bronco (principal, interest) 610
- Insurance for Bronco, required by contract 140
- Gas, maintenance for Bronco 190
### Gas, maintenance, for seven-year-old Corolla
- **Cost:** $110

### Liability insurance for Corolla
- **Cost:** $90

### Food
- **Cost:** $1,000

### Cleaning supplies
- **Cost:** $20

### Personal care (haircuts, etc.)
- **Cost:** $25

### Clothing
- **Cost:** $500

### Laundry and dry cleaning
- **Cost:** $10

### Miscellaneous (newspapers, dog food, etc.)
- **Cost:** $50

### Public school fees, library fees for two older children
- **Cost:** $50

### Lunch money, club dues, transportation, allowances for older children
- **Cost:** $200

### Daycare for baby
- **Cost:** $800

### Expected drugs, other health care supplies for baby
- **Cost:** $200

### Health insurance
- **Cost:** $820

### Contributions to church
- **Cost:** $400

### Social security and income taxes
- **Cost:** $2,400

### Total
- **Cost:** $9,515

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Can you tell if Jason and Evie are eligible for Chapter 7? Would it make a difference if they rented their home for $1600 instead of purchasing it and leased their car for $610? §707(b)(2).

### 7.3. You have worked through the numbers for Michael Negron, a competitive skateboarder who seems to have run up $30,000 in general unsecured debt after he broke his leg last year. Michael is really upset about his debts. He rents a modest apartment and he drives an old clunker (“hey, it’s paid for”). His income over the past six months puts him above the median for a one-earner family in his state, and after allowable expenses, Michael seems to have available about $150 a month. His income has been very erratic as he tries to make a comeback, and he’s not sure if the leg is OK. He is very reluctant to commit to a Chapter 13 plan. Do you have any advice to make him eligible for Chapter 7? §§707(b)(2)(B)(iv); 707(b)(2)(A)(iii); 707(b)(1); 101(12A); 526(a)(4).

### 7.4. Ken Lyarre was a phenomenally successful CEO, twice featured on the cover of Business Week. The first time was when his privately owned string of diet counseling centers took the health and fitness market by storm, and the second when he lost a class action lawsuit against him for common law fraud and the jury returned a verdict of $1 billion. Ken’s lawyers are planning an appeal, but they can’t seem to make eye contact with him when they discuss his chances of winning.

Ken thinks he has a better strategy: Chapter 7 liquidation. He has about $1 million in assets that aren’t already tied up in various spendthrift and offshore trusts, and he says he is glad to give that up. Because of the trusts his income now and into the future will be about $2 million annually. Is Ken eligible for Chapter 7? See §707(a), (b)(1), (b)(2).

### 7.5. You and your three partners run a large consumer practice in Tulsa. More than 95 percent of the people you see have incomes below the state median, adjusted for family size. That makes the means test easy, but it doesn’t seem to make the reporting any easier. Your paralegals used to be able to help a client fill out all the necessary schedules in about half an hour, and most clients either brought enough information with them or had to make one trip back home for the necessary information. Now the paralegals usually
spend more than two hours with each client, and the clients themselves are making an average of three trips before their petitions are complete. The main problem seems to be with listing all the deductible expenses for the means test. Since this information is irrelevant to the debtor’s case, you would like to skip it or let the debtor just estimate the amounts. Is either approach a sensible response? §§707(a)(3); 707(b)(4)(C), (D); 521(a)(1); 18 USC §152(3).