UNITED STATES BANKRUPTCY COURT

EASTERN DISTRICT OF WASHINGTON

In Re: STEPHENS, JACKIE E., Debtor.	No. 97-06242-W11 MEMORANDUM DECISION RE: CREDITOR MARIAH WOLFF'S MOTION TO DISMISS FOR BAD FAITH

THIS MATTER came on for hearing before the Honorable Patricia C. Williams on August 26, 1999 upon creditor Mariah Wolff's Motion to Dismiss for Bad Faith and Motion for Appointment of Examiner. The debtor was represented by Dan O'Rourke; creditor Mariah Wolff was represented by Victoria Vreeland; and Robert D. Miller, the Assistant United States Trustee, was present. The court reviewed the files and records herein, heard argument of counsel and was fully advised in the premises. The court now enters its Memorandum Decision.

Creditor Wolff filed a motion under 11 U.S.C. § 1307(c) to dismiss the case for cause and in the alternative to appoint an examiner under 11 U.S.C. § 1104(c). Creditor Wolff in her Motion to Dismiss for cause cites to 11 U.S.C. § 1307(c) which applies to petitions filed under Chapter 13. Although this petition was originally filed as a Chapter 13, the case was converted to a Chapter 11 on September 8, 1998. The applicable code section for

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dismissal for cause in Chapter 11's is 11 U.S.C. § 1112(b). The court will address creditor Wolff's motion pursuant to the applicable statute.

Section 1112(b) of the Bankruptcy Code provides that "on request of a party in interest . . . and after notice and a hearing, the court may . . . dismiss a case under this chapter . . . for cause. . . ." Although bad faith is not expressly mentioned, it has been incorporated into the section by judicial interpretation. See *In re Thirtieth Place, Inc.*, 30 B.R. 503, 505 (9th Cir. BAP (Ariz.) 1983); *Matter of Little Creek Dev. Co.*, 779 F.2d 1068, 1071 (5th Cir. (Tex.) 1986); *In re HBA East, Inc.*, 87 B.R. 248, 258 (Bankr. E.D.N.Y. 1988). The requesting party is not required to show malice in a challenge for bad faith. *In re Southern Cal. Sound Sys., Inc.*, 69 B.R. 893, 901 n. 2 (Bankr. S.D. Cal. 1987). The party is merely required to show that the case was filed "for a purpose other than that sanctioned by the Bankruptcy Code." *Id.*

"The existence of good faith depends on an amalgam of factors and not upon a specific fact. The test is whether a debtor is attempting to deter and harass creditors or attempting a speedy, efficient reorganization on a feasible basis." *In re Marsch*, 36 F.3d 825, 828 (9th Cir. 1994). Once a movant establishes the existence of a genuine issue concerning the debtor's lack of good faith, the debtor then bears the burden of proving good faith by a preponderance of the evidence. See *In re Setzer*, 47 B.R. 340, 345 (Bankr. E.D.N.Y. 1985); *In re Yukon Enterprises*, Inc., 39 B.R. 919, 921-22 (Bankr. C.D. Cal. 1984); *In re Spenard Ventures, Inc.*, 18 B.R. 164, 166 (Bankr. D. Alaska 1982).

The courts have considered lists of factors typically present in bad faith filings. The most influential list is found in the *Matter of Little Creek Development Co., supra.*

> Several, but not all, of the following conditions usually exist. The debtor has one asset, such as a tract of undeveloped or developed real property. The secured creditors' liens encumber this tract. There are generally no employees except for the principals, little or no cash flow, and no available sources of income to sustain a plan of reorganization or to make adequate protection payments pursuant to 11 U.S.C. §§ 361, 362(d)(1), 363(e), or 364(d)(1). Typically, there are only a few, if any, unsecured creditors whose claims are relatively small. The property has usually been posted for foreclosure because of arrearages on the debt and the debtor has been unsuccessful in defending actions against the foreclosure in state court. Alternatively, the debtor and one creditor may have proceeded to a standstill in state court litigation, and the debtor has lost or has been required to post a bond which it cannot afford. Bankruptcy offers the only possibility of forestalling loss of the property. There are sometimes allegations of wrongdoing by the debtor or its principals. The 'new debtor syndrome,' in which a one-asset entity has been created or revitalized on the eve of foreclosure to isolate the insolvent property and its creditors, exemplifies, although it does not uniquely categorize, bad faith cases.
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> Resort to the protection of the bankruptcy laws is not proper under these circumstances because there is no going concern to preserve, there are no employees to protect, and there is no hope of rehabilitation, except according to the debtor's 'terminal euphoria.'

Matter of Little Creek Development Co., supra, at 1073 (5th Cir. 1986).

Many types of factual situations have lead to allegations of bad faith. *In re Karum Group, Inc.*, 66 B.R. 436 (Bankr. W.D. Wa. 1986), determined that commencement of a reorganization proceeding solely to avoid the state law requirement of filing a supercedes bond constituted bad faith. *Southern Cal Sound Systems, supra,* determined that commencement of a reorganization proceeding solely for the purpose of rejecting an executory contract constituted bad

faith.

The Ninth Circuit held that if the purpose of the filing was not consistent with the purpose and spirit of the Bankruptcy Code, then cause exists to dismiss the Chapter 11.

> The term 'good faith' is somewhat misleading. Though it suggests that the debtor's subjective intent is determinative, this is not the case. Instead, the 'good faith' filing requirement encompasses several, distinct equitable limitations that courts have placed on Chapter 11 filings. [Cite deleted] Courts have implied such limitations to deter filings that seek to achieve objectives outside the legitimate scope of the bankruptcy laws. . . . Pursuant to 11 U.S.C. § 1112(b), courts have dismissed cases filed for a variety of tactical reasons unrelated to reorganization. While the case law refers to these dismissals as dismissals for 'bad faith' filing, it is probably more accurate in light of the precise language of section 1112(b) to call them dismissal 'for cause.'

Marsch, supra, at 827 (9th Cir. 1994).

This proceeding was commenced on November 14, 1997 as a Chapter 13. After a hearing on creditor's Motion to Dismiss on the basis of eligibility, on August 7, 1998 the court determined that the debtor was ineligible for Chapter 13 relief and on September 8, 1998 the debtor converted to a Chapter 11 proceeding. By agreement of the parties, testimony for this hearing was submitted in deposition form. The following factual conclusions result from the review of the deposition testimony cited by the parties. The court has accepted all the debtor's deposition testimony as true.

Creditor Wolff, pursuant to her state court lawsuit, entered into a settlement agreement with the debtor in July 28, 1995 by which the debtor was to pay creditor Wolff $300,000 by February 15, 1996. [Exhibit 2]. Most of the payments were to occur upon the sale of real estate listed by the debtor in his contemporaneous affidavit. [Exhibit 3]. In that affidavit, the debtor also

represented that the list of real estate comprised all of his holdings and that he had no expectation of financial gain from any partnership, financial arrangement or contract except those listed. Debtor was to execute contemporaneous Deeds of Trust in favor of creditor Wolff on certain listed real estate. Eventually the settlement agreement was reduced to judgment.

Debtor did not provide the Deeds of Trust until August 26, 1995. Meanwhile, he had sold his principal residence to his girlfriend Ms. Paulus on August 25, 1995 (in which they both still reside) and received $34,935 cash proceeds. On July 17, 1995, he sold the 14th Avenue rental property to Ms. Paulus and received $14,612 cash proceeds. Statement of Affairs. Pursuant to an option agreement dated June 30, 1995, he sold the Montana property on May 20, 1996 which property was not listed in the affidavit (Exhibit 3). [Stephens Depo. of 2/27/98, p. 136. All references are to this deposition unless otherwise noted.] The bankruptcy schedules list an unimproved parcel in Ohio owned by the debtor for several years having a value of $10,000. This parcel was not listed in the affidavit.

Debtor argues that even assuming these actions violated the agreement between him and the creditor, those actions took place more than two years before the commencement of this proceeding and are not relevant to the question of whether the debtor commenced this bankruptcy proceeding in bad faith. Such historical course of conduct by the debtor is relevant. The question of whether the debtor commenced this proceeding in order to effect a meaningful reorganization must necessarily place great emphasis on events and conditions immediately before and during the proceeding. A debtor

may have a history of engaging in improper conduct and yet change that course of conduct and commence a bankruptcy proceeding and successfully reorganize his financial affairs. However, that past improper conduct is relevant in considering the debtor's purpose in commencing the proceeding and the likelihood of a successful reorganization.

By the time of the bankruptcy filing, several of the properties referenced in the settlement agreement had been sold with some of the proceeds paid to creditor Wolff. The Statement of Affairs indicates that from the sale of property, the debtor received $49,728 in 1995; $49,728 in 1996 and $58,440 in 1997. Schedule "A" indicates that the debtor still retained a four plex, a duplex and a rental home all of which were encumbered by creditor Wolff's Deed of Trust.[1] According to the Statement of Affairs, the debtor received rental income, net of expenses, of approximately $12,000 in 1996 and approximately $10,000 in 1997. The debtor's Schedule "I" and the operating statements do not indicate if any rental income was received during the pendency of the proceeding.

This proceeding is clearly a continuation of the battle between the debtor and creditor Wolff (since July, 1995 there have been state court supplemental proceedings, writs of garnishment and threats of fraudulent transfer actions). There are six unsecured creditors in addition to creditor Wolff on the debtor's schedules

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[1]One property has been listed for sale since October, 1995 with the same realtor who purchased the Montana property. As no motion to approve sale has even been filed, it appears this property still has not yet been sold although the debtor stated he "has no complaints" concerning the realtor. [Stephens Depo., p. 124.]

and the total owed those six creditors is $14,089. This consists of two credit cards, the debtor's lawyer and accountant, a utility and Mrs./Mr. Gatten, the owner of the corporation which occasionally employs the debtor. Mr. Gatten is also the individual to whom the debtor transferred a boat in January, 1997 in partial payment of a debt. Statement of Affairs. The debtor testified that he will be paying the accountant as soon as he is able [Stephens Depo., p. 154] and will be paying an obligation to another corporation owned by Mr./Mrs. Gatten. That obligation relates to the fact that this unrelated corporation for some unexplained reason has been providing insurance benefits for the debtor through North American Insurance and the debtor believes he must repay and intends to repay those premiums. [Stephens Depo., p. 155]. Neither the unrelated corporation or North American Insurance were listed on the schedules.

In order to determine whether the true purpose of this bankruptcy proceeding was to reorganize a financially distressed business, the pre-petition and post-petition operation of that business must be examined. The debtor's business activities generally fall into three categories: 1) the rental of and investment in real property; 2) performing geological consulting work; and 3) acting as an officer and employer of a corporation. In addition to the rental of real property describe above, the debtor is the president of the corporation Blue Ridge which is owned by Mr./Mrs. Gatten. [Williams 9/25/97 Depo., p. 6]. In the past 4 to 5 years, he has received compensation of at least $30,000 a year and the debtor sets his own salary. [Stephens Depo. of 1/3/97, p. 15]. In early 1997 when creditor Wolff issued a writ of

garnishment to Blue Ridge, the debtor elected to do no more work for that corporation but started again once he filed bankruptcy. [Stephens Depo., p. 107]. During 1997 he received total compensation from Blue Ridge of $4,500. Ms. Paulus is the office manager for Blue Ridge which has two additional employees. The only evidence in the record other than the monthly operating statements (which will be addressed later) of post-petition compensation received from Blue Ridge is debtor's testimony that during the first two months of 1998 he received $6,500. [Stephens Depo., pp. 81-82].

The debtor also provides consulting services as a geologist through his wholly owned corporation Jackie Stevens & Associates, Inc. On February 27, 1998, he testified he was working 20 hours a week for "himself" and working for Maya Gold. He did not remember a single entity or person to whom he personally provided consulting services in 1997. [Stephens Depo., pp. 37-38]. Nor did he know if he had any records which would reflect such consulting service nor did he know if Jackie Stevens & Associates filed tax returns or had income.[2] Later he stated it was "probably true" he had no

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[2]The debtor testified in his deposition on February 27, 1998 on page 39, lines 3-15 as follows:

Q: In 1997, for whom did you provide personal consulting services?
A: I don't know.
Q: You don't know?
A: No.
Q: You don't remember one entity or person you provided personal consulting services for in 1997?
A: No. That doesn't mean I didn't.
Q: Do you have any documents that would reflect for whom you provided consulting servicing as Jackie E. Stephens or Jackie E. Stephens & Associates, Inc., in 1997?
A: I don't know.

consulting income from 1994 through 1997. [Stephens Depo., p. 160].

The debtor's other business is referred to as "Maya Gold".[3] The debtor testified that it is a Honduras corporation. [Stephens Depo., p. 6]. Generally the debtor performs geologic exploration work for it. He owns 10% of the corporation but did not remember how much cash capital he contributed, if any, but indicated that his contribution was work which he contributed from "time to time." [Stephens Depo., p. 46]. He testified that Maya Gold was incorporated in 1997 and that he is the president. It has no employees. It has a bank account in Honduras on which the debtor is the only signatory. [Stephens Depo., pp. 47-48]. The other two owners of Maya Gold live in Costa Rica. Essentially, the debtor contacts these other two individuals and asks them to put money into the Maya Gold account. He then travels to Honduras and takes the money out of the account. [Stephens Depo., p. 67]. He thinks these two individuals have collectively contributed about $75,000 to Maya Gold, [Stephens Depo., p. 165] but that there is no understanding when they will stop contributing or what circumstances would cause them to stop contributing. There is no written agreement among the owners. [Stephens Depo., pp. 52-53]. The debtor testified that he is to be paid $350 day for each day he prospects for Maya Gold and that the purpose of the contributions made by the other owners is to pay for the prospecting. He determines how often and when he travels to Central America and how

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[3]Blue Ridge, Maya Gold and Jackie Stevens & Associates all have the same business address.

much time he spends prospecting.[4] No records were produced and the debtor testified that all bank account records for Maya Gold are kept in Honduras by that bank. The debtor writes a check in

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[4]The debtor testified in his deposition on February 27, 1998 on page 52, lines 6-25 as follows:

> Q: So in January 1997 - well, you determine how many field days, how may days you are going to go prospecting, correct?
> A: Yes.
> Q: And is that based on when you can get away from either work or obligations you have in Spokane?
> A: It can be.
> Q: Is there any arrangement or agreement that you have with Stetson-Baar and McCrory that you will do only X number of field days per month?
> A: No.
> Q: Are you permitted under your arrangment with them to do ten days per month?
> A: I can do as many as I want.
> Q: So you could be doing 30 or 31 days a month?
> A: Yes.
> Q: Is there any arrangement with them as to how long this corporation - how long the Maya Gold venture will continue?
> A: No.

Also, the debtor testified in his deposition on February 27, 1998 on page 55, lines 2-21 as follows:

> Q: Who puts in money besides those two?
> A: I already answered it, and I said they put the money in.
> Q: No one else?
> A: Yes.
> Q: And how much did they put in last month?
> A: I don't know.
> Q: How much did they put in the month before?
> A: I don't know.
> Q: What if they don't put in any money?
> A: Then I stay home.
> Q: And you have no agreement or arrangement with them that they will contribute a fixed amount per month?
> A: No. There is no agreement.
> Q: And there is no agreement that there is a maximum total amount that they will ever contribute?
> A: That is correct.
> Q: Do you call them and say, put some money in the account, I want to come down?
> A: That is usually that or talk to them.

Honduras in an amount he determines and then returns to Spokane with the cash. [Stephens Depo., pp. 55-57].

The Statement of Affairs reflects that in 1997 he received $44,000 from Maya Gold. His Schedule "I" indicates that he is employed by Maya Gold for $5,000 a month.

The debtor pre-petition had no checking account and all funds received from Maya Gold or other income were kept "in my pocket."[5] Monthly checks representing proceeds from a real estate contract were taken to various banks and cashed. [Stephens Depo., p. 94]. In response to questions about the use of income or proceeds from the sale of property to purchase assets, the debtor consistently maintains that the funds were used for "general things" and "survival" which the court interprets to mean living expenses. The debtor produced no records to demonstrate the use of the 1995 or 1996 income of $99,556 each year or the 1997 income of $106,880.[6]

As to post-petition income, the only evidence is the debtor's operating statements. On February 16, 1999, the debtor filed an operating statement for September, 1998 (when the case was converted

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[5]The debtor testified in his deposition held on February 27, 1998 at page 67, lines 13-22, the following:

Q: In your trips to Honduras to get paid and you have the cash and you come back to the U.S., have you - what have you done with the cash that you have been paid from Maya Gold in `97?
A: Survival. Just survival.
Q: Where do you put it?
A: In my pocket.
Q: So you keep all your cash in your physical possession?
A: Yes.

[6]The original Schedule "J" shows rent at $700 month but both debtor and Ms. Paulus consistently testified that he pays her $300 a month to live in the house. It shows monthly expenses of $2,373.83.

to a Chapter 11) through January of 1999. That operating statement simply indicates that the debtor, during the pendency of the Chapter 11 proceeding, did not utilize the debtor-in-possession checking account but remained on a cash basis. It does not indicate income received post-petition, but merely refers to "Maya Gold $5,000." Attached was a sample average monthly expense Schedule "J" showing expenses of $3,339.[7]

After that date, the debtor utilized the debtor-in-possession account. The monthly operating statements which are merely copies of the bank statements from that account show total deposits from February of 1999 through July 21, 1999 of $13,945. There is no indication of the source of the income. It is unknown if the debtor continues to receive proceeds from the real estate contract. There is no evidence as to the amount of rents from the income property or the expenses associated with those rental properties. Nor is there any indication of the debtor's 1998 or 1999 prospecting or consulting activities and income. The debtor's proposed Plan and Disclosure Statement filed April 1, 1999 contains no projections, budgets or other meaningful financial information. It merely indicates that the debtor will continue to conduct his business, including employment with Maya Gold, and use income to make the proposed plan payments.

CONCLUSION

A review of the totality of the facts establish that this petition was filed in bad faith. Substantially all the debtor's assets are encumbered by the judgment creditor's liens. The debtor

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[7]Rent is still shown at $700 a month.

has no employees and the ongoing business activity of Maya Gold defies any common sense or reasonable business practices. The debtor has sole and exclusive control over his own cash flow and can provide no credible source of income to sustain a plan of reorganization. There are few unsecured creditors other than insiders and the debtor's own professionals. The record is replete with examples of wrongdoing by this debtor which are too numerous to recount. The most obvious examples have been cited above. It is clear that the timing of the debtor's filing evidences an intent to delay and frustrate the legitimate efforts of the secured creditor to enforce her rights.

Although the debtor has filed a proposed Disclosure Statement and Plan, filed all reports and paid required fees, there is no evidence or meaningful information regarding the amount or source of post-petition income of the debtor nor the post-petition operation of any of the business activities. This case involves essentially a two-party dispute. The debtor can show no realistic possibility of reorganizing and the bankruptcy offers the only possibility of forestalling loss of the debtor's property. Notwithstanding the debtor's reverence for form, the sole purpose of the bankruptcy was to delay the debtor's day of reckoning. The purpose of this filing was not to effectuate a reorganization but was a litigation tactic. Nor does the minimal evidence concerning post-petition activity indicate any meaningful efforts to reorganize the debtor's business in accordance with accepted business practices. Therefore, I find the petition was filed in bad faith and an order will be entered dismissing this case.

The Clerk of the Court is directed to file this Memorandum

Decision and provide copies to counsel and the Assistant U.S. Trustee.

DATED this 24th day of September, 1999.

PATRICIA C. WILLIAMS, Bankruptcy Judge

CERTIFICATE OF MAILING

The undersigned Clerk of the U.S. Bankruptcy Court for the Eastern District of Washington hereby certifies that a copy of the document on which this stamp appears was mailed this date to the following parties as required by the Bankruptcy Code and Rules of Bankruptcy.

Vreeland

USB

[illegible]

T.S. McGREGOR, Clerk

By: [illegible]
Deputy Clerk

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Date