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T.S. MCGREGOR, CLERK
U.S. BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WASHINGTON

In Re:)
LARRY A. KREYSSLER,)
Debtor(s).)

No. 03-07748-PCW13

PATRICIA M. KREYSSLER,)
Plaintiff(s),)

Adv. No. A03-00172-PCW

vs.)

MEMORANDUM DECISION RE:
ADVERSARY A03-00172 AND
CONFIRMATION OF PLAN IN
MAIN CASE 03-07748

LARRY A. KREYSSLER and JOAN)
KREYSSLER and the marital community)
of JOAN and LARRY KREYSSLER, and)
KREYSSLER, INC., a Montana)
corporation,)
Defendant(s).)

THIS MATTER came on for hearing and trial before the Honorable Patricia C. Williams on September 29, 2004 through October 4, 2004. Plaintiff was represented by Richard Hayden; Defendants were represented by Timothy Durkop; and Joseph Harkrader represented the Chapter 13 Trustee. The court reviewed the files and records herein, heard

MEMORANDUM DECISION RE: . . . - 1

1 testimony of the witnesses, heard argument of the parties, and was fully
2 advised in the premises. The court now enters its Memorandum Decision.

3 The trial in this adversary proceeding occurred simultaneously with
4 the evidentiary hearing on the Trustee's and the plaintiff creditor's
5 objections to confirmation of the Chapter 13 plan and motions to dismiss
6 the Chapter 13 proceeding. The prior summary judgment decision which is
7 currently on appeal determined that the obligation owed to plaintiff ex-
8 wife by debtor ex-husband is in the nature of property settlement and
9 not spousal maintenance or support. Before trial, the parties resolved
10 the issue of the classification of certain obligations to plaintiff as
11 not subject to discharge pursuant to 11 U.S.C. § 523(a)(15). The only
12 issue remaining in the adversary is whether the corporate veil
13 protecting the corporation, Kreysler, Inc., should be pierced rendering
14 the corporation liable for the obligations of the debtor. The issues
15 relating to confirmation of the Chapter 13 plan are the debtor's lack of
16 good faith and his failure to devote all projected disposable income to
17 the plan. At trial the plaintiff also argued that the plan fails to pay
18 creditors as much as they would receive in a Chapter 7 liquidation as
19 the value of the corporate stock has been understated.

20 FACTS

21 The underlying cause of these disputes is that the debtor and
22 plaintiff negotiated a stream of payments to the plaintiff as part of
23 the marital dissolution proceeding in September, 2002, and within six
24 months, the debtor attempted to modify the payment stream on the basis
25 he could not pay. When that effort failed, he filed bankruptcy. The
26 plaintiff simply does not believe that the debtor and his new wife
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1 cannot and should not pay as he agreed. Nor does the Trustee.

2 The extensive facts will be more fully described, but it is clear
3 that in early 2003 the debtor's income, or more accurately, the income
4 of his wholly owned corporation, was reduced to slightly more than half
5 of recent historical levels by factors beyond the debtor's control. The
6 debtor in 2003 began reducing expenses by selling a motorcycle and time
7 share which required monthly payments. He also attempted to renegotiate
8 the payment stream to plaintiff. When that failed, the plaintiff filed
9 contempt charges in state court for failure to pay under the decree.
10 In response, the debtor commenced a Chapter 13. The plaintiff argues
11 that although those facts are true, the defendant regularly pays
12 personal expenses through the corporation, thus artificially reducing
13 his personal income in an attempt to avoid payments to her and only her
14 as she is the only creditor in the bankruptcy. She argues that the
15 inaccuracy of his schedules are a continuation of his attempts to
16 minimize income and that his attempt to renegotiate the dissolution
17 decree was improper as the decree stated it could not be modified. This
18 proceeding involves emotional issues as much as it does legal issues but
19 the court is concerned only with the latter.

20 In support of the arguments regarding lack of good faith and
21 corporate liability, the plaintiff argues that the Sub-Chapter S
22 corporation wholly owned by the debtor pays many of the personal
23 expenses of the debtor which means that the debtor has more disposable
24 income than is demonstrated on Schedules "I" and "J". The debtor formed
25 this corporation many years ago to avail himself of the tax advantages
26 of a Sub-Chapter S corporation. He is the only employee of the
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1 corporation and it is his only source of income. He acts as sales
2 representative for 6 to 8 manufacturers who produce window and door
3 components.¹ He is an independent contractor terminable on thirty (30)
4 days notice and his assigned territory varies from manufacturer to
5 manufacturer, but generally is Eastern Washington, Idaho, Western
6 Montana, and part of Oregon.

7 The personal expenses which are paid by the corporation fall into
8 four categories. The first category is the medical insurance on the
9 plaintiff which the debtor is required to maintain under the terms of
10 the dissolution decree. Prior to the dissolution, the insurance was
11 provided by the corporation with the premiums paid by it, and the
12 defendant has continued this arrangement. Plaintiff argues this is a
13 personal expense which should be paid by the debtor. Since the
14 plaintiff is the beneficiary of this corporate expense and it is not
15 known whether the debtor, as an individual, could even procure medical
16 insurance coverage for his ex-wife, this category is of no significance.
17 Such payment, whether made by the corporation or the debtor is
18 reasonably necessary under §1325(b)(2)(A).

19 The second category is the family cable bill which is paid by the
20 corporation. The evidence is that in 2003 while seeking ways to reduce
21 corporate expenses, the debtor reviewed his internet and telephone
22 services. Eventually, the corporation obtained internet access, which
23 is necessary for the day-to-day operation of the business, from Comcast.
24 For a charge of \$91 per month, Comcast also provides television cable
25

26 The court's prior summary judgment decision erroneously referred
27 to sales of insurance policies by the debtor.

1 coverage for the family. The debtor testified this was the "best deal."
2 This category is of little importance in reaching the ultimate
3 determination of whether significant personal expenses are paid by the
4 corporation, but it is relevant when considering the accuracy of the
5 Schedules. Schedule "J" lists as a personal expense, a monthly cable
6 charge of \$40.00.

7 The third category is the 1999 Dodge Ram pickup truck owned and
8 insured and maintained by the corporation, which is the vehicle used by
9 the debtor for all purposes. Debtor testified that he drives about
10 30,000 miles a year of which perhaps 2,000 are personal rather than
11 business-purpose miles. There is no reimbursement by the debtor to the
12 corporation for the personal miles. Again, this category is of little
13 significance. It is not untypical in a wholly owned corporation to have
14 such an arrangement and indeed this is one of the advantages of forming
15 a Sub-Chapter S corporation. The personal use is only about eight
16 percent (8%) a year and would be reasonably necessary under 1325
17 (b) (2) (A).

18 The corporation incurs substantial travel expenses most of which
19 are charged on its credit cards. The debtor's only personal credit card
20 is a gasoline credit card. Charges on the corporation credit cards also
21 include office supplies, postage, and other items. According to the
22 2001 federal corporate tax return, corporate income was \$194,023, with
23 travel expenses of \$47,000. At that time, the debtor was living in and
24 operating the corporation from Missoula, Montana. The 2002 corporate
25 tax return lists income of \$215,161 and travel expenses of \$44,000. The
26 debtor moved to Spokane some time in 2002. The 2003 corporate return
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1 lists income of \$128,752 and travel expenses of \$28,000.

2 Plaintiff's expert testified that from an accounting tax
3 preparation or compliance viewpoint this amount of travel expense, when
4 compared to income, would constitute a "red flag" necessitating further
5 inquiry. It is this category of corporate expense which lends the only
6 significant credence to plaintiff's theory that the corporation is
7 paying the personal expenses of the debtor. The plaintiff introduced no
8 evidence indicating that the supporting documentation for these expenses
9 was requested from the debtor or his corporate tax preparer.

10 **MUST DEBTOR PAY PLAINTIFF AS CONTINUING CLAIM**
11 **UNDER 11 U.S.C. § 1322 (b) (5) ?**

12 During the course of the trial and the hearing on confirmation, an
13 issue arose as to the treatment of the property settlement obligation as
14 a continuing claim under 11 U.S.C. § 1322 (b) (5). A continuing claim is
15 one which matures after completion of the plan. The plan proposes to
16 pay this obligation as a general unsecured claim, although the decree
17 required the property distribution monthly payments to be made over a 12
18 year period. The Code does not mandate that any claim be treated as a
19 continuing claim, but states that the plan "may" do so.

20 11 U.S.C. § 1328(a)(1) states that the court shall grant the debtor
21 a discharge of all debts except any debt "provided for under section
22 1322(b)(5). . ." If a court requires a debtor or a debtor voluntarily
23 proposes to pay a continuing claims under § 1322(b)(5), a discharge of
24 that obligation does not occur upon successful completion of the plan.
25 Although the language of § 1322(b)(5) does not limit continuing claims
26 to those which are not subject to discharge under the Code, when read in
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1 connection with § 1328(a)(1), § 1322(b)(5) must be interpreted as only
2 applying to obligations not otherwise subject to discharge under the
3 Code. To find otherwise would lead to results not contemplated by the
4 Code. For example, an unsecured promissory note payable monthly over a
5 10 year payment is a continuing claim as it would mature after
6 completion of the plan. Requiring or allowing payment of the note under
7 § 1322(b)(5) would result in making that an otherwise dischargeable
8 claim, not subject to discharge.

9 Obligations which are not subject to discharge under § 523 such as
10 student loan obligations are often treated as continuing claims. No
11 cases arising in the Ninth Circuit have been cited in which a court has
12 required an otherwise dischargeable claim to be paid under § 1322(b)(5)
13 thus continuing the duty to pay after completion of the plan. Requiring
14 an otherwise dischargeable claim to be treated as a continuing claim
15 would preclude discharge of the claim pursuant to § 1328(a)(1), thus
16 nullifying the spirit and language of § 523 which defines claims which
17 are not subject to discharge. Exceptions to discharge are to be
18 narrowly construed as the discharge of claims is favored in the Code.
19 As the plaintiff's claim is subject to discharge, it would not be
20 appropriate to treat it as a continuing claim under § 1322(b)(5).

21 LIQUIDATION TEST UNDER § 1325(a)(4)

22 The property of the estate is the stock of Kreyssler, Inc. To
23 satisfy the liquidation test of § 1325(a)(4), the debtor must
24 demonstrate that a willing buyer would pay less for the stock to a
25 willing seller than the debtor proposes to pay under his plan. The base
26 amount of his plan is \$19,200.00. In his schedules, the debtor valued
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1 his corporate stock at \$15,000 which he believes is the value of
2 Kreyssler, Inc. He based his value on the corporation's "hard assets"
3 which consist of the 1999 Dodge Ram truck and some computer equipment.
4 The NADA value on the truck at the time was \$12,000 to \$14,000. The
5 debtor did not know the value of the computer and related items, but
6 believed it was minimal. When pressed, he opined it was not more than
7 \$1,000. At the time of the bankruptcy filing, the corporation had a
8 bank balance of approximately \$8,000 which he did not include in valuing
9 the stock. Nor did the debtor include any accounts receivables as he
10 normally does not know of their existence. The purchasers submit orders
11 to the manufacturer without any involvement of the debtor and the
12 manufacturer simply calculates the debtor's commission on the sale and
13 sends him a check. He generates and pays an invoice on the day the
14 check is received. Although it was apparent from the testimony and only
15 to be expected that an on-going business would have liabilities, the
16 debtor was not asked any questions regarding the liabilities of the
17 corporation or how they were factored into his valuation. Based on the
18 federal corporate returns and monthly operating statements which reflect
19 to some extent the operation of the corporation after the filing, the
20 liabilities may have equaled the amount in the bank account at the time
21 of filing.

22 The debtor did not include in the value of the stock any goodwill
23 as he does not believe that the corporation has goodwill. He only
24 represents about 8 to 9 manufacturers whose agreements are terminable at
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1 will with thirty (30) days notice.² Mr. Strickland, a former employee
2 of one of the manufacturers, testified that he was not aware of any
3 situation in which these manufacturer's representative agreements had
4 been sold or assigned. He did know of situations where third parties
5 attempted to purchase the agreements, but the manufacturer would simply
6 terminate the agreement. Mr. Strickland did know of situations where a
7 representative had brought a family member into the business and the
8 manufacturer had agreed to allow the relationship to continue, but it
9 was solely the manufacturer's discretion based upon the specific
10 situation. Mr. Strickland stated that he would not be interested in
11 purchasing such a business as it is a highly personal relationship and
12 "there is nothing to sell."

13 The plaintiff's expert Mr. Dubois valued the Kreyssler, Inc. at
14 between \$240,000-\$263,000. At the time of the valuation, he was not
15 aware that the two largest accounts had been terminated. Mr. Dubois
16 stated that he did not know how difficult it would be to find a willing
17 buyer for the business, but based his valuation upon what a willing
18 buyer would pay a willing seller. He did concede that some businesses
19 do not, in fact, have any goodwill. Mr. Dubois reiterated several times
20 that he was not provided sufficient financial and accounting information
21 with supporting documentation to fully analyze the financial affairs of
22 the debtor and the financial strength of the corporation.

23

24 Historically, the debtor acquired an interest in a
25 manufacturer's representative's business in another area by paying
26 "royalties" to the other individual who continued to work as the
27 manufacturer's representative. Not long after acquiring that
28 interest, the manufacturer terminated the agreement for unrelated
reasons.

1 Mr. Dubois' valuation was based upon a sophisticated point system
2 analyzed by a computer program. His basic premise was that the debtor
3 would continue to be employed in the business. They is not likely in a
4 Chapter 7 liquidation. Mr. Dubois concluded that the corporation was
5 capable of distributing significantly greater amounts to the debtor than
6 the current salary and distributions of \$3,775 per month net. He opined
7 that the corporation, if it reduced its discretionary spending,³ would
8 distribute an additional \$6,000 to the debtor each month for total wages
9 and owner distributions of roughly \$10,000 per month before taxes. It
10 is not credible that a corporation with \$128,000 of income in 2003 and
11 the same projected through the end of 2004 would be able to annually
12 distribute \$120,000 to its owner. Mr. Dubois' opinion was based upon
13 his belief that the corporation could generate an additional \$95,000
14 annually, thus distributing up to an additional \$95,000 before tax
15 income to debtor. This belief arose from the lack of knowledge of the
16 loss of the two largest accounts. The debtor's valuation is more
17 credible. Based upon that valuation, the liquidation test has been met.

18 CORPORATE DISREGARD UNDER STATE LAW

19 The only issue remaining in the adversary proceeding is plaintiff's
20 request to hold the corporation, Kreyssler, Inc., responsible for the
21 obligations of the debtor. The plaintiff argues that the debtor has
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23 This discretionary spending by the corporation was based in part
24 upon the total amounts reflected as travel expenses in the corporate
25 tax returns on the theory that the travel expense category was used to
26 pay personal living expenses. The total travel expenses in 2002, the
27 highest year of corporate income, were \$43,000 and in 2003 were
28 \$28,000 neither of which would average \$6,000 a month. The additional
\$6,000 a month available for distribution to the debtor appears to be
mythical.

1 merged his identity with that of the corporation and that reverse
2 piercing of the corporate veil should occur, i.e., that the corporation
3 should be held liable for the obligations of the sole shareholder.
4 Washington law describes such theories as "corporate disregard."

5 Kreyssler, Inc. is a Montana corporation with its principal place
6 of business in Washington. It elected Sub-Chapter S status under the
7 Internal Revenue Code. A Sub-Chapter S election results in the
8 corporation being treated for tax purposes as a partnership so that net
9 corporate profits pass through the corporation free of tax to the
10 stockholders who receive the tax benefits or tax liabilities which would
11 otherwise be available to the corporation. *In re Weaver*, 219 B.R. 890
12 (Bankr. D. Mont. 1998). The debtor is the single stockholder and
13 officer of Kreyssler, Inc. Operating any business in the corporate form
14 rather than a sole proprietorship not only confers tax benefits but also
15 protects the individual stockholder from personal liability for the acts
16 of the corporation. Indeed the protection from personal liability for
17 corporate acts is one of the cornerstones of corporate law and the fact
18 that a single individual owns all stock and is the sole director and
19 employer does not destroy that protection.

20 The doctrine of corporate disregard is an exception to the general
21 principle that stockholders are not liable for acts of the corporation.
22 Washington courts take a conservative approach to application of that
23 exception and only apply it under exceptional circumstances. See 17
24 Stewart M. Landefeld, et al., *Wn. Corp. Law: Corporations and LLC's*,
25 § 17.2 (2004). In those exceptional circumstances, the court, in
26 effect, extends the scope of the duty initially owed by the corporation
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1 and does so to avoid manifest injustice or to remedy fraud. The
2 Washington courts have done so when they have concluded that a violation
3 of duty will result if the corporate entity is not disregarded.
4 *Morgan v. Burks*, 93 Wn.2d 580 (1980). Corporate disregard is an
5 equitable remedy imposed to correct an abuse of the privilege of
6 maintaining a corporate entity.

7 There are two theories of corporate disregard, but they are rarely
8 distinguished in the case law. The first theory is referred to as
9 "alter ego." It rests upon a determination that the corporation is the
10 alter ego of the individual. This occurs when the identity of the
11 individual and corporation have merged or become so confused that they
12 cannot be severed. There is no corporate veil to be pierced.
13 Generally, this theory arises in situations involving the imputation of
14 knowledge from the individual to the corporation. *Standard Fire Ins.*
15 *Co. v. Blakeslee*, 54 Wn. App. 1 (1989). Case law concluding that the
16 individual and the corporate identities have merged rely upon such facts
17 as confusing names, failure to maintain separate books and records,
18 commingling of assets and failure to comply with corporate licensing
19 requirements. In the situation of *Kreyssler, Inc.*, there is no issue
20 concerning the imputation of knowledge. The corporation does maintain
21 separate books and records, files corporate tax returns, is an active
22 corporation properly formed. There is no evidence that any third-party
23 was confused as to whether it was dealing with a corporate entity or an
24 individual.

25 The other theory of corporate disregard is referred to as "piercing
26 the corporate veil." The creation of a corporation creates a veil
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1 through which liabilities of the corporation do not pass. The
2 stockholders receive the benefit of that veil. "Reverse piercing"
3 occurs when liabilities of the stockholders pass through the veil and
4 attach to the corporation. The fact a corporation is unable to pay
5 creditors or the fact a stockholder is unable to meet his personal
6 obligations is not sufficient to pierce the corporate veil. The fact
7 that a single individual owns the corporation neither lessens its legal
8 status nor weighs in favor of corporate disregard nor does the fact that
9 one corporation is wholly owned by another. *Minton v. Ralston Purina*
10 *Co.*, 146 Wn.2d 385 (2002). There must be some exceptional circumstances
11 present to justify such relief.

12 The court in *Truckweld Equipment Co., Inc. v. Olson*, 26 Wn. App.
13 638 (1980) stated at page 643:

14 The doctrine of disregarding the corporate entity or piercing
15 the corporate veil is an equitable remedy imposed to rectify
16 an abuse of the corporate privilege. 1 W. Fletcher, §§ 41 et
17 *seq.* Typically the corporation is considered an entity
18 separate and distinct from its officers or stockholders even
19 where they are only one in number. *Grayson v. Nordic Constr.*
Co., *supra*. In exceptional circumstances, however, the
20 corporate entity will be disregarded where its recognition
21 would aid in perpetrating a fraud or result in a manifest
22 injustice. *Harrison v. Puga*, 4 Wn. App. 52, 480 P.2d 247, 46
23 A.L.R.3d 415 (1971).

24 In determining whether the corporate veil should be pierced,
25 Washington courts have developed a two part test. Firstly, the
26 corporate form must intentionally be used to violate or evade a duty and
27 that evasion must constitute fraud or an improper manipulation of the
28 corporation. Secondly, the remedy must be necessary to prevent
injustice and loss to the injured party which loss was caused by abuse
of the corporate form. *Meisel v. M & N Modern Hydraulic Press Co.*,

1 97 Wn.2d 403 (1982). If some other remedy is available to the injured
2 party or if the party could have avoided the harm by use of ordinary
3 business practices, it is not appropriate to resort to the exceptional
4 remedy of piercing the corporate veil. *Morgan v. Burks, supra; Molander*
5 *v. Raugust-Mathwig, Inc.*, 44 Wn. App. 53 (1986).

6 The plaintiff has cited state court decisions for the proposition
7 that reverse piercing may occur in marital dissolution proceedings. If
8 exceptional circumstances exist and the required elements can be met,
9 state courts may and do utilize reverse piercing in marital dissolution
10 proceedings. This is not a marital dissolution proceeding. This is a
11 bankruptcy proceeding where the plaintiff and debtor were divorced
12 months before any bankruptcy was commenced, and the state court did not
13 impose any liability on Kreysler, Inc.

14 The issue here is whether, in the context of this Chapter 13
15 proceeding, the corporation should be held liable for all the personal
16 obligations of the debtor. Setting aside any question of the standing
17 of a creditor to raise that issue, piercing the veil to hold the
18 corporation liable would result in benefit to all creditors and not just
19 the former wife. In this case, however, the plaintiff is the only
20 significant creditor.

21 The corporate form must have been utilized in an improper or
22 fraudulent manner to the detriment of creditor for this remedy to be
23 applicable. Only if the debtor's inability to pay personal obligations
24 has been caused by, or is related to, improper or fraudulent use of the
25 corporate form would state law allow a piercing of the veil. In this
26 case, the argument is that the debtor has improperly or fraudulently
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1 used the corporate form to avoid paying creditors by paying many living
2 expense with corporate funds thus reducing the corporation's
3 distributions to him which results in less disposable income available
4 to pay creditors.

5 Although at first glance this may seem to be a recitation of the
6 disposable income test under § 1325(b), the review of the state law
7 indicates that the state law and bankruptcy law require quite dissimilar
8 analysis. Different standards must be met to reverse pierce the
9 corporate veil than those utilized in determining disposable income.
10 Under state law, plaintiff must demonstrate that fraudulent or immoral
11 acts occurred in the utilization of the corporate form. Fraudulent or
12 immoral conduct is irrelevant to the application of § 1325(b). Unlike
13 § 1325(b) which places the burden of proof on the debtor, the plaintiff
14 has the burden of proof when seeking to pierce the corporate veil.
15 *Critzer v. Oban*, 52 Wn.2d 446 (1958).

16 In this case, the plaintiff certainly presented evidence that
17 raises questions regarding the corporation's travel expense category.
18 The plaintiff did not produce evidence that, in fact, personal living
19 expenses were being paid from that account nor any evidence from which
20 the court could quantify the amount of any such personal living
21 expenses. From the evidence, it is not possible to determine if those
22 living expenses would be considered "necessary" and thus have no effect
23 on debtor's disposable income. The amount paid by the corporation for
24 cable TV is insignificant and not evidence of fraud or abuse. The
25 defendant was questioned regarding some fragmentary internal records
26 from 2001 which showed that while married, the plaintiff and the
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1 defendant vacationed in the Carribean and to some undetermined extent
2 used the corporate credit cards. Contemporaneously, there was also the
3 purchase of an \$800 watch for plaintiff on the corporate credit card.
4 The personal trip and gift funded by the corporation during the marriage
5 of the parties occurred some years before the bankruptcy filing when the
6 debtor was not insolvent. The plaintiff has not demonstrated an abuse
7 of the corporate form. Plaintiff's burden of proof cannot be met solely
8 by the fact that the corporate travel expenses would cause a tax
9 preparer to make further inquiry as to the composition of that category
10 of expenses.

11 LACK OF GOOD FAITH UNDER § 1325(a)(3)

12 The burden is on the debtor to prove that his plan was proposed in
13 good faith. *In re Leavitt*, 209 B.R. 935 (9th Cir. B.A.P. 1997). To
14 determine good faith, the totality of the circumstances must be examined
15 and no fraud or evil motive need be demonstrated. The question is
16 whether the debtor is using the Code inequitably or contrary to the
17 purposes for which it was intended. *Chinichian*, 784 F.2d 1440 (9th Cir.
18 1986). Decisions have enumerated various factors to be examined in
19 determining good faith, for example, *In re Gonzales*, 172 B.R. 320 (E.D.
20 Wash. 1994), but no list of factors can reflect the myriad individual
21 circumstances in which Chapter 13 proceedings arise and the breadth of
22 human conduct.

23 Duplicative Filings

24 On April 28, 2003, the debtor commenced his first Chapter 13
25 (03-0633) which gave rise to this adversary proceeding. At that time,
26 the plaintiff had brought contempt charges against the debtor in Montana
27

1 for failure to make the property settlement payments. The debtor had
2 been in default in those payments and had informed plaintiff that the
3 loss of income rendered him unable to repay. The parties attempted to
4 renegotiate the dissolution decree and when that was not successful, the
5 plaintiff filed contempt charges. At the time the charges were filed,
6 the debtor was not in default. The Trustee criticizes the debtor for
7 commencing a bankruptcy proceeding when not in default in the property
8 settlement payment and for failing to "deal with the issues in the
9 Montana state court." The plaintiff argues that the debtor, in bad
10 faith, "threatened" bankruptcy in the negotiations and the bankruptcy is
11 an improper effort to avoid payment of the property settlement agreement
12 which, by the terms of the dissolution decree, could not be modified.
13 The court does not agree. In light of the fact that the debtor's income
14 had been substantially reduced and contempt charges had been brought,
15 bankruptcy may have been the only realistic option for the debtor.

16 On July 28, 2003, this adversary was commenced. Also that month,
17 a hearing was held in the first Chapter 13 which resulted in an order
18 requiring the debtor to provide certain information to the Trustee and
19 file a Liquidation Analysis and a BR 2016 Disclosure of Compensation of
20 Attorney for Debtor. On August 5, 2003, the Trustee filed a certificate
21 stating that some information had been provided but some had not and
22 that the pleadings had not been filed. Based on the certificate, the
23 court entered an ex-parte order dismissing the case on August 15, 2003.
24 The debtor promptly filed a motion to vacate with a declaration from
25 counsel stating that all information had been provided to the Trustee
26 albeit not in the form anticipated. Admittedly, the BR 2016 Disclosure

1 of Compensation of Attorney for Debtor by counsel and the Liquidation
2 Analysis had not been filed.

3 On September 18, 2003, the second Chapter 13 (03-07748) was
4 commenced. The explanation for the second filing was that before the
5 hearing on the motion to vacate the order of dismissal could occur,
6 another contempt hearing was requested by the plaintiff in state court.
7 The commencement of the second proceeding is, at most, an indication
8 that counsel was remiss in filing the Liquidation Analysis and BR 2016
9 Statement of Attorney Compensation, but is not an indication of
10 inequitable or improper conduct on the part of the debtor.

11 Single Creditor

12 Although there are a few small creditors who will be effected by
13 this second Chapter 13 proceeding, the only significant creditor is the
14 plaintiff. Confirmation of the plan will result in discharge of all but
15 a small percentage of the financial obligation to the ex-wife. Such
16 obligations are inherently different than obligations to commercial
17 institutions, credit card holders and other types of consumer debt.
18 Often, the motivation for a discharge of such obligations is not
19 financial. When the sole significant claim to be discharged is held by
20 a former spouse, strict examination of the debtor's affairs is not only
21 predictable, but required.

22 The former wife was employed as a para-professional librarian
23 during the marriage but voluntarily terminated her employment sometime
24 before the dissolution at the urging of the debtor. In the 2002 decree,
25 the state court awarded her the family home which had about \$52,000 of
26 equity and it was sold post-dissolution. Since the dissolution, she has
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1 been a student with small student loans being her only source of income.
2 She regularly borrows from family members to meet her minimal monthly
3 living expenses.

4 One of the reasons the plaintiff is the only significant creditor
5 in this case is that the debtor voluntarily took steps pre-petition to
6 reduce both personal expenses and corporate expenses. His motorcycle
7 was sold alleviating the need for monthly payments and the timeshare was
8 assigned to the plaintiff's brother for the same reason. Although it is
9 certainly a factor in examining bad faith that there is only one
10 meaningful creditor and that creditor is a former spouse, that alone is
11 not determinative of bad faith.

12 Substantial Distribution to Creditors

13 The debtor proposes to pay \$400 per month for 48 month for a base
14 amount of \$19,200. Although the Proof of Claim filed by the plaintiff
15 is in the amount of \$293,000, from previous hearings and this trial it
16 has been concluded that the actual amount owed is between \$241,000 and
17 \$250,000. The proposed plan would distribute about \$17,000 to the
18 plaintiff or about 7% of her claim. Nominal distribution to unsecured
19 creditors is not necessarily a demonstration of bad faith but a factor
20 to be considered. *In re Warren*, 89 B.R. 87 (9th Cir. B.A.P. 1988).

21 BEST EFFORTS/PROJECTED DISPOSABLE INCOME

22 House

23 The plaintiff argues that the debtor voluntarily impoverished
24 himself by purchasing an expensive house in September of 2002. The
25 purchase price was \$196,000. The monthly payments are \$1,529 which is
26 high for the Spokane area. According to the debtor, the home has
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1 appreciated and now has a value between \$210,000 and \$215,000. The
2 mortgage balance is about \$180,000. At the time of purchase, the
3 debtor's income was more than twice its current level. His taxable
4 income in 2002 was \$104,776 and in 2003 was \$42,800. Debtor did not
5 learn that his two largest accounts would be terminated until November
6 or December of 2002, by which time he was obligated on the mortgage.
7 Absent that loss of corporate income, the debtor would have been able to
8 afford not only the payments required by the mortgage but payment of his
9 other creditors.

10 Inconsistent/Incomplete Schedules

11 The Schedules "I" and "J" in the two Chapter 13 cases are
12 identical. They reflect net monthly income of \$4,175 which includes \$400
13 per month received by debtor's new wife. They do not reflect the \$428
14 per month received by her for child support.⁴ The \$828 monthly income
15 received by the current wife is used to pay household expenses.
16 Although the current wife testified that the child support payments may
17 have been disrupted and in default at the commencement of the first
18 Chapter 13 proceeding, she was actively making attempts to collect. The
19 Schedule I's understates monthly income by \$428.

20 The debtor offered to increase his plan payments by further
21 reducing expenses. The expense he identified as subject to reduction
22 was the tithing he states that he and his new wife have done for some
23 time. The Schedule "J" does not show any amount for a tithing expense.
24 The Trustee believes that the debtor's current disposable income is

25 _____
26 Although in 2003, the current wife received income from the sale
27 of separate property, that income was used to pay separate obligations
28 and is not property of this estate.

1 between \$1,000 and \$2,000 a month.

2 Because Kreyssler, Inc. is a wholly owned corporation, the debtor
3 was required to file monthly operating statements reflecting its income
4 and expenses. The debtor is an experienced businessman who historically
5 has maintained books and records. His testimony and accounting records
6 demonstrate an understanding of accounting principles. The monthly
7 operating statements filed were not complete, were formatted
8 inconsistently, and, in some months, did not reveal income and expenses
9 of the corporation. Of the 12 monthly operating statements which should
10 have been filed, seven meaningful monthly operating statements exist
11 which reflect projected income of the corporation for 2004 in
12 approximately the same amount as the 2003 income i.e. approximately
13 \$130,000. The debtor could provide no explanation for the inconsistent
14 and incomplete monthly operating statements.

15 The debtor testified that he is attempting to generate additional
16 business and develop new accounts with manufacturers. He believes he
17 will be able to do so during the term of the plan. He states that if
18 the corporate income increases, it will disburse additional funds to him
19 thus allowing him to increase his plan payments. He stated that he is
20 willing to periodically provide financial information to the Trustee
21 during the term of the plan.

22 Corporate Travel Expense

23 The burden is on the debtor to demonstrate he is proposing to
24 devote all projected disposable income to the plan. Although plaintiff
25 failed to meet her burden of proof of corporate abuse, her allegation
26 must be also analyzed in light of the debtor's burden on the issue of
27

1 disposable income.

2 The debtor testified that he averages 6-7 days per month "on the
3 road." He normally flies once a month and on occasion, twice a month,
4 to Boise, Idaho. Boise is not a great distance from Spokane which
5 implies that the airfare would be modest, but the debtor stated that he
6 was uncertain what portion of the travel expense would be attributed to
7 airfare. Typically, the debtor attends one convention a year which is
8 a few days in duration. There was no evidence whether he had done so in
9 2003 or 2004. Other travel is generally done by corporate vehicle.
10 Annually, debtor averages 60-75 nights in lodging on business for an
11 average cost of \$60-\$70 per night. The corporation purchases his meals,
12 while traveling and he does not often entertain customers or take them
13 to dinner but on occasion does take them to lunch. The incomplete
14 nature of the monthly operating statements provided by the debtor has
15 been addressed, but based upon the seven months of information provided,
16 the average travel expenses since the filing of this bankruptcy would be
17 about \$3,100 per month or \$37,000 for 2004. Travel expense was only
18 \$28,000 for 2003.

19 The debtor's testimony regarding reimbursement to the corporation
20 for personal expenses it paid was vague and at times contradictory.
21 When asked about the 2001 personal charges, for the vacation with the
22 Plaintiff, the debtor stated he would have broken out the personal
23 charges from the corporate cards, but later said he did not know if he
24 had done so. When asked why the corporate books do not reflect
25 reimbursement from him, he stated that he would have written a personal
26 check to the corporate credit card issuer for the personal portion of
27

1 the bill. He testified that there were few personal expenses paid by
2 the corporation in the past couple of years. In later cross examination,
3 he was asked what efforts he had made to reimburse the corporation for
4 personal expenses and he indicated that he had not reimbursed the
5 corporation. From his demeanor, it was apparent that he did not
6 understand that last series of questions on cross examination. However,
7 when the debtor's counsel tried to rehabilitate the debtor's testimony
8 and asked similar questions, the debtor then stated that he did not know
9 if he had ever written a check to the corporation but did not address
10 his earlier testimony that he might have written checks payable to the
11 credit card issuers. In total, the testimony regarding reimbursement to
12 the corporation of any personal expenses was inconclusive.

13 In 2003, the debtor attempted to reduce travel expenses of the
14 corporation as its income had been substantially reduced. According to
15 the debtor, the 2004 corporate income is to date approximately the same
16 as for 2003. No explanation was provided as to why the travel expenses
17 increased dramatically from 2003 to the expenses reflected on the 2004
18 monthly operating statements. It is inexplicable how the travel
19 described by the debtor, i.e., the monthly trips to Boise and annual
20 convention, would result in expenses of this magnitude or how the 30,000
21 miles of driving relate to the travel category of expenses. Based upon
22 his vague and at times inconsistent testimony regarding the travel
23 expense category and the discomfort evidenced when examined about these
24 expenses, the conclusion is that there are indeed some personal expenses
25 contained in this category of corporate expense. The unease evidenced
26 during testimony related, however, to the expenses that the court did

27

1 not consider as significant, i.e., the medical insurance premium, cable
2 TV expense, etc. At other times during the debtor's testimony, he
3 appeared credible and sincere particularly when describing his attempts
4 to reduce all expenses both personally and in the corporation. His
5 discomfort on the topic of corporate travel was not of such magnitude
6 to convince the court he was withholding information. The demeanor of
7 all the individuals did convince the court that strong negative emotions
8 exist and color all contact between the former spouses, even contact
9 through counsel in litigation.

10 The incomplete monthly operating statements, the discrepancies in
11 Schedules "I" and "J" and the various discovery disputes which occurred
12 during the adversary proceeding demonstrate the debtor's reluctance to
13 provide full and frank disclosure of the corporate financial affairs to
14 the plaintiff, his former wife. That reluctance created a cloud of
15 suspicion not only on the part of his former wife but on the part of the
16 Trustee and the court. Once the debtor was forced to reveal the
17 information, it became apparent that there had been no substantive
18 reason for the failure to readily disclose, such as a deliberate attempt
19 to hide income. Mistakes were made in the bankruptcy information.
20 Those mistakes increased the cloud of suspicion but unfortunately are
21 the type of mistakes sometimes made by debtors and, once explained, not
22 of sufficient magnitude to conclude or convince the court that they were
23 attempts to mislead.

24 At trial, the debtor was forced to reveal more specifics of the
25 interrelationship between his and the corporate affairs, but the
26 evidence did not indicate impropriety in the relationship. The evidence
27

1 does not indicate that the debtor is utilizing the bankruptcy code
2 contrary to the purposes for which it was intended. The evidence
3 indicates that the personal expenses being paid by the corporation are
4 minimal and to some extent necessary. Absent a request to produce by
5 the plaintiff and no evidence of any such request was brought to the
6 attention of the court, the debtor had no duty to produce the supporting
7 documentation regarding the corporate travel expense category.

8 CONCLUSION


9 Although a close question, the court concludes that the debtor has
10 met his burden of proof on the issue of good faith. He concedes that he
11 has additional income and has not met his burden of proof on the issue
12 of disposable income and "best efforts" but has stated that he is
13 willing to increase his plan payments.⁵ Those payments must be increased
14 to \$868 per month (current plan payment of \$400 plus the \$428 child
15 support and the \$40 cable bill). The Chapter 13 Trustee shall submit
16 an order confirming the plan, increasing the Plan payments and
17 reflecting the new base amount. By December 15, 2004, the debtor is
18 required to file complete monthly operating statements regarding the
19 corporation evidencing the total income and expense throughout this
20 proceeding. Due to the history of incomplete monthly operating
21 statements and inaccurate Schedules "I" and "J" and the debtor's
22 anticipation of increasing corporate income, the debtor must provide to
23 the Trustee and to the plaintiff by April 15, 2005 and each year
24 thereafter prior to discharge, copy of the corporate and personal

25 _____
26 Counsel indicated that due to an error, the current plan
27 included a reference to the proceeds from the June, 2003 sale of
28 the motorcycle which appeared in the plan in the first bankruptcy
proceeding. That provision should be deleted from the plan.

1 federal income tax returns for the prior year.

2 As plaintiff did not prevail on the only issue remaining in the
3 adversary proceeding, a separate order will be entered dismissing that
4 action.

5
6 DATED this 22nd day of November, 2004.

7
8 
9 PATRICIA C. WILLIAMS, Bankruptcy Judge