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Lifestyles of the Rich and Not So Famous in Bankruptcy Proceedings

*By Michael J. Lichtenstein**

There are numerous cases in which individual debtors not only enter a bankruptcy proceeding enjoying a lavish lifestyle but actually seek to maintain that lifestyle, often while attempting to pay creditors less than the full amount owed. In this article, the author reviews Chapter 7 and Chapter 11 proceedings in which the debtors attempt to sustain a luxurious lifestyle.

Thinking of an individual debtor in a bankruptcy proceeding does not typically conjure up images of a lavish lifestyle in a mansion, multiple vacation homes or country club memberships. However, it turns out that there are numerous cases in which individual debtors not only enter a bankruptcy proceeding enjoying such a lifestyle but actually seek to maintain that lifestyle, often while attempting to pay creditors less than the full amount owed. Many courts have not reacted too positively to such attempts, while others have been more sympathetic. Generally, with some exceptions, courts have refused to dismiss Chapter 7 proceedings based solely upon the debtor's lifestyle. However, in the context of individual Chapter 11 confirmations, the courts have expressed dissatisfaction with individual debtors reluctant to forego their pre-petition lavish lifestyle. In most cases, courts have denied confirmation in a Chapter 11 proceeding, finding bad faith in the debtor's attempt to pay creditors less money so as to sustain a luxurious lifestyle.

CHAPTER 7 PROCEEDINGS

In *In re Quinn*,¹ the U.S. Trustee moved to dismiss the debtors' Chapter 7 proceeding, alleging bad faith. The grounds for bad faith were the debtors' ability to pay their debts (but failing to do so) while maintaining their lavish lifestyle.² The debtors owned five properties, including investment property; the husband, a doctor, earned in excess of \$500,000 per year; and after filing for

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¹ 490 B.R. 607, 609 (Bankr. D.N.M. 2012).

² *Id.* at 612.

bankruptcy, the debtors took several trips, including a ski trip, spring break in Hawaii, and a trip to Arizona.³

The court suggested that: “At first blush, it may appear that Dr. and Mrs. Quinn are not the type of persons who need Chapter 7 relief.”⁴ In addition to earning more than \$560,000 per year together, they drove luxury cars and had recently purchased a home for \$955,000.⁵ Notwithstanding the foregoing, the court declined to dismiss the Chapter 7 proceeding for two reasons: the court concluded that dismissal could not be based exclusively or primarily on a debtors’ substantial financial means or an ability to repay creditors; also, dismissal for cause cannot be based exclusively or primarily on debtors’ conduct that would form the basis for objecting to a discharge.⁶ The court commented that, while the debtors’ lifestyle was lavish, they earned a lot of money.⁷ Earning a sizeable income is not an indicator of bad faith.⁸

Similarly, in *McDow v. Smith*,⁹ the court considered whether cause for dismissal under Section 707 of the Bankruptcy Code included a lack of good faith. This Chapter 7 debtor earned in excess of \$450,000 per year and had monthly living expenses of \$31,000, including rental of a large house and payment of private school tuition for three children.¹⁰ The United States Trustee argued that the petition was filed in bad faith as evidenced by the debtor’s lavish lifestyle and his ability to repay his debts.¹¹ The bankruptcy court refused to dismiss the case because a lavish lifestyle and the ability to repay debts were not accompanied by other egregious circumstances that would warrant dismissal for cause.¹²

The district court concluded that a debtor’s bad faith could, in the totality

³ *Id.* at 610–11.

⁴ *Id.* at 613.

⁵ *Id.*

⁶ *Id.* at 617. One might assume that the court did not approve of the debtors’ actions but believed that a complaint objecting to discharge might be a more appropriate approach.

⁷ *Id.* at 619.

⁸ *Id.* See also *Perlin v. Hitachi Capital America Corp.*, 497 F.3d 364, 375 (3rd Cir. 2007) (having substantial income and comfortable lifestyle was insufficient to demonstrate bad faith in filing Chapter 7 petition).

⁹ 295 B.R. 69, 71 (E.D. Va. 2003).

¹⁰ *Id.* at 72.

¹¹ *Id.* at 73.

¹² *Id.*

of circumstances, constitute cause for dismissal.¹³ However, an ability to repay debts is not sufficient alone to constitute cause for dismissal.¹⁴ While acknowledging that some courts have dismissed Chapter 7 petitions in light of debtors' lavish lifestyles, the district court concluded that more egregious conduct, like concealed or misrepresented assets, is required to justify dismissal.¹⁵ The court acknowledged that the "result reached here may understandably offend some on the ground that this debtor, given his income and lifestyle, is a member of a class of people who are undeserving of the privileges and benefits of the Bankruptcy Code."¹⁶

Other courts have not been as generous or sympathetic. "Bankruptcy protection was not intended to assist those who, despite their own misconduct, are attempting to preserve a comfortable standard of living at the expense of their creditors."¹⁷ In that case, the court granted the United States Trustee's motion to dismiss the Chapter 7 proceeding arguing bad faith based upon credit card abuse and living an extravagant lifestyle.¹⁸ The court agreed that \$161,000 of credit card debt for which the monthly payments exceeded the debtors' income to maintain their lifestyle in bad faith justified dismissal.¹⁹

In *In re Zick*,²⁰ a creditor moved to dismiss the Chapter 7 proceeding alleging bad faith based upon information contained in the bankruptcy petition. The Sixth Circuit agreed that lack of good faith could constitute cause for dismissal of a Chapter 7 petition.²¹ Here, the debtor's bad faith was evidenced by his high income coupled with his failure to make significant lifestyle adjustments or efforts to repay his creditors.²² His income exceeded \$360,000 and he listed \$90,000 of personal property.²³ Affirming the district court's decision to

¹³ *Id.* at 80.

¹⁴ *McDow v. Smith*, 295 B.R. at 80.

¹⁵ *Id.* at 81.

¹⁶ *Id.* at 82.

¹⁷ *In re Kamen*, 231 B.R. 275 (Bankr. N.D. Ohio 1999).

¹⁸ *Id.* at 277–78. See also *In re Lombardo*, 370 B.R. 506, 514 (Bankr. E.D.N.Y. 2007) (dismissing Chapter 7 for bad faith after considering debtor's income and expenses); *In re Jakovljevic-Ostojic*, 517 B.R. 119, (Bankr. N.D. Ill. 2014) (dismissing Chapter 7 for bad faith because debtor inflated expenses and had ability to repay debts).

¹⁹ 231 B.R. at 278.

²⁰ 931 F.2d 1124, 1126 (6th Cir. 1991).

²¹ *Id.* at 1127.

²² *Id.* at 1128.

²³ *Id.*

dismiss the Chapter 7 petition, the Sixth Circuit identified excessive and continued expenditures and lavish lifestyle as factors to be considered when evaluating that a petition had been filed in bad faith.²⁴

CHAPTER 11 PROCEEDINGS

Many of the Chapter 11 decisions have been in the context of an individual seeking to confirm a plan of reorganization. For example, in *In re Weber*,²⁵ the court concluded a plan was not proposed in good faith when the debtor lived a lavish lifestyle and sought to pay creditors five percent under the plan. In that case, the debtor wanted to maintain two homes, travel extensively and retain his membership in a private golf club.²⁶ His post-petition travel included trips to China, Bermuda, Florida, Arizona, Utah, Vermont, and Switzerland.²⁷ The court criticized the debtor for his extensive travel and an extravagant monthly budget (including \$1,012 for newspapers).²⁸

The court concluded that: “The record could not be more clear that the trips were extravagant in light of the Debtor’s bankruptcy, that the Debtor’s lifestyle was unreasonable, and that the Debtor’s conduct both offends the integrity of the system and sends a wrong message to the public. The message that this Debtor’s Plan and conduct send is that an individual may file a Chapter 11 petition and continue to live in luxury while paying a relative pittance to creditors.”²⁹ Reviewing the plan, the court concluded that a “debtor cannot file a Chapter 11 petition and claim an entitlement to live in the style to which he or she has become accustomed.”³⁰ As the court pointed out, the purpose of bankruptcy is to provide a debtor with a fresh start, not “to preserve a debtor’s extravagant lifestyle.”³¹

²⁴ *Id.* at 1129. See also *In re Adler*, 329 B.R. 406 (Bankr. S.D.N.Y. 20015) (debtor lacked good faith in seeking to convert Chapter 11 to Chapter 7 where he had substantial income and could have made plan payments).

²⁵ 209 B.R. 793 (Bankr. D. Mass. 1997).

²⁶ *Id.* at 796.

²⁷ *Id.*

²⁸ *Id.* at 799.

²⁹ *Id.* at 800.

³⁰ *Id.* at 800.

³¹ *Id.* See also *In re Belco Vending, Inc.*, 67 B.R. 234, 240 (Bankr. D. Mass. 1986) (denying confirmation to individual debtor whose sole objective was apparently to retain rights to live in a veritable manor house).

Similarly, in *In re Harman*,³² the court denied confirmation of a plan because the debtors' personal expenses under their proposed budget were too lavish to constitute fair and equitable treatment to unsecured creditors. The debtors sought to retain \$166,000 in non-exempt property while making insubstantial payments to creditors.³³ The court did not approve: "Firstly, we find the Debtors' budget to reflect the same unwillingness to curtail a high-cost lifestyle which the Court in *Devine* found impossible to tolerate from Chapter 11 debtors-in-possession."³⁴ The court denied plan confirmation and criticized the debtors for seeking to maintain their lavish lifestyle while proposing to pay creditors either 15 percent or payment in full over a 30 year period.³⁵

The individual debtor sought to confirm a plan of reorganization in *In re Osbourne*.³⁶ The husband debtor was a real estate broker and the couple owned a 4,200 square foot house, a vacation home, two luxury cars, had a son at private school and a son in college.³⁷ While the debtors anticipated significant income to fund the plan, they also proposed equally significant monthly expenses.³⁸ The bankruptcy administrator objected to the plan because the debtors' proposed repayments were inadequate given their substantial cash reserves and standard of living.³⁹ The second objection was that many of the debtors' expenses were excessive and unnecessary.⁴⁰ The court found that "based on the debtors' massive \$140,000 'war chest,' extremely high income, retention of substantial assets, and their spending habits," the proposed distribution of \$20,000 over five years did not indicate good faith.⁴¹

Perhaps the most egregious facts can be found in *In re Gosman*,⁴² where the individual debtor sought to liquidate a portion of his non-exempt assets for the creditors' benefit while retaining exempt assets. The latter included a \$40

³² 141 B.R. 878 (Bankr. E.D. Pa. 1992).

³³ *Id.* at 888.

³⁴ *Id.*

³⁵ *Id.* at 889.

³⁶ Bankr. E.D.N.C. May 30, 2013.

³⁷ *Id.*

³⁸ *Id.*

³⁹ *Id.*

⁴⁰ *Id.* See also *In re Walker*, 165 B.R. 994, 1002 (E.D. Va. 1994) (plan presented fundamental abuse of Chapter 11 in part because it did not commit full range of debtors' resources to repay creditors).

⁴¹ *Id.*

⁴² 282 B.R. 45 (Bankr. S.D. Ill. 2002).

million ocean-front Palm Beach mansion, an \$11 million art collection, a valuable antique collection, and an interest in a corporation that owned real estate valued at \$7.5 million.⁴³ The committee of unsecured creditors objected to the debtor's plan on the basis that it violated the "absolute priority"⁴⁴ rule and unsecured creditors were not being paid in full.⁴⁵ The debtor argued that exempt property did not count for purposes of retaining property under the "absolute priority" rule.⁴⁶

The court disagreed and could find no language in the Bankruptcy Code excluding exempt property from the effect of the "absolute priority" rule.⁴⁷ The court concluded that it could only approve a cram down if the debtor contributed all of his exempt property for the benefit of unsecured creditors, which he failed to do.⁴⁸

CONCLUSION

It appears that living a lavish lifestyle and having lots of money does not necessarily prevent individuals from filing for bankruptcy. Those attributes alone, without any malfeasance or misappropriation, will generally not result in the dismissal of a Chapter 7 proceeding. However, in Chapter 11 proceedings, it is more difficult to overcome judicial distaste for wealthy debtors who seek to maintain their lifestyle at the expense of their creditors. Most individual debtors who have sought plan confirmation while maintaining a decadent level of living and paying only cents on the dollar to creditors have been met with fierce resistance from creditors and bankruptcy judges. Typically, cases with those facts do not result in plan confirmation.

⁴³ *Id.* at 46.

⁴⁴ The "absolute priority" rule requires that no junior class of creditors or equity security holders retain property unless each of the senior classes has been paid in full. 11 U.S.C. § 1129(b)(2)(B)(ii).

⁴⁵ *Id.*

⁴⁶ *Id.* See also *In re Kemp*, 134 B.R. 413, 416–17 (Bankr. E.D. Cal. 1991) (denying Chapter 11 confirmation because ability to make substantially higher plan payments was indications of bad faith).

⁴⁷ *Id.* at 49.

⁴⁸ *Id.* at 53.