

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
WESTERN DIVISION

In Re:) Case No. 04-36695
)
Joseph Kevin Pannell) Chapter 7
Rachel Lee Pannell,)
)
Debtors.) JUDGE MARY ANN WHIPPLE

MEMORANDUM OF DECISION AND ORDER
REGARDING MOTION TO DISMISS

This case came before the court for hearing on the United States Trustee's ("UST") Motion to Dismiss [Doc. # 12] and Debtors' opposition [Doc. # 15]. The UST moves to dismiss Debtors' Chapter 7 case for substantial abuse under 11 U.S.C. § 707(b). He argues that Debtors have misled the court by under-reporting their income on their bankruptcy schedules and have sufficient disposable income to fund a Chapter 13 plan and pay all of their unsecured debt.

The court has jurisdiction over this case pursuant to 28 U.S.C. §1334 and the general order of reference entered in this district. Proceedings to determine the dismissal of a case under § 707(b) are core proceedings that the court may hear and decide. 28 U.S.C. § 157(b)(1) and (b)(2)(A). Regardless of whether or not specifically referred to in this decision, the court has examined the submitted materials, weighed the credibility of the witnesses, considered all of the evidence, and reviewed the entire record of the case. Based upon that review, and for the following reasons, the UST's motion will be granted.

FACTUAL BACKGROUND

Debtors filed their Chapter 7 petition on August 10, 2004. They live in Lima, Ohio, are married and have two children, ages 15 and 19. The nineteen year old now attends college out-of-state. Joseph Pannell is 39 years old and is employed by the Ohio Department of Rehabilitation and Corrections at a correctional facility in Marion, Ohio. Rachel Pannell is 41 years old and is employed by the Heart Institute of Northwest Ohio as a nuclear medicine technician. Although Mr. Pannell has been transferred twice after the closure by the State of Ohio of the Lima correctional facility, there is no evidence suggesting that their current employment is anything but stable.

Debtors' bankruptcy Schedule I indicates that their combined gross monthly income is \$6,822,

and their combined net monthly income is \$4,701. Although these figures indicate a gross annual income of \$81,864, Debtors' 2003 and 2004 income tax returns indicate that they earned \$102,571 and \$103,231, respectively. There is no suggestion that Debtors' income has decreased for any reason. Thus, Debtors' actual monthly income, considering their 2004 annual income less approximately thirty percent in withholding taxes and other payroll deductions,¹ is \$6,021. Schedule I also indicates that, in addition to withholding taxes, Rachel Pannell's payroll deductions include contributions to her 401k plan of \$236 per month. Although Debtors also received income tax refunds for 2002 and 2003 in the amount of \$4,614 and \$7,420, respectively, they have adjusted the amounts being withheld from their paychecks and received (or will receive) only \$ 1,143 for 2004.

Debtors' Schedule J indicates that their monthly expenses total \$4,616. Their itemized expenses include payments totaling \$1,150 on three automobiles and a boat. Although Debtors have reaffirmed their debt on two of the automobiles, a 2000 Dodge Neon and a 2000 Chevrolet Silverado, they indicated at the hearing on the motion that they are not reaffirming the debt on the third vehicle or the boat. Monthly payments on the 2002 Chevrolet Impala and the boat that are not being reaffirmed total \$577. Other adjustments to Debtors' Schedule J include a \$300 monthly second mortgage payment inadvertently omitted and an increase in their first mortgage payment from \$600 to \$703 to correctly reflect the payment of property tax and insurance as components of the mortgage payment. With these adjustments, together with the payments on the boat and car that are no longer necessary, Debtors' monthly expenses total \$4,442.

Debtors offered into evidence a summary of their check register for the twelve month period before filing their Chapter 7 petition. (Debtors' Ex. 1). The register indicates a negative balance at the end of seven out of twelve months during that period. But the register also includes purchases and payments well beyond those provided for in Schedule J. Explaining several of the entries, Joseph Pannell testified that their expenses include private school tuition for their son, music lessons and driver's education classes. In addition, the register includes payments for, among other things, cell phone expenses averaging

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Debtors' Schedule I indicates payroll deductions totaling 28% from Joseph Pannell's gross pay. Rachel Pannell's withholding taxes total approximately 32%.

approximately \$130 per month.

Debtors are current on the mortgage payments on their home, which is valued at \$92,000 and

is subject to first and second mortgages totaling \$88,929. Debtors' home was refinanced in 2003, at which time they also obtained a loan secured by a second mortgage. According to Joseph Pannell, most of the unsecured debt that they currently owe was incurred after that time. Debtors' Schedule F lists \$49,892 in unsecured nonpriority debts. An additional \$2,619 represents the unsecured portion of the debts owed on the boat and car that Debtors are not reaffirming. Thus, Debtors' total unsecured debt is \$52,511. Of this amount, Debtors owe \$17,595 on student loan debt that they concede is nondischargeable and for which they have provided for payment on Schedule J. The balance of their unsecured debt totals \$34,915, almost all of which consists of credit card debt. Joseph Pannell testified that they attempted a repayment program through a credit counselor but were unable to continue payments under the program after he was transferred to work at a location requiring a significant increase in transportation costs, which Debtors list at \$400. However, no major medical expenses, unemployment, or other unexpected financial crisis precipitated Debtors' bankruptcy filing.

LAW AND ANALYSIS

Section 707(b) provides as follows:

After notice and a hearing, the court, on its own motion or on a motion by the United States trustee, . . . may dismiss a case filed by an individual debtor under this chapter whose debts are primarily consumer debts if it finds that the granting of relief would be a substantial abuse of the provisions of this chapter. There shall be a presumption in favor of granting the relief requested by the debtor.

11 U.S.C. § 707(b). Viewed in light of the court's ability to raise the substantial abuse issue sua sponte, it appears that the presumption in favor of granting relief under Chapter 7 is something other than simply a rule regarding the burden of production and burden of proof. *In re Kelly*, 841 F.2d 908, 917 (9th Cir. 1988). It is "in reality a caution and a reminder to the bankruptcy court that the Code and Congress favor the granting of bankruptcy relief, and that accordingly 'the court should give the benefit of any doubt to the debtor and dismiss a case only when a substantial abuse is clearly present.'" *Id.* (citation omitted); 4 Alan N. Resnick, et al., *Collier on Bankruptcy* ¶ 15th ed. 2003); see also *In re Krohn*, 886 F.2d 123, 128 (6th

Cir. 1989) (referring to the presumption found in § 707(b) as a “statutory preference” in favor of granting relief).

Debtors have stipulated that their debts consist primarily, if not entirely, of consumer debts.

Thus, the first prerequisite for dismissal under § 707(b) has been satisfied. The second prerequisite requires a finding that the granting of relief under Chapter 7 would be a substantial abuse.

The Bankruptcy Code does not define “substantial abuse.” Instead, its meaning was left to be determined by the courts. The amendment that added subsection (b) to § 707 was enacted in 1984 in response to an increasing number of bankruptcies being filed by people perceived as non-needy debtors. *Krohn*, 886 F.2d at 126 (quoting S. Rep. No. 65, 98th Cong., 1st Sess. 53, 54 (1983)). The legislative history indicates that the amendment “was intended to uphold ‘creditors’ interests in obtaining repayment where such payment would not be a burden.” *In re Laury-Norvell*, 157 B.R. 14, 16 (Bankr. N.D. Ohio 1993) (quoting S. Rep. No. 65, 98th Cong., 1st Sess. 53, 54 (1983)). While courts that have addressed the issue have developed various formulations for analyzing whether the filing of a debtor’s petition rises to the level of “substantial abuse,” see *In re Attanasio*, 218 B.R. 180 (Bankr. N.D. Ala. 1998) (providing an exhaustive discussion of the various standards employed), this court is bound by the approach set forth by the Sixth Circuit in *Krohn*.

In *Krohn*, the court held that “substantial abuse can be predicated upon either lack of honesty or want of need.” *Id.* at 126. The court set forth a totality of the circumstances test to determine whether the debtor is “merely seeking an advantage over his creditors, or instead is ‘honest,’ in the sense that his relationship with his creditors has been marked by essentially honorable and undeceptive dealings, and whether he is ‘needy’ in the sense that his financial predicament warrants the discharge of his debts in exchange for liquidation of his assets.” *Id.*

The UST argues that substantial abuse may be found in that Debtors misled the Trustee and their creditors by significantly under-reporting their income on Schedule I. Debtors’ good faith and candor in filing their bankruptcy schedules is certainly relevant to ascertaining their honesty in dealing with their creditors. See *id.* Debtors’ counsel suggests that the discrepancy in Debtors’ reported income on Schedule I and their income reported to the Internal Revenue is due to counsel’s error in preparing the document. While the court notes that by signing their petition, Debtors declared under penalty of perjury

that the information provided in the petition and schedules is true, correct and complete, the court accepts counsel's representation and finds that Debtors income was inadvertently understated and does not impugn their honesty.

The UST also argues that Debtors are not "needy" such that discharge of their debts is

warranted. One of the primary factors to be considered when determining whether a debtor is needy "is his ability to repay his debts out of future earnings." *Id.* Indeed, "that factor alone may be sufficient to warrant dismissal for substantial abuse." *Id.* The Sixth Circuit explained that "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." *Id.* Other factors to be considered include "whether the debtor enjoys a stable source of 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." *Id.* at 126-27.

In order to determine whether a debtor has the ability to pay, courts often evaluate whether the debtor has sufficient disposable income to fund a Chapter 13 plan. *Behlke v. Eisen (In re Behlke)*, 358 F.3d 429, 435 (6th Cir. 2004). "Disposable income" is defined as "income which is received by the debtor and which is not reasonably necessary to be expended . . . for the maintenance or support of the debtor or a dependent of the debtor. . . ." 11 U.S.C. § 1325(b)(2).

In this case, Debtors' monthly net income, adjusted to reflect their income reported on their 2004 income tax return, is approximately \$6,021. Their listed monthly expenses, adjusted as indicated earlier in this opinion, total \$4,442, providing Debtors with \$1,579 of disposable income that they could use to repay their debt. In addition, Rachel Pannell contributes \$236 per month to her 401k plan. That expenditure is not necessary for the maintenance or support of Debtors or their dependents. *See Behlke*, 358 F.3d at 435-36 (applying in the context of a § 707(b) motion the reasoning in *Harshbarger v. Pees (In re Harshbarger)*, 66 F.3d 775 (6th Cir. 1995), that it would be unfair to creditors to allow debtors "to commit part of their earnings to the payment of their own retirement fund while at the same time paying their

creditors less than a 100% dividend.”).² Therefore, Debtors’ monthly disposable income, including the amount currently being contributed to the 401k plan, is \$1,815. Applying this amount to repayment of the unsecured debt of \$34,915 that

they seek to discharge under Chapter 7, Debtors would be able to repay 100 percent of the debt in less than two years.

While the Sixth Circuit clearly stated that a debtor’s ability to pay their debts out of future earnings alone may support a finding of substantial abuse under § 707(b) and warrant dismissal of the Chapter 7 case, the court also considers other relevant factors. Debtors enjoy a stable source of income and are eligible for adjustment of their debts under Chapter 13. The court also considers the fact that Debtors lifestyle, while not lavish, is far from austere. Although the expenses listed in their adjusted Schedule J, as compared to their expenditures noted in their check registers, appear to reflect some “belt-tightening,” they are not reduced such that Debtors or their children are deprived of adequate food, clothing, shelter or other necessities. Debtors eat out often, have high monthly cable company bills and substantial monthly cell phone expense, all subject to reduction. Rather, even applying their disposable monthly income to repay their unsecured creditors, Debtors are still able to pay for private school tuition and to enjoy a generous monthly food budget of \$700 for the three family members at home.

Having considered the totality of the circumstances, and finding that Debtors’ disposable income permits repayment of their unsecured debt with relative ease, the court finds that any presumption in favor of granting relief is overcome and concludes that granting Debtors a discharge in this case would be a substantial abuse of the provisions of Chapter 7.

THEREFORE, for the foregoing reasons, good cause appearing,

IT IS ORDERED that the United States Trustee’s motion [Doc. #12] be, and hereby is, **GRANTED**. Debtors are granted thirty (30) days leave from the date of this order to file a motion to convert to a Chapter 13 case or the case will be dismissed.

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Mr. Pannell is also contributing by payroll deduction to his retirement account as a member in the State of Ohio Public Employees Retirement System. Such membership and contributions are mandatory under Ohio law. Ohio Rev. Code Ann. §§ 145.03(A), 145.47. Unlike 401k plan contributions, they cannot be voluntarily eliminated to provide disposable income with which to fund a Chapter 13 plan.

Mary Ann Whipple
United States Bankruptcy Judge