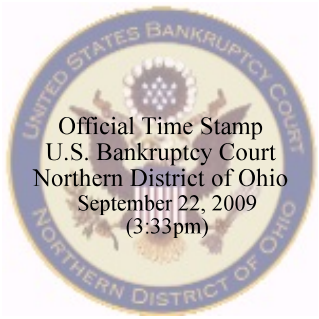
NOT FOR COMMERCIAL PUBLICATION

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION



In re:	)	Case No. 09-13920
	)	
VALENCIA L. KERN,	)	Chapter 7
	)	
Debtor.	)	Judge Pat E. Morgenstern-Clarren
	)	
	)	**MEMORANDUM OF OPINION**[1]

The United States trustee (UST) moves to dismiss this chapter 7 case under 11 U.S.C. § 707(b)(3) on the ground that the totality of the circumstances of the debtor's financial situation shows that granting the debtor a discharge would be an abuse of the bankruptcy system. The debtor Valencia Kern argues to the contrary. Because the United States trustee did not meet his burden of proof at trial, the motion to dismiss is denied.

JURISDICTION

Jurisdiction exists under 28 U.S.C. § 1334 and General Order No. 84 entered by the United States District Court for the Northern District of Ohio. This is a core proceeding under 28 U.S.C. § 157(b)(2).

FACTS

I.

The court held an evidentiary hearing on September 17, 2009. The United States trustee (UST) presented his case through the testimony of the debtor, as if on cross-examination; Philip

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Lamos, counsel to the chapter 13 trustee for the Northern District of Ohio at Cleveland; and John Weaver, a bankruptcy analyst with the UST's office. The debtor presented her case through her own testimony and cross-examination of the other witnesses. Both sides offered documents into evidence, and the court accepted all such documents without objection.

The following findings of fact are based on that evidence and reflect the court's weighing of the evidence presented, including determining the credibility of the witnesses. "In doing so, the Court considered the witnesses' demeanor, the substance of the testimony, and the context in which the statements were made, recognizing that a transcript does not convey tone, attitude, body language or nuance of expression." *In re The V Companies*, 274 B.R. 721, 726 (Bankr. N.D. Ohio 2002); *see also* FED. R. BANKR. P. 7052 (incorporating FED. R. CIV. P. 52). When the court finds that a witness's explanation was satisfactory or unsatisfactory, it is using this definition:

> The word satisfactory may mean reasonable, or it may mean that the Court, after having heard the excuse, the explanation, has that mental attitude which finds contentment in saying that he believes the explanation–he believes what the [witness] say[s] with reference to the [issue at hand]. He is satisfied. He no longer wonders. He is contented.

United States v. Trogdon (*In re Trogdon)*, 111 B.R. 655, 659 (Bankr. N.D. Ohio 1990) (internal citations and quotation marks omitted).

II.

The debtor Valencia Kern has been employed at St. Vincent Charity Hospital for 11 years as manager of the coding department. She considers her job to be stable, insofar, as she said, any job is stable in the current economy. She earned about $63,000.00 in 2007 and $59,000.00 in

2008. Her current gross monthly salary is $6,046.15. The debtor raised her three sons on her own; they are now 24, 30, and 38. The youngest son has special needs, having been diagnosed with clinical depression at age five, and later with attention deficit disorder. He lives out of state, works part time, and goes to school. The debtor sends him about $150.00 a month to assist him.

The debtor's financial troubles began in 2005. The debtor owns a two family house located at 2961 S. Moreland Boulevard, Cleveland, Ohio and lives in the upper unit. The house was originally owned by the debtor's mother, who lived in the lower unit. They had an agreement that the debtor would make the monthly payments on the note secured by a first mortgage on the property and her mother would make the tax payments. The debtor kept her end of their bargain, but her mother did not. The mother twice came to the debtor to tell her that the taxes were in arrears, and the debtor had to make arrangements to pay them. When the debtor's mother came to her in 2005 for the third time to say that the taxes had not been paid, the debtor responded that she would help only if her mother transferred the house to her. The mother agreed.

At that time, Option One held a note secured by a first mortgage on the house. National City Bank agreed to refinance the Option One note, subject to the debtor making significant repairs and the house being appraised at an appropriate value. After the debtor made the repairs, National City Bank declined to provide financing on the ground that the house values in that area would not support the loan.

The debtor then turned to HFC to refinance the loan. The debtor ran into problems in the course of the refinancing, including discovering that her mother had borrowed $20,000.00 from National City Bank and given it a second mortgage on the property. National City Bank agreed

to accept $13,000.00 to release its lien. According to the debtor, the final paper work shows that HFC "paid itself" $11,000.00 from the amount refinanced, a situation that the debtor is currently looking into. The bottom line is that the debtor borrowed $126,000.00 from HFC secured by a first mortgage on the house, which amount was used to pay Option One, National City Bank, some creditors of her mother, a few creditors of the debtor, and the $11,000.00 transfer noted above. After the house title transferred to the debtor, the debtor's mother paid monthly rent for the lower unit. The debtor is current with her payments to HFC.

The debtor also owns a rental property at 2908 E. 126th St. in Cleveland. HFC holds a first mortgage on that property as well.[2] That property was last rented out in 2004. The house was later vandalized by thieves who stripped out the copper and left the water running inside the house. The debtor was left with a flooded house and a $1,000.00 water bill. The debtor is surrendering this property in this chapter 7 case.

The debtor's mother died in April 2009. At that point, the debtor lost the monthly rental income her mother had been paying. In the meantime, the debtor's oldest son had moved into the lower unit in February 2009. He is unemployed, having lost his job following a traffic accident. This son has a personality disorder. The lower unit has black mold and other significant problems that must be fixed before the debtor can look for a paying tenant. The debtor cannot begin the repairs until her son moves out, but the son refuses to move.

In February 2009, HFC told the debtor that her monthly note payments would be increased from $1,149.00 to $1,449.80, for a period of one year, because of some unpaid taxes.

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[2] According to the debtor's schedules A and D, she owes HFC $59,190.00 on a note secured by a first mortgage on this property.

The debtor approached the county and negotiated a payment plan for the taxes. She then asked HFC to agree to this approach because she could not make the requested increased payments on her very "fragile" budget. Household refused to leave the note payment at the lower amount. The debtor then sought help from Neighborhood Housing, Community Development, Consumers Credit, Third Federal, Society, Buckeye Development, and the City of Cleveland. No one was able to assist. The debtor also took an on-line course that advised her to file a bankruptcy case. Feeling that she had no alternatives left, she filed this case on May 5, 2009.

The debtor scheduled secured debt in the total amount of $200,702.00; priority unsecured debt for real estate taxes on the E. 126th Street property in the amount of $1,163.32; and general unsecured debt in the amount of $56,148.03. While the testimony did not address the nature of the unsecured debt, the debtor testified that she lives a very modest life. She basically goes to work and comes home, which is consistent with her recreation budget of $10.00 a month. The only furniture in her house is a bed. She helps her youngest son, because of his special needs.

The debtor's amended schedule I shows a $28.16 monthly deduction from the debtor's paycheck for a whole life insurance policy on her life; the face amount of the policy is $120,000.00 and her sons are the beneficiaries. The debtor's amended schedule J also includes a monthly expense of $285.09 for life insurance. Based on the testimony, this seems to consist of four additional policies. The first is on the debtor's life ($50,000.00), with her sons as the beneficiaries. The monthly expense attributable to this policy is $127.86, $70.00 of which is to repay a loan on the policy and the remainder is the regular monthly payment. The second and third are policies on two of her sons' lives; $50,000.00 on her youngest son and $10,000.00 on her middle son. The fourth is a $25,000.00 policy on the life of her ex-husband. The debtor is

the beneficiary under the last three policies, which she said she maintains in part because she would be responsible for burial costs for her sons and her ex-husband should any one of them predecease her. The monthly payment for the policy on her middle son is $38.35. The combined payment for the policies on her youngest son and her ex-husband is $88.88, and no further breakdown was provided. The remainder of her insurance expense goes to repaying loans on two of these policies. The debtor purchased the $50,000.00 policy related to her youngest son so that he could borrow against it for school expenses, which is what he has done. She purchased the insurance on her ex-husband's life when the children were younger and he was not contributing to their support.

The debtor's amended schedule I also shows a monthly payroll deduction of $118.91 for a 401(k) contribution. The debtor testified that this is a voluntary expenditure, but that the payroll deduction can only be changed at one time during the year. There was no testimony as to the specific date on which the contribution can be changed. There is approximately $17,000.00 in her 401(k) account.

THE POSITIONS OF THE PARTIES

The UST contends that this case should be dismissed because the totality of the circumstances show that the debtor can propose a chapter 13 plan that would pay something more than 0% to unsecured creditors. He suggests that she can fund such a plan by applying funds from three sources: her ongoing 401(k) contributions, her current life insurance expenses, and the funds that will be available in mid-2010 when her house note payments go down. The debtor responds that she is living on a bare bones budget, she has acted responsibly throughout her life, her budget does not include the $150.00 support she provides for her son with special

needs, the note payment funds are not available for another year, she maintains the insurance for legitimate reasons, and when her total expenses and income are considered she would not be able to fund a chapter 13 plan.

DISCUSSION

Under bankruptcy code § 707(b)(1), the court "may dismiss a case filed by an individual debtor under [chapter 7] whose debts are primarily consumer debts . . . if it finds that the granting of relief would be an abuse of the provisions of [chapter 7]." 11 U.S.C. § 707(b)(1). The parties agree that the debtor's debts are primarily consumer debts. *See* 11 U.S.C. § 101(8). In a case such as this, where there is no presumption of abuse under § 707(b)(2), the court may still dismiss a case for abuse under § 707(b)(3), when "the totality of the circumstances . . . of the debtor's financial situation demonstrates abuse." 11 U.S.C. § 707(b)(3)(B).[3] As the movant, the UST has the burden of proving by a preponderance of the evidence that the case should be dismissed. *In re Baker*, 400 B.R. 594, 587 (Bankr. N.D. Ohio 2009).

In 2005, Congress amended the bankruptcy code to, among other things, lower the standard for dismissal from "substantial abuse" to simple "abuse." Courts considering a motion to dismiss under § 707(b)(3)(B) continue to use the same factors used before the 2005 amendments to determine whether a debtor is needy for purposes of determining substantial abuse. *See, for example, In re Mestemaker*, 359 B.R. 849, 856 (Bankr. N.D. Ohio 2007). Those factors include, but are not limited to:

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[3] The UST did not identify the subpart of § 707(b)(3) on which he was relying. Based on his brief and hearing arguments, the court reads his motion as being brought under § 707(b)(3)(B), rather than § 707(b)(3)(A) which provides for dismissal when a petition is filed in bad faith.

1. the debtor's ability to repay debt out of future earnings, based upon a hypothetical chapter 13 plan;

2. whether the debtor has a stable source of future income;

3. whether the debtor is eligible for chapter 13;

4. whether there are state remedies available to the debtor;

5. whether the debtor can obtain relief through private negotiations; and

6. whether the debtor can reduce expenses significantly without being deprived of necessities such as food, clothing and shelter.

Behlke v. Eisen (In re Behlke), 358 F.3d 429, 434 (6th Cir. 2004).

After considering all of the relevant factors, the court concludes that the UST did not meet his burden of proving that the totality of the debtor's financial circumstances demonstrate abuse. The UST is correct that the debtor is a long time employee at the hospital and appears to have a regular, stable source of future income. She is also eligible for chapter 13 relief based on the statutory limits for non-contingent, liquidated unsecured and secured debt in a chapter 13 case. *See* 11 U.S.C. § 109(e). The other factors, however, either balance strongly in the debtor's favor or are neutral.

The court is particularly struck by the efforts made by the debtor to obtain relief through private negotiations prior to filing. The evidence showed that she tried to gain control over her financial situation by having her mother transfer the house to her. When real estate taxes on one of the two properties became a problem, she tried to get relief by successfully negotiating with the county for a payment plan. This plan was intended to keep the debtor out of bankruptcy, had her mortgage lender been willing to accept it. HFC, however, was unwilling to do so. Instead,

HFC stuck to its legal position that the monthly mortgage payments on the note had to be increased, which precipitated the bankruptcy filing. The debtor also pursued other means of relief with banks and public agencies, and met with a similar lack of success. The UST did not identify any state remedy, or other relief, that would be available to the debtor if her case is dismissed.

The UST argues that the debtor will have enough income to repay debt out of future earnings in a hypothetical chapter 13 plan if she makes certain adjustments to her budget. First, he contends that, in a chapter 7, the fact that the debtor continues to make contributions to her 401(k) plan supports a finding of abuse. The debtor responds that if she filed a chapter 13, these contributions would be considered deductions from her current monthly income under 11 U.S.C. § 707(b)(2), so they should be irrelevant to this analysis. The UST relies on *In re Croskey*, No. 06-33437, 2007 WL 1302571 (Bankr. N.D. Ohio May 1, 2007) and *In re Gonzalez*, 378 B.R. 168 (Bankr. N.D. Ohio 2007), both of which stand for the proposition that 401(k) contributions may be considered under the abuse analysis. However, as the *Gonzalez* opinion notes, this type of contribution is not always inappropriate. Section 707(b)(3)(B) "being a 'totality of the circumstances' test, requires that a court consider all relevant factors, thus leaving open the possibility that situations will arise requiring that a debtor be permitted to expense against their 'disposable income' contributions and/or loan repayments to a retirement account." *Gonzalez*, 378 B.R. at 174. *Accord In re Tucker*, 389 B.R. 535, 540 (Bankr. N.D. Ohio 2008). The evidence in this case did not establish the debtor's age or what funds will be available to her at retirement. The schedules show that the debtor has few assets, basically a car and a house with black mold. If she wishes to stay in the house, at some point she will need to remove the black

mold, a process that is expensive to remedy, if a remedy is possible. Considering the debtor's overall situation, the evidence did not show that the 401(k) deduction is not a reasonably necessary expenditure.

The second expense that the UST focuses on is insurance. The UST acknowledged that it may be reasonable for the debtor to carry some amount of insurance to cover family burial expenses and also to provide for her youngest son on her death. He did not, however, quantify what an appropriate reduction would be or what such policies would cost. While some insurance expense is clearly appropriate, the court agrees that the evidence suggests that the debtor could decrease her insurance expenses, at least by limiting the policy on her ex-husband's life to burial expenses, now that her sons are grown. The debtor scheduled a monthly deduction and expenses for life insurance totaling $313.25. Even if the court were to determine that half of that amount is unnecessary, however, the debtor's budget does not include the $150.00 which she sends to her youngest son. Therefore, for all practical purposes, adding a substantial portion of the insurance expense back into the debtor's income would largely be canceled by taking the son's support payment back out.

The UST also argues that the debtor's monthly expenses will drop in May 2010 because her mortgage loan payment on her home will decrease by approximately $300.00 when she has satisfied the real estate tax arrearage. At that time, he contends, she will have $300.00 a month to pay her debtors in a chapter 13 plan. While it is reasonable to look ahead to the debtor's anticipated situation, it is also reasonable to consider the reality of today's situation. The debtor is clearly in need of financial relief today. If the debtor were to file a chapter 13, she would not have this $300.00 a month to pay to her creditors. In sum, the evidence did not show by a

preponderance of the evidence that the debtor would be able to repay debt out of her future earnings.

CONCLUSION

For the reasons stated above, the court concludes that the UST did not prove that permitting the debtor to maintain her chapter 7 case and receive a discharge would be an abuse of the bankruptcy system. The motion to dismiss is, therefore, denied. A separate order reflecting this decision will be entered.

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

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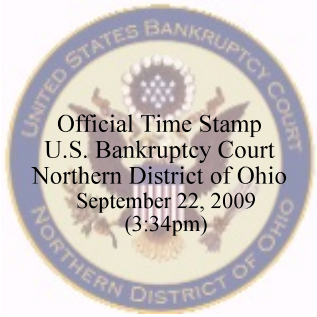

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VALENCIA L. KERN,	)	Chapter 7
	)	
Debtor.	)	Judge Pat E. Morgenstern-Clarren
	)	
	)	**ORDER**

For the reasons stated in the memorandum of opinion issued this same date, the United States trustee's motion to dismiss this case under 11 U.S.C. § 707(b)(3) is denied. (Docket 8).

IT IS SO ORDERED.

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge