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Booted… Kicked Out!

Dismissal For Bad Faith Under Section 707(a)

This may seem obvious
yet it is hardly simple.[1]

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[1] Quoted language taken from Judge Rebecca B. Connelly's opinion on the subject of whether a § 707(a) dismissal would be appropriate based on the bad faith alleged by the moving creditor in that case. *In re Minick*, 588 B.R. 772, 775 (Bankr. W.D. Va. 2018).
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I. Introduction

The Bankruptcy Code provides parties with a limited number of options to address issues raised by a debtor's actions leading up to a Chapter 7 petition. One of those options is to file a motion to dismiss the case for cause under § 707(a).[3] That section provides:

> The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including—
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> (1) unreasonable delay by the debtor that is prejudicial to creditors;
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> (2) nonpayment of any fees or charges required under chapter 123 of title 28; and
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> (3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521(a), but only on a motion by the United States trustee.
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> 11 U.S.C. § 707(a).

The Code specifies three clear examples of "cause" for dismissal but other fails to define the term. Consequently, courts are left to determine what constitute cause for dismissal of a Chapter 7 case. This paper attempts to address an issue that continues to divide the circuit courts: whether cause includes acts committed by the debtor in bad faith.

II. Cause and Bad Faith

While any categorization of the tests formulated by the circuit courts for cause could be

[3] Congress did not limit § 707(a) in many of the ways that it limited § 707(b), which provides for dismissal or conversion for "abuse." Under § 707(b) a motion to dismiss for abuse may only be filed against a debtor with primarily consumer debts. Such limitation does not constrain a moving party under § 707(a). Although there is a time limit to seek dismissal under § 707(b), none exists under § 707(a). *In re Gharraph*, 496 B.R. 875 (Bankr. S.D. Ohio, August 7, 2013). Also, any interested party may move for dismissal for cause under § 707(a), with the one exception for a motion to dismiss based on the debtor's failure to file information required under § 521(a)(1), which is limited to action by the United States trustee.

subject to criticism, the opinions may be divided into two main groups: (1) The Eighth and Ninth Circuit tests which hold that § 707(a) does not provide a basis to dismiss a Chapter 7 case for bad faith;[4] and (2) the Third,[5] Fourth,[6] Fifth,[7] Sixth,[8] and Eleventh[9] Circuit tests which hold that § 707(a) does provide a basis to dismiss a Chapter 7 case for bad faith.

A. The Minority View: Cause does not include Bad Faith under § 707(a).

The Eighth Circuit. In *Huckfeldt*, the debtor and his ex-wife accumulated more than $250,000.00 in debts. Of this amount, $166,000 accrued from student loans for the debtor's medical school education and his wife's law school education.[10] They also borrowed $47,000.00 from his ex-wife's parents. The divorce decree ordered the debtor to pay debts totaling approximately $241,000.00, including his student loans, one-half of the debt to his ex-wife's parents, and other enumerated debts. The decree further ordered the debtor to hold his ex-wife harmless for these debts.

In June of 1992, six months before he completed his residency, the debtor filed a Chapter 7 petition. He listed assets of $1,250.00 and liabilities of $546,857.00. After filing the petition, he accepted a fellowship earning $45,000 per year, substantially less than the income he likely could have earned as a surgeon. Shortly after the debtor filed his petition, the creditors of his ex-wife began pursuing her for repayment.[11]

In September 1992, the debtor's ex-wife and her parents filed a motion to dismiss the

[4] *In re Huckfeldt*, 39 F.3d 829 (8th Cir. 1994); *In re Padilla* , 222 F.3d 1184, 1191 (9th Cir. 2000); *In re Sherman (Sherman v. SEC*), 441 F.3d 794 (9th Cir. 2006).
[5] *In re Tamecki (Tamecki v. Frank)* 229 F.3d 205 (3rd Cir., 2000).
[6] *Janvey v. Romero*, 883 F.3d 406, 412 (4th Cir. 2018).
[7] *In re Krueger*, 812 F.3d. 365 (5th Cir. 2016).
[8] *In re Zick (Industrial Ins. Serv., Inc. v. Zick,* 931 F.2d 1124 (6th Cir. 1991).
[9] *Piazza v. Nueterra Healthcare Physical Therapy, LLC* (*In re Piazza*), 719 F.3d 1253 (11th Cir. 2013).
[10] *Huckfeldt at* 832.

[11] Ultimately, in March of 1993, Mr. Huckfeldt's wife filed her ow bankruptcy petition.

debtor's case on the ground that it was filed in bad faith. They alleged that the debtor had threatened to file for bankruptcy during the divorce proceedings and had commenced the bankruptcy proceeding in defiance of the divorce decree for the purpose of shifting his responsibility for assigned debts, under the divorce decree, to his ex-wife. The creditors further alleged that the debtor deliberately took steps to reduce his annual income to reduce the amount he would be required to pay creditors.

The bankruptcy court found that the debtor could have earned $110,000 to $120,000 per year. The bankruptcy court concluded that it was the intent of the debtor to leave his ex-wife with all the debts and obligations incurred during their marriage and to force her to file a bankruptcy petition, even though he had the ability to soon begin paying those debts. The bankruptcy court dismissed the case and the district court affirmed, expressly holding that § 707(a) authorizes dismissal for bad faith.

On appeal, the debtor argued that his ability to repay his debts was not grounds for bad faith under § 707(a). The Eighth Circuit first concluded that dismissal for bad faith under § 707(a) is not appropriate.

> We agree with the narrow, cautious approach to bad faith . . . [F]raming the issue in terms of bad faith may tend to misdirect the inquiry away from the fundamental principles and purposes of Chapter 7. Thus, we think the Sec. 707(a) analysis is better conducted under the statutory standard, "for cause." If the bankruptcy court elects instead to act under the inherent judicial power to punish a bad faith litigant, that action should not be taken under Sec. 707(a).[12]

The Eighth Circuit next noted that the bankruptcy court dismissed the case because the debtor filed the petition for the purpose of frustrating the divorce court decree and forcing his

[12] *Huckfeldt* at 832.

ex-wife into bankruptcy. In spite of employing a different test, the Eighth Circuit affirmed the judgment of the bankruptcy court, writing: "[T]he petition in this case was . . . filed . . . to defeat the wife from a right of possession in and to the real estate which was to be awarded to her under the divorce proceedings. This violates the purpose and intent of the statute . . . "[13]

In summary, the Eighth Circuit declined to hold that "cause" under § 707(a) includes bad faith acts by the debtor. The Eighth Circuit did, however, affirm the rulings of the bankruptcy and district courts holding that they had properly dismissed the case for cause because the debtor had filed a Chapter 7 petition for an improper cause.

The Ninth Circuit. The Ninth Circuit has also held that "bad faith as a general proposition does not provide 'cause' to dismiss a Chapter 7 petition under § 707(a)."[14] In *In re Sherman*, the debtor (Richard Sherman) was an attorney who represented several defendants pre-petition who were the focus of a fraud investigation by the Securities and Exchange Commission in federal district court.[15] The district court enjoined the defendants from transferring their assets and ordered them to disgorge certain ill-gotten gains to an equity receiver. Sherman violated the inunction by withdrawing over $50,000 from the companies' litigation trust accounts and soliciting additional funds from investors. The district court found him in contempt of the injunction and ordered him to disgorge the funds to the receiver.

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[13] *Huckfeldt* at 833.
[14] *In re Padilla*, 222 F.3d 1184, 1191 (9th Cir. 2000).
[15] *In re Sherman* (*Sherman v. SEC*), 441 F.3d 794 (9th Cir. 2006).

Sherman also represented investors in subsidiaries of the fraudulent companies on a 40% contingency basis. He received periodic payments in advance of his collections with the proviso that he would return any over-payment. The receiver (who was later joined by the SEC) settled these suits and sued Sherman to recover the over-payment. Sherman filed a Chapter 7 petition before the district court could rule on the issue. The district court allowed the SEC to continue the suit since the automatic stay did not apply to it[16] and ordered Sherman to disgorge more than $600,000 in over-payments.

The SEC and the receiver moved to dismiss the bankruptcy case under § 707(a). The bankruptcy court denied the motion. Shortly thereafter Sherman agreed that the debt arising from the over-payment was non-dischargeable. He further agreed to pay the receiver $50,000.00 immediately and another $636,000.00 over time.

The district court reversed, thus granting the motion to dismiss. Sherman appealed to the Ninth Circuit. The Ninth Circuit reversed the district court, ruling that "the SEC and the district court chose the wrong vehicle — § 707(a) — for ensuring that Sherman paid the contempt and disgorgement judgment debts and did not misuse the bankruptcy process."[17]

Relying on its previous ruling in *In re Padilla*, the Court of Appeals reaffirmed its holding that "cause," rather than "bad faith," is the proper standard for evaluating a motion to dismiss under § 707(a).[18] The court then restated the two-part test in *Padilla*:

> First, we must consider whether the circumstances asserted to constitute "cause" are "contemplated by any specific Code provision applicable to Chapter 7 petitions." If the asserted "cause" is contemplated by a specific Code provision, then it does not constitute "cause" under § 707(a). If, however, the asserted

[16] 11 U.S.C. § 362(b)(4).
[17] *Sherman* at 812.
[18] *Id.*, at 813.

> "cause" is not contemplated by a specific Code provision, then we must further consider whether the circumstances asserted otherwise meet the criteria for "cause" for dismissal under § 707(a).[19]

The Ninth Circuit ruled that there was no "cause" to dismiss the case because the type of misconduct alleged by the SEC was addressed by other provisions of the Code. The SEC first argued that Sherman filed his petition to avoid the jurisdiction of other courts. The Ninth Circuit wrote that "[there is nothing problematic about an individual filing a legitimate bankruptcy petition with the intention of taking advantage of the automatic stay provisions."[20] The remedy in § 707(a), the court emphasized, "is too powerful a medicine for the problem at hand, as it precludes adjudication of the bankruptcy even where there are debts aside from pending litigation that exceed assets."[21]

The Ninth Circuit next noted that the concerns embedded in the assertion of the SEC that Sherman had engaged in scorched-earth tactics could be addressed by the filing of a complaint under § 547 seeking to avoid preferential transfers. Finally, the Ninth Circuit noted that the assertion of the SEC that the debtor had misrepresented liabilities and expenses could be addressed by a complaint under § 727(a)(4)(A) objecting to Sherman's discharge.

B. The Majority View: "Cause" includes Bad Faith under § 707(a)

The majority view holds that cause for dismissal under § 707(a) is appropriate if an examination of the totality of the circumstances reveals that the debtor has acted in bad faith.

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[19] *Id.* (quoting *Padilla* at 1193-94).
[20] *Id.*, at 814.
[21] *Id.*, at 815.

The Fourth Circuit. In *Janvey v. Romero*, the Fourth Circuit held that bad faith may constitute cause for dismissal but held that the holding should be limited to real misconduct.[22] In that case, a receiver, Janvey, had obtained a $1.275M judgment against the debtor, Romero, based on a Ponzi scheme executed by the debtor's employer. The judgment accounted for about 90% of the debtor's debt. The debtor had more than $5M in assets, but the vast majority of the assets were exempt. The debtor's wife was quite ill and the debtor was unable to acquire employment because of his association with the Ponzi scheme. The debtor filed a Chapter 7 petition and the receiver filed a motion to dismiss for bad faith under § 707(a).

The receiver's motion was based on three factual assertions. First, the receiver asserted that the case should be dismissed because the judgment was virtually the only debt owed by the debtor. The court found that the debtor filed the petition for many acceptable reasons and held that the fact that the debtor filed the petition to discharge a single debt did not constitute bad faith without more. Second, the receiver asserted that the case should be dismissed because the debtor twice failed to bargain in good faith when negotiating a settlement with the receiver. The court, in essence, refused to look behind the settlement negotiations. Third, the receiver asserted that the debtor should be denied the benefit of the bankruptcy process because he had too many assets that were exempt. The court denied the motion under this argument, noting that it would undermine the exemption scheme if a case were dismissed for this reason.

In holding that "cause" could include bad faith under § 707(a), the court wrote:

> We think the majority view is the sounder one, because it is the most helpful in preventing serious abuses of the bankruptcy process. But acknowledging that bad faith may constitute "cause" under § 707(a) also requires that the remedy of dismissal be

[22] *Janvey v. Romero*, 883 F.3d 406, 412 (4th Cir. 2018)

reserved for cases of real misconduct.[23]

The Sixth Circuit. In *In re Zick*, the Sixth Circuit held that dismissal under § 707(a) may be based on bad faith, but bad faith should be narrowly construed to apply only to those cases in which the debtor acts in an egregious manner.[24] In *Zick*, the debtor's former employer obtained a mediation award in the amount of $600,000.00 against the debtor based on the debtor's solicitation of former clients in violation of an employment agreement. The debtor filed a Chapter 7 petition within ten days of the award. The former employer filed a motion to dismiss under § 707(a) on the grounds that the debtor had created a one-creditor case and had failed to make changes in his lifestyle in order to pay the debt. The bankruptcy court granted the motion and the district court affirmed. The debtor appealed to the Sixth Circuit.

The Sixth Circuit set forth the following test to determine whether dismissal for bad faith is appropriate under § 707(a):

> Dismissal based on lack of good faith must be undertaken on an ad hoc basis. It should be confined carefully and is generally utilized only in those egregious cases that entail concealed or misrepresented assets and/or sources of income, and excessive and continued expenditures, lavish lifestyle, and intention to avoid a large single debt based on conduct akin to fraud, misconduct, or gross negligence. It was not abuse of discretion to conclude that the factors found in this case amounted to a lack of good faith on the part of [the debtor].[25]

The Sixth Circuit affirmed the dismissal of the debtor's case under this test, concluding that the bankruptcy court had not abused its discretion.

The Fifth Circuit. The Fifth Circuit through *In re Krueger* also joined the majority of circuit courts in holding that a debtor's bad faith during the bankruptcy process can serve as the

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23 *Janvey* at 412.
24 *In re Zick (Industrial Ins. Serv., Inc. v. Zick)* 931 F.2d 1124, 1129 (6th Cir. 1991)
25 *Id.*, at 1129.

basis of a dismissal "for cause," even if the bad faith conduct is arguably encompassed by other provisions of the Code.[26] The test in the Fifth Circuit, although based on a totality-of-the-circumstances test, may be somewhat less restrictive than that employed in the Fourth and Sixth Circuits. In *Krueger*, the Fifth Circuit upheld the trial court's order dismissing the case after finding that the debtor's bad faith acts were induced by non-economic motives.

In *Krueger*, the debtor and Michael Torres co-owned Cru Energy, Inc., ("Cru") a bio-energy company. The state court enjoined the debtor from participating in Cru. The debtor then created a parallel company in a naked attempt to avoid the injunction. The state court found the debtor in criminal contempt of court for transferring funds out of Cru in violation of the injunction and sentenced him to three days in jail.

Krueger filed a bankruptcy petition and his interest in Cru became property of the estate. In spite of this, the debtor held a shareholders' meeting and voted his own shares and the proxies that he held. Torres was not present. At the meeting, Torres was voted out of office, a new board was formed, the debtor was elected President, CEO, and treasurer of Cru, and all claims of Cru against the debtor were dismissed.

The bankruptcy court found that Krueger filed the petition to avoid the pending criminal contempt proceeding, to avoid the state court summary judgment proceedings, to delay the state court litigation because he no longer found the venue favorable, and to move his business interests from Cru to a newly formed corporation. The bankruptcy court also found that the debtor knowingly and willfully failed to schedule his officer and director position in the new corporation. The bankruptcy court concluded that the debtor lied about his interest in the new corporation to prevent discovery of his efforts to flout the state court injunction and retake control

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[26] *In re Krueger*, 812 F.3d. 365, 375 (5th Cir. 2016).

of Cru's business, that he violated the automatic stay when he voted his shares at the Cru shareholder meeting, that he took money from Cru bank accounts, that he used a false address on his bankruptcy petition, that he repeatedly committed perjury during the bankruptcy court proceedings on a wide range of topics, and that he threatened a witness during the bankruptcy court's hearing on the § 707(a) motion.

After holding that the case could be dismissed by motion without the filing of an adversary complaint, the Fifth Circuit affirmed the decision of the bankruptcy court, writing:

> Under a flexible, totality of the circumstances approach, the [bankruptcy] court found that Krueger filed chapter 7 because of a criminal contempt proceeding pending against him, because his state court litigation had taken a turn for the worse, and to provide him the cover to retake control of Cru. These "non-economic motives" are "unworthy of bankruptcy protection." *Huckfeldt*, 39 F.3d at 833. Once his chapter 7 case commenced, Krueger engaged in conduct designed to manipulate the proceedings to his own ends, including false filings, false testimony, and witness intimidation. His duplicitous behavior is exactly the sort of conduct contemplated by most courts as giving cause for dismissal under § 707(a). Finally, the bankruptcy court weighed the costs of dismissal to creditors and was able to mitigate them through appropriate orders. In light of the court's balancing inquiry and findings, it cannot be said that the bankruptcy court abused its discretion in dismissing this case.[27]

Eleventh Circuit. In *Piazza,* the debtor filed a Chapter 7 petition in 2010 and listed unsecured debt totaling roughly $319,683.[28] Of that amount, approximately $161,383 was owed to a single creditor, Nueterra Healthcare Physical Therapy, LLC ("Nueterra"). The debt arose from the debtor's failure to pay a business guarantee. Nueterra had attempted to collect on the judgment without success for more than two years. The debtor's second largest debt was a $51,948 non-dischargeable student loan.

[27] *Krueger* at 365.
[28] *Piazza v. Nueterra Healthcare Physical Therapy, LLC* (*In re Piazza*), 719 F.3d 1253 (11th Cir. 2013).

Nueterra filed a motion to dismiss for bad faith under § 707(a). The bankruptcy court held that "cause" includes bad faith, and granted the motion. The district court affirmed, and the debtor further appealed. The Eleventh Circuit Court affirmed, holding that "cause" under § 707(a) includes bad faith and concluding that the bankruptcy court did not clearly err in basing the decision on four identified facts.[29]

First, the circuit court concluded that it was relevant that the debtor filed bankruptcy to avoid paying a large single debt arising from a state-court judgment he evaded for more than two years. The court also found it relevant that the debtor admitted that the Nueterra judgment was a deciding factor in his decision to file the Chapter 7 petition.

Second, the Eleventh Circuit found that the bankruptcy court did not clearly err in basing its decision on the fact that the debtor continued "paying debts of insiders" by paying his great aunt's mortgage and paying his wife approximately $4,000 each month, something that he had done since the beginning of their marriage, a period of more than five years.

Third, the Eleventh Circuit found that the bankruptcy court did not clearly err in basing its decision on the fact the debtor failed to make life-style adjustments. The debtor had admitted that he cosigned on his sister's car loan and leased a new luxury vehicle for himself in 2010.

Fourth, the Eleventh Circuit found that the bankruptcy court did not clearly err in basing its decision on the fact the debtor failed to pay his creditors despite having "sufficient resources" to repay at least a portion of his debts. The debtor admitted he and his wife's joint monthly income exceeded $10,000, or a total of $300,000 between the Nueterra judgment and the bankruptcy filing, a period of 34 months.

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[29] *Piazza* at 1274.

The Third Circuit. In *In re Tamecki,* the debtor filed a Chapter 7 petition with a single debt listed -- a credit card debt in the approximate amount of $35,000.[30] He owned one substantial asset, which he held with his estranged wife, a tenancy by the entireties property. There was $100,000 in equity in the house, and the debtor properly claimed his equity in the real property exempt. The debtor and his wife had been separated for about five years at the time that the debtor filed his petition.

The trustee filed a motion to dismiss the case under § 707(a) arguing that the debtor's final decree of divorce was right around the corner and that the debtor would soon be entitled to his share of the proceeds from the sale of the house. The trustee further argued that the debtor acted in bad faith in filing his petition because he knew that he would soon be in a position to repay his debts. The debtor asserted that the trustee had to prove extreme misconduct, that the ability to repay his debt in the future was not evidence of bad faith, and that he did no more than avail himself of an exemption available under the Code.

The bankruptcy court first held that once the moving party calls into question a debtor's good faith under § 707(a), the ultimate burden of proof shifts to the debtor to prove his good faith. The bankruptcy court found that debtor had failed to prove his good faith in filing for bankruptcy and dismissed the debtor's petition under § 707(a). The district court affirmed.

The Third Circuit affirmed in a 2-to-1 decision. The court echoed the Sixth Circuit test in *Zick*.

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[30] *In re Tamecki (Tamecki v. Frank)* 229 F.3d 205 (3rd Cir., 2000).

> Dismissal based on lack of good faith... should be confined carefully and is generally utilized only in those egregious cases that entail concealed or misrepresented assets and/or sources of income, lavish lifestyles, and intention to avoid a large single debt based upon conduct akin to fraud, misconduct or gross negligence.[31]

The court then agreed with the bankruptcy court's conclusion that once the moving party calls into question a debtor's good faith, the ultimate burden of proof "shifts to the [debtor] to prove his good faith."[32]

The dissent disagreed that a bankruptcy court could dismiss a Chapter 7 case for cause if the debtor failed to demonstrate good faith in filing.

> *Zick* does not require consumer debtors to affirmatively demonstrate good faith absent any challenge. *Zick* says that lack of good faith may be a valid basis for dismissing a bankruptcy case for cause under section 707(a), *see Zick*, 931 F.2d at 1126, not that dismissal is appropriate anytime the debtor fails to affirmatively demonstrate his good faith. Even if the burden shifts to a consumer chapter 7 debtor to defend his good faith after good faith has been put "at issue," I would submit that placing good faith at issue requires more than an unsupported hypothesis about the state of Tamecki's relationship with his estranged wife and pointing to a specific credit card debt in the bankruptcy schedules. I frankly find it untenable that an entirely unsupported assertion can trigger an obligation on the part of a debtor to affirmatively prove his good faith or lose all entitlement to bankruptcy relief. Such a procedure would be contrary to that employed by our sister courts of appeals, and constitutes an unwarranted departure from existing law.[33]

The dissent makes several points that, taken together, argue how low this standard is for a movant. Under the standard in *Tamecki*, the ultimate burden of proof shifts to the debtor once the movant has asserted that the debtor might have more income in the future. If the burden passes to the debtor then the debtor must prove his good faith.

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[31] *Tamecki* at 207 (citing *Zick*, 931 F.2d at 1129).
[32] *Id.,* (citing *In re Marks*, 174 B.R. 37, 40 (E.D. Pa. 1994).
[33] *Tamecki* at 211 (Rendell, J., dissenting).

Further, according to the dissent, there are other statutes in the Code that are relevant to policing the concerns of the trustee in this case. Section 707(b) provides that the court may convert a case to Chapter 13 (with the debtor's permission) or dismiss a case initiated by an individual with primarily consumer debts if the debtor has the ability to make certain minimum payments in Chapter 13 for a period of thirty-six to sixty months. In addition, § 541(a)(5) provides that the estate includes any property acquired by the debtor within 180 days of the date of petition that is obtained by bequest, devise, or inheritance, or pursuant to a marriage property settlement or life insurance policy. Congress considered the possibility of future assets by a debtor and provided for such occurrence in the Code.

III. Factors Indicating Bad Faith under a Totality-of-the-Circumstances Test

For the majority of circuits holding that bad faith may be cause under § 707(a), the question then become how to determine whether such bad faith exists. In judging whether there is cause in the form of bad faith to dismiss a case, courts generally consider the debtor's entire course of conduct—before, during, and after the filing of a Chapter 7 petition.

> As the bankruptcy court did here, a court should consider any and all "facts and circumstances surrounding the debtor's filing for bankruptcy." The finding of a debtor's bad faith is a factual determination reviewed for clear error. Clear error is a formidable standard: this court "disturb[s] factual findings only if left with a firm and definite conviction that the bankruptcy court made a mistake."[34]

Courts have fashioned lists of factors that are to be considered under a totality of the

[34] *Krueger* at 374, quoting *Perlin v. Hitachi Capital Am. Corp. (In re Perlin*), 497 F.3d 364, 373–74 (3d Cir.2007) and *ASARCO, LLC v. Jordan Hyden Womble Culbreth & Holzer, P.C. (In re ASARCO, LLC)*, 751 F.3d 291, 294 (5th Cir.2014), *aff'd sub nom. Baker Botts LLP v. ASARCO LLC*, 135 S.Ct. 2158, 192 L.Ed.2d 208 (2015).

circumstances when determining whether a debtor has acted in bad faith.[35] As with any totality-of-the-circumstances test, the analysis does not consist of an accounting, rather each factor is to be considered in light of its weight and relevance in the case under consideration. A factor that is irrelevant in one case may be determinative in another.

In a widely cited opinion, *McDow v. Smith*, the District Court for the Eastern District of Virginia listed eleven reasons that are typically considered when a party has accused a debtor of bad faith.[36] The list is only one of many that the courts have considered but represents a "distillation of the various totality of the circumstances tests" for determining cause under 707(a).[37]

1. **Deception by the Debtor.** The first factor concerns whether the debtor has concealed or misrepresented assets or income, including the improper or unexplained transfers of assets prior to filing. It should be noted that any such act might also result in the denial of the

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[35] In *Piazza*, the Eleventh Circuit affirmed the lower court's determination of bad faith based on 15 factors from *In re Baird*, 456 B.R. 112, 116-17 (Bankr. M.D. Fla 2010):

> (i) the debtor reduced his creditors to a single creditor shortly before the petition date;
> (ii) the debtor made no life-style adjustments or continued living a lavish life-style;
> (iii) the debtor filed the case in response to a judgment, pending litigation, or collection action;
> (iv) there is an intent to avoid a large, single debt;
> (v) the debtor made no effort to repay his debts;
> (vi) the unfairness of the use of Chapter 7;
> (vii) the debtor has sufficient resources to pay his debts;
> (viii) the debtor is paying debts of insiders;
> (ix) the schedules inflate expenses to disguise financial well-being;
> (x) the debtor transferred assets;
> (xi) the debtor is over-utilizing the protections of the Bankruptcy Code to the unconscionable detriment of creditors;
> (xii) the debtor employed a deliberate and persistent pattern of evading a single major creditor;
> (xiii) the debtor failed to make candid and full disclosure;
> (xiv) the debtor's debts are modest in relation to his assets and income; and
> (xv) there are multiple bankruptcy filings or other procedural "gymnastics."

[36] *McDow v. Smith*, 295 B.R. 69, 79 n. 22 (E.D. Va. 2003). The court assembled the list from those in *In re Zick*, 931 F.2d at 1129; *In re Griffieth*, 209 B.R. 823, 826 (Bankr. N.D. NY 1996); *In re Spagnolia*, 199 B.R. 362, 365 (Bankr. W.D.Ky.1995); and *In re Hammonds*, 139 B.R. 535, 542 (Bankr. D.Co. 1992).

[37] *Janvey* at 413 (citing *McDow* at 79).

debtor’s discharge.[38]

2. **The Debtor’s Schedules.** The second factor concerns the debtor's lack of candor and completeness in his statements and schedules, such as the inflation of his expenses to disguise his financial well-being. And again, such an act could result in the denial of the debtor’s discharge.[39]

3. **Ability to Pay.** The third factor listed in *McDow* considers whether the debtor has sufficient resources to repay his debts but fails to do so and leads a lavish lifestyle. Courts will not always apply this factor on its face. In *Janvey*, the movant’s argument provided the court with an opportunity to consider this factor, but the Fourth Circuit held that a debtor’s ability to repay his debts alone does not constitute cause for dismissal and that a debtor should not be forced to repay his creditors from exempt assets.[40] The court first cited *In re Bushyhead*[41] which noted that there was a consensus among the courts that a debtor’s ability to repay his debts does not, without more constitute a basis for dismissal. The court next cited the Congressional Record: “…the section [§ 707(a)] does not contemplate . . . that the ability of the debtor to repay his debts in whole or in part constitutes adequate cause for dismissal.”[42] The court then noted that Janvey’s suggestion that Romero should use his exempt assets to pay the judgment would turn the bankruptcy scheme on its head. The court concluded that while a debtor’s ability to pay his debts could be a relevant factor, it did not constitute a *per se* rule of dismissal.

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[38] *See* 11 U.S.C. § 727(a)(2), (4), (5) and (6).
[39] *See* 11 U.S.C. § 727(a)(3).
[40] A receiver, Janvey, obtained a$1.275 million judgment against the debtor, Romero. Romero’s assets, including three parcels of real property, totaled more than $5.348 million. Most of his assets were properly claimed exempt. Janvey moved to dismiss for cause under § 707(a), asserting that Romero should be required to use his exempt assets to pay the judgment against him.
[41] 525 B.R. 136, 148 (Bankr. N.D. Ok. 2015)
[42] H.R. Rep. No. 95-595, at 380 (1977). *See also, In re Snyder*, 509 B.R. 945, 951 (Bankr. D.N.M. 2014); and *In re Young*, 92 B.R. 782 (Bankr. N.D. Ill. 1988); In re Cecil, 71 B.R. 730 (Bankr. W.D. Va. 1987).

4. **A Single Debt.** The fourth factor listed in *McDow* examines whether the debtor filed a petition to avoid a large single debt incurred through conduct akin to fraud, misconduct, or gross negligence, such as a judgment in pending litigation, or a collection action.

In *Janvey*, the creditor argued that bankruptcy should be unavailable to the debtor Romero because he sought to discharge a single large debt —namely, Janvey's judgment against him. The Fourth Circuit rejected this argument for two reasons. First, the court reasoned that, as a factual matter, Romero did not file the petition solely to avoid the judgment. The court first affirmed the bankruptcy court's finding that one of Romero's primary reasons for filing was the fact that his wife was totally physically incapacitated requiring the expenditure of substantial sums of money to pay for her care. Second, the court noted that Romero had another $150,000.00 in debt. The court wrote:

> [T]he fact that Janvey's judgment accounted for roughly 90% of Romero's total debt does not negate those other claims. In fact, courts have declined to dismiss Chapter 7 petitions filed in response to debts that constitute similarly large fractions of the debtor's total debt.[43]

The Fourth Circuit also held that, as a legal matter, the fact that a bankruptcy petition was filed in response to a single debt, without more, would not constitute a bad-faith cause for dismissal. The court wrote that if "filing bankruptcy to avoid the payment of a debt was cause for dismissal, no debtor would ever be able to file a bankruptcy case."[44] The court agreed with those courts that have held that without additional evidence of fraud or misconduct, the fact that a debtor filed for bankruptcy in response to a single large debt is not sufficient for a finding of bad

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[43] *Janvey* at 414 (citing *See In re Bage* , No. 13-33367, 2014 WL 4749072, at *2, *5 (Bankr. N.D. Ohio Sept. 24, 2014) (denying a motion to dismiss where litigation-related debt accounted for more than 90% of the total unsecured debt); *In re Ajunwa* , No. 11-11363 (ALG), 2012 WL 3820638, at *1, *9 (Bankr. S.D.N.Y. Sept. 4, 2012) (denying a motion to dismiss where one judgment "accounted for over 90% of the total claims listed").

[44] Id., at 415 (quoting *In re Uche*, 555 B.R. 57, 62 (Bankr. M.D. Fla. 2016)).

faith.[45] The court concluded by noting that courts may consider the nature of a debtor's motivation to file for bankruptcy, but that it would take more than just this fact standing alone to dismiss a case.

In contrast, the Sixth Circuit in *Zick* affirmed the bankruptcy court's dismissal of the case based on the existence of a single debt and the assertion that the debtor could have altered his lifestyle to pay the creditor. The court held that these facts justified characterizing the debtor's acts as egregious.

5. Evasion of a Single Creditor. The fifth factor in *McDow* asks whether the debtor's petition is part of a "deliberate and persistent pattern" of evading a single creditor.

6. **Overuse of the Code.** The sixth factor examines whether the debtor is "overutilizing the protection of the Code" to the detriment of his creditors.

7. **Reduction to Single Creditor.** The seventh factor considers whether the debtor reduced his creditors to a single creditor prior to filing the petition.

8. **Failure to Attempt to Repay Creditors.** The eighth factor concerns the debtor's failure to attempt to repay creditors.

9. **Insider Payments.** The ninth factor questions whether the debtor has made payments to insider creditors. Here it should be noted that the trustee may have grounds to pursue the recovery of any such payments as preferences under 11 U.S.C. § 547.

10. **Procedural Gymnastics.** The tenth *McDow* factor looks into whether the debtor has engaged in "procedural gymnastics" that have the effect of frustrating creditors.

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[45] The Fourth Circuit cited the following opinions in support of this holding: *In re Chovev* 559 B.R. 339, 347 (Bankr. E.D.N.Y. 2016); *In re McVicker*, 546 B.R. 46, 51 (N.D. Ohio 2016); *In re Gutierrez* 528 B.R. 1, 15 (Bankr. D. Vt. 2014); *In re Grullon* No. 13-11716 (ALG), 2014 WL 2109924, at *3 (Bankr. S.D.N.Y. May 20, 2014); *In re Mazzella*, No. 09-78449-478, 2010 WL 5058395, at *6 (Bankr. E.D.N.Y. Dec. 6, 2010); *In re Glunk*, 342 B.R. 717, 736 (Bankr. E.D. Pa. 2006).

11. **Misuse of the Bankruptcy Process.** The eleventh factor concerns whether the debtor has unfairly used the bankruptcy process.

Overall, the list may seem long,[46] but a number of the factors are somewhat redundant. The first and second factors are similar. Concealment and misrepresentation of assets or income typically are included in a discussion of deceptive schedules. Likewise, the fourth, fifth and seventh factors are quite similar. A single debt, evasion of paying that debt, and reducing the number of creditors to one creditor could be combined as part of one discussion.

IV. Ability to Pay in the Determination of Cause under 707(a).

Even in those circuits where courts have concluded that cause for dismissal may include a debtor's bad faith, courts do not typically rely on a single factor under the various tests considering the totality of the circumstances. This appears particularly true when courts grapple with the issue of a debtor's ability to pay. Although it may be one factor to consider among others, most courts have held that a Chapter 7 debtor's ability to repay his or her debts does not, standing alone, support dismissal under § 707(a) for "cause."[47]

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[46] In *Janvey*, the plaintiff fashioned a twelfth potential reason for dismissal for bad faith under the cause provision of § 707(a) – lack of good faith in pre-bankruptcy settlement negotiations. The debtor (Romero) had twice offered to settle the claim for a reduced amount, and Janvey rejected both offers. Janvey argued that Romero was trying to pressure him into accepting a mere fraction of his judgment by casting bankruptcy as the alternative to settlement, but the court found groundless the notion that Romero's attempts to settle with a judgment creditor constituted cause to dismiss his case. The court noted that the law encourages voluntary settlement of disputes because it spares the parties substantial costs and lightens the load on the judicial system.
Janvey claimed that Romero's two settlement offers were unacceptably low. The court noted that this was not the whole story, that Janvey had admitted that he declined the offer in part to make an example of Romero and thereby demonstrate to the other judgment debtors in the fraud case that he expected payment in full. The court concluded that while Janvey had every right to reject Romero's offers, Romero had every right to seek the benefits of the bankruptcy process.

[47] See, *e.g.*, 2nd Circuit example: *In re Burrell*, 2008 Bankr. LEXIS 4920, 2008 WL 3209620 (Bankr. S.D. N.Y., August 6, 2008); 3rd Circuit example: *Perlin v. Hitachi Capital America Corp.*, 497 F.3d 364 (3rd Cir., August 3, 2007); 4th Circuit example: *McDow v. Smith*, 295 B.R. 69 (E.D. Va. 2003); 6th Circuit example: *In re Mohr*, 425 B.R. 457 (Bankr. S.D. Ohio, March 15, 2010); 7th Circuit example: *In re Blok*, 2011 Bankr. LEXIS 3526, 2011 WL

The *McDow* court faced just such circumstances when faced with a debtor with primarily nonconsumer debts that earned over $37,000 per month in income.[48] In surveying the relevant case law, the *McDow* court determined that other courts only found dismissal of debtors with such lavish lifestyles to warrant dismissal when there was also evidence that the debtors participated in misconduct such as misrepresenting assets or defrauding creditors. The court also found support for the premise that a debtor's ability to pay should not, standing alone, support dismissal under § 707(a) in the legislative history. The Fourth Circuit in *Janvey* cited just this history when noting that current § 707(a)[49] "does not contemplate . . . that the ability of the debtor to repay his debts in whole or in part constitutes adequate cause for dismissal."[50]

V. Conclusion

The inherent subjectivity of defining cause under § 707(a) can be maddening for debtors' counsel whose clients value nothing more in the legal advice they receive than predictability as to expected results as they enter, typically with great trepidation, the bankruptcy process. The uncertainty in the definition of cause is particularly troubling because its subjective interpretation and application to the facts of a case by a court completely control the ultimate fate of the debtor. There is no realistic opportunity for a compromised solution when dealing with § 707(a) actions. The application of § 707(a) does not result in a "partial" discharge, and clients don't emerge from

4344594 (Bankr. S.D. Ind., Sept. 15, 2011); 10th Circuit example: *In re Quinn*, 490 B.R. 607 (Bankr. D. N.M., Dec. 28, 2012) (dismissal of a Chapter 7 case for cause may not be based exclusively or primarily on a debtor's substantial financial means or ability to repay creditors). Compilation of representative cases by www.cbar.pro. But see, *e.g.*, *In re Rahim*, 442 B.R. 578 (Bankr. E.D. Mich., Dec 16, 2010), *aff'd*, 449 B.R. 527 (E.D. Mich., May 23, 2011) (ability to pay unsecured creditors is a sufficient basis for dismissal or conversion of a case under § 707(a)).

48 *McDow* at 72.

49 Section 707(a) was originally enacted as part of the Bankruptcy Reform Act of 1978 as Section 707 and later renumbered upon the addition of Section 707(b).

50 *Janvey* at 416 (citing H.R. Rep. No. 95-595, at 380 (1977)).

§ 707(a) actions with "mixed" results. The application of § 707(a) results in only one of two opposite outcomes -- either the continuation or the dismissal of the case. Of course, the courts also must feel the burden of interpreting § 707(a) in the context of a particular debtor's circumstances.

Chief Bankruptcy Judge Rebecca B. Connelly may have explained best both the power and complexity of the court's role in overseeing § 707(a) actions in a recent opinion from the Western District of Virginia.[51] "Essentially, the open-ended authority to dismiss a case for cause enables a bankruptcy judge to serve as gatekeeper to combat abuse of the bankruptcy laws. This may seem obvious yet it is hardly simple. The bankruptcy court must determine at the outset if a debtor, who is otherwise statutorily eligible to file a bankruptcy petition, should nonetheless be denied the opportunity to proceed in a bankruptcy case. Dismissal for bad faith, therefore, should be reserved for cases of real misconduct."[52]

What are such cases of "real misconduct" that rise to the level of bad faith? Consider these examples, all of which seem to involve multiple factors suggesting bad faith.

1. Paying debts of insiders, transferring assets to family, and failing to "make life-style adjustments" despite the debts. "Atypical" conduct that falls short of the "honest and forthright invocation" of the Bankruptcy Code's protections.[53]
2. Lavish lifestyle, the debtors had not attempted to reduce their expenses, and had singled out a judgment creditor for nonpayment of a debt they owed.[54]
3. Conversion of $14,000 in non-exempt funds into improvements to his and his wife's

[51] *In re Minick*, 588 B.R. 772 (Bankr. W.D. Va. 2018).
[52] *Id.*, at 775.
[53] *Piazza* at 1271.
[54] *In re Gilman*, 2012 Bankr. LEXIS 1601, *1, 2012 WL 1230276.

exempt assets one month prior to filing, materially understatement of current monthly income, ability to pay, and onl[y one debt other than the mortgage.[55]

4. Inaccurate schedules and underreported income.[56]

5. Failure to attend rescheduled meetings of creditors and to provide requested documentation to the Trustee.[57]

6. Ability to pay combined with a manipulation of financial circumstances in order to satisfy all but two debts.[58]

7. Ability to pay and a one-creditor dispute, aimed solely at avoiding the repayment of any amount purportedly due to the creditor.[59]

Applying the tests for "cause" under § 707(a) is challenging given the wide range of analysis employed by the circuit courts and the very fact-specific nature of such determinations. Ultimately, a debtor' attorney will need to rely on his or her own senses and perform what may best be described as a "smell test"[60] to determine when a debtor's misconduct may be perceived as so egregious that it may trigger a bad faith inquiry and an action to dismiss.

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[55] *In re Matthews*, 2013 Bankr. LEXIS 1319, *30, 69 Collier Bankr. Cas. 2d (MB) 785, 2013 WL 1385221
[56] *In re Woodburn*, 2008 Bankr. LEXIS 2447, 2008 WL 2777352 (Bankr. E.D. N.C., July 17, 2008).
[57] *In re Warner*, 2011 Bankr. LEXIS 4853, 2011 WL 6140856 (Bankr. N.D. Ohio, Dec 9, 2011).
[58] *In re Fiero*, 2008 Bankr. LEXIS 1573, 2008 WL 2045820 (Bankr. E.D. N.C., May 12, 2008).
[59] *In re Bryant*, 474 B.R. 770 (Bankr. N.D. Fla., July 3, 2012).
[60] *Zick* at 1127 (approving of the use of a "smell test" in deciding § 707(a) motions).