

In the United States Bankruptcy Court

for the Northern District of Iowa

H & H DISTRIBUTING CO. OF CLEAR LAKE
Debtor.

Bankruptcy No. 95-40614XM
Chapter 7

DECISION RE: INVOLUNTARY PETITION

The matter before the court is the involuntary petition filed against H & H Distributing Company of Clear Lake (DEBTOR) seeking an order for relief under chapter 7. The petition was filed April 7, 1995 by H & H Distributing Company (PETITIONER). The petitioner is located in West Union, Iowa. Debtor filed its answer on June 16, 1995, denying that Petitioner was an eligible petitioner and denying that debtor was generally not paying its debts as they become due. Debtor contends that petitioner's claim is in bona fide dispute. Trial was held September 28, 1995 in Fort Dodge. Richard H. Moeller, Esq. appeared for the petitioner; M. Wayne Oltrogge, Esq. appeared for the debtor. The court now issues its findings and conclusions as required by Fed.R.Bankr.P. 7052.

Findings

Debtor is an Iowa corporation which for many years sold foodstuffs to institutional and commercial buyers in the Clear Lake/Mason City area. Petitioner operates a similar business in the West Union area. Donald E. Hansen began these business operations. He incorporated Petitioner and established a branch office in Clear Lake. His son, James E. Hansen, acquired the Clear Lake operation and separately incorporated it in 1968. He is a 75 per cent shareholder of the debtor, and he has been its president for more than 10 years. His mother, Ruth L. Hansen, and his sister, Sandra K. Baldwin, own the other 25 per cent of the stock of the debtor.

After debtor's separate incorporation, it bought nearly all of its inventory from the petitioner. Sometime in the 1980s, James E. Hansen became concerned that debtor was being overcharged on its purchases from petitioner. He raised that concern with petitioner, and in 1988, the debtor received a refund of overcharges for some period of prior years.

Debtor continued to buy goods from the petitioner. Debtor's account balance with the petitioner increased. James E. Hansen again disputed the charges being made by petitioner, but no settlement of the dispute was reached. For a short period, debtor purchased goods on a cash-on-delivery basis, but in September 1992, petitioner ceased selling goods to the debtor. Debtor found no substitute supplier. It ceased operations immediately. Its employees quit and went to work for the petitioner.

In September 1992, petitioner sued debtor on the open account in the Iowa District Court for Fayette County. Debtor denied the claim and filed a counterclaim on theories of unjust enrichment, fraudulent misrepresentation, and tortious interference with contractual and prospective business advantage. It also filed cross claims, presumably on the same theories, against Sandra K. Baldwin, who is president of the petitioner, and against Hansen's parents, who are shareholders of the petitioner. Trial to the

court took place in July 1994. The court issued its decision in October 1994. It granted judgment for the petitioner in the amount of \$226,511.56 plus interest at 10 per cent from the date of the decree and costs of \$279.60. The court denied the counterclaim and cross claims. Debtor appealed the judgment but did not post bond or otherwise obtain a state court stay of execution. The appeal is presently stayed by the involuntary petition. 11 U.S.C. 362(a).

Prior to the filing of petitioner's state court action, and apparently after the dispute with petitioner arose, debtor collected between \$140,000 and \$160,000 from approximately 500 accounts receivable, the largest of which may have been \$3,000 to \$4,000. After it ceased operations, debtor sold trucks that it owned. James E. Hansen borrowed from the corporation nearly all of the proceeds of accounts and truck sales. Some has been repaid by accounting offsets against his wage claims against the corporation. Hansen says he also repaid some of the loan by paying ongoing bills of the corporation. Hansen was unable to testify as to the exact amount of the loan or the repayments.

Debtor has few assets. It owns a combine, which Hansen estimates has a fair market value of between \$90,000 and \$100,000, a walk-in cooler, a freezer, some office furniture and some remaining accounts which Hansen believes are probably valueless. It also owns the claim against Hansen on the loan. Also, for two years, Hansen borrowed the debtor's combine for use on his farm. He concedes he probably owes the debtor something for its use, perhaps \$5,000 to \$7,000 per year.

The debtor has few debts. It has an obligation to a couple named Mullins for its lease of business real estate. Payments under the lease are current. There is no evidence as to the amount of the obligation. It owes Case Credit Corp. approximately \$80,000 on the combine; payments on that debt are current. It owes attorney David W. Dunn a balance of approximately \$10,000 for representing it in the state court litigation. Shortly before the state court trial, the corporation gave Dunn a junior security interest in the combine to secure his fees. Dunn has taken no action to collect. There was no evidence introduced as to the terms of repayment for the debt, only that it is owed and is secured. Debtor allegedly owed James Hansen some amount for unpaid wages.

Debtor's only other debt is to petitioner. Debtor has made no payments on the judgment. Petitioner garnished \$900 from a corporate bank account. Hansen testified that at the time the bankruptcy was filed, the only debt on which payments were not being regularly made or for which security arrangements had not been made was petitioner's "disputed claim."

Discussion

Debtor denies that petitioner is an eligible petitioner under 11 U.S.C. 303(b). As debtor has fewer than 12 debts of any nature, the petitioner qualifies as a single petitioner if it is the holder of a non-contingent claim \$10,000 greater in amount than the value of any lien it holds. The claim must not be the subject of a bona fide dispute. 11 U.S.C. 303(b)(2). Debtor contends that because it disputes the claim and because the petitioner's judgment against it is on appeal, the claim is the subject of a bona fide dispute. I disagree.

In Iowa, a judgment on appeal is a final judgment. Shaw v. Addison, 236 Iowa 720, 727, 18 N.W.2d 796, 800 (1945). The Bankruptcy Code does not define "bona fide dispute." The Eighth Circuit Court of Appeals has adopted an objective inquiry to determine if there exists a bona fide dispute on a debt. Rimell v. Mark Twain Bank (In re Rimell), 946 F.2d 1363, 1365 (8th Cir. 1991), *cert. denied*, 504 U.S. 941, 112 S.Ct. 2275 (1992). A bona fide dispute is found if there are substantial factual and legal questions raised by the debtor as to its liability. Id. The debtor's subjective belief as to the genuineness

of the dispute does not satisfy the test. In this case, the state court has determined that the debtor owes petitioner more than \$226,000 and that debtor has no claim against the petitioner. Does debtor's appeal of that judgment mean the petitioner's claim is still subject to a bona fide dispute? Debtor cites no case to support an affirmative answer. Two bankruptcy court cases support a negative determination. In re Drexler, 56 B.R. 960, 967 (Bankr. S.D. N.Y. 1986); *cf.* In re Raymark Industries, Inc., 99 B.R. 298, 299 (Bankr. E.D. Pa. 1989) (claim based on stayed judgment is subject to bona fide dispute). Because an unstayed judgment is enforceable as a final judgment under state law, I conclude that such judgment is not in bona fide dispute under 11 U.S.C. 303(b). Petitioner is an eligible petitioner.

The court must order relief under chapter 7 in this case if "the debtor is generally not paying such debtor's debts as such debts become due unless such debts are the subject of a bona fide dispute." 11 U.S.C. 303(h)(1). Because debtor's debt to petitioner is not in bona fide dispute, petitioner's claim may be considered in determining whether debtor is generally not paying its debts as they become due.

Bankruptcy courts have generally held that the non-payment of a single debt does not constitute a general failure to pay debts as debts become due. Paroline v. Doling, 116 B.R. 583, 585 (Bankr. S.D. Ohio 1990). Oft cited in support of this proposition is the statute's reference to "debts" not "debt." Id. I agree with that interpretation of the Code. Petitioner contends that debtor is also failing to pay attorney, David W. Dunn. But that contention is based on petitioner's assumption that an attorney bills for a matter either periodically or at the conclusion of the case. Petitioner presumes, therefore, that in addition to the debtor's owing Dunn money, payment of the debt is due. There is no evidence of this. Dunn may have agreed otherwise. Money is owed there is no doubt, and the debtor has given security for the debt. But there is no evidence that payment of the debt is delinquent.

The evidence is that there is one creditor whose claim is due who is not being paid--the Petitioner. Such showing is insufficient under the Code to meet the test that the debtor is generally not paying its debts as they become due.

Courts have granted relief even when only one creditor is not being paid if particular circumstances justify it, for example where state law remedies are inadequate or where the debtor has "engaged in trick, sham, artifice or fraud." Id.; In re Blaine Richards & Co., Inc., 16 B.R. 362, 365 (Bankr. E.D. N.Y. 1982); Matter of 7H Land & Cattle Co., 6 B.R. 29, 32 (Bankr. D. Nev. 1980).

Petitioner does not allege an inadequate remedy under state law. It merely argues that the collection remedies available in bankruptcy court are more efficient than the state court remedies. Petitioner does not allege fraud, although there may be fraud in the circumstances of this case. It appears that while under the pressure by its largest creditor, the debtor liquidated the bulk of its assets and loaned them to its principal. James Hansen in turn has used the loan to pay some of his salary and some day-to-day expenses of the corporation. These appear at least to be badges of fraud. The evidence was not sufficient at trial to ascertain the reason for the loan, its terms, or the likelihood of its repayment. I cannot determine on this record that debtor has committed fraud. To the extent that the petitioner can prove a fraudulent conveyance to Hansen under state law, it may do so in a state forum. Production Credit Ass'n of the Midlands v. Shirley, 485 N.W.2d 469 (Iowa 1992). Petitioner has failed to prove either fraud or lack of an adequate state remedy and is, therefore, not entitled to an order for relief under such exceptions. Order for relief shall not enter in this case.

IT IS ORDERED that the request for an order for relief under chapter 7 is denied, and the involuntary petition is dismissed.

IT IS FURTHER ORDERED that the trustee shall file his final report and return possession of debtor's property to it.

SO ORDERED THIS 6th DAY OF OCTOBER 1995.

William L. Edmonds

Chief Bankruptcy Judge

I certify that on _____ I mailed a copy of this order and a judgment by U.S. mail to: M. Wayne Oltrogge, Richard Moeller, Les Reddick, Larry Eide and U.S. Trustee.