In the United States Bankruptcy Court

for the Northern District of Iowa

MICHAEL EUGENE LONG	Bankruptcy No. 99-01561-C
Debtor(s).	Chapter 7

ORDER RE U.S. TRUSTEE'S MOTION TO DISMISS

On September 8, 1999, the above-captioned matter came on for hearing pursuant to assignment. Debtor appeared in person with Attorney Michael Mollman. The U.S. Trustee's Office was represented by Assistant U.S. Trustee John Schmillen. Evidence was presented after which the Court took the matter under advisement. This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(A) and (O).

STATEMENT OF THE CASE

The matter before the Court is a Motion to Dismiss filed by the U.S. Trustee's Office alleging abuse of the bankruptcy process under 11 U.S.C. §707(a). Specifically, the motion alleges that Debtor's Schedule F lists approximately 100 general unsecured claims and, of that amount, approximately 74 constitute dishonored checks. The U.S. Trustee asserts that Chapter 7 is limited to providing a fresh start for honest debtors. The U.S. Trustee claims that this volume of dishonored checks constitutes abuse of the system and, therefore, seeks dismissal of this case and a 180 day bar against refiling to allow creditors to pursue appropriate nonbankruptcy remedies.

FINDINGS OF FACT

Debtor Michael Long is single and lives with his parents in Cedar Rapids, Iowa. He is employed by Wal-Mart. He held prior employment with Bill Witters Construction. Debtor was unemployed from February 1999 until shortly after he filed his Chapter 7 petition on June 11, 1999.

Debtor had a checking account at First Trust in Cedar Rapids, Iowa. The bank closed this account on April 26, 1999. Debtor testified that he did not learn that the bank had closed this account until the end of May, 1999.

Debtor lived with two friends, Mike and Pam Barry, from January 1999 until shortly before he filed his petition for relief. During this time, Debtor and the Barry's financed themselves largely through the use of checks Debtor wrote on an account that contained no funds. Debtor testified that he knew when he wrote these checks that there was no money in this account. Debtor testified, however, that he intended to cover these checks at some unspecified time through unemployment compensation. He further testified that the Barry's were to receive a credit card with a $10,000 credit limit. The Barry's were to take a cash-advance of $4,000 on this card to cover the checks Debtor had written. This financial arrangement ended with a flurry of checks Debtor wrote to Ms. Barry between May 25, 1999

and May 27, 1999 totaling over $1,700. Mr. Barry's recent incarceration terminated the existing living arrangement.

The evidence concerning the extent of Debtor's check-writing was somewhat contradictory. Debtor claimed that he wrote around forty-three bad checks in the total amount of $4,100. Debtor's schedules are not particularly helpful because he listed both check collection agencies and the original payees as creditors on his schedules. Through evidence presented at trial and Debtor's schedules, however, the court concludes that Debtor wrote approximately seventy bad checks for a total amount of approximately $4,500. Debtor's total unsecured debt is $26,871.

Debtor never informed the payees of these checks that the account did not have funds to cover the checks. He did not ask any of the payees to hold a check, nor did he post-date any of them. Debtor deposited $400 in the checking account some time in April. He testified the Barry's owe him money as a result of their plan, but he did not list a claim against them as an asset on his bankruptcy schedules.

On August 11, 1999, the United States Trustee filed the pending Motion to Dismiss Debtor's petition pursuant to §707(a).

11 U.S.C. §707

Section 707 of the Bankruptcy Code allows a court to dismiss a case under Chapter 7 of the Bankruptcy Code (the "Code") on two alternative grounds. First, the Court may dismiss a Chapter 7 case "for cause" upon the motion of any party in interest. 11 U.S.C. §707(a). Second, the court, acting on its own motion or on motion of the U.S. Trustee, may dismiss a case involving primarily consumer debts if granting a discharge would amount to a "substantial abuse" of the bankruptcy system. 11 U.S.C. §707(b). The U.S. Trustee has filed a motion pursuant to §707(a) to discharge Debtor's case with prejudice to refile for 180 days.

STANDARDS UNDER §707(A)

Section 707(a) lists three non-exclusive factors that constitute "cause" for dismissing a debtor's case. In re Huckfeldt, 39 F.3d 829, 831 (8th Cir. 1994). The Eighth Circuit has held that "cause" under §707 (a) contains a "narrow, cautious" version of bad faith. Huckfeldt, 39 F.3d at 832 (8th Cir. 1994) (approving of In re Kahn, 172 B.R. 613, 624-26 (Bankr. D. Minn. 1994), in limiting "bad faith" under §707(a) to "extreme misconduct failing outside the purview of more specific Code provisions"). In fact, the Eighth Circuit declines to call this test a "bad faith test." Huckfeldt, 39 F.3d at 832. Instead, the court refers to the test as simply a "for cause" analysis. Id.

The factors of "cause" under the Eighth Circuit's test focus on whether a debtor is "an honest but unfortunate debtor" entitled to relief under Chapter 7. Huckfeldt, 39 F.3d at 832. A debtor's "noneconomic motivation" for seeking relief is reviewed to determine whether it constitutes cause justifying dismissal under §707(a). Huckfeldt, 39 F.3d at 832. Other courts have also found that a debtor's motivation to accomplish an end that is outside of the relief the Code contemplates is relevant in the §707(a) analysis. See In re Padilla, 214 B.R. 496, 499 (B.A.P. 9th Cir. 1997); Kahn, 172 B.R. at 625. Therefore, a proper analysis under §707(a) requires the Court to ask if the debtor is seeking relief as an "honest but unfortunate" debtor or has other inappropriate motivation.

Where the debtor has exhibited dishonesty toward creditors, as opposed to the Court, the circumstances that constitute "cause" must ordinarily involve egregious conduct that other provisions

of the Code do not address. Huckfeldt, 39 F.3d at 831. No cases specifically address whether incurring a large number of obligations for bad checks is sufficiently egregious conduct to remove a case from other provisions and warrant a dismissal under §707(a). Cases involving the use of credit cards prior to filing provide some guidance. While these cases are distinguishable because the credit card relationship is a consensual one born of honesty, they are helpful in determining when to use §707 to address conduct that other provisions of the Code covers.

The Ninth Circuit B.A.P. has held that where only a few creditors are harmed by a debtor's excessive use of credit cards prior to filing, the proper remedy is an individual creditor objection to discharge under §523(a)(2). Padilla, 214 B.R. at 500. The court specifically noted that the debtor had been honest with the court and that other provisions of the Code granted creditors a remedy for the debtor's dishonesty toward them. Padilla, 214 B.R. at 500.

At least one court has indicated, however, that analysis under §707 is appropriate when there are a number of small creditors who would qualify for §523(a)(2) relief. In re Motaharnia, 215 B.R. 63, 73 (Bankr. C.D. Cal. 1997). The court held that although §523(a)(2) covers the debtor's conduct, analysis under §707 is appropriate where numerous creditors hold claims in small amounts. The court in Padilla reasoned that a court should not resort to the broad remedy of dismissing a debtor's case where §523(a) grants a qualifying creditor individual and specific relief. Instead, the debtor should receive a discharge and individual creditors should be allowed to challenge the discharge where appropriate. This result allows the debtor to retain as much of the discharge as the debtor justly deserves.

Where individual relief is impractical because of the small amount of each creditor's claim, however, the propriety of court intervention becomes more compelling. Moreover, when a significant portion of the debtor's creditors could bring an individual dischargeability complaint, §707 does not greatly impair the benefits the debtor has under the Code.

In summary, if only a few creditors can seek relief under other provisions of the Code, §707 is an inappropriately severe sanction. However, where a large number of creditors could seek individual relief under other provisions of the Code, §707 is a judicially efficient remedy. Under §707(a), a court may analyze conduct that §523(a) otherwise covers if the number of claims in question is sufficient to render the broad sweep of §707 the most efficient and effective remedy.

APPLICATION OF §707(A) STANDARDS TO DEBTOR

As part of a plan to support himself and his friends, Debtor engaged in a check-writing effort that involved approximately seventy instances of potentially criminal conduct. See Iowa Code §714.1(6) (1999) (making it a criminal offense for a party to make, utter, deliver, or give any check to obtain property in return, knowing that the bank will not honor the check when presented). Other provisions of the Code allow the parties whom this conduct harmed to seek individual relief. See 11 U.S.C. §523 (a)(7) (1994) (excepting fines to government institutions from discharge); 11 U.S.C. §523(a)(2)(1994) (excepting from discharge debts incurred with actual fraud, false pretenses or a false representation); In re Newell, 164 B.R. 992, 995 (Bankr. E.D. Mo. 1994) (finding debt for bad checks nondischargeable under §523(a)(2) where debtor knew there were insufficient funds in her checking account to cover the check); 11 U.S.C. §362(b)(1) (1994) (excepting criminal proceedings from the automatic stay).

The record reveals, however, that approximately seventeen percent of Debtor's obligations are the result of bad checks written by Debtor. Although three claims are for one thousand dollars or more, the majority are for claims between twenty and fifty dollars. Because of the small amount of their

claims, most of these creditors may elect not to incur the expense of bringing a §523(a)(2) action. In addition, the Court can most effectively address Debtor's conduct through one single §707 analysis, rather than entertaining numerous §523(a)(2) complaints. Although there is no showing Debtor has misled this Court or engaged in conduct more egregious than §523(a) addresses, analysis under §707 (a) is appropriate because of the number of creditors harmed by Debtor's conduct.

Debtor's conduct establishes the "cause" necessary to dismiss the case pursuant to § 707. Debtor wrote approximately seventy checks that he knew the bank would not honor when presented. Implicit in tendering a check is the representation that Debtor's bank would honor the checks when presented. See e.g., In re Kurdoghlian, 30 B.R. 500, 502 (B.A.P. 9th Cir. 1983) (finding that tendering a check is an implicit representation that there are sufficient funds to cover that check). The payees of these checks became involuntary creditors as a result of Debtor's misrepresentation that the bank would honor the check when presented. The fact that approximately seventeen percent of Debtor's credit relationships were based on this type of conduct is sufficient cause to dismiss Debtor's case under §707(a).

Debtor's professed intention to cover his bad checks at some point does not negate his misrepresentations in incurring the debts. Debtor's conduct is distinguishable from the conduct of debtors who incur substantial credit card debt with the intent to repay. In the latter case, the credit relationship itself is consensual and does not involve misrepresentation. The debtors in those cases are exercising their rights under a loan agreement with the belief that they will be able to perform their obligations under that agreement. As long as the debtor intends to perform contractual obligations, the use of credit cards, although not always advisable, can be an acceptable means of financing. The creditors here became creditors involuntarily because of Debtor's misrepresentations regarding the availability of funds in his checking account.

Debtor wrote these checks as part of a plan with the Barry's to use bad checks to finance the trio's living expenses. When this plan failed, Debtor sought relief under the Code. Relief from the consequences of a failed, potentially criminal, scheme, however, is outside the relief the Code contemplates. The Code seeks only to "relieve the honest debtor from the weight of oppressive indebtedness and permit" the debtor to start over. Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).

Despite the number of creditors whom Debtor's conduct has harmed, there remains approximately $20,000 of unsecured debt that Debtor incurred legitimately. Debtor's income is sufficiently restricted that he would obtain an obvious benefit from the discharge of this debt. The U.S. Trustee has only asked this Court to dismiss Debtor's case with prejudice to refile after 180 days. This is an appropriate remedy because it will allow the State and other parties whom Debtor's conduct has harmed to seek their remedies. Debtor will then have an opportunity to refile and again seek the relief the Code offers.

Although other provisions of the Code provide individual relief for creditors in this case, the number of claims Debtor incurred through potentially criminal conduct renders §707(a) the most appropriate remedy. The amount of debt Debtor incurred legitimately, together with Debtor's current financial circumstances, renders the U.S. Trustee's requested remedy of dismissal with prejudice to refile for 180 days a reasonable option.

APPLICABLE LAW UNDER §707(b)

Although the Court has sufficient grounds to dismiss Debtor's case pursuant to §707(a), it also has independent authority and grounds to dismiss Debtor's case pursuant to §707(b) as a substantial abuse

of the bankruptcy system. A court may dismiss a Chapter 7 case upon its own motion, or pursuant to a motion of the U.S. Trustee under §707(b). That provision, however, gives debtors a presumption in favor of discharge. This presumption is rebutted when factors are present which indicate that the debtor has not been honest towards his creditors or the court. Motaharnia, 215 B.R. at 73; In re Krohn, 886 F.2d 123, 128 (6th Cir. 1989).

Three requirements must be satisfied for a court to dismiss a case under §707(b). First, the debtor must have "consumer debt." 11 U.S.C. §707(b). Second, consumer debt must be the primary portion of the debtor's obligations. Id. Lastly, the Court must dismiss the debtor's case if granting the debtor relief would constitute a "substantial abuse of the provisions" of Chapter 7. Id. The substantial abuse standard is intended to be flexible. In re Walton, 866 F.2d 981, 983 (8th Cir. 1989). The parties do not argue that Debtor's debts are not primarily consumer obligations. Therefore, the issue is whether Debtor's conduct constitutes a substantial abuse of the provisions of Chapter 7.

The Eighth Circuit has well-developed law regarding a debtor's ability to pay a portion of his debts as constituting substantial abuse.[(1)] This Circuit has not, however, addressed whether other factors can constitute substantial abuse if a debtor does not have the ability to repay a significant portion of the debtor's obligations. As of the date Debtor filed his petition, he had earned $4,000 this year. It is clear that this level of income is insufficient to allow Debtor to repay a significant portion of his debts. Thus, the issue is whether Debtor's conduct otherwise constitutes substantial abuse.

Substantial abuse can consist of either lack of honesty or want of need. Krohn, 886 F.2d at 127-28. In determining whether Debtor's lack of honesty is sufficient to warrant dismissal under §707(b), the Court must examine all of the circumstances and determine if Debtor's "relationship with his creditors has been marked by essentially honorable and undeceptive dealings." Krohn, 886 F.2d at 126. This approach is especially applicable given the overall policy that "one of the primary purposes of bankruptcy is to relieve an honest debtor" from the weight of oppressive debts and permit the debtor to start fresh. Hunt, 292 U.S. at 244 (emphasis added).

The Court has the power under §707(b) to deal equitably with the "unusual situation where an unscrupulous debtor seeks to enlist the court's assistance in a scheme to take unfair advantage of his creditors." Krohn, 886 F.2d at 126. This broad power under §707(b) allows the Court to "prevent such abuses as will bring the great goals of bankruptcy into disesteem and disrepute" and to dismiss a debtor's case where a substantial portion of his debts are the result of criminal conduct. In re Bruno, 68 B.R. 101, 103-4 (Bankr. W.D. Mo. 1986).

APPLICATION OF §707(B) TO DEBTOR

This is not a case involving a debtor's failed attempt to legally manage his finances. Nor does this case involve isolated and sporadic insufficient fund checks that are the result of poor financial skills. This case involves Debtor's failed attempt to manage his finances through potentially criminal means that include a consistent stream of dishonored checks over a five-month period immediately preceding bankruptcy. Granting a debtor relief from the consequences of illegal conduct is the type of involvement that brings the bankruptcy court into disrepute. Bruno, 68 B.R. at 104.

While Debtor testified that he did not intend to defraud his creditors, he did intend to write nonsufficient funds checks as part of a plan to support himself and his friends. Allowing Debtor to benefit from the provisions of Chapter 7 would remove the financial deterrent of having to repay obligations he incurred when his potentially illicit plan failed. Granting Debtor protection under the

provisions of Chapter 7 would be a substantial abuse of the bankruptcy system because it would give court approval to colorably criminal conduct.

Debtor's conduct toward his creditors is so tainted with inappropriate conduct as to render dismissal under § 707(b) appropriate. Just as the number of credit relationships created by these checks in this case is sufficient "cause," under §707(a), so too does the number of these relationships constitute substantial abuse under §707(b).

Debtor has approximately $20,000 of unsecured debt that is not tainted with potential criminality. The proper remedy, given the severity of Debtor's conduct and the amount of Debtor's legitimate obligations, is to grant the U.S. Trustee's request and dismiss Debtor's case with prejudice to refile in 180 days. Although this remedy is admittedly not ideal, it will allow Debtor to obtain the benefits of relief without this Court sanctioning potentially criminal conduct. The State of Iowa and Debtor's creditors will have 180 days to pursue their respective State remedies. Debtor will then have the ability to seek relief from his remaining obligations.

Although there is a presumption in favor of relief under §707(b), the circumstances of this case sufficiently rebut that presumption. It would be a substantial abuse of the bankruptcy system to allow Debtor to seek refuge under the Code for the ramifications of his conduct. This Court concludes that §707(b) is an appropriate remedy for Debtor's conduct toward his creditors because of the substantial number of credit relationships involving nonsufficient funds checks. The U.S. Trustee does not seek permanent dismissal in this motion. This Court concludes that dismissal with prejudice to refile in 180 days is most appropriate under all of the existing circumstances.

WHEREFORE, for all the reasons set out herein, the U.S. Trustee's motion is granted and this case is dismissed with a bar to refiling for a period of 180 days.

SO ORDERED this 27 day of September, 1999.

Paul J. Kilburg
Chief Bankruptcy Judge

1. See e.g., In re Walton, 866 F.2d 981, 983-84 (8th Cir. 1989) (holding that debtor's ability to pay 2/3 of his unsecured debts in a three-year Chapter 13 plan or all of those debts in a five-year plan constituted substantial abuse); U.S. Trustee v. Harris, 960 F.2d 74, 75-6 (8th Cir. 1992) (holding that a debtor's ability to repay 156% of his unsecured debts over a three-year period is sufficient to constitute substantial abuse without a showing of egregious conduct); Fonder v. U.S., 974 F.2d 996, 999-1000 (8th Cir. 1992) (upholding dismissal of debtor's case where he had the ability to pay 89% of his unsecured debt in a three-year plan, and stating that dismissal would be appropriate even where the debtor did not qualify for Chapter 13 relief); In re Nelson, 233 B.R. 349, 353 (B.A.P. 8th Cir. 1998) (upholding bankruptcy court's dismissal of Chapter 7 case where debtor had sufficient income to pay nearly 80% of unsecured creditors under a Chapter 13 plan); In re Rustige, No. 98-01227F, slip op. at 11 (Bankr. N.D. Iowa Nov. 17, 1998) (dismissing Chapter 7 case where, absent unreasonable expenses, debtor had five-hundred dollars per month in disposable income).