

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF

ARTHUR and MELVA HEIM,

DEBTORS

CASE NO. BK80-905

MEMORANDUM OPINION

This matter came on for hearing on December 10, 1986, on a motion to dismiss or appoint examiner filed by the creditor, High Plains Agricultural Credit Corporation. Appearing on behalf of the debtor was Jess Nielsen of Nielsen & Birch, North Platte, Nebraska. Appearing on behalf of the creditor was Kelly S. Breen of Laughlin, Peterson & Lang, Omaha, Nebraska.

Findings of Fact

Debtors, Arthur and Melva Heim, filed in this court a voluntary petition for relief under 11 U.S.C. Chapter 11 on May 1, 1980. At the time of filing, the debtors were engaged in the business of wheat farming and oil development. To date, no plan of reorganization has been filed by the debtors. During the course of their bankruptcy, the debtors have been involved in prolonged litigation with regard to their farm property, a summary of which litigation follows: a first mortgage from the debtors to Travelers Indemnity Company was recorded on April 21, 1976. A second mortgage on the debtors' real estate was recorded on March 23, 1977, in favor of High Plains Agricultural Credit Corporation ("creditor"), the creditor herein. On May 21, 1979, Travelers commenced proceedings to foreclose its mortgage from the debtors. In its order of foreclosure of August 2, 1982, the District Court found, *inter alia*, that the debtors owed the creditor \$346,712.56. The real estate was sold to the creditor at sheriff's sale, which sale was confirmed by the District Court on October 12, 1983, and subsequently affirmed by the Nebraska Supreme Court on August 10, 1984, in Travelers Indemnity Company vs. Heim, 218 Neb. 326, 352 N.W.2d 921 (1984).

On September 11, 1984, the debtors instituted an action against the creditors alleging that, because of a delay in paying the purchase price, the creditor had waived and abandoned its purchase at sheriff's sale. The debtors requested that the land be resold and asked for an accounting regarding the wheat crop harvested from the real estate by the creditor. On May 9, 1985, the District Court ruled that it lacked jurisdiction to declare an

abandonment by the creditor or to hear the debtors' request for an accounting. On June 6, 1986, the Supreme Court ruled on appeal that the District Court did have jurisdiction to hear the motions but that the debtors had failed to allege a basis for vacating the confirmed judicial sale. The Court also declined to enter an order for an accounting. Travelers Indemnity Company vs. Heim, 223 Neb. 75, 388 N.W.2d 106 (1986).

All of the debtors' real property has now been sold, and Mr. Heim testified that he has had no farm income since 1985. He also testified that he has all of the scheduled farm equipment and vehicles except a 1975 Buick, a 1976 Mercury, a 1978 Cadillac, and a tractor that was traded in for a newer tractor that was subsequently repossessed. According to Mr. Heim's testimony, the equipment is located on a neighbor's farm. He further testified that he receives oil production income from a well designated as Kennedy-Larson. Mr. Heim indicated that he has no other interest in any producing well, although he claims to have mineral leases in Kimball County for which he pays no rent. It is apparent from Mr. Heim's testimony and the evidence adduced at trial that the Kennedy-Larson well is currently the debtors' only source of income.

The debtors-in-possession have traded secured collateral without paying the secured creditor. The debtors-in-possession gave a security interest in growing crops, then sold the crops and spent the funds without paying the creditor and without getting permission to use cash collateral.

From April of 1982 until May of 1986, the debtors filed no operating reports with the Bankruptcy Court. Pursuant to an order of this Court, the debtors filed operating reports in 1986 for the years 1982 through 1986. These operating reports and Mr. Heim's testimony indicate that the debtors have had a negative cash flow since filing their Chapter 11 petition herein. In addition to their living and operating expenses, the debtors-in-possession have made charitable donations of at least \$119,042.11 since the filing of their petition, despite their negative cash flow.

Mr. Heim further testified that he intends to lease farm ground for farming operations. He also indicated that, in addition to receiving income from the Kennedy-Larson well, he intends to obtain funds from investors to engage in other drilling operations. However, he presented no specific evidence as to the identity of these investors, the amounts they intend to invest, the location of the mineral interests on which he intends to drill, or their value. In at least one year during the pendency of the debtors' Chapter 11 case, 1981, Mr. Heim's testimony and the operating reports indicate that the debtors' expenditures in oil drilling ventures exceeded the funds provided by investors by more than \$55,000.

Finally, Mr. Heim testified that he filed his Chapter 11 petition in order to litigate his claims outside of the Bankruptcy Court, and that he had no present intent to reorganize under the Bankruptcy Code.

The creditor has brought this motion to dismiss or, in the alternative, appoint an examiner.

Issues

1. Should the debtors' Chapter 11 petition be dismissed pursuant to 11 U.S.C. §1112(b)(1), §1112(b)(2), or §1112(b)(3)?
2. Should the debtors' Chapter 11 petition be dismissed due to lack of good faith in filing?
3. Should an examiner be appointed to investigate any allegations of misconduct, mismanagement or irregularity in the management of the affairs of the debtors?

Decision

The case shall be dismissed pursuant to 11 U.S.C. §1112(b)(1) on April 30, 1987.

Discussion and Conclusions of Law

11 U.S.C. §1112(b) provides in pertinent part as follows:

Except as provided in sub-section (c) of this section, on request of a party in interest or the United States Trustee, and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause, including--

- (1) continuing loss to or diminution of the estate in absence of a reasonable likelihood of rehabilitation;
- (2) inability to effectuate a plan;
- (3) unreasonable delay by the debtor that is prejudicial to creditors;

Mr. Heim admitted and the debtors' operating reports indicate that the debtors have had a negative cash flow since filing their Chapter 11 petition herein nearly seven years ago. This situation has existed despite substantial receipts on the part of the estate during this period. The first requirement for a dismissal under

§1112(b)(1) of the Code is that continuing loss to or diminution of the estate must exist. With regard to this requirement, Colliers provides the following guidelines:

"Obviously, if the debtor has a negative cash flow after entry of the order for relief in the Chapter 11 case, the first of the two elements of §1112(b)(1) is satisfied. Section 1112(b)(1) does not, however, specify that only cash losses are to be considered. Although the debtor may have a positive cash flow, the court should consider whether the debtor is suffering a loss by reason of actual depreciation in the value of property of the estate. The continuing loss or diminution standard set forth in §1112(b)(1) requires the court to consider depreciation of assets in the economic, rather than accounting sense. A debtor which is operating at a loss according to generally accepted accounting principles may not fall within the 'continuing loss' or 'diminution of the estate' standards if it can be established that the value of the debtor's assets is appreciating rather than depreciating." 5 Collier on Bankruptcy, ¶1112.03[2][c][i], (15th Edition. 1979).

Most of the debtor's assets are gone, and there is certainly no evidence before the Court that the value of the debtors' remaining assets is appreciating. Not only have the debtors been operating at a loss, they have been doing so for almost seven years. This in itself is enough to satisfy the first requirement of §1112(b)(1). In re W.J. Rewoldt Company, 22 Bankr. 459 (Bkrtcy. D. Mich. 1982); In re Johnson, 29 B.R. 136 (Bkrtcy. S.D. Florida 1983). It is obvious that one factor in these operating losses is the fact that the debtors contributed more than \$119,000 to charity during this period. There is no indication that the funds for the contributions came from any source other than the bankruptcy estate. Further, these donations were made without court approval and cannot be considered to have been made in the ordinary course of business. It should also be noted that none of the debtors' expenditures during this time went toward payment to their secured or unsecured creditors. Clearly, the first requirement of §1112(b)(1) has been satisfied, as this Court does conclude that there has been continuing loss to the estate.

Section 1112(b)(1) requires as a second condition that there be an absence of reasonable likelihood of rehabilitation. With regard to rehabilitation, Colliers states as follows:

"Under the standard contained in §1112(b)(1), losses alone are not grounds for conversion. In order for the court to dismiss

or convert under paragraph (1), the debtor's financial condition must be such as to permit the court to determine that there is no reasonable likelihood that the debtor will be rehabilitated. 'Rehabilitate' has been defined to mean 'to put back in good condition; reestablish on a firm, sound basis.' Rehabilitation, as used in §1112(b)(1), does not mean the same thing as reorganization, as such term is used in Chapter 11. Since the debtor can be liquidated in Chapter 7, the ability to confirm a plan of reorganization is considerably different than reaching a firm, sound financial base." 5 Collier on Bankruptcy, ¶1112.03[2][c][i] (15th Edition. 1979) (footnotes omitted).

Mr. Heim has admitted that he has had no farm income since 1985, and the evidence has shown that at present his only income is derived from the Kennedy-Larson well. He has indicated that he "will farm or try to farm in 1987." (Brief for Debtor at 6). He has also indicated that he intends to obtain funds from investors in order to engage in oil drilling operations. However, for neither of these proposals has Mr. Heim presented any real evidence as to how these plans will proceed and what the likelihood of their success may be. Any business venture involves a certain amount of speculation. However, in this Court's view, Mr. Heim's proposals are pure speculation with very little evidence of their feasibility. This combined with the fact that the debtors have been unable to operate these same kinds of ventures successfully for the past six and one-half years leads this Court to conclude that there is no reasonable likelihood of rehabilitation in this case. Thus, this Court is of the opinion that the two-pronged requirement of §1112(b)(1) has been satisfied and that this case should be dismissed.

Although it is unnecessary to reach the remaining issues in view of the decision to dismiss pursuant to §1112(b)(1), the Court nevertheless will dispose of them here. Section 1112(b)(2) lists as a cause for dismissal the inability to effectuate a plan. It is true that the debtors did not file a plan in almost seven years. However, the debtors were involved in litigation concerning their farm land until June 6, 1986. It is this Court's opinion that it would have been difficult, if not impossible, to formulate an effective plan of reorganization when the debtors were not certain as to the outcome of this litigation and as to what assets they were dealing with. Therefore, the Court would not dismiss on the basis of the failure to file a plan herein.

Section 1112(b)(3) grounds dismissal upon unreasonable delay by the debtor that is prejudicial to the creditors. This Court finds that the delay in this case was caused by the litigation

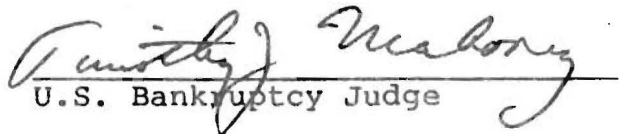
over the farm land. While recognizing that the debtors' intent in pursuing this litigation was no doubt to delay losing their land, the Court believes that this delay does not rise to the level of being unreasonable or prejudicial to the creditors.

The creditor has also raised the issue of good faith in this case. Mr. Heim testified that the debtors filed their Chapter 11 petition solely to enable them to engage in litigation over their farm land. He further testified that he had no intention of filing a plan and would not have done so had the debtors' litigation been successful. The creditor asserts that these actions combined with the debtors' actions in diminishing the estate constitute a lack of good faith. In a 1984 case, In re Johns-Manville, 36 B.R. 727 (Bkrtcy. 1984), the Bankruptcy Court for the Southern District of New York held that the only requirement for filing a Chapter 11 petition is that the entity filing the petition be an eligible debtor, i.e., a real business with real creditors, in need of reorganization. The fact that a debtor was attempting to stave off creditors by filing a petition in bankruptcy was not viewed as filing in bad faith. In fact, that is the precise reason why most debtors file Chapter 11 petitions. Id. at 240. This view was later affirmed by the District Court in In re Johns-Manville, 39 B.R. 234 (D.C. S.D. N.Y. 1984). This Court believes that, whatever their intentions, the Heims were eligible debtors and thus filed their petition in good faith. Further, the Court questions the propriety of raising this issue nearly seven years after the filing of the petition.

This Court concludes that this case should be and shall be dismissed on April 30, 1987, because of continuing losses to the estate and because of no reasonable likelihood of rehabilitation pursuant to 11 U.S.C. §1112(b)(1). The Court leaves the case open only to permit the filing of requests for administrative expenses which must be filed and heard before April 30, 1986.

DATED: February 23, 1987.

BY THE COURT:


U.S. Bankruptcy Judge

Copies to:

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