

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Western Division

In re:)
JEFFREY P. SCHULTZ) Bankr. Case No. 91-50290
Social Security No. [REDACTED]-5434) Chapter 11
Debtor.) MEMORANDUM OF DECISION RE:
CFE'S MOTION TO CONVERT
)

The matter before the Court is the Motion to Convert filed by Commerce First Financial and Debtor's response thereto. This is a core proceeding under 28 U.S.C. § 157(b)(2). This memorandum and accompanying Order shall constitute findings and conclusions under F.R.Bankr.P. 7052.

I.

Debtor filed a Chapter 11 petition on September 23, 1991. He scheduled the following assets on October 9, 1991:

1,560 acres in Fall River County, South Dakota valued at \$45,000.00 and secured by First State Bank of Newcastle on a claim of \$150,000.00;

644 acres (surface and mineral) in Lipscomb, Texas valued at \$85,000.00 (Debtor's interest) with no claim against it;

1,720 acres (minerals) in Ellis County, Oklahoma valued at \$20,000.00 (Debtor's interest) with no claim against it;

2 acres with a cabin in Canada valued at \$10,000.00 (Debtor's interest) with no claim against it;

1,920 acres (minerals) in Fall River County, South Dakota valued at \$12,000.00 (Debtor's interest) with no claim against it; and

3,260 acres (minerals) in Niobrara County, Wyoming valued at \$8,000.00 (Debtor's interest) with no claim against

it; and

miscellaneous personal property with a total value of \$215,000.00. This personal property included 116 cow/calf pairs, 5 bulls and 50 yearling heifers.

Debtor scheduled four secured creditors:

First Western National Bank with a \$17,000.00 claim fully secured by a 1990 Chevrolet van valued at \$17,000.00 and a \$13,000.00 claim fully secured by a 1990 Chevrolet Corvette valued at \$25,000.00;

First State Bank of Newcastle with an \$80,000.00 claim fully secured by 1,560 acres in Fall River County valued at \$45,000.00 and a \$70,000.00 claim fully secured by 116 cow/calf pairs, 5 bulls, and 50 yearling heifers valued at \$156,000.00;

Community First State Bank with a \$153,000.00 claim fully secured by 2 acres, a convenience store, and a bulk plant valued at \$200,000.00 (and with a Small Business Administration guarantee); and

First Federal Savings Bank with a \$14,000.00 claim fully secured by a house and lot in Edgemont valued at \$20,000.00.

Debtor stated his wife Patricia Schultz was a co-debtor on each of the secured claims, except that held by First Federal Savings Bank. Debtor did not schedule any priority unsecured creditors and he listed only one unsecured creditor: Commerce First Financial (CFF) for \$63,912.00 plus interest. Debtor disputed CFF's claim.

Debtor scheduled three executory contracts: a 640 acre grazing lease from the South Dakota Commissioner of School and Public Lands; a 720 acres grazing lease from the Buffalo Gap National Grasslands [U.S. Forest Service]; and a one-third interest in a CRP contract on 640 acres in Lipscomb County, Texas that paid him \$8,500.00 per year. By Order entered November 20, 1991, Debtor

was authorized to continue the grazing leases.

In his statement of financial affairs, Debtor stated he was currently in litigation with CFF. He also admitted that he had transferred his ownership of a 1990 Corvette and a half section of land in Lipscomb County, Texas to his wife approximately two months prior to his bankruptcy petition and that he had also had his name taken off the checking account for the convenience store, "PJ's", and bulk plant, "Hi-D-Way Oil", that he and his wife own. Debtor also stated that some property was transferred out of or into a trust for him that had been created by his grandparents in 1982 but it is unclear what property was transferred and when.

CFF filed a Motion to Dismiss or Convert on January 17, 1992 on the grounds that this is a one-creditor case where a reorganization plan is unnecessary, that Debtor does not have the ability to propose a confirmable plan, and that Debtor has not properly valued all assets of the estate.

Debtor filed his first proposed Disclosure Statement and Plan on January 22, 1992. Therein, he offered to pay CFF \$36,436.63 over ten years at nine percent interest. The liquidation analysis attached to the Disclosure Statement and Plan revealed Debtor had equity of \$196,270.00. As of that date, Debtor stated he had 184 cows, 38 heifer calves, and 5 bulls.

CFF objected to Debtor's proposed Disclosure Statement. CFF argued that Debtor's description and value of assets were inadequate; there was no financial history; there was no projection

of income from the ranch, convenience store, and bulk plant; CFF's debt was greatly understated and the repayment terms were not satisfactory; the plan was not feasible; Debtor erroneously had stated that creditors other than CFF are impaired; and the plan was proposed in bad faith. In his response, Debtor outlined why he disputed CFF's claim.

The United States Trustee objected to the Disclosure Statement on the grounds that Debtor had failed to provide any historical income and expense analysis.

A hearing on CFF's Motion to Dismiss or Convert and Debtor's proposed Disclosure Statement was held March 3, 1992. Both matters were continued pending a resolution of the amount of CFF's claim. CFF and Debtor were ordered to file simultaneous briefs on whether this Court could "reconsider" the June 2, 1986 judgment that CFF obtained in the United States District Court for the District of South Dakota, Western Division.¹

Debtor filed an objection to CFF's claim on April 3, 1992. Debtor filed a proof of claim on April 7, 1992 for \$131,937.57 (unsecured).

At a continued hearing on April 7, 1992, this Court ruled it did not have jurisdiction to reconsider a judgment entered by the District Court. Debtor's exclusivity period was extended to allow Debtor to seek relief from the District Court. The hearing on Debtor's Disclosure Statement and CFF's Motion to Dismiss or

¹ The Hon. Richard H. Battey, presiding.

Convert was again continued pending a decision by the District Court. By Order entered May 26, 1992, the Court also continued the hearing on Debtor's objection to CFF's claim to July 1992 when Debtor was to give a status report on the District Court's reconsideration of CFF's judgment.

At the July 7, 1992 hearing on Debtor's objection to CFF's claim, Debtor reported that his motion for reconsideration was in draft form and would be filed with the District Court yet that month. The case was held in abeyance pending a decision by the District Court.

On February 3, 1993, CFF filed a second Motion to Convert. CFF restated its previous arguments and further stated that the District Court had recently refused to re-open or reduce CFF's judgment against Debtor. Debtor responded on February 24, 1993 that it intended to appeal the District Court's decision. That matter is currently pending before the Court of Appeals for the Eighth Circuit.

A hearing on CFF's second Motion to Convert was held March 2, 1993. The Court ordered the matter continued pending Debtor's filing of an amended disclosure statement and plan by March 25, 1993. Debtor filed a first amended plan and disclosure statement on March 25, 1993 and the disclosure statement was set for hearing on May 3, 1993.

A continued hearing on CFF's second Motion to Convert was held April 6, 1993. By Order entered April 8, 1993 Order, the Court

outlined what information Debtor was required to include in a second amended plan and disclosure statement. The Court instructed Debtor's counsel to seek the earliest available date for a hearing on approval of the second amended disclosure statement. Debtor's request to incur additional debt with First State Bank of Newcastle, Wyoming was also continued until Debtor filed another plan and disclosure statement.

Debtor filed his second amended plan and disclosure statement on June 25, 1993. On that same day, CFF filed a motion requesting that a continued hearing on its second motion to convert be set. Over Debtor's resistance, the Court scheduled a continued hearing on CFF's second motion to convert. Debtor, the First State Bank of Newcastle, and Jean Meadows filed resistances to CFF's second motion to convert.

The continued hearing on CFF's second motion to convert was held July 12, 1993. The only witness was Debtor. Four exhibits were received: Debtor's 1991 and 1992 federal income tax returns, a copy of an undated memorandum from Edward C. Reuther [sic] which stated he had offered Debtor \$100.00 per acres for his land in Fall River County in the spring of 1992, and an unsigned summary of Debtor's equity position on October 7, 1991 (date petition was filed) and on June 24, 1993 (date second amended disclosure statement was filed). The matter was taken under advisement on

August 10, 1993 after receipt of briefs.²

CFF filed objections to Debtor's second amended disclosure statement on July 23, 1993. The hearing on Debtor's second amended disclosure statement was held August 10, 1993. The second amended disclosure statement was approved subject to revision to meet CFF's objections. Debtor was directed to circulate a copy of the final disclosure statement to CFF's counsel under Local Bankr. R. 105(D). To date, Debtor has not filed the disclosure statement as approved.

II.

A Chapter 11 case may be converted or dismissed for cause. Cause may include, but is not limited to,

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

11 U.S.C. § 1112(b) (in pertinent part). The movant has the burden to establish cause. *In re Sheehan*, 58 B.R. 296, 299 (Bankr. D.S.D. 1986). A determination of cause is within the discretion of the Court upon consideration of all circumstances. *Id.*

Cause for dismissing a Chapter 11 case may include a debtor's inability to reorganize timely. *First National Bank v. Kerr (In re Kerr)*, 908 F.2d 400, 404 (8th Cir. 1990), *see also United States Savings Association v.*

² The documents attached to each party's brief were not considered as evidence in this matter because the exhibits were not introduced at the July 12, 1993 hearing with proper foundation and were not subject to the opposing party's scrutiny. The adage "better late than never" does not always apply.

Timbers of Inwood Forest, Ltd., 108 S.Ct. 626, 632-33 (1988).

The movant may meet his burden [to establish cause] by showing the debtor will not be able to generate sufficient income to fund a plan or that reorganization will not improve a debtor's income generation. [Citations omitted.] Once the movant has met his initial burden, the burden may shift to the debtor to demonstrate "that [he has] at least some chance of achieving every state of [his reorganization] proposal."

In re Travis, Bankr. No. 90-10094, slip op. at 4 (Bankr. D.S.D. April 5, 1991) (quoting *In re Minnesota Alpha Foundation*, 122 B.R. 89, 94 (Bankr. D. Minn. 1990)). The feasibility test is "firmly rooted in predictions based on objective fact." *Clarkson v. Cooke Sales and Service Co.* (*In re Clarkson*), 767 F.2d 417, 420 (8th Cir. 1985). "The test is whether the things which are to be done after confirmation can be done as a practical matter under the facts." *Id.* Once a debtor is given a reasonable amount of time to reorganize, the Chapter 11 case may be dismissed or converted if a plausible plan has not been proposed. *Kerr*, 908 F.2d at 404; *In re Ashton*, 107 B.R. 670, 675 (Bankr. D.N.D. 1989); and *Sheehan*, 58 B.R. at 300.

Cause for dismissal or conversion may also include bad faith. *Kerr*, 908 F.2d at 404. Bad faith warranting dismissal includes concealment, evasion, and direct violations of the Code or a court order that clearly establish an improper motive. *Id.* Violations of the Code or court order include self-dealing and asset manipulation without court approval. *Id.* Evasion may be shown by a debtor's

filing of frivolous motions or commencement of actions in an effort to frustrate creditors. *Id.* Before dismissing a case for bad faith, the court may also need to consider whether reorganization is possible. *Id.* at 404 and 404 n.10.

III.

Based on the evidence presented at the hearing on July 12, 1993 and a thorough review of the record, this Court concludes that CFF has not met its burden of showing cause for conversion of this case. In essence, the hearing ended in a draw and the decision must go to Debtor since CFF has the burden of proof under § 1112(b).

The only evidence presented to the Court on Debtor's ability to reorganize was Debtor's own testimony. Neither party clearly established the present size of Debtor's cow herd. Debtor's statements regarding his plans to sell cows and buy back heifers was confusing because he failed to distinguish between bred and unbred heifers and he did not state his planned dates for the sales and purchases nor the expected sale and purchase prices. He did propound, however, some basis for his plan and, in the absence of contrary evidence, the Court could only conclude at this juncture that Debtor's third amended plan has a reasonable chance of success, especially if Debtor's present secured creditors remain comfortable and his wife and other family members continue to provide his living expenses.

CFF's allegations regarding Debtor's prepetition transfers of

estate property and his current post-petition efforts to re-litigate CFF's claim in Texas³ are troublesome. However, the allegations remained only allegations because the Court was not presented with any evidence to support those contentions. For example, the Court has never had exhibits or testimony presented on the nature and amount of Debtor's pre-petition transfers. With Debtor's testimony alone, it is almost impossible to prove Debtor's pre-petition and post-petition transfers were in violation of the Code.

CFF's most persuasive argument for conversion is that Debtor has unreasonably delayed this case and that Debtor's goal is to frustrate CFF's collection efforts -- not to reorganize. But for the fact that the estate's equity position has not significantly eroded, the Court would grant CFF's Motion to Convert. However, since the estate has equity sufficient to cover CFF's claim and since Debtor may still reach an accord with CFF and propose a confirmable plan, the Court declines to order conversion at this time.

³ CFF filed an objection to Debtor's application to employ counsel in Texas. Debtor filed a response to that objection. Debtor, however, has never filed an application to employ counsel in Texas. Any expenditure of estate funds to further that litigation would be in violation of 11 U.S.C. §§ 327, 330(a), and 363(b)(1). Any compromise of the claim without this Court's approval would be in violation of F.R.Bankr.P. 9019. Most important, if Debtor is attempting to re-litigate or continue earlier litigation against him by CFF, he is likely in violation of the automatic stay, since this Court's approval for that litigation was not obtained. *Farley v. Henson*, ___ F.2d ___, 1993 WL 291392 (8th Cir. August 6, 1993).

Although CFF did not precisely argue this point under its second Motion to Convert or supporting briefs, the Court notes that the present plan may *not* be confirmable under the Code, even if the repayment terms are feasible. Two problems loom for Debtor at confirmation. First, Debtor will have the burden to show that one impaired class has accepted the plan as required by 11 U.S.C. § 1129(a)(1). While Debtor has repeatedly stated that creditors other than CFF are impaired, there is little evidence in the record to support that contention under the definition set forth at § 1124. *See L & J Anaheim Associates v. Kawasaki Leasing International, Inc., (In re L & J Anaheim Associates)*, 995 F.2d 940 (9th Cir. 1993).

Second, as long as CFF objects to the treatment of its claim, then Debtor can receive confirmation of a plan under § 1129(a) and 1129(b)(2)(B) *only* if he pays CFF the present value of its claim or if Debtor receives nothing, including future profits, until CFF is paid in full. *See Norwest Bank Worthington v. Ahlers*, 108 S.Ct. 963, 969 (1988). Thus, in addition to showing that the twenty-year repayment term to CFF is offered in good faith, as required by § 1129(a)(4), and is "fair and equitable," as required by § 1129(b)(2)(B)(i), Debtor will have to show that repayment over twenty years at eight percent interest will provide CFF with the present value of its claim as of the effective date of the plan.

Receiving the present value of an unsecured claim over time is but one factor of "fair and equitable" under 11 U.S.C.

§ 129(b)(2)(B)(i). *In re Consul Restaurant Corp.*, 146 B.R. 979, 989 (Bankr. D. Minn. 1992); *In re Manion*, 127 B.R. 887, (Bankr. N.D. Fla. 1991). Without a legitimate purpose, the plan may not shift the risk of failure under the plan to the dissenting claim holder. *Consul Restaurant Corp.*, 146 B.R. at 989. Ultimately, Debtor may be placed in the precarious position of determining how much property to liquidate in order to save the remainder. *In re Yasparro*, 100 B.R. 91, 98 (Bankr. M.D. Fla. 1989).

To date, the only thing Debtor has accomplished is a delay in paying CFF's claim. In light of that fact and since the Court has already given Debtor ample opportunities to address CFF's claim and to file amended plans, the Court will no longer tolerate delays or any inaccuracies in Debtor's documents and testimony. While CFF bore the difficult burden of proof on its second motion to convert, Debtor is now faced with a similar exacting task at confirmation. Debtor's testimony alone will not be sufficient. If CFF continues to object to Debtor's plan on good faith grounds under § 1129(a)(3), Debtor has the burden to show that all questionable pre-petition transfers and post-petition sales of estate property were not contrary to the Code. Further, at confirmation Debtor will be obligated to justify income and expense projections as ones "firmly rooted in predictions based on objective fact." *See Clarkson*, 767 F.2d at 420.

An order will be entered giving Debtor until November 9, 1993 to get a plan confirmed. If Debtor does not have a confirmed plan by that date, counsel for CFF may file an affidavit under Local Bankr. R. 307 and a conversion order will be entered without further notice. CFF's second Motion to Convert will be held in abeyance until then. If the circumstances of the case change materially in the interim, CFF may seek a continued hearing on its Motion upon reasonable notice to all parties.

Dated this ____ day of September, 1993.

BY THE COURT:

Irvin N. Hoyt
Chief Bankruptcy Judge

ATTEST:

PATRICIA MERRITT, CLERK

By _____
Deputy

(SEAL)

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Western Division

In re:)
JEFFREY P. SCHULTZ) Bankr. Case No. 91-50290
Social Security No. [REDACTED]-5434) Chapter 11
Debtor.) ORDER HOLDING CFF'S MOTION
) TO CONVERT IN ABEYANCE
) AND SETTING DEADLINE
) FOR CONFIRMATION
)

In compliance with and recognition of the Memorandum of Decision Re: CFF's Motion to Convert entered this day,

IT IS HEREBY ORDERED that Commerce First Financial's (CFF's) Motion to Convert filed on February 3, 1993 shall be held in abeyance until no later than November 9, 1993 pending confirmation of a plan; and

IT IS FURTHER ORDERED that if Debtor does not obtain confirmation of a plan by November 9, 1993, counsel for CFF may file an affidavit of non compliance under Local Bankr. R. 307 and this case shall be converted to a Chapter 7 proceeding without further notice or opportunity for hearing; and

IT IS FURTHER ORDERED that should the circumstances of the case change so as to jeopardize or further impair CFF's claim, CFF may seek a continued hearing on its Motion to Convert prior to November 9, 1993 upon reasonable notice to Debtor and all other creditors and parties in interest.

So ordered this ____ day of September, 1993.

BY THE COURT:

Irvin N. Hoyt
Chief Bankruptcy Judge

ATTEST:

PATRICIA MERRITT, CLERK

By _____
Deputy
(SEAL)