

UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ILLINOIS
EAST ST. LOUIS DIVISION

IN RE:

BOBBY AND MARGIE LOGAN)	CASE NO. 97-41769
)	Chapter 13
Debtors)	
)	

**ORDER OVERRULING OBJECTION OF RAYMOND LOGAN AND
ORDER CONFIRMING DEBTORS' CHAPTER 13 PLAN**

Procedural Posture

This is the latest in a series of legal battles among family members, dating back at least five years, starting in a Kansas state court. This round began when the Debtors filed a voluntary chapter 7 bankruptcy petition on October 31, 1997. That chapter 7 case was converted to a chapter 13 case on December 2, 1997. The Debtors proposed a chapter 13 plan which drew the objection of Raymond Logan ("Raymond"), a creditor. Raymond not only objected to the confirmation of the Debtors' plan, but also moved to dismiss the chapter 13 case. Both the objection and the motion to dismiss were premised on the Debtors' lack of "good faith" under the various provisions of the Bankruptcy Code. The Bankruptcy Court denied Raymond's motion to dismiss on July 28, 1998 and confirmed the Debtors' chapter 13 plan over Raymond's objection. Raymond appealed only the confirmation of the plan, and on appeal, the District Court reversed and remanded for additional findings with respect to the Debtors' "good faith" in the proposal of their chapter 13 plan.

On remand, the Bankruptcy Court held a confirmation Hearing on March 30, 2000 wherein the Debtors appeared in person and by counsel, James Haller; Raymond appeared in person and by counsel, Douglas Antonik; the chapter 13 trustee, Robert Kearney, also was present. The Court, for the reasons stated below, now overrules Raymond's objection and confirms the Debtors' chapter 13 plan.

Background

Raymond and Debtor Bobby Logan are brothers. In April 1992, Robert and Ruth Logan, parents of Raymond and Bobby, (the "Parents") traveled from their home in Kansas to the Debtors' home in Godfrey, Illinois to seek medical assistance. Both Parents died in July, 1993. Raymond is the executor of the Parents' estates. Under the Parents' wills, the probate estate is to be divided equally between Bobby and Raymond.

Between April 1992 and July, 1993, over \$150,000 of the Parents' cash and certificates of deposits were transferred to the Debtors as well as the Parents' Beloit, Kansas home. Raymond, in this individual capacity and as executor for the Parents' estates, sued the Debtors in a Kansas state court (the "State Court"). Suffice to say that, by April 17, 1996, Raymond had obtained a judgment in the State Court against the Debtors for \$85,378.99 in compensatory damages and \$80,000 in punitive damages. Among the findings made by the State Court with respect to the compensatory damages award were that both Debtors actively assisted in the transfers of funds from the Parents' banks in Beloit to themselves and that the Debtors breached their confidential and fiduciary relationship to the Parents. Among the findings made with respect to the punitive damages award were that the Debtors were aware of the harm in their transfer of substantially all of the Parents' assets, leaving the Parents few resources to meet their medical and living expenses. The \$85,000 award of compensatory and \$80,000 award of punitive damages were upheld on appeal on May 1, 1997 and those awards were not further appealed.

In addition to the transfers of the Parents' assets, the Debtors participated during 1993 to 1997 in what can be described only as a number of confusing and suspicious financial transactions. For example, there was testimony that, during 1993-1994, Margie Logan conducted large yard sales and kept the cash proceeds in a box in a drawer. At one point, the amount of cash in the box amounted to approximately \$80,000. Margie testified that this \$80,000 in the box consisted not only of yard sale proceeds, but also the proceeds of a \$75,000 "Scudder fund", but had no idea from

where the money had originally come to purchase the Scudder fund in the first place. Later, the \$80,000 of the box proceeds, or at least a large part of them, were used to purchase the \$75,000 "Paducah CD". Bobby testified that the \$75,000 used to purchase the Paducah CD was a gift from his mother before she died.

In addition, there was also testimony that the Debtors received an IRS tax refund in the approximate amount of \$29,000. Bobby, on cross-examination, had no recollection of this refund and Margie testified that at least \$24,000 of that amount was used to pay the Debtors' son's rent for two years. There was also testimony that Bobby retired from his job as a Methodist minister in 1996, and cashed in his pension in the approximate amount of \$130,000. Prior to retirement, Bobby had been earning an annual salary in the \$20,000's and Margie was unemployed. The testimony indicates that at least \$50,000 of the pension funds went to pay the legal expenses of the Debtors' son Wesley, related to a custody fight over Wesley's son. Oddly enough, the Debtors offered no copies of itemized billing statements to support this explanation. The remainder of this money was used to pay Wesley's living expenses, medical expenses and the living and medical expenses of the Debtors. Bobby did not remember the specifics of cashing in his pension, the amount, or how the funds were spent. In general, no credible explanation was given with respect to many of these transactions, and the source and the disposition of these various funds was not clear.

This lack of credible explanation of these financial transactions, combined with the State Court judgment, prompt Raymond to conclude that, in a chapter 7, at most, all of the debts listed by the Debtors would be nondischargeable under Section¹ 727, and, at the least, the debt owed specifically to Raymond is nondischargeable under Section 523. Raymond contends that it is this taint of nondischargeability that renders the Debtors' chapter 13 plan unconfirmable because it was not proposed in "good faith" as is required by Section 1325 (a)(3).

¹All section references are to the Bankruptcy Code, Title 11 of the United States Code.

A determination of whether the Debtors' plan was proposed in good faith requires a discussion of the plan's specifics. Raymond holds a secured claim in the amount of \$4,700 and a unsecured claim of \$228,882.51.² Without a doubt, Raymond is the Debtors' largest creditor. The unsecured class consists of Raymond's unsecured claim, and a minimal amount of credit card debt and other unsecured debt. It was contended at trial that Raymond was the only unsecured creditor that has filed a timely proof of claim, and therefore would be the only claimant to share in the distribution to unsecured creditors.

The Debtors' current plan proposes to pay \$435.00 for sixty (60) months. In addition to the monthly payments, the Debtors propose to contribute to the plan: (1) \$5500 (to be paid by a friend of the Debtors); (2) \$8000, less expenses (which represents the Debtors' recovery from a lawsuit against Raymond) and (3) another \$8000 (Bobby's estimated 50% share from the Parents' estate). The Debtors contend that the monthly payments alone will be sufficient to pay a minimum of 10% to unsecured creditors. As of March 22, 2000, the Chapter 13 Trustee was holding \$21,789.79, which included the Debtors' March, 2000 payment, the \$5500 from the Debtors' friend, and the recovery from the lawsuit against Raymond.³

Discussion

²On October 27, 1998, upon the Debtors' objection to Raymond's filed claim, Judge Meyers entered an order finding that Raymond's claim is secured in the amount of \$4,700 and unsecured in the amount of \$228,882.51.

³Creditors wishing to share in the distribution of the funds paid to the chapter 13 trustee have 90 days after the first date set for the meeting of creditors to file a proof of claim. See, Rule 3002 of the Federal Rules of Bankruptcy Procedure. The docket here indicates that the meeting of creditors in the chapter 13 occurred in February, 1998 and therefore the deadline for creditors to file claims has long expired. During opening statement at the March 30th hearing, the Debtors' counsel contended that Raymond was the only unsecured creditor that filed a proof of claim and estimated that Raymond would receive approximately \$30,000 over the life of the plan, which, as was contended, is much greater than the estimated \$5,000 that Raymond would be able to collect (taking into account state and federal exemptions) through normal channels had the Debtors not filed a chapter 13.

The concept of "good faith" has at least two applications in chapter 13 cases. A prerequisite to confirmation of a chapter 13 plan is that it must be "proposed in good faith...", and that, if such "good faith" is found to be lacking, the plan cannot be confirmed. §1325(a)(3). Broader, however, is the concept that a chapter 13 case can be dismissed "for cause" under §1307(c) and the filing of a chapter 13 petition with a "lack of good faith" is among the judicially-engrafted reasons justifying "cause" to dismiss under this section.⁴ Because only the §1325-type good faith issue has been preserved for appeal here, the inquiry shall be limited only to whether the Debtors proposed their chapter 13 plan in good faith and whether the plan should be confirmed.

The Seventh Circuit Court of Appeals has had the opportunity to pass upon the factors to be considered in making a "good faith" determination under Section 1325 in the *Rimgale* case,⁵ and counsel for Raymond conceded at the hearing that the first four of the *Rimgale* factors have been met.⁶ Only the fifth factor, whether the *proposed payments* indicate a "fundamental fairness in dealing with one's creditors", is at issue. In weighing that factor, the *Rimgale* court suggested that the bankruptcy court "may wish to examine" the following: (1) the timing of the bankruptcy; (2) the proportion of the total unsecured debt that is represented by the state court judgment, and (3) the

⁴See, *In re Love*, 957 F.2d 1350, 1354 (7th Cir. 1992) for a discussion of the distinction between good faith of the *filing of the petition* under §1307 (where the remedy is dismissal of the case) and good faith of the *proposal of the plan* under §1325 (where the remedy is denial of confirmation of the plan, but *not* dismissal of the case). Raymond did not appeal the Bankruptcy Court's denial of his motion to dismiss and therefore the only issue preserved for appeal is the §1325 good faith issue, whether the plan was proposed in good faith, and where the remedy, if successful, is at most, denial of confirmation of the plan.

⁵*In re Rimgale*, 669 F.2d 426 (7th Cir. 1982).

⁶In *Rimgale*, the Seventh Circuit Court of Appeals set forth five factors to be considered in whether a chapter 13 plan has been proposed in good faith under Bankruptcy Code Section 1325: (1) Does the proposed plan state the secured and unsecured debts accurately? (2) Does it state expenses accurately? (3) Is the percentage of repayment to unsecured claims correct? (4) If there are or have been deficiencies in the plan, do the inaccuracies amount to an attempt to mislead the bankruptcy court? and (5) Do the proposed payments indicate a "fundamental fairness in dealing with one's creditors"?

equities of classifying together ordinary consumer debt and a judgment debt arising out of intentionally tortious conduct. *Rimgale*, 669 F.2d , fn 22 at 433.

The Seventh Circuit in the case of *In re Smith*, 848 F.2d 813 (7th Cir. 1988) had further opportunity to expound upon the factors first enunciated in *Rimgale*, and determined that, despite the 1984 amendments to the Bankruptcy Code, a "totality of the circumstances" test was still appropriate in a §1325-good faith analysis.⁷ Drawing upon case law from other circuits, the Seventh Circuit held that the "totality of the circumstances" test must include the following: (1) why the debtor filed under chapter 13; (2) how the debt arose; (3) whether those debts would be nondischargeable in a chapter 7, giving way to an inquiry into the debtor's pre-filing conduct; (4) the debtor's motive in seeking chapter 13 relief; and (5) the circumstances under which debts were incurred". *Smith*, 848 F.2d at 818. Apparently, these factors were to be considered in addition to the five factors set forth in *Rimgale*, or perhaps these added factors broadened that which was to be considered under *Rimgale*'s fifth "fundamental fairness" inquiry.

Raymond's proposed findings and conclusions articulate additional factors to be considered,

⁷Prior to the 1984 amendments, some courts, as part of the "totality of the circumstances" in Section 1325 good faith determinations, considered (1) the amount of the proposed payments; and (2) the duration of the plan. See, for example, *In re Estus*, 695 F.2d 311 (8th Cir. 1982). The 1984 amendments to the Bankruptcy Code (the Bankruptcy Amendments & Federal Judgeship Act of 1984, or "BAFJA", Pub. L. No. 989-353, 99 stat. 333) added Section 1325(b)(1)(B) (requiring the plan to provide for all of the debtor's disposable income for at least three years, or the "ability to pay" test) and Section 1325(b)(2) (defining "disposable income"). With these amendments, Congress legislatively set statutory parameters with respect to the amount of the proposed payments and the duration of the plan. The Seventh Circuit Court of Appeals in *Smith* acknowledged that the 1984 amendments certainly narrowed some of the factors considered in a "totality of the circumstances" inquiry, but nevertheless held that such an inquiry was still appropriate, and, further held that whether the debt sought to be discharged in the chapter 13 was nondischargeable in a chapter 7 was still very much a factor to be considered. *Smith*, 848 F.2d at 817-819. (citing with approval the *Estus* case). For further discussion of the *Estus* case and cases adhering to its approach, see footnotes 9 and 10, *infra*.

such as the timing of the petition, how the debtor's actions affected creditors; the debtor's treatment of creditors both before and after the petition was filed; and whether the debtor has been forthcoming with the bankruptcy court and the creditors, citing *Matter of Love*, 957 F.2d 1350, 1357 (7th Cir. 1992) and *In re Schaitz*, 913 F.2d 452 (7th Cir. 1990). *Love* is a §1307 case, and therefore, since Raymond has not appealed the denial of his motion to dismiss, Raymond's reliance on that case is misplaced. *Schaitz* is a §1325 case, but even the court in *Schaitz* said that "the most fundamental and encompassing" of the "totality of the circumstances" is "whether the debtor has dealt fairly with his creditors, and whether the debtor is "really trying to pay the creditors to the reasonable limit of his ability or is he trying to thwart them?". The court added, "A sincere effort at repayment is a sine qua non of good faith". (Citation omitted). *Schaitz*, 913 F.2d at 453-454. So, given this backdrop, the Court will employ a "totality of the circumstances" test here taking into consideration all of the articulated factors, with an overall focus on whether the Debtors here are making a sincere effort of repayment at a reasonable limit of their ability.

The gravamen of Raymond's objection is that the Debtors' pre-filing conduct here was egregious, that the debt arising from that conduct is nondischargeable, and that the Debtors' reason for this chapter 13 is to escape the payment of this nondischargeable debt, thus hampering the remedies Raymond would otherwise have under nonbankruptcy law. The Debtors' inability (either by faulty memory or otherwise) to account for the source or disposition of a substantial amount of funds may have rendered all of their debts nondischargeable in a chapter 7; the State Court judgment may have been nondischargeable under Sections 523(a)(2), (4) or (6) in a chapter 7. However, nondischargeability alone does not mean the plan was not proposed in good faith; for, if it did, the "super discharge" provisions of Section 1328 would be rendered useless. ("Nor can good faith be defined as the absence of any conduct that would traditionally have barred discharge, without rendering Chapter 13's discharge provisions nugatory.") *In re Rimgale*, 669 F.2d at 431-432.

So, as bizarre as the lack of explanation for many of the cash transactions may seem, the likelihood that all or a good portion of the Debtors' debt would be nondischargeable, or that the debt arose from egregious pre-petition conduct alone will not render a plan as having been filed in bad faith. For the same reasons, nor is the plan unconfirmable because its objective is to discharge nondischargeable debt, even if all of the debt to be discharged upon the plan's completion would otherwise be nondischargeable. *In re Schaitz*, 913 F.2d 452, 454(7th Cir. 1990); *Smith*, 848 F.2d at 818. The "good faith" to which Section 1325 (a)(3) refers is the proposal of *the plan*, not the incurring of the debt.

There must be more, then, than just "bad" pre-filing conduct and an objective to discharge nondischargeable debt. Raymond argues that the "more" here lies in the timing of the filing of the chapter 7 that was converted to this chapter 13. Whether or not the timing of the filing is proper under a Section 1325 "totality of the circumstances" analysis, the Court will nevertheless address it.

The Debtors filed their first chapter 13 on September 7, 1995, the day before the State Court hearing on punitive damages. The effect of that first chapter 13 filing was to stay the State Court action. That first chapter 13 was voluntarily dismissed on November 22, 1995 and Raymond was free to pursue his State Court case against the Debtors. The second bankruptcy case, the Chapter 7 (which was converted to a chapter 13 on December 2, 1997) was filed on October 31, 1997 over five months after the State Court judgment had been affirmed by the Kansas Court of Appeals. Apparently, as alluded to by Raymond's counsel in his opening statement, Raymond instituted garnishment or attachment proceedings in an attempt to collect the State Court judgment in October, 1997, and subsequently the Debtors filed their chapter 7 case.

The Court agrees with the Debtors that the timing of the 1997 chapter 7 was well after the State Court judgments were initially entered and after they had run their course on appeal. Even so, a "short" (which is a relative term) time between the entry of judgment and the filing of the petition,

while relevant, does not, alone, indicate bad faith. "The [Bankruptcy] Code does not require a debtor to wait a certain period of time after a judgement is entered prior to filing bankruptcy." *In re Smith*, 848 F.2d at 821. Nor is there anything "sinister" in filing a chapter 13 in order to seek relief from garnishment proceedings. "[i]t is common for Debtors (sic) to seek refuge in bankruptcy court from a variety of state court proceedings including ... garnishments". *In re Bayer*, 210 B. R. 794, 796 (8th Cir. B.A.P., 1997). There was uncontroverted testimony that the Debtors attempted to settle the State Court litigation for \$75,000 as early as 1995, before the first chapter 13 was filed, and Raymond rejected that offer. The Court finds that the timing of filing here does not indicate bad faith.

All which has been dealt with so far concentrates on events that occurred prepetition, but the real heart of the "totality of the circumstances" test in a "good faith" determination is whether the Debtors have dealt fairly with their creditors *in the proposal of their chapter 13 plan*. Having already said that it takes more than just a nondischargeable debt and a filing timed on the heels of creditor action, the Court believes that there must also, at a minimum, be some type of infirmity with respect to the schedules or the provisions of the plan itself. No evidence was presented to suggest that the Debtors failed to disclose assets or debts. No evidence has been presented to suggest that the Debtors' treatment of claims is suspect or runs afoul of Section 1325. No evidence has been presented to suggest that the Debtors' budget is inflated, unreasonable or excessive. No evidence has been presented to suggest that the Debtors are not submitting all of their disposable income to the trustee. Indeed, had any of these infirmities been present, the chapter 13 trustee (who recommended confirmation of the plan the first time around, and, who, this time around, was present in the courtroom for the entire hearing) would have spoken up, but and the only comment by the trustee here was that he continued to have no objection to the Debtors' plan because it meets the confirmation requirements of Section 1325.

What the Debtors' plan provides is the Debtors' best efforts and a level of repayment that

not only is within their reasonable limits, but exceeds them. The Debtors' current plan last five years, and even had the Debtors stuck with their original three year plan, that would not have been an indication of bad faith, because the Debtors have a right to propose a three year plan and the plan is extended only for cause. §1322(d). The Debtors are submitting an additional \$5000 to the plan which is being given to them by a family friend. All the recovery on the judgment against Raymond, less reasonable expenses, is being submitted to the trustee. The Debtors also proposed to submit Bobby's 50% share of the Parents' estates, which, after accounting for legal fees incurred by Raymond in pursuing his and the estates' claims against Bobby, is estimated to be around \$8000. All of these submissions to the plan ultimately benefit Raymond, since he appears to be the only unsecured creditor eligible to participate in distribution under the plan. See, footnote 3, *supra*. The Debtors have not been behind in their payments to the chapter 13 trustee, and, indeed, are strongly motivated to complete the payments under their plan since the debt owed to Raymond could be nondischargeable in a chapter 7.

One must ask also if Raymond isn't faring better through the chapter 13 compared to obtaining a nondischargeable debt in a chapter 7:

The bankrupt is not likely to emerge from a Chapter 7 bankruptcy with assets upon which the holder of a (nondischargeable) debt against him can levy. The purpose of making a debt nondischargeable in bankruptcy is to enable satisfaction of the debt out of the debtor's future income rather than allowing the debtor to wipe the slate clean; and a Chapter 13 plan, may, in particular though not all circumstances, provide a more secure method of applying future income to such a debt than if the creditor were left to rely on garnishment and other collection procedures provided by state law. Where this is so, the creditors will actually benefit from the fact that Chapter 13 covers debts nondischargeable under Chapter 7.

Schaitz, 913 F.2d at 454.

The law of this circuit clearly has held that among the factors to be considered in the "totality of the circumstances" in Section 1325(a)(3) cases is whether the debt would otherwise be nondischargeable in a chapter 7. And, while the *Smith* court acknowledged that nondischargeability

alone would not defeat plan confirmation, 848 F.2d at 818, the court there favorably cited the *Estus* case⁸ as one where a similar "totality of the circumstances" approach had been taken.⁹ Although the *Estus* case and cases that generally follow its "totality of the circumstances" approach (including the cases in this circuit) have been criticized,¹⁰ that test still applies in this circuit. In considering what this Court believes to be the appropriate factors to be considered in that "totality of the

⁸695 F.2d 311 (8th Cir. 1982).

⁹*Estus* was "the first court of appeals decision to expressly include as an indicator of bad faith a debt's nondischargeability in Chapter 7..." *In re Keach*, 243 B.R. 851, 860 (1st Cir. B.A.P. 2000).

¹⁰See, *In re Keach*, 243 B.R. 851 (1st Cir. B.A.P. 2000) where the Bankruptcy Appellate Panel for the First Circuit Court of Appeals vacated and remanded a bankruptcy court decision which denied confirmation on §1325(a)(3) grounds. There, a creditor sued the debtor, in part, for deceptive trade practices (fraud) and obtained a prepetition state court judgment against the debtor in the amount of \$76,000 in compensatory damages and \$30,000 in punitive damages. During the pendency of the chapter 7, the creditor filed a nondischargeability complaint and obtained summary judgment against the debtor in the same amount as the state court judgment based on issue preclusion principles. The chapter 7 debtor unsuccessfully attempted to convert his chapter 7 case to a chapter 13 case. That conversion was denied, and the debtor filed a new chapter 13 case after he received a discharge of his debts (other than the nondischargeability judgment) but before the chapter 7 case was closed. In his chapter 13 plan, the debtor proposed to devote all of his disposable income to the plan, pay priority tax debt in full, and pay a 5% dividend on the nondischargeable fraud claim. After a thorough but critical discussion of how the "good faith" case law evolved, the *Keach* court determined that the former Bankruptcy Act established that "good faith" was only "honesty in the debtor's conduct related to the plan or case" and "had nothing to do with the debtor's prepetition actions or the debtor's assertion of legal rights". 243 B.R. at 857. With the enactment of the Bankruptcy Code in 1978, courts became split as to whether the "good faith" inquiry was this limited, or whether the inquiry should be broadened to consider whether there has been an abuse of the "spirit" of chapter 13, which would bring into focus other factors such as chapter 7 nondischargeability, the percentage dividend to unsecureds, and successive filings. 243 B.R. at 857. The blunt conclusion of the *Keach* court was that, "the meaning of the term 'good faith' has gone far afield from that intended by the drafters of the Bankruptcy Code" and that if Congress had wanted judges to concern themselves with a debtor's pre-filing conduct and the "spirit" of chapter 13, it would have clearly spelled out this change to pre-Code law and so legislated. 243 B.R. at 867-868. Starting from that premise, *Keach* goes so far as to say the "the *Estus* line of decisions represents pure judicial legislation" because *Estus* and its progeny are "blatantly inconsistent with a debtor's clear statutory rights", one of which is a discharge under Section 1328 even for debts arising from fraudulent conduct. 243 B.R. at 868. In a nutshell: if you're in the First Circuit, you don't care how the debtor has acted prepetition. This court is not in the First Circuit, but Raymonds' plan objection here still fails even under the criticized "totality of the circumstances" approach.

circumstances" test, and the respective weight to be afforded each factor, this Court concludes that the prefiling conduct of the Debtors here, although certainly not commendable, is not enough to defeat confirmation of their plan.

Even if the Court were to agree that "good faith" was lacking, the only remedy preserved on appeal was denial of confirmation, not dismissal or conversion of the case. How would the plan be amended to improve upon that which it already provides? Based on the discussion above and the evidence presented at the hearing, it could not be improved by providing for greater monthly payments or a longer duration, because the Debtors have met their statutory limits (and duties) which respect to those matters. The plan proposed here by the Debtors represents, to the best of their ability and within their reasonable limits, a fair attempt to deal with their debts, including the one owed to Raymond.

Accordingly, the Court concludes that the Debtors' current chapter 13 plan was proposed in good faith under Section 1325(a)(3), and therefore, Raymond's objection is OVERRULED and the Debtors' plan is CONFIRMED.

DATE: May 25, 2000

/s/ ANTHONY J. METZ, Judge
United States Bankruptcy Court

Distribution:

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