IN THE UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re:	**In Proceedings Under Chapter 7**
Steven & Erin Kelly,	**Case No.: 09-21440**
Debtors.	**JUDGE RANDOLPH BAXTER**

MEMORANDUM OF OPINION AND ORDER

This matter is before the Court on the Motion to Dismiss Case Pursuant to 11 U.S.C. § 707(b)(1) and (3) (the "Motion") filed by the United States Trustee for Region 9 (the "Trustee") over the objection of Steven and Erin Kelly (the "Debtors"). This Court acquires core matter jurisdiction over this matter pursuant to 28 U.S.C. §§ 157(a), (b)(1), 28 U.S.C. § 1334 and General Order No. 84 of the District.

A hearing was held upon due notice to all entitled parties. After considering the record, generally, arguments of counsel and evidence adduced, the following constitutes the Court's factual findings and conclusions of law:

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The Debtors filed their voluntary petition for relief under Chapter 7 of the Bankruptcy Code on December 3, 2009. The co-debtors have been employed as educators in secondary school systems for fourteen years, with a combined annual income of $105,000 a year. Notedly, however, their gross income is listed as $96,667 on their Statement of Financial Affairs. As teachers, the Debtors must contribute 10% of their income to the mandatory state teacher retirement fund. Despite the mandatory contribution, the Debtors are above median income.

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Their petition schedules reflect monthly expenses of $6,676 against monthly net income of $6,529. Of their expenses, the Debtors list a first and second mortgage totaling $2,328 and three student loan payments totaling $286. The schedules also indicate that the Debtors have $134,122.18 of unsecured non-priority claims scheduled for discharge.

The U.S. Trustee filed the Motion to Dismiss for Abuse based on the totality of the Debtors' circumstances. First, the U.S. Trustee asserts that the Debtors' mortgage, which constitutes approximately 30% of their net monthly income, is more than twice the IRS standard for their household size and geographical location. He contends that the high mortgage expense should be factored into the totality of the circumstances analysis. Second, the U.S. Trustee asserts that it is improper for the Debtors to claim their student loan payments as an expense. The U.S. Trustee also argues that the student loans are unsecured debt and cannot be given preferential treatment over other unsecured debt. As such, the $286 monthly student loan payment should be used to pay all unsecured creditors under a Chapter 13 plan. Finally, the U.S. Trustee asserts that the Debtors received a tax refund that can be devoted to fund a Chapter 13 plan.

The Debtors disagree with the U.S. Trustee's assertions. Specifically, they deny the existence of any disposable monthly income. The Debtors contend that, although they have not paid their student loans since the commencement of their bankruptcy, they do not have extra income. They assert that the $286 used to pay their student loans are now used to pay household expenses. Furthermore, the Debtors argue that they only received a tax refund because of certain childcare related tax deductions. They assert that the tax refund only occurs yearly. The Debtors contend that they cannot change their tax exemptions to receive more money each month and

less refund at the end of the tax year.

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The dispositive issue before this Court is whether the Debtor's petition for relief, as amended, constitutes an abusive filing.

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Section 707 of the Bankruptcy Code provides for dismissal of a Chapter 7 case or conversion to a case under Chapter 11 or 13. A case is dismissed where a court finds that the granting of relief would constitute an abuse of the Chapter 7 provisions.

Title 11 U.S.C. § 707(b) states the following:

> (b)(1) After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, trustee (or bankruptcy administrator, if any), or any party in interest, may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts, or, with the debtor's consent, convert such a case to a case under chapter 11 or 13 of this title, if it finds that the granting of relief would be an abuse of the provisions of this chapter. In making a determination whether to dismiss a case under this section, the court may not take into consideration whether a debtor has made, or continues to make, charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to any qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4)).
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> (2)(A)(i) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter, the court shall presume abuse exists if the debtor's current monthly income reduced by the amounts determined under clauses (ii), (iii), and (iv), and multiplied by 60 is not less than the lesser of--
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> (I) 25 percent of the debtor's nonpriority unsecured claims in the case, or $6,000, whichever is greater; or
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> (II) $10,000.

Section 101(8) of the Bankruptcy Code defines "consumer debt" as "debt incurred by an individual primarily for a personal, family, or household purpose."

If the presumption of abuse does not arise under Section 707(b)(2), or is rebutted, then

the court considers the totality of the circumstances under 11 U.S.C. § 707(b)(3):

> (3) In considering under paragraph (1) whether the granting of relief would be an abuse of the provisions of this chapter in a case in which the presumption in subparagraph (A)(i) of such paragraph does not arise or is rebutted, the court shall consider--
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> (A) whether the debtor filed the petition in bad faith; or
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> (B) the totality of the circumstances (including whether the debtor seeks to reject a personal services contract and the financial need for such rejection as sought by the debtor) of the debtor's financial situation demonstrates abuse.

Section 707(b)(2)(A) of the Bankruptcy Code sets forth the criteria for a presumption of abuse and constitutes the means test for a debtor's ability to repay his debts. The means test is a form that presents a statement of the debtor's current monthly income and shows whether or not a presumption of abuse arises as a consequence of identifying monthly disposable income in excess of the limits described under Section 707(b)(2)(A)(ii), (iii) and (iv). A debtor's monthly disposable income is determined by deducting certain allowances and other expenses from the debtor's current monthly income. A presumption of abuse arises and the debtor fails the means test if the debtor's monthly disposable income is sufficient to show that he can repay at least $100 monthly to unsecured creditors over 60 months or 25% of the debtors unsecured debts, if that amount is greater than $6,000, or $166.67 per month to unsecured creditors over 60 months, if $10,000 is less than 25% of the unsecured debt.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") has amended the Bankruptcy Code in ways that impact the present Motion. First, BAPCPA removed the express presumption in favor of granting the relief requested by the debtor and, second, BAPCPA added § 707(b)(3) to the Bankruptcy Code as an additional basis for dismissal of a

Chapter 7 debtor's bankruptcy case. *See* 11 U.S.C. § 707(b).

Pre-BAPCPA, a United States Trustee seeking dismissal of a chapter 7 case bore the burden of overcoming the strong presumption in favor of granting the discharge requested by the debtor. *In re Farrell*, 150 B.R. 116, 118 (Bankr. D.N.J. 1992). Historically, courts treated the pre-BAPCPA presumption in favor of granting the relief requested by the debtor as a "caution and reminder" for the court to "give the benefit of any doubt to the debtor and dismiss a case only when a substantial abuse is clearly present." *In re Kelly*, 841 F.2d 908, 917 (9th Cir.1988); *see also In re Krohn*, 886 F.2d 123 (6th Cir. 1989). BAPCPA eliminated the substantial abuse standard utilized in determining if a debtor's case required dismissal and adopted a lower standard of abuse in considering a motion under § 707(b). *See* 11 U.S.C.§ 707(b)(3).

Pre-BAPCPA, a debtor's case could be dismissed for substantial abuse based upon either lack of honesty or want of need. *See Behlke v. Eisen (In re Behlke)*, 358 F.3d 429 (6th Cir.2004); *see also In re Krohn*, 886 F.2d 123 (6th Cir.1989). BAPCPA codified the lack of honesty and want of need factors under § 707(b)(3). Therein, a debtor's case can be dismissed for abuse upon either bad faith (i.e. lack of honesty) or where the totality of the circumstances of the debtor's financial situation demonstrates abuse (i.e. want of need). 11 U.S.C. § 707(b)(3); *See In re Oot*, 368 B.R. 662, (Bankr. N.D. Ohio 2007); *In re Wright*, 364 B.R. 640, (Bankr. N.D. Ohio 2007); *In re Henebury*, 361 B.R. 595 (Bankr. S.D. Fla. 2007); *In re Mestemaker*, 359 B.R. 849 (Bankr. N.D. Ohio 2007); *In re Simmons*, 357 B.R. 480 (Bankr. N.D. Ohio 2006). "It is a closely related fundament of statutory construction that, where Congress codifies prior case law, those prior holdings remain not only good law, but should serve as a valuable touchstone for interpreting the statute." *In re Oot*, 368 B.R. 662, 666 (Bankr. N.D. Ohio 2007) (*citing CoStar Group Inc. v.*

LoopNet, Inc., 373 F.3d 544, 553 (4th Cir.2004)). Therefore, pre-BAPCPA decisions provide sound guidance and are instructive in evaluating motions to dismiss.

Section 707(b)(3) grants a court the authority to dismiss a Chapter 7 case, where the presumption of abuse does not arise, for either bad faith or the totality of the circumstances if the debtor's financial situation demonstrates abuse. 11 U.S.C. § 707(b)(3). Since there have been no allegations of bad faith brought by the Trustee against the Debtor, the Court's consideration herein is focused on the totality of the circumstances.

The Bankruptcy Code does not define the phrase "totality of the circumstances." Notwithstanding, two pre-BAPCPA Sixth Circuit Court of Appeals decisions, *Behlke v. Eisen (In re Behlke)*, 358 F.3d 429 (6th Cir.2004) and *In re Krohn*, 886 F.2d 123 (6th Cir.1989), provide guidance regarding the totality of the circumstances test for dismissal under § 707(b). Among the factors to be considered in deciding whether the totality of the circumstances warranted a dismissal of the debtor's case under § 707(b), the *Krohn* court opined:

> A court would not be justified in concluding that a debtor is needy and worthy of discharge, where his disposable income permits liquidation of his consumer debts with relative ease. Other factors relevant to need include whether the debtor enjoys a stable source of future income, whether he is eligible for adjustment of his debts through Chapter 13 of the Bankruptcy Code, whether there are state remedies with the potential to ease his financial predicament, the degree of relief obtainable through private negotiations, and whether his expenses can be reduced significantly without depriving him of adequate food, clothing, shelter and other necessities.

In re Krohn, 886 F.2d at 126; *accord Behlke v. Eisen*, 358 F.3d at 435. Additionally, to meet the burden established in 11 U.S.C. § 707 (b) for dismissal, the Trustee, who is the moving party, must prove by a preponderance of the evidence that the debts in question are consumer debts, and that

granting relief would constitute abuse. *In re Browne*, 253 B.R. 854, 856-857 (Bankr. N.D. Ohio 2000).

To determine whether a debtor can significantly reduce his expenses, courts will look to the debtor's scheduled expenses to determine their reasonableness. *In re Mooney*, 313 B.R. 709, 715 (Bankr. N.D. Ohio 2004). This is not to say, however, that a court must simply accept the expense amounts a debtor schedules as necessary. In determining the reasonableness of a debtor's expenses, a court must scrutinize those provided expenses and may "make downward adjustments where necessary." *In re Felske*, 385 B.R. 649, 655 (Bankr. N.D. Ohio 2008). Although a debtor need not reduce his expenses in such a way that he is living in poverty, the Bankruptcy Code envisions some sacrifice on the debtor's part in granting him relief. *Id.* at 656. A court need not get bogged down in minute details of the debtor's expenses, but the debtor must demonstrate that he is making some sacrifices to repay unsecured creditors. *In re Mars*, 340 B.R. 844, 850 (Bankr. W.D. Mich. 2006).

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Herein, the U.S. Trustee asserts that the Debtors' case should be dismissed in light of the totality of the circumstances surrounding the Debtors' ability to pay their unsecured creditors. Specifically, the U.S. Trustee argues that 1) the Debtors pay their student loans to the detriment of other unsecured creditors and instead should dedicate these funds to a Chapter 13 plan; 2) the Debtors each year receive and will expect to continue to receive a tax refund that may be used to fund a Chapter 13 plan and 3) the Debtors' expenses exceed that of the IRS standards and these excessive expenses should be considered when analyzing the totality of the circumstances. The U.S. Trustee acknowledges that the presumption of abuse under 707(b)(2) does not arise as the Debtors' monthly disposable income does not meet the requirements under that specific

subsection.

Although Schedules I and J provide a glimpse into the Debtors' financial situation, the schedules are a starting point and are not necessarily the final authority on the Debtors current financial situation for the calculation of disposable income. *In re Petro,* 395 B.R. 369, 378 (6th Cir. B.A.P. 2008); *In re Goble,* 401 B.R. 261, 277 (Bankr.S.D. Ohio 2009). Although the Debtors scheduled their student loan payments as a monthly expense on their bankruptcy schedules, the Debtors testified to having only made one payment to one of the three student loans since the filing of their bankruptcy petition. (Schedule J; S. Kelly, Direct). Repayment of student loans may not be preferred over other unsecured creditors except under special circumstances. *See In re Vaccariello*, 375 B.R. 809 (Bankr.N.D. Ohio 2007). Therefore, the Debtors, in theory, should have $286 of disposable monthly income if they devoted the funds used to pay their student loans to a Chapter 13 plan. (See, Schedule J). The Debtors testified, however, that these funds are no longer available as they are now used to pay for household and necessary expenses, which, prior to their bankruptcy filing, were being paid with credit cards. (S. Kelly, Direct).

Second, the U.S. Trustee argues that the Debtors excessive mortgage expense should be included in the totality of the circumstances analysis. The Court, however, is not convinced of this argument. The Debtors purchased their home seven years ago. In an attempt to improve the value of their home, the Debtors took out a home equity line of credit, among other efforts, shortly after the purchase of their home. As a result of the economic downturn, the Debtors' home suffered a loss in value and selling the home was not practical. (S. Kelly, Direct). The Debtors now have a large amount of unsecured debt and an underwater mortgage. Such

testimony was unrefuted. These circumstances do not point to abuse and at no time did the Court find these Debtors' testimony to be incredible. In fact, the Debtors' circumstances are aligned with the goals of the bankruptcy process which is to provide honest but financially distressed debtors a fresh start. Although the Debtors testimony was credible, the Court finds the purchase of two brand new vehicles on the eve of bankruptcy troubling for several reasons.

First, the Debtors argue that they purchased two new vehicles four (4) months prior to filing bankruptcy, despite owning two fairly late model cars, to save money. They contend that the maintenance costs for their previous cars was too expensive and that the overall cost to maintain the new vehicles would be less. The Debtors, however, provided no evidence to support this conclusion. Instead, the evidence indicates that the vehicle purchases actually increased their monthly vehicle debt by $200. (See, Exh. 2-16). Second, the increase in their monthly vehicle debt negatively impacts other unsecured creditors because it decreases the amount available to fund a Chapter 13 Plan. The U.S. Trustee argues that the Debtors could provide a 24% dividend to their unsecured creditors with their tax refund alone, however, the extra $200 could increase this dividend. (C.Lowman, Direct). Lastly, the Debtors' intentions to retain both new vehicles and reaffirm the total vehicle debt of $817/month, while simultaneously seeking to discharge $134,000 of unsecured debt detrimentally affects other creditors. (See, Exh. 2-36; Exh. 8). The Debtors again show preference of one unsecured creditor over other older unsecured debt.

Finally, the U.S. Trustee asserts that the Debtors yearly income tax refund should be used to fund a Chapter 13 plan. Several courts have recognized that, for the purposes of calculating a debtor's income under §707(b)(3), tax refunds may be used as long as there is a realistic

expectation that the refunds will continue prospectively. *In re Pandl,* 407 B.R. 299, 302 (Bankr.S.D. Ohio 2009); *In re Gonzalez,* 378 B.R. 168 (Bankr.N.D. Ohio 2007). Herein, the Debtors testified to receiving a tax refund for the past several years but argue that the refund will probably decrease in the future.[1] (See, Exh. 5). Taking into account the changes to the Debtors' income and available tax credits, the U.S. Trustee argues that Debtors still expect to receive approximately $3,000 annual tax refunds for future tax years which could be used to fund a Chapter 13 Plan. (C.Lowman, Direct). This assertion was undisputed. Thusly, the U.S. Trustee has met his burden of proof to show that allowing these Debtors to continue under Chapter 7 would be an abuse of the bankruptcy process based on the totality of the circumstances.

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Accordingly, the U.S. Trustee's motion to dismiss pursuant to 11 U.S.C. §§ 707(b)(3) is granted, and the Debtors' case is hereby dismissed. The Debtors' objection is hereby overruled. Each party is to bear its respective costs.

IT IS SO ORDERED.

JUDGE RANDOLPH BAXTER
UNITED STATES BANKRUPTCY COURT

Dated, this 19th day of May, 2010

[1] The decrease in the Debtors tax refund is two fold: 1) for this tax year the Debtors received a one-time tax credit for two vehicle purchases and for the "making work pay" credit and 2) the Debtors testified that Mr. Kelly will no longer be coaching. The loss in supplemental income will also affect their tax refund.