

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS**

IN RE:)	
)	
JARED DAVID GANO,)	Case No. 99-14363
)	Chapter 7
)	
Debtor.)	
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)	
REBECCA (GANO) SHULZ,)	
)	
Plaintiff,)	
)	
v.)	Adversary No. 00-5036
)	
JARED DAVID GANO,)	
)	
Defendant.)	
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MEMORANDUM AND OPINION

This matter comes before the Court as an adversary proceeding to determine the dischargeability under 11 U.S.C. §523(a)(15)¹ of defendant/debtor Jared Gano’s obligation under a divorce decree to hold harmless plaintiff Rebecca Shulz, his non-debtor former spouse, against recovery of a deficiency judgment resulting from the foreclosure sale of the home occupied by parties during their marriage. This matter came on for trial on December 19, 2000. Both parties testified and each offered exhibits which the Court received upon stipulation of their admissibility.

¹All statutory references are to the Bankruptcy Code, Title 11, United States Code, unless otherwise noted.

I. JURISDICTION.

The Court has jurisdiction over this adversary proceeding. 28 U.S.C. § 1334. This is a core proceeding. 28 U.S.C. § 157 (b)(2)(K).

II. FINDINGS OF FACT

Rebecca Shulz (“Rebecca”) and Jared Gano (“Jared”) were divorced on December 30, 1998 in Reno County, Kansas, District Court, Case No. 98 D 1047. Under the divorce decree entered in that case, Jared was responsible for payment of the first mortgage on the home, owed to Fleet Mortgage Company (“Fleet”), as well as the second mortgage owed to Master Financial Corporation (“Master”), debts which were joint debts of the parties. The parties further stipulated that Rebecca’s exception to discharge relates only to the judgment, if any, against the parties after foreclosure of the above-referenced mortgages.

According to a stipulated exhibit offered by Jared, Fleet took judgment in foreclosure against Rebecca in personam and Jared in rem, as well as against second mortgagee Master, on October 10, 2000 in Reno County, Kansas, District Court, Case No. 00 C 244.² On a date not disclosed to this Court, the state court later confirmed a sheriff’s sale of the home and entered a finding that the deficiency judgment payable to Fleet was approximately \$8,829.03 after sale of the property for \$35,316.12.³ In the foreclosure decree mentioned above, Master was not granted judgment, but the state court did find that Master retained a valid second mortgage on the property to secure an original indebtedness of approximately \$31,000 plus interest. Thus, this Court may assume that the amount of the deficiency owed by the parties is at least \$8,829.03 and could be as

²See Defendant’s Exhibit D.

³See Defendants’ Exhibit E.

much as \$39,829.03 plus accruing interest, although it is unclear from the Journal Entry that Master's debt was ever reduced to judgment.

A determination of whether the debtor has met his burden of proof under either element of §523(a)(15) requires close scrutiny of Jared's financial circumstances although both parties offered evidence concerning their respective situations. Jared was, at the time of filing, employed at Eaton Industries in Hutchinson, Kansas. According to the Schedule I he filed with his petition, he received approximately \$2,064/month gross wages and after payroll deductions for taxes and union dues, netted \$1,862/month. His expenses on Schedule J were \$1,685, leaving him approximately \$197 per month in disposable income. He had no reported dependents. At trial, Jared introduced his Exhibit F which purported to be a statement of his income and expenses today. Jared quit working at Eaton in July of 2000 (after the filing of this adversary) and began doing business as an "owner-operator" trucker. He leases an over-the-road truck and tractor and currently works for Brisk Transport which is a transit contractor for Dillon's. He is paid by the load and pays for fuel, taxes, truck lease, and truck repairs from his gross earnings. He has not checked on what his income taxes will be and has neither reserved nor paid in any estimates. He anticipates a slowing down of business between January and April and what money he has saved back he needs for that period. He anticipates Brisk will have the Dillon's contract for another two to three years at the currently set rates.

Jared's Exhibit F was a cash flow statement showing a gross monthly income of \$7,393, and after deduction of operating expenses directly attributable to the business, he nets about \$3,764 per month. However, Jared's substantial increase in take-home pay has been matched or exceeded by a substantial increase in his expenses. Further, Jared's exhibit made no reference to any withholding for income taxes and Jared testified that he has paid no estimated income tax in 2000.

If Jared's current monthly income is annualized, he can expect to pay income tax on approximately \$45,168 ($12 \times 3,764 = \$45,168$).⁴ According to the 1999 Tax Tables contained on IRS Form 1040, Jared as a single taxpayer will pay approximately \$9302 per year or \$725 per month in federal income tax, which will reduce his net income to approximately \$3,039 per month. This income estimate includes \$350 monthly child support owing to Jared's fiancé ("Tonya") by her former husband, but which support has not been recently paid. Jared's fiancé, with whom he lives and intends to marry at some undisclosed date, has worked for \$6 per hour in the past, but is currently unemployed. She lacks a high school degree and her employment options may be substantially limited.

Jared's expenses have, as noted above, substantially increased. Since the filing, Jared has cohabited with Tonya and her daughter, Kayla, who is 7 years old. Jared and Tonya have produced a child between them, Sophie, who was 8 weeks old at the time of trial. Jared testified that he supports Tonya and Kayla, along with the baby. Kayla has ear trouble and has had surgery paid for by Jared's health insurance (from Eaton through COBRA). Jared is paying some \$577 per month for this. He can expect to retain this coverage for about another 12 months. There were no children of the marriage of Jared and Rebecca.

The Court notes a number of non-support areas in which Jared's expenses appear higher than reason would permit, particularly given the youth of his business and the substantial expenses associated with it. For instance, the Court notes that Jared's housing expense has increased by nearly \$200/month and that his food cost has increased by \$300/month. His telephone expense has more than doubled, increasing by \$110/month. Additionally, he now uses a cellular phone which

⁴The Court was provided with no information regarding what Jared's deductions and credits might amount to, but, for these purposes, this approximation should be sufficient.

costs in excess of \$150/month whereas he had no cell phone before working for Brisk. He testified that he has premium cable TV service, costing some \$60/month, and where once he had one car payment of \$397/month per Schedule J, he now has two car payments totaling \$630/month, an increase of \$233/month. With the establishment of a new family, Jared has also incurred increases in medical expense of \$85, medical insurance of \$577, and diapers of \$200. As noted above, Jared's income tax liability will likely increase dramatically with the establishment of his new business. Thus, his expenses have increased by a total of \$1,915 while his income has only increased by \$1,117 after the taxes theorized by the Court.

Jared has incurred additional debt post-petition for vehicles. Tonya drives a Chevrolet Cavalier which was purchased with a loan from Peoples Bank of McPherson. Jared drives a Chevrolet Lumina acquired from Shep Chevrolet with a loan from Mrs. Shep, Shep Chevrolet's owner. Jared also pays Kent Berry \$735/month as a lease payment for his truck (this cost is considered in his net income).

Rebecca's financial situation is markedly different. She is virtually unemployed, but apparently has the ability to generate some income. She estimates an income of approximately \$60 per month. Rebecca does not work by choice because her husband has custody of his two children by a previous marriage in the summer. He pays \$190 per month for support of one of his children who lives in Wisconsin. Rebecca's husband's net pay is \$1200 per month. Each year she also receives \$17,216 on a 25 year annuity which began in 1993. This is a structured settlement from personal injuries incurred by her in an automobile accident. She has recently borrowed \$43,000 secured by her settlement and car. The proceeds of the loan went to buy the car and to pay off the credit card liabilities assigned to her in the divorce decree. Accordingly, she has no access to the annuity until 2005.

Rebecca's (and her husband's) expenses are minimal. She is making only one car payment and apparently gets the benefit of her husband's medical coverage. Her stated expenses total \$1,638 which is more than her family's income before considering the income from her annuity. However, if the annuity is attributed to her monthly income, it increases by \$1,434/month which leaves her family a substantial surplus of \$733/month after expenses.

III. ISSUES.

At issue here is whether Jared's duty to hold Rebecca harmless on the foreclosure deficiency debt is a debt which is excepted from Jared's discharge under §523(a)(15). In resolving this matter, the Court must address the following questions. First, the court considers whether Jared's obligation is one which arises in the course of a divorce proceeding or in connection with a divorce decree. If it is, then the Court must determine whether the debtor has the ability to pay the debt from income or property not reasonably necessary for the maintenance or support of himself or his dependents and for the payment of necessary expenditures for the continuation, preservation and operation of his business. §523(a)(15)(A). If the Court finds the debtor has the ability to pay, then the Court must decide whether discharge of this debt results in a benefit to him that would outweigh any detriment to his nondebtor spouse. §523(a)(15)(B).

IV. ANALYSIS.

This is a difficult case to resolve. In essence, the Court must decide whether Jared should be freed from this debt because of his strained financial circumstances while understanding that its decision may result in significant financial hardship to Rebecca who appears to have made every effort to honor her obligations under the divorce decree. There is neither dispute nor doubt that Jared's obligation to Rebecca under the divorce decree is a debt which was incurred in the course of or in connection with the divorce decree entered in Reno County as required by §523(a)(15)'s

prefatory language. The Court must then determine whether Jared can pay the debt without impairing his ability to support himself and his dependents or his business under §523(a)(15)(A). Jared has the burden of proof on this point and, should he prevail, he retains the burden of proof to demonstrate that the benefit of gaining discharge of this debt outweighs the detrimental consequences of the discharge to Rebecca. In re Johnson, 212 B.R. 662 (Bankr. D. Kan. 1997).

“Section 523(a)(15)(A) requires a showing by the debtor that he does not have the ability to pay the debt in question.” Johnson, 212 B.R. at 666. Many courts refer to the disposable income test contained in §1325(b)(2) to determine if the debtor has the ability to pay. See In re Hill, 184 B.R. 750 (Bankr. N.D. Ill. 1995). Jared asserts that he would be unable to repay the deficiency judgment which, as set out above, may be anywhere from \$8,000 to \$39,000 in amount. This places the reasonable necessity of his reported expenses in question. Jared’s expenses are in some respects excessive. His \$200 monthly phone bill is unreasonably high for his needs, as is his cellular bill of \$150. The court notes that his phone bills listed in Schedule J were a mere \$90/month.

Also of concern is Jared’s assumed “duty” of support to Tonya and her daughter. He testified that he intends to marry his fiancé, but that he has not adopted Kayla, yet many of his increased expenses are related to his newly “assumed” family situation. Are Tonya and Kayla “dependents” for the purposes of the statute? The bankruptcy code does not define the word “dependent.” Few bankruptcy cases have considered whether or when stepchildren are “dependents” for various purposes. Courts presented with this issue have looked to the legality of the obligation rather than the debtor simply having assumed it. For instance, in In re Dempton, 182 B.R. 38 (Bankr. W. D. Mo. 1995), the court addressed a motion to dismiss for substantial abuse under §707(b). The court found that deciding the case required the Court to treat debtor’s spouse’s

child support from a previous marriage as income and that a determination of the debtor's future reasonable expenses could include consideration of the cost necessary to support the debtor's spouse's children. Id. at 40(citing In re Braley, 103 B.R. 758, 760 (Bankr. E. D. Va. 1989)). Other courts have found that a filing by debtors was not substantial abuse even where they supported their grandchildren and adult children. See In re Wegner, 91 B.R. 854, 859 (Bankr. D. Minn. 1988). Thus, for disposable income purposes, some courts have held that support of individuals who are not necessarily legal dependents may be considered as a legitimate expense.

Other courts have held that only legal dependents' support should be considered in the disposable income determination. In In re Wilkins, 1997 WL 1047545 (Bankr. D. Minn., 1997), joint debtors sought to claim adult children as their "dependents." The court noted the "wide array" of decisions on this point, but determined that the "sounder" view was that unemancipated minor children and disabled adult children who were de facto dependent should be considered eligible for support which is deductible for disposable income purposes. This Court agrees that only legal dependents should be considered in such a determination.

In Kansas, parents have a legal obligation, the failure of which is punishable as a crime, to support their natural or adopted children, whether or not born within wedlock. Kan. Stat. Ann. §21-3605(a)(2). Therefore, in determining debtor's ability to pay the deficiency judgment, this Court will only consider expenses necessary and reasonable to support the debtor and his baby daughter as he has no legal obligation to support Tonya or her daughter.

Lacking any definitive evidence of what the expenses pertinent to one child may be, the Court is left to speculate as to how his expenses might be reduced. Jared's Schedule J listed a food expense of \$150/month, \$300/month less than now. His medical expenses were somewhat lower (\$15/month) and his medical insurance premiums were apparently paid by someone else.

Thus, his expenses related directly to himself, his sole legal dependent, and his business should be as follows:

EXPENSES	AMOUNT
Rent	\$ 700
Food	\$ 150
Phone	\$ 90
Utilities	\$ 150
Water	\$ 30
Cell Phone	\$ 75 ⁵
Cable TV	\$ 30
Clothing	\$ 50
Health Insurance	\$ 577
Medical Expense	\$ 75
Car Insurance	\$ 120
Car Tags	\$ 38
Transportation	\$ 80
Car Payments ⁶	\$ 380
	\$ 250
Diapers	\$ 200
Property Tax	\$ 41
Federal Income Tax (estimate)	\$ 725
Total Expenses	\$3761

⁵Debtor's current bill of \$150 seems excessive given the numerous opportunities available to obtain cell phone discount rates.

⁶The Court includes car payments for the Cavalier and Lumina in Jared's expenses because he is legally obligated on both notes.

Monthly Net Income	\$3764
Expenses Exceed Monthly Income	\$ 3

As shown above, even after taking into consideration a reduction of the debtor's stated expenses for his dependent, and before taking into consideration the currently unpaid child support of his fiancé which is a part of debtor's income projection, Jared will have very little income with which to pay a very substantial obligation without invading moneys reasonably necessary to support himself, his daughter and his trucking business.

The Court recognizes that Tonya appears to have the ability to work and produce income and that she could attempt to enforce her former husband's support obligation to increase their cash flow. Frankly, the Court is troubled by Jared undertaking a set of substantial, new obligations (supporting 3 people, acquiring two vehicles, and beginning a new and high-overhead business) when he was still ostensibly obligated to Rebecca to protect her on the marital obligation in question. Nonetheless, debtor's grasp on solvency is flimsy at best and it is on that point that § 523(a)(15) focuses. Even assuming Jared could manage a \$150 monthly payment to the deficiency creditors and that they would accept such an accommodation, he would face a twenty-year payout with no interest. Section 523(a)(15)(A) represents Congress' attempt to require debtors to pay obligations under domestic decrees to nondebtor spouses, but not to destitute themselves and their dependents in the process. In re McElroy, 229 B.R. 478, 482 (Bankr. M.D. Fla. 1998)(citing In re Christison, 201 B.R. 298 (Bankr. M.D. Fla.. 1996)). It appears to the Court that Jared will be very fortunate to avoid further extreme financial difficulty without being saddled with this obligation. The Court must therefore find that Jared has met his burden of proof as to §523(a)(15)(A): that he is unable to pay the foreclosure deficiency from income not reasonably necessary for the support

of himself, his dependent, or his business.

Although Jared having successfully shown his inability to pay this debt should resolve the case, the Court will also address the §523(a)(15)(B) “balancing” test. Application of this test requires the Court to determine whether the benefits conferred on the debtor by gaining a discharge of this debt will be outweighed by the detriment such a discharge might work on the nondebtor spouse. This requires a court to weigh a variety of factors including (1) the income and expenses of both parties; (2) whether the nondebtor spouse is jointly liable on the debt; (3) the number of dependents; (4) the nature of the debt; (5) whether the debt has been reaffirmed; and (6) the nondebtor spouse’s ability to pay. Johnson, 212 B.R. at 667.

Here, Rebecca’s financial situation, while strained, is not as precarious as Jared’s. In fact, before considering her annuity, Rebecca’s budget shows a negative cash flow. It is the presence of the annuity that lends another troubling factor to this case. Rebecca receives the annuity as a structured settlement for a personal injury. The annuity, while long-lived, is for a finite amount of money. Moreover, Rebecca has pledged her interest in the annuity to a bank until 2005. While the Court is sensitive to Rebecca’s concern that the annuity is not “like” income, the Court finds no authority to the contrary. While personal injury settlements are exempt in some states and under the federal exemption scheme set out in §522(d)(11), Kansas has opted out of the federal exemptions⁷ and there is no corresponding state law exemption of this asset. While the annuity may not be taxable as income⁸, it is nonetheless available, subject to any liens, to help fund

⁷K.S.A. §60-2312(a).

⁸26 U.S.C. §104(a)(2) (excluding awards of compensatory or punitive damages from gross income for federal income tax purposes). See Posin, Fed. Income Taxation of Individuals, 3rd Ed. West Publishing Co. (1997).

Rebecca's family needs. Were Rebecca a debtor in this court, the annuity proceeds would certainly be considered in determining the extent of her disposable income under the §1325 tests.

A brief view of the Johnson factors listed supra as applied to this case makes clear that Rebecca's detriment will not outweigh the benefits of a discharge to Jared. If the annuity is considered part of Rebecca's income, she has a surplus of approximately \$733 per month to service the deficiency debt. This leaves her with substantially more financial flexibility than Jared. Rebecca was jointly liable on the debts in question. Rebecca is her only dependent, while Jared has two actual dependents. Jared and Rebecca incurred the debt to finance their marital abode. Jared has not reaffirmed any debts in this case and, as noted above, Rebecca is more able to pay the deficiency than is Jared.

Thus, in considering the totality of the circumstances, this Court finds that a discharge of this indebtedness will benefit Jared more than it will disadvantage Rebecca. In so finding, this Court abides by Congress' express instruction as set out in §523(a)(15). The Court recognizes that Rebecca has held up her end of the divorce decree by paying the debts assigned to her and it is not without some misgiving that it rules against her today. Nevertheless, the terms of the statute and the cases interpreting it leave the Court no alternative.

V. Conclusion

The Court therefore finds that Jared has met his burden to prove his inability to pay the debts complained of and that the benefit he will derive from being discharged outweighs the detriment Rebecca will suffer thereby. THEREFORE, judgment will be entered for Jared Gano, defendant, on Rebecca Shulz' Complaint To Avoid Discharge Of Divorce Decree Obligation Of Debtor on a separate form. The foregoing are the findings of fact and conclusions of law of this

Court pursuant to Fed. R. Bankr. P. 7052.

IT IS SO ORDERED.

Dated at Wichita, Kansas, this 17th day of January, 2001.

ROBERT E. NUGENT, BANKRUPTCY JUDGE
UNITED STATES BANKRUPTCY COURT
DISTRICT OF KANSAS

CERTIFICATE OF SERVICE

The undersigned certifies that copies of the **MEMORANDUM AND OPINION** were deposited in the United States mail, postage prepaid on this 17th day of January, 2001, to the following:

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