

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF: )  
 )  
RAY ARP, ) CASE NO. BK95-80897  
 )  
 )  
DEBTOR ) CH. 13

MEMORANDUM

Hearing was held on February 14, 1997, on the Amended Plan. Appearances: Mary Powers for the debtor, Richard Gilloon for Arlie Carson and Kathleen Laughlin as Trustee. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(L).

**Background**

The debtor in this case, Ray W. Arp, originally filed a Chapter 7 case on March 31, 1995. On April 4, 1995, four days after filing bankruptcy, the debtor transferred real property that he owned in Washington County, Nebraska to his mother for \$4,000. Three weeks later, the debtor, on behalf of his mother, transferred the property to Michael Young, a co-worker of the debtor, for \$6,000.

The U.S. Trustee moved to dismiss the Chapter 7 case for failure to submit schedules, and the debtor did not resist the motion or file any schedules. The case was dismissed on June 5, 1995. Following the dismissal of the Chapter 7 case, the debtor filed a Chapter 13 case on June 23, 1995. The amended Chapter 13 plan filed by the debtor on March 28, 1996 provided to pay the trustee \$105.00 per month for a period of 36 months.

The Chapter 13 Trustee filed a resistance to the debtor's motion to confirm the plan because the plan did not propose to pay unsecured creditors at least as much as would be received in a Chapter 7 bankruptcy proceeding. The trustee asserted that in a Chapter 7 case the true value of the real estate referred to above, \$6,000, would be brought back into the estate and distributed to unsecured claim holders.

Arlie Carson, a judgment creditor of the debtor, also filed a resistance to the debtor's motion to confirm. Carson had previously obtained a judgment in the state of Hawaii against the debtor in the amount of \$104,900, which Carson claims was based on the fraudulent conduct of the debtor. Carson maintained in his filed resistance that the debtor had proposed this plan in bad faith and that therefore the plan should not be confirmed.

### **Facts**

The debtor is currently employed by a local Chevrolet dealer as a car salesman, but has only been employed there since the beginning of February 1997. He does not receive a salary or a draw against a commission, but rather receives a straight commission of a certain percentage of the dealer's gross profit for each sale he makes. The debtor stated that in the two weeks prior to trial he had made approximately \$1,100 to \$1,200, but has not yet received a paycheck.

In 1996, the debtor was employed as a vacuum cleaner salesman by Kirby Co., but left that employment in the spring. He then began working for J&L Foundation Systems, but was laid off at the end of October 1996. The debtor was unemployed from that time until he began working again in February 1997.

The debtor suffered a heart attack in September 1994, but that has not prevented the debtor from engaging in what has been the two primary means of earning income in his adult life: sales and construction. Although the debtor stated that heart surgery was required for him, there are no current plans for an operation. It does not seem that his heart condition is a detriment to his ability to earn income or that it has been responsible for his inability to do so during certain periods of his life.

The debtor is not married, but does have a daughter who was born in 1990. He is currently four months behind in child support payments with a total delinquency at time of trial of \$600. In addition, at time of trial, the debtor was \$800 behind in rent payments.

### **Decision**

The plan as proposed does not show a lack of good faith on the part of the debtor, and the debtor did not lack good

faith in filing the Chapter 13 petition so as to warrant dismissal. However, the plan as proposed is not feasible, and for that reason cannot be confirmed pursuant to 11 U.S.C. § 1325(a)(6).

## **Discussion**

### I. Trustee's Objection

The Trustee's objection to the debtor's plan was substantially resolved at the hearing. The debtor maintained his willingness to extend the plan to 60 months at the rate of \$105 per month, which would pay the unsecured creditors the value of the Washington County property and would pay the applicable trustee's fees.

The plan as proposed, however, only provides for a 36 month plan. Accordingly, the plan must be amended to provide for the longer plan period to meet the "best interest of creditors" test.

### II. Carson's objection

Carson has objected to the debtor's plan on the basis that it was not proposed in good faith and that the debtor lacked good faith in filing the Chapter 13 case to begin with.

The "good faith" requirement is imposed on the proponent of a plan pursuant to Section 1325(a)(3) of the Bankruptcy Code, which provides as follows:

(a) Except as provided in subsection (b), the court shall confirm a plan if --

. . .

(3) the plan has been proposed in good faith and not by any means forbidden by law

. . .

11 U.S.C. § 1325(a)(3).

The term "good faith" as it is used in § 1325(a)(3) is not defined by the Bankruptcy Code and has not been given a definitive meaning by the Eighth Circuit. In re Strauss, Neb. Bkr. 96:389 (D. Neb. 1996). See, Noreen v. Slattengren, 974

F.2d 75 (8th Cir. 1992); Handeen v. LeMaire (In re LeMaire), 898 F.2d 1346 (8th Cir. 1990); Education Assistance Corp. v. Zellner, 827 F.2d 1222 (8th Cir. 1987); United States v. Estus (In re Estus), 695 F.2d 311 (8th Cir. 1982). In Estus, the Eighth Circuit provided a list of eleven factors, in addition to the percentage of repayment to unsecured creditors, that a court should weigh in determining whether a plan was proposed in good faith.<sup>1</sup> 695 F.2d at 317. The court stated that

[I]n determining whether a debtor's plan meets the section 1325(a)(3) confirmation requirement of good faith, we believe the proper inquiry should follow the analysis adopted by the Fourth Circuit [in In re Deans, 692 F.2d 968 (4th Cir. 1982)]: whether the plan constitutes an abuse of the provisions, purpose or spirit of Chapter 13. The bankruptcy court must utilize its fact-finding expertise and judge each case on its own facts after considering all the circumstances of the case. If, after weighing all the facts and circumstances, the plan is determined to constitute an abuse of the provisions, purpose or spirit of Chapter 13, confirmation must be denied.

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<sup>1</sup> The eleven factors listed by the Eighth Circuit in Estus are as follows: (1) the amount of the proposed payments and the amount of the debtor's surplus; (2) the debtor's employment history, ability to earn and likelihood of future increases in income; (3) the probable or expected duration of the plan; (4) the accuracy of the plan's statements of the debts, expenses and percentage repayment of unsecured debt and whether any inaccuracies are an attempt to mislead the court; (5) the extent of preferential treatment between classes of creditors; (6) the extent to which secured claims are modified; (7) the type of debt sought to be discharged and whether any such debt is nondischargeable in Chapter 7; (8) the existence of special circumstances such as inordinate medical expenses; (9) the frequency with which the debtor has sought relief under the Bankruptcy Reform Act; (10) the motivation and sincerity of the debtor in seeking Chapter 13 relief; and (11) the burden which the plan's administration would place upon the trustee. Id. at 317.

Id. at 316.

Upon the inclusion of § 1325(b) in the Bankruptcy Code pursuant to the Bankruptcy Amendments and Federal Judges Act of 1984, most of the Estus factors were subsumed. Zellner, 827 F.2d at 1227. "Although Zellner modified the good faith determination in response to . . . [§] 1325(b), it is recognized that Zellner preserved the traditional 'totality of circumstances' approach with respect to Estus factors not addressed by the legislative amendments." LeMaire, 898 F.2d 1349. See, Slattengren, 974 F.2d at 76.

The narrower focus is now on such factors as "whether the debtor has stated his debts and expenses accurately; whether he has made any fraudulent misrepresentation to mislead the bankruptcy court; or whether he has unfairly manipulated the Bankruptcy Code." Zellner 827 F.2d at 1227. See, LeMaire, 898 F.2d at 1349. However, the factors set forth in Estus remain to be considered as part of the "totality of circumstances" test, with less emphasis on the financial factors and greater emphasis on the subjective factors. Strauss, Neb.Bkr. 96:389 at 392 n.4.

#### A. Judgment involving fraud

Carson alleges that the judgment he obtained was one regarding fraud, that such a debt would be nondischargeable in a chapter 7 case, and that the debtor's plan was not proposed in good faith in its treatment of the claim. A judgment involving fraud of the debtor would be nondischargeable pursuant to 11 U.S.C. § 523(a)(2)(A), and this court would be bound by the finding of fraud of a Hawaii state court under principles of collateral estoppel even though the judgment entered against the debtor was a default judgment. See, Grogan v. Garner, 498 U.S. 279, 111 S. Ct. 654, 112 L. Ed. 2d 755 (1991) (Collateral estoppel principles apply in discharge exception proceedings under 11 U.S.C. § 523(a)); Marrese v. American Academy of Orthopaedic Surgeons, 470 U.S. 373, 105 S. Ct. 1327, 84 L. Ed. 2d 274 (1985) (Federal courts must look to the law of the state where the judgment is rendered to determine its preclusive effect); Fuller v. Pacific Medical Collections, Inc., 891 P.2d 300, 306 (Haw. Ct. App. 1995) ("[A] default judgment is a final judgment to which collateral estoppel applies unless the default judgment is void.")

However, the fact that a Chapter 13 debtor is attempting to discharge a debt that would be nondischargeable in Chapter 7 is not sufficient in itself to warrant a finding that the plan was not proposed in good faith. State v. Doersam (In re Doersam), 849 F.2d 237 (6th Cir. 1988); In re Lilley, 185 B.R. 489 (E.D. Pa. 1995). In addition, the facts of this case are clearly distinguishable from those in LeMaire, wherein a debtor attempted to discharge a civil judgment awarded to the victim of an intentional shooting. This is not a single creditor case, nor was the debtor's original Chapter 7 case filed on the heels of the Hawaii judgment, which was entered on August 29, 1994.

#### B. Transfer of real property

Carson contends that the debtor's transfer of real property during the pendency of his Chapter 7 case is evidence of the debtor's bad faith with regard to the debtor's filing of the Chapter 13 case and the debtor's proposed plan of reorganization.

It should be noted that a debtor's good faith may be addressed in two different contexts: first, the debtor must commence the Chapter 13 case in good faith,<sup>2</sup> and second, the debtor must then propose a plan in good faith. In re Spencer, 137 B.R. 506 (Bankr. N.D. Okla. 1992).

If lack of good faith is urged as a cause for dismissal, the question would ordinarily be whether the Ch. 13 case should ever have been filed at all--whether debtor needs or deserves relief of any sort under Ch.13--whether the mere filing of the case is sufficient to abuse Ch.13's provisions, such that the appropriate remedy is dismissal of the case without waiting for debtor's plan to come on for confirmation.

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<sup>2</sup> The Eighth Circuit has stated that lack of good faith in filing a Chapter 13 petition is sufficient cause for dismissal under 11 U.S.C. § 1307(c). Molitor v. Eidson (In re Molitor), 76 F.3d 218, 220 (8th Cir. 1996). See, In re Lilley, 91 F.3d 491 (3d Cir. 1996); In re Love, 957 F.2d 1350 (7th Cir. 1992); Eisen v. Curry (In re Eisen), 14 F.3d 469 (9th Cir. 1994); Gier v. Farmers State Bank (In re Gier), 986 F.2d 1326 (10th Cir. 1993).

But if lack of good faith is urged as ground for denial of confirmation of a proposed plan, the question would ordinarily be whether a debtor who admittedly needs or deserves relief of some sort under Ch. 13 has proposed a plan which would treat debtor and creditors in a manner consistent with Ch. 13's purposes and policies-- whether the proposed plan will do, or whether another and better one should be proposed instead . . . These . . . different questions . . . certainly overlap but are not identical and should be distinguished from each other as appropriate.

In re Jernigan, 130 B.R. 879 (Bankr. N.D. Okla. 1991). Although the two concepts are distinct, and the inquiry as to the point in time of the questioned acts and motives is different, the indicia of bad faith applicable to dismissal may be the same as the indicia of bad faith applicable to confirmation of a debtor's Chapter 13 plan. In re Powers, 135 B.R. 980 (Bankr. C.D. Cal. 1991).

The debtor's prior conduct with regard to the real property does not impact the treatment of Carson's claim. In fact, the transaction will not harm any of the creditors. The debtor will pay into the proposed Chapter 13 plan the value of the real property transferred, insuring that the creditors will receive as much in a Chapter 13 plan as they would have in a Chapter 7.

Whether the real estate transfer should prevent the debtor from seeking reorganization in Chapter 13 at all, in that the mere filing of the petition is in bad faith, is a separate question.

While the conduct engaged in by the debtor prior to his Chapter 13 filing is of a type described by § 727(a)(2)(B), there has not been a finding by this court that the conduct engaged in by the debtor during his Chapter 7 case would have warranted a denial of discharge. No request for such finding was made in the Chapter 7 case and it is not appropriate to try that hypothetical issue in the Chapter 13 case. Section 727(a)(2)(B) is not applicable in Chapter 13, and the Code does not expressly prohibit a debtor from converting a case to Chapter 13 from Chapter 7 following a denial of discharge

pursuant to that section. Furthermore, it is not bad faith to convert a Chapter 7 case to a Chapter 13 following an adverse decision regarding dischargeability. See, In re Chaffin, 836 F.2d 215 (5th Cir. 1988) (not bad faith to convert to Chapter 13 from Chapter 7 following a determination of nondischargeability of a debt); Street v. Lawson (In re Street), 55 B.R. 763 (9th Cir. B.A.P. 1985) (same). If it is not, per se, bad faith to convert a case to Chapter 13 after an adverse finding in Chapter 7, it should not be deemed bad faith to file a Chapter 13 case if the Chapter 7 case was dismissed without such an adverse determination.

Although the conduct engaged in by the debtor in the transfer of real property during the pendency of his Chapter 7 is troubling,

courts should exercise great caution in limiting access to Ch. 13 solely on the basis of past conduct. If Ch. 13 is open only to debtors who never did anything at all wrong, then Ch. 13 will be open to very few; and such stringent screening would be inconsistent with Congressional intent to encourage resort to Ch. 13. As a rule, debtor's conduct before Ch. 13 should be less important than his prospects and proposals in Ch. 13.

Spencer, 137 B.R. at 515 (citation omitted).

If there was any evidence that the debtor's creditors had suffered or were in any way put at a disadvantage because of the debtor's conduct, this case would be dismissed. However, the evidence indicates that the creditors have not adversely been affected by the debtor's conduct prior to filing this case.

Moreover, if there was any evidence that the debtor had engaged in the transfer of real estate in order to deceive or hinder his creditors, the Chapter 13 Trustee, or this court, this case would be dismissed. At the hearing, the debtor testified he did not know that the post-petition real estate transfer was prohibited and that he had very little contact with his bankruptcy attorney after filing the Chapter 7 petition. While his testimony is not entirely credible, there

was no contrary evidence to suggest an intentional act with knowledge that such act was improper.

It is true that

neither malice nor actual fraud is required to find a lack of good faith. The bankruptcy judge is not required to have evidence of debtor ill will directed at creditors, or that debtor was affirmatively attempting to violate the law--malfeasance is not a prerequisite to bad faith. Rather, the court may find a lack of good faith where the debtor "used the [bankruptcy] process in a way that the underlying policy of securing an orderly and fair adjustment of the relationship between debtor and creditors could not be realized . . ."

In re Powers, 135 B.R. 980, 994 (Bankr. C.D. Cal. 1991). However, there must at least be some evidence of knowledge, constructive or actual, on the part of the debtor as to the nature of his actions. In this case, the evidence is insufficient to show that the debtor acted with such knowledge and, therefore, dismissal of the case for lack of good faith is not appropriate.

### III. Feasibility of the Plan

Although there is insufficient evidence to find that the case must be dismissed because of bad faith, or that the plan cannot be confirmed because it was proposed in bad faith, the plan as proposed is not feasible, and on that basis, confirmation of the plan must be denied. 11 U.S.C. § 1325(a)(6).

The debtor has proposed to pay \$105 per month to the trustee. However, the debtor is currently behind in both child support and rent payments. Although he has made regular payments to the trustee over the last ten months, he currently is behind in the amount owed to the trustee because of missed or insufficient payments in the first few months of 1996. In order for a plan to be feasible, a debtor must be able to pay regular household debts, including rent, and court ordered child support, in addition to any plan payments. Currently, it appears the debtor is unable to do so.

The debtor has also had a unstable employment history during the last 12 months. The debtor began his current employment only two weeks before the confirmation hearing. Although the debtor stated that he has earned between \$1100 and \$1200 during his first two weeks, he has not yet received any compensation from the employer. Because his wages will be based on a straight commission, it is not possible to know what his income will be without some evidence as to the amounts earned in previous income periods. There is simply no way for this court to determine whether the debtor's proposed budget is in line with his income without knowing what his income will be.

Therefore, the debtor's amended plan is denied confirmation, and the debtor is granted 60 days to file a second amended plan which must address feasibility.

Separate journal entry to be filed.

DATED: March 7, 1997

BY THE COURT:

/s/ Timothy J. Mahoney  
Timothy J. Mahoney  
Chief Judge

Copies faxed by the Court to:

POWERS, MARY 498-0339  
GILLOON, RICHARD 390-7137

Copies mailed by the Court to:

Kathleen Laughlin, Trustee  
United States Trustee

Movant (\*) is responsible for giving notice of this journal entry to all other parties (that are not listed above) if required by rule or statute.

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:	)	
	)	
RAY ARP,	)	CASE NO. BK95-80897
	)	A
<u>DEBTOR(S)</u>	)	CH. 13
	)	Filing No. 40, 47, 50
Plaintiff(s)	)	
vs.	)	<u>JOURNAL ENTRY</u>
	)	DATE: March 7, 1997
<u>Defendant(s)</u>	)	HEARING DATE: February 14, 1997

Before a United States Bankruptcy Judge for the District of Nebraska regarding Amended Plan by Debtor; Resistance by Trustee; Objection by Arlie Carson.

APPEARANCES

Mary Powers, Attorney for debtor  
Richard Gilloon, Attorney for Arlie Carson  
Kathleen Laughlin, Trustee

IT IS ORDERED:

Plan denied confirmation. amended plan due in sixty days. See memorandum this date.

BY THE COURT:

/s/ Timothy J. Mahoney  
Timothy J. Mahoney  
Chief Judge

Copies faxed by the Court to:

POWERS, MARY	498-0339
GILLOON, RICHARD	390-7137

Copies mailed by the Court to:

Kathleen Laughlin, Trustee  
United States Trustee

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