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09/25/2008

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TEXAS
SHERMAN DIVISION

IN RE:	§	
	§	
JUNG HEE KIM and MIN CHUL KIM,	§	Case No. 07-42374
	§	(Chapter 7)
Debtors.	§	

MEMORANUM OPINION AND ORDER REGARDING
MOTION TO DISMISS PURSUANT TO 11 U.S.C. §707(B)(3)

Jung Hee Kim and Min Chul Kim (collectively, the "Debtors") jointly filed a petition for relief under Chapter 7 of Title 11 of the United States Code (the "Bankruptcy Code") on October 15, 2007. This matter is before the Court on a motion by the United States Trustee (the "UST") seeking dismissal of the Debtors' case pursuant to §707(b)(3) of the Bankruptcy Code. The Debtors oppose the UST's motion. The Court conducted a hearing on April 22, 2008, and, at the conclusion of the hearing, scheduled the matter for later ruling.

JURISDICTION

A motion seeking dismissal of a bankruptcy case raises a core matter over which this Court has jurisdiction to enter a final order. *See* 28 U.S.C. §§157(b)(2)(A) and (B) and 1334.

RELEVANT BACKGROUND

The Debtors' obligations are primarily consumer debts. The Debtors list fourteen credit cards in their bankruptcy schedules as well as several unsecured lines of credit. The Debtors have no non-exempt assets, and they scheduled the total sum of $260,144.79 in non-priority, unsecured claims.

At the hearing on April 22, 2008, Mr. Kim testified that he and his wife filed for bankruptcy as a result of their credit card debts. Mr. Kim testified and the evidence reflects that they incurred nearly all of their unsecured debts as a result of gambling during the two years prior to bankruptcy. Mr. Kim testified that they intended to repay their debts with their winnings from gambling.

During 2006, the Debtors won approximately $171,400 through gambling. The Debtors, however, lost in excess of $190,000. The Debtors suffered total losses of more than $275,000 during 2006 and 2007 as a result of their gambling activities.

The Debtors primarily gambled at casinos in Oklahoma. During the two years that the Debtors used their credit cards and unsecured lines of credit to gamble, the Debtors had a business known as "Kimmy Trading" where they sold clothing items. The Debtors' tax return for 2005 shows a net business loss of $2,169, and the Debtors' tax return for 2006 shows only $842 in net business income.

During the spring of 2007, Mrs. Kim purchased items from Louis Vuitton (for a total cost of $1,542), Gucci (for a total cost of $1,444), Tiffany (for a total cost of $497), Sephora Cosmetics (for a total cost of $399), and Best Buy (for a total cost of $1,642). Mrs. Kim testified that some or all of these gifts were an "apology" to her daughters, one of whom has been providing the Debtors with financial assistance. In addition, Mrs. Kim paid more than $1,586 to Korean Airlines during early 2007.

The Debtors' credit card statements reflect that they had reached the limits of all or most of their credit cards by July 2007. The Debtors ceased gambling in July 2007 and filed for bankruptcy approximately 90 days later. Notably, §523(a)(2)(C) of the Bankruptcy Code provides that, for purposes of §523(a)(2)(A), consumer debts exceeding

$500 and owed to a single creditor by an individual debtor for "luxury goods or services" incurred on or within 90 days before bankruptcy are presumed to be nondischargeable.

At the time of the hearing on April 22, 2008, the Debtors had ceased operating Kimmy Trading. The Debtors had no income other than the financial assistance provided by family members. The Debtors each testified that they have sought professional help from Gamblers' Anonymous. The Debtors, however, do not speak fluent English and were unable to obtain assistance from Gamblers' Anonymous.

ANALYSIS

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "BAPCPA") became fully effective on October 17, 2005. One goal of the BAPCPA was "to address what Congress perceived to be certain abuses of the bankruptcy process. Among the abuses identified by Congress was the easy access to chapter 7 liquidation proceedings by consumer debtors, who if required to file under chapter 13, could afford to pay some dividend to their unsecured creditors." *In re Hardacre,* 338 B.R. 718, 720 (Bankr. N.D. Tex. 2006) (citing 151 CONG. REC. S2459, 2469-70 (Mar. 10, 2005)). "The principal method implemented to steer debtors away from Chapter 7 and into Chapter 13 is the new version of §707," which is usually referred to as the "means test." *In re Singletary,* 354 B.R. 455, 458-59 (Bankr. S.D. Tex. 2006).

Prior to the enactment of the BAPCPA, §707(b) of the Bankruptcy Code provided for the dismissal of a case when "the granting of relief would be a substantial abuse of the provisions of this chapter."[1] BAPCPA altered the circumstances under which a case may

[1] Section 707(b) was one of several consumer credit amendments added to the Bankruptcy Code in 1984. Congress had two reasons for originally enacting §707(b):

be dismissed by removing the "substantial" qualifier and providing for "abuse" to be determined pursuant to either the new §707(b)(2) or the new §707(b)(3). When a debtor's disposable income exceeds fixed amounts (*i.e.*, when the debtor fails the "means test"), the new §707(b)(2) creates a presumption of abuse. When the presumption of abuse does not arise, the new §707(b)(3) looks to the debtor's intent in filing the bankruptcy petition and the totality of the circumstances to determine abuse.

The present case involves the later type of motion to dismiss. The UST argues that the Debtors used unsecured credit for a lavish and improper purpose prior to bankruptcy without any actual, honest intent to repay their debts. Thus, as discussed more fully below, the UST argues that this case should be dismissed because the Debtors "filed the petition in bad faith," 11 U.S.C. §707(b)(3)(A), and because "the totality of the circumstances ... of the [Debtors'] financial situation demonstrates abuse," 11 U.S.C. §707(b)(3)(B).

Totality of the Circumstances

Prior to the enactment of the BAPCPA, many courts, including this Court, employed a "totality of the circumstances" standard for determining whether to dismiss a debtor's Chapter 7 proceeding based on "substantial abuse." *See, e.g., In re Cortez*, 457 F.3d 448 (5th Cir. 2006); *In re Faulhaber*, 243 B.R. 281, 284 (Bankr. E.D. Tex. 1999).

> First, it wanted to address the problem of consumer debtors taking inordinate advantage of modern easy-credit practices, running up consumer debt, and then seeking discharge of that debt through Chapter 7 bankruptcy. Congress apparently felt §707(b) would remedy the problem of consumer debtors unfairly taking advantage of Chapter 7 even though they are able over time to pay off their debts. Second, Congress wanted to give the courts a specific mechanism to more readily dismiss petitions by abusive consumer debtors. As the bankruptcy court aptly noted, §707(b) was not enacted to narrow and discourage court review of abuse cases to those involving consumer debt, but to broaden and encourage such review in light of the fact many bankruptcy courts were not dismissing abusive consumer petitions.

Stewart v. United States Trustee (In re Stewart), 175 F.3d 796, 812-13 (10th Cir. 1999) (citations omitted).

Although Congress has lowered standard for dismissal in changing the test from "substantial abuse" to "abuse," pre-BAPCPA cases which consider whether a case should be dismissed for substantial abuse remain instructive in an analysis under §707(b)(3). *See, e.g., In re Singletary,* 354 B.R. at 461-62 (describing §707(b)(3) as a codification, and clarification, of the pre-BAPCPA standard under §707(b)); *In re dePellegrini,* 365 B.R. 830, 832 (Bankr. S.D. Ohio 2007) (finding that pre-BAPCPA cases are still instructive under §707(b)(3)). More particularly, "[b]ecause Congress retained the phrase 'totality of the circumstances' in BAPCPA, the Court concludes that it may look to pre-BAPCPA case law to construe the meaning of that phrase under §707(b)(3)." *In re Pfiefer,* 365 B.R. 187, 191 (Bankr. D. Mont. 2007).

It is not possible, of course, to list all the factors that may be relevant to determining whether to apply §707(b)(3)(B) to an individual debtor. "Counted among them, however, would surely be the debtor's good faith and candor in filing schedules and other documents, whether he has engaged in 'eve of bankruptcy purchases,' and whether he was forced into Chapter 7 by unforeseen or catastrophic events." *In re Krohn***,** 886 F.2d 123, 126 (6th Cir. 1989). Another factor to be considered is the debtor's ability (or inability) to repay his debts out of future earnings. Although this Court adopted a totality of the circumstances approach prior to the enactment of the BAPCPA, some circuits held that the debtor's ability to pay alone could establish substantial abuse. *See, e.g., In re Walton,* 866 F.2d 981, 983-84 (8th Cir. 1989) (holding that the ability to fund a Chapter 13 plan can be a sufficient reason to dismiss a Chapter 7 case under §707(b)); *Zolg v. Kelly (In re Kelly),* 841 F.2d 908, 915 (9th Cir. 1988) ("[A] finding that a debtor is able to pay his debts, standing alone, supports a conclusion of substantial

abuse."). On the other hand, very few courts have found substantial abuse where the debtor is unable to pay his creditors. *See In re Motaharnia*, 215 B.R. 63 (Bankr. C.D. Cal. 1997),

As the bankruptcy court discussed in *Motaharnia*, if a case is dismissed under §707(b) and the debtor has no present or future ability to pay creditors, the dismissal is equivalent to dismissal with prejudice or denial of discharge. *Id*. at 72. "This occurs because the debtors would be unable to repair their problems and re-file their case as the facts indicating bad faith (the existence of large amounts of pre-petition credit-card debt) cannot be changed by any later action of the debtors, nor do the debtors have the current income or future earning capacity to fund either a chapter 11 or chapter 13 case." *Id.* Thus, in order to obtain a §707(b) dismissal when the debtor is unable to pay his debts, courts have required the movant to clearly demonstrate a substantial abuse of the bankruptcy system, *see Motaharina*, 215 B.R. at 73, or to establish that the debtor filed his bankruptcy petition in bad faith because he did not intend to repay his debts, *see In re Baum*, 386 B.R. 649 (Bankr. N.D. Ohio 2008).

Courts addressing the use of unsecured credit for gambling have held that gambling losses should be viewed as "an excess similar to other excesses associated with living beyond one's means." *In re Hammer*, 124 B.R. 287, 290 (Bankr. C.D. Ill. 1991), vacated on other grounds, *In re Pilgrim,* 135 B.R. 314 (C.D. Ill. 1992); *In re Vianese*, 192 B.R. 61, 71 (Bankr. N.D. N.Y. 1996) (following *Hammer*). "A debtor who finances excess gambling losses through the use of a credit card is no different from a debtor who uses a credit card to take a vacation or makes purchases he cannot afford." *Hammer,* 124 B.R. at 190. Although bankruptcy courts need not determine whether the debtor's

obligations to creditors are nondischargeable in the context of a motion to dismiss under §707(b), the following factors may be relevant in determining whether a motion to dismiss should be granted in cases involving credit card abuse:

1. Whether an overwhelming percentage of the debtor's unsecured debt is credit card debt.
2. Whether the debtor has used so many credit cards that it would multiply the workload of the court to adjudicate each §523(a)(2) action separately,
3. Whether there is no economic incentive for an individual creditor to bring a §523 action,
4. Whether the credit card was used for luxury goods, high lifestyle or improper purpose, and
5. Whether the debtor made an honest effort to repay his obligations before filing bankruptcy.

See Motaharnia, 215 B.R. at 73. *See also In re Khachikyan***,** 335 B.R. 121 (9th Cir. BAP 2005) (agreeing (with reservations) with the analysis in *Motaharnia*).

Here, the UST presented this case as a "bust out" scheme. *Neary v. Padilla (In re Padilla),* 222 F.3d 1184, 1187-1188 (9th Cir. 2000). That is, the UST argues that during the two years leading up to their bankruptcy filing, the Debtors accumulated a massive amount of consumer debt with no actual intent to ever repay it. If this alleged scheme had involved a single creditor, that creditor could bring an action under §523(a) of the Bankruptcy Code. In this case, however, the UST argues that the Debtors used so many credit cards and lines of credit to fund their gambling that it would multiply this Court's workload to adjudicate each §523(a) action separately. The UST further argues that none of the Debtors' unsecured creditors brought a nondischargeability action against the Debtors there is no economic incentive for an individual creditor to do so in this case.

The evidence reflects that the Debtors accumulated a massive amount of unsecured debt in only two years to fund their gambling activities. The Debtors had no

significant sources of income during this time, and they were losing more money by gambling than they were winning. The Debtors used many different credit cards and unsecured lines of credit to fund their gambling, and they lacked the ability and intent to repay this debt at the time they incurred it as discussed more fully below. *See In re Uddin*, 196 B.R. 19, 24 (Bankr. S.D. N.Y. 1999) (granting §707(b) motion where debtor made no attempt to repay his creditors or curb his spending and debtor's financial distress was directly related to purchases of luxury goods and accrual of gambling debts). Moreover, at the same time the Debtors were incurring massive gambling losses, and despite the fact that they had no significant income from the operation of their business, the Debtors gave generous gifts to their daughters. The Debtors finally ceased gambling and making luxury purchases in or around July 2007 because they had reached or nearly reached the limit of their existing credit – and, perhaps, because they intended to file a bankruptcy petition, and any such use of their credit could have been scrutinized under §523(a)(2)(C) of the Bankruptcy Code. In any event, under the particular facts of this case, the UST has established that the totality of the Debtor's financial circumstances demonstrates abuse of the bankruptcy system and that this case should be dismissed pursuant to §707(b)(3)(B).

Bad Faith

The UST also argues that the Debtor's case should be dismissed based on the Debtors' bad faith. Although the Court has already determined that grounds exist to dismiss this case based on the totality of the circumstances, the Court will address the UST's remaining argument in order to provide the parties with a full discussion of the issues presented at the hearing on the UST's motion.

Prior to the enactment of §707(b)(3)(A), some courts held that a Chapter 7 case could not be dismissed based solely on the petition being filed in bad faith. *See, e.g., In re Solomon,* 277 B.R. 706 (Bankr. E.D. Tex. 2008). These courts reasoned that, in contrast to Chapters 11, 12 and 13 of the Bankruptcy Code, Chapter 7 had no explicit good faith requirement. *See, e.g., In re Padilla*, 222 F.3d at 1191-92; *In re Solomon*, 277 B.R. at 709-710 (quoting *In re Riney,* 259 B.R. 217, 222 (Bankr. M.D. Fla. 2001)). Other courts took the opposite view, finding that a debtor's case could be dismissed based solely on the petition being filed in bad faith. *See, e.g., Industrial Insurance Services Inc. v. Zick (In re Zick),* 931 F.2d 1124 (6th Cir. 1991) (lack of good faith is valid basis to dismiss Chapter 7 case 'for cause' under § 707(a)); *First USA v. Lamanna (In re Lamanna),* 153 F.3d 1, 5 fn. 9 (1st Cir. 1998) (bad faith may be a part of a § 707(b) 'substantial abuse' calculation). The enactment of §707(b)(3)(A) codified the latter line of cases insofar as it is now permissible for a bankruptcy court to dismiss a Chapter 7 petition on the basis of bad faith alone if the debtor is an individual with primarily consumer debts.

In the context of §707(b), good faith refers to subjective good faith. *See In re Faulhaber,* 243 B.R. 281, 285 fn. 5 (Bankr. E.D. Tex. 1999) (examining good faith under the totality of the circumstances test). Since debtors rarely admit bad faith, courts have looked to circumstantial evidence to prove a debtor's state of mind at the time he filed his petition. *See id.* (describing "good faith" as involving "a determination of whether the debtor was motivated by a genuine desire to deal with an intolerable debt load fairly and equitably so as to relieve him of an oppressive debt burden and allow him to move post-bankruptcy in a productive manner"). Dismissal for bad faith has most often occurred in

egregious factual situations wherein the debtor has accumulated massive amounts of credit card debt with no intent to repay the debt, lives a lifestyle far above what he could afford, and/or intends to avoid a large single debt based on conduct akin to fraud or gross negligence. *See In re Zick,* 931 F.2d 1124, 1129 (6th Cir. 1991); *see also, e.g., In re Haddad,* 246 B.R. 27, 38 (Bankr. S.D. N.Y. 2000) (in addition to living an extravagant lifestyle, debtor was not candid in disclosure requirements and attempted to claim a wedding band as exempt while unmarried); *In re Ragan,* 171 B.R. 592, 596 (Bankr. N.D. Ohio 1994) (case dismissed under §707(b) after debtor withdrew more than $160,000 from IRA and recklessly spent it all with little or no regard for obligations to creditors).

Here, the Debtors conceded at the hearing on the UST's motion that they filed for bankruptcy as a result of gambling debts which they could not afford to repay. A review of the Debtors' account statements shows that, in or around June 2006, the Debtors began opening new credit cards and lines of credit in order to gamble. Their balances rapidly grew, and, by the time they filed their Chapter 7 petition, the minimum payments due on their various accounts far exceeded their income from Kimmy Trading. Indeed, the purses and other gifts the Debtors gave their daughters in 2002 exceeded their net business income during the years prior to bankruptcy.

The Debtors, however, testified that they intended to repay their creditors with gambling winnings. "Cases such as this one, involving card-use to finance gambling, with the claim of *intent to pay with gambling winnings,* present a particularly difficult challenge for determining whether the debtor, at card-use, *subjectively* intended to pay."

In re Mercer, 246 F.3d 391, 409-410 (5th Cir. 2001) (emphasis in original).[2] "Obviously, gamblers gamble with the hope of winning, *not* losing." *Id.* at 410 (emphasis in original). "But, *hoping* to win is *not* synonymous with *intending* to pay." *Id.* An intent to repay suggests a plan to repay and an anticipated source of funds from which payments might be made. "Accordingly, if a debtor presents evidence of alternative sources of expected-income sufficient to make her minimum payment, her intent with regard to her gambling winnings would be less relevant." *Id.* A debtor's "hopeless insolvency" is "evidence from which his lack of honest belief *may* be inferred.'" *Id.* at 409 (quoting RESTATEMENT (SECOND) OF TORTS § 526 cmt. d (emphasis added)).

Here, in less than two years, the Debtors borrowed and spent hundreds of thousands of dollars gambling with little or no regard for their obligations to their creditors. The Debtors may have hoped to use gambling winnings to repay their debts, but the Debtors' stated intent to repay their debts with their winnings was not credible in light of their massive gambling losses. *See Universal Card Servs. v. Pickett (In re Pickett),* 234 B.R. 748, 757 (Bankr. W.D. Mo. 1999) (intent to pay not credible when debtor's business was losing money and, at the same time, debtor was losing substantial sums at gambling tables). The documentary evidence reflects that the Debtors often made minimal payments on their various accounts and suggests that they frequently shifted debt among their accounts by using one account to make a "payment" on another account. The steady rise in the Debtors' unsecured obligations during the two years prior to bankruptcy shows that the Debtors used the bulk of their gambling winnings to finance

[2] The reasoning of the Fifth Circuit in *Mercer* is directed to the legal characterization of credit card transactions as representing a subjective intent to repay the debt. *Id.* at 406-407. Thus, it is irrelevant that *Mercer* was a nondischargeability action under §523(a)(2)(A) of the Bankruptcy Code while the instant Motion is brought under §707(b). *See In re Baum,* 386 B.R. at 654 (holding that the same standards for determining "intent" under 11 U.S.C. §523(a)(2)(A) apply to a motion to dismiss under 11 U.S.C. §707(b)).

more gambling rather than to pay existing debts. The Debtors did not file for bankruptcy relief because they had experienced an epiphany and desired to change their conduct, but because they ran out of credit to finance their lifestyle. For all of the foregoing reasons, the Court finds and concludes that the Debtors filed their bankruptcy petition in bad faith, and this case should be dismissed pursuant to §707(b)(3)(A).

CONCLUSION

IT IS THEREFORE ORDERED that the UST's motion to dismiss this case pursuant to 11 U.S.C. §707(b)(3) shall be, and it is hereby, **GRANTED.**

Signed on 9/25/2008

Brenda T. Rhoades MD

HONORABLE BRENDA T. RHOADES,
UNITED STATES BANKRUPTCY JUDGE