In the United States Bankruptcy Court

for the Northern District of Iowa

FREDERICK A. WILKER
GLADYS WILKER
Debtor(s).

Bankruptcy No. 98-01117-W

Chapter 13

ORDER RE CONFIRMATION OF DEBTORS' SECOND MODIFIED PLAN

On September 22, 1999, the above-captioned matter came on for trial pursuant to assignment. The matter before the Court is the confirmation of Frederick and Gladys Wilker's (collectively "Debtors") Second Modified Plan (the "Plan") and objections thereto. Debtors appeared in person with Attorney Carey Kirk. The Chapter 13 Trustee Carol Dunbar was present. Also present was Assistant U.S. Attorney Lawrence Kudej representing Farm Service Agency ("FSA"). This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(L).

STATEMENT OF THE CASE

Debtors filed for relief under Chapter 7 of the Bankruptcy Code on April 15, 1998. The Court granted Debtors' motion to convert their case to Chapter 13 by Order dated July 21, 1998. Debtors subsequently filed their first Chapter 13 plan, which was modified on January 19, 1999, and again on April 20, 1999. The second modified plan of April 20, 1999 is the plan proposed for confirmation.

FINDINGS OF FACT

I. Provisions of the Plan

Debtors propose to pay $149 per month to creditors under the Plan. These payments will provide a dividend to unsecured creditors of approximately four percent. Mr. Wilker testified that his wife has had health problems resulting from recent exposure to chemical pesticides. Mrs. Wilker was hospitalized in May of 1999. She is apparently still receiving treatment for pesticide poisoning, but has returned to work. Mr. Wilker was unable to provide accurate figures regarding the total amount of health costs Mrs. Wilker has incurred thus far. Debtors' insurance may pay up to 80% of the total cost. Mr. Wilker testified that due to Mrs. Wilker's health problems, they are only able to pay $149 per month into the Plan. Aside from Mr. Wilker's testimony, Debtors presented no other evidence concerning medical expenses.

II. Debtors' Prepetition Relations With Creditors

When the petition was filed, Debtors owed Luana Savings Bank (the "Bank") approximately $34,000, which is secured by collateral that now has a value of $28,100. Debtors filed their petition for relief on April 15, 1998. They nevertheless signed a new note with the Bank in August of 1998 which apparently includes Debtors' entire prepetition obligation to the Bank. Debtors have been liquidating

assets and paying the Bank on this secured claim, without Court approval, throughout the pendency of this bankruptcy. At the time of trial, the Bank held a claim of $28,800, secured by collateral valued at $28,100.

Debtors list FSA as holding a secured claim in the amount of $4,933 and an unsecured claim of nearly $8,000. FSA's security is limited to corn that was sealed pursuant to a 1995 contract. Mr. Wilker fed sealed corn to his cattle without FSA's permission. FSA approached Mr. Wilker about this violation of the 1995 agreement. Mr. Wilker responded by writing a check to FSA for the corn he used. The check was returned for insufficient funds and has never been honored. Mr. Wilker testified that he was aware at the time he wrote the check that his account did not contain sufficient funds to cover the check.

In 1995, Debtors owed Four County Ag Services approximately $2,000, Postville Implement approximately $4,000, and Brynsass Sales and Service approximately $4,000. Despite these obligations, and the obligation to FSA arising from the conversion of the corn, Debtors loaned their son $15,000.

Debtors list James and Beverly Harms as holders of an unsecured claim against Debtors in the amount of $19,593.32. This claim arose from a transaction between Debtors and the Harmses in early 1997. Debtors "purchased" 19 head of cattle from the Harmses in what was intended to be a cash transaction. When Mr. Wilker arrived to pick up the cattle, however, he told the Harmses that he forgot his checkbook but would return later to write them a check. Mr. Wilker took all but four of the cattle. He never returned to pay the Harmses. Mr. Wilker admitted at trial that he did not have the cash in his checking account to cover the cost of the cattle at time he took them.

Debtors paid $775 to the Ament Law Firm on March 4, 1998, within 90 days of filing their Chapter 7 petition. Debtors paid an additional $400 to the Ament Law Firm on July 9, 1998, after they filed their Chapter 7 petition. Mr. Wilker testified that he did not remember what the $400 payment was for. The Plan contemplates that Debtors will make additional payments to the Ament Law Firm totaling $1,400.

III. Debtors' Schedules

Debtors submitted a financial statement to the Bank on November 7, 1997. Mr. Wilker claims he signed this in blank and Bank employee David Schultz completed the form. Mr. Wilker acknowledges, however, that he signed this financial statement under oath and that he did not ask the Bank to make any changes when he later saw this form. This financial statement lists Debtors' loan to their son as an asset.

The financial statement lists Certificates of Deposit at Decorah State Bank in the amount of $11,500. Mr. Wilker asserts that the only Certificate of Deposit they had was in the amount of $5,000. The financial statement lists grain on hand as of November 7, 1997 in the amount of $8,580. Mr. Wilker testified that he did not know if he had $8,000 worth of grain on hand in November of 1997.

The financial statement indicates that Debtors owned 60 head of cattle as of November, 1997. Mr. Wilker testified that he sold 19 head of cattle in January, 1998 and applied the proceeds toward an obligation owed to the Bank. He claims that the rest of his cattle either died or were given away to neighbors. He was not able to name anyone who may have received these cattle. Debtor admits that as of the time of the filing of the Chapter 7 petition in April of 1998, he may have still had four or five head of cattle.

Debtors' schedules do not reveal the $15,000 loan to their son that is listed as an asset on the financial statement. The schedules do not list any Certificates of Deposit or cash on hand. The schedules are silent as to the cattle Mr. Wilker testified to having at the time Debtors filed for relief. Debtors schedules also do not reveal the transfer of any cattle prepetition.

Mrs. Wilker owned a $5,000 Certificate of Deposit prior to the filing of Debtors' petition. She redeemed this Certificate of Deposit for cash on March 23, 1998. Debtors filed their petition on April 15, 1998. Mrs. Wilker testified that she used the cash from her Certificate of Deposit solely to pay bills listed on Government's Exhibit K. The earliest receipt in Exhibit K is dated April 17, 1998. This establishes that Debtors had $5,000 cash on hand when they filed their petition. Debtors' schedules fail to reveal either the Certificate of Deposit or the cash from its redemption.

Debtors scheduled their total tax refunds at $2,000. (Debtors' Sch. B.) Debtors had already filed their tax returns for 1997 when they filed these schedules. Their returns indicate that Debtors were entitled to, and claimed, a refund of approximately $6,000. (Government's Ex. P at 6& 9-10.) Debtors subsequently received income tax refunds totaling approximately $6,000. Mr. Wilker testified that on April 22, 1998, he used $3,900 of the refund to buy grass and barley seed. He testified that he paid for this seed in cash.

Over an extended period of time, including the months preceding bankruptcy, Debtors received patronage dividends from Ace Telephone Company, Postville Coop, and Foremost Dairy. (Government's Ex. P at 23.) This income is not included in the disposable income analysis or in Debtors' schedules. At the time they filed their Chapter 7 petition, Debtors also had bank accounts with small balances which are not included in the schedules.

Debtors acknowledge that they owed a debt to FSA at the time they filed for relief under Chapter 7. Mr. Wilker also acknowledges that he did not include FSA as a creditor on Debtors' November 7 financial statement to the Bank. Debtors similarly did not list FSA as a creditor when they filed their Chapter 7 petition on April 15, 1998.

IV. Disposable Income

The Plan states that Debtors have disposable income of $149 per month available to fund their Plan. This is based on a scheduled net monthly income of $3,143. Mr. Wilker testified that Debtors' sole income at this time comes from the couples' paychecks. Debtor's pay stubs, however, indicate that Debtors' combined net monthly income is actually $3,525.30. (Trustee's Ex. A.) Mr. Wilker testified that the lower figure may reflect income as of 1997 although the Plan is dated April 20, 1999.

In addition to issues concerning disposable income and expenses, Debtors' schedules reflect that Mr. Wilker contributes $40 per pay period into the Federal Thrift Savings Plan. This is a completely voluntary program. He could eliminate contributions to this program without penalty. This would generate an additional $86 per month in income. Finally, Debtors have received substantial income tax refunds in past years, including refunds in excess of $6,000 for taxable year 1997. The Plan does not reflect these tax refunds or excess withholdings in its disposable income analysis.

V. Debtors' Liquidation Analysis

Debtors' liquidation analysis does not refer to the post-petition transfers that a Chapter 7 trustee could potentially recover, including the transfer of nearly $5,000 cash on hand that Debtors failed to schedule. The liquidation analysis fails to account for the potential recovery of cattle Debtors

transferred for no consideration prior to filing the petition. The liquidation analysis does not account for any bank assets, patronage dividends, or tax refunds. There is no reference in the liquidation analysis to Debtors' potential lawsuit arising out of a pesticide incident that allegedly caused Mrs. Wilker's health problems and damage to Debtors' cattle and crops. Debtors value this lawsuit at $98,000 on their schedules. (Attachment to Sch. B.) The liquidation analysis does not account for the $15,000 debt Debtors' son owes to them.

In addition to the foregoing relating to assets and expenses, Debtors have claimed Mr. Wilker's pension as exempt in their modified plan. However, the pension is not claimed exempt in their schedules.

CONCLUSIONS OF LAW

The proponent of a Chapter 13 plan bears the burden of establishing every element of confirmability, including good faith. In re Standfield, 152 B.R. 528, 534 (Bankr. N.D. Ill. 1993); In re Norman, 162 B.R. 581, 583 (Bankr. M.D. Fla. 1993); In re Clements, 185 B.R. 903, 906 (Bankr. M.D. Fla. 1995). As proponents of the Plan, Debtors bear the burden of establishing its confirmability.

Bad Faith Filing of Plan (1325(a)(3))

To qualify for confirmation, a Chapter 13 plan must be proposed "in good faith and not by any means forbidden by law." 11 U.S.C. §1325(a)(3). The Court determines whether a debtor has proposed a plan in good faith on a case by case basis, using a totality of the circumstances approach that focuses on specific factors. In re LeMaire, 898 F.2d 1346, 1349 (8th Cir. 1990); In re Nielsen, 211 B.R. 19, 22 (B.A.P. 8th Cir. 1997).

Specifically, the Court focuses on: 1) the accuracy of the debtor's schedules; 2) whether the debtor made any fraudulent misrepresentations to mislead the bankruptcy court; 3) whether the debtor has unfairly manipulated the bankruptcy code; 4) whether the debtor seeks to take advantage of Chapter 13's super discharge; and 5) the debtor's motivation and sincerity in seeking Chapter 13 relief. Education Assistance Corp. v. Zellner, 827 F.2d 1222, 1227 (8th Cir. 1987); LeMaire, 898 F.2d at 1349; In re Turpen, 218 B.R. 908, 914 (Bankr. N.D. Iowa 1998). Pre-filing conduct is relevant to this analysis to the extent it indicates a post-filing lack of good faith. LeMaire, 898 F.2d at 1352. Eighth Circuit precedent has been interpreted to require an analysis of the "blameworthiness of a debtor's pre-petition conduct." In re Sitarz, 150 B.R. 710, 722-24 (Bankr. D. Minn. 1993).

I. Debtors' Inaccurate Schedules

Debtors' counsel quotes part of a Sixth Circuit case that does not mention a debtor's inaccurate schedules or failure to disclose assets as a factor in determining bad faith. The Court notes first that well-developed Eighth Circuit precedent exists on this issue and reliance on Sixth Circuit law is unnecessary. The Court also notes that the case Debtors' counsel cites in fact grounds its finding of bad faith, in part, on the debtor's failure to disclose assets. In re Caldwell, 895 F.2d 1123, 1126 (6th Cir. 1990). Indeed, the paragraph immediately following the portion of the opinion Debtors quote provides the following:

> "Rather than a good faith effort to repay this debt, we see an unbroken pattern of deceit and delay ... [Debtor] did not disclose a personal IRA containing $6,300 until the bankruptcy trustee discovered the account...."

Caldwell, 895 F.2d at 1127.

It is this Court's conclusion that intentionally inaccurate schedules are always relevant to the issue of bad faith and inaccurate schedules can support a finding of bad faith under §1325(a)(3). Zellner, 827 F.2d at 1227; Turpen, 218 B.R. at 914; In re Tobiason, 185 B.R. 59, 63 (Bankr. D. Neb. 1995). In Turpen, the Court found that the plan was proposed in bad faith because the schedules failed to list a $100,000 asset and because the debtor sought to take advantage of the super-discharge and proposed essentially a Chapter 13 liquidation plan.

A proposed Chapter 13 plan can be denied confirmation under §1325(a)(3) solely because it fails to list a stock option that the debtor held at the time of filing. The debtor has an obligation to list all assets held at the time of filing, even if those assets contain no value or are exempt. Tobiason, 185 B.R. at 62-3.

Based on the evidence presented, it is probable that Debtors would benefit from Chapter 13's super-discharge. In addition, Debtors' schedules do not list a number of assets they held at the time of filing. Debtors did not list the $15,000 obligation their son owed to them, a Certificate of Deposit worth $5,000 (or the cash-on-hand from its liquidation), at least 4 head of cattle, and various bank accounts. Debtors also seriously understated their income on their schedules and did not list FSA's claim.

Debtors argue that their transfer of $15,000 to their son was a gift rather than a loan. Debtors, however, listed the loan as an asset when applying to the Bank for a loan. Mr. Wilker testified that he signed the financial statement in blank and was unaware of its contents. Because the financial statement was signed under oath and a correction was never requested, Debtors' denials are unpersuasive.

Debtors claim that they did not have to list the $5,000 cash they had on hand at the time they filed their petition because they converted it to exempt property post-petition. (Debtor's Br. at 4.) This argument is without merit. Debtors are required to list all assets regardless of value or exempt status. SeeTobiason, 185 B.R. at 62-3; In re Tripp, 224 B.R. 95, 98-9 (Bankr. N.D. Iowa 1998). It is for the Court to determine whether these assets are exempt, not the debtor. Even if Debtors did not have an obligation to list exempt assets, the cash on hand is not exempt. The Court determines a debtor's exemptions based on the facts and law as they exist on the date of filing. See 11 U.S.C. §522(b)(2)(A); Owen v. Owen, 500 U.S. 305, 314 n. 6 (1990); In re Reed, 184 B.R. 733, 737 (Bankr. W.D. Tex. 1995) (post-petition conversion of exempt homestead to cash did not render cash non-exempt). Debtors held $5,000 of non-exempt cash on the date they filed their petition and their post-petition transfers cannot change that status.

On their schedules, Debtors seriously undervalue a very liquid asset - their tax refund. Debtors value this refund at $2,000. Debtors were aware at the time they filed their schedules that the refund would be closer to $6,000. They nevertheless disclosed only as much of the refund as is exempt. See 11 U.S.C. §522(b)(2); Iowa Code §627.6(9)(c). A debtor's plan is nonconfirmable under §1325(a)(3) if a debtor knowingly undervalues a number of assets on the Chapter 13 schedules. See In re Murrell, 160 B.R. 128, 131 (Bankr. W.D. Mo. 1993). This Court concludes that Debtors' knowing and significant undervaluation of their tax refund is relevant to the totality of the circumstances analysis.

The Plan does not purport to cure any of the deficiencies in Debtors' schedules. The Plan makes no provision for the liquidation of the obligation Debtors' son owes to them. The Plan also makes no provision to pay Debtors' creditors the $5,000 they omitted from their schedules. In addition, Debtors

have not expressed an intention to dedicate their tax refunds, which they knowingly undervalued, to the Plan.

A debtor's failure to cure defects in schedules may constitute bad faith under §1325(a)(3). In re Rosencranz, 193 B.R. 629, 636 (Bankr. E.D. Mass. 1996). A debtors' initial inaccuracies coupled with the failure to commit these assets to their plan is sufficient for the court to find bad faith under §1325 (a)(3). Here, Debtors have not corrected their schedules or dedicated the missing assets to the Plan. Under the totality of the circumstances, Debtors' inaccurate schedules, coupled with their failure to cure these inaccuracies in the Plan, establishes that Debtors filed their Plan in bad faith.

II. The Timing of Debtors' Loan to Their Son

At least one court has applied Eighth Circuit law to find bad faith under §1325(a)(3) where a debtor incurs obligations through dishonest methods while, at the same time, loaning money to family members. See In re Jobe, 197 B.R. 823 (Bankr. W.D. Tex. 1996). In Jobe, the debtors executed a promissory note in connection with the purchase of their homestead. Jobe, 197 B.R. at 824. The debtors failed to timely pay the note but promised the holder that they would pay the obligation with proceeds from the sale of cattle. During this same time period, the debtors loaned $4,000 to their nephew, but never paid the promissory note. Jobe, 197 B.R. at 824-25. The court determined that this conduct, together with various inaccuracies on the debtors' schedules, was sufficient evidence of bad faith to prevent confirmation. Jobe, 197 B.R. at 828.

Debtors' schedules contain serious inaccuracies. In addition, prior to filing, Mr. Wilker took possession of nineteen head of cattle from Mr. and Mrs. Harms promising to return with a check for the purchase price. Mr. Wilker never returned. He testified at trial that he knew at the time he took the cattle that he did not have sufficient funds in his account to cover the nearly $20,000 purchase price. Debtors also eliminated the only property securing FSA's claim by feeding sealed corn to their cattle. Debtors then gave an unknown number of these cattle to friends and neighbors, but wrote FSA a bad check for the lost collateral. Debtors claim that this conduct was the result of severe financial difficulties. Nonetheless, Debtors had sufficient funds to loan to their son $15,000 during this same time. Under the totality of the circumstances, this conduct establishes that Debtors filed the Plan in bad faith.

III. Debtors' Potential Fraud Against the Harmses

The bankruptcy court, as part of its §1325(a)(3) determination, must analyze the public policy implications of granting a debtor a super-discharge. Sitarz, 150 B.R. at 722 (citing LeMaire, 898 F.2d at 1351). This analysis is required regardless of the type of injury the debtor's conduct caused. Id. This policy determination requires an evaluation of the offensiveness of the conduct giving rise to the debt as well as the effect discharging the debt would have on creditors. Sitarz, 150 B.R. at 723-24.

Debtors incurred an obligation to the Harmses that may well be nondischargeable in a Chapter 7 but dischargeable in a Chapter 13. See 11 U.S.C. §§523(a)(2)(A) and 1328. The Harmses are individual farmers. The Harmses presumably expended their own funds for the costs of purchasing, caring for, and raising the cattle they sold to Debtors. Nonetheless, Debtors seek to discharge their obligation to the Harmses by paying four percent of that obligation under a Chapter 13 plan. As the Sitarz court found, this result is contrary to the policies underlying the Bankruptcy Code. Sitarz, 150 B.R. at 724.

Based on Debtors' inaccurate schedules, their failure to cure the inaccurate schedules in the Plan, the timing of their loan to their son, and the manner in which they incurred their debt to Mr. and Mrs.

Harms, Debtors have failed to establish that they proposed the Plan in good faith. The Plan, therefore, is not confirmable under §1325(a)(3).

Best Efforts (1325(b))

The Court cannot confirm a Chapter 13 plan if: 1) the trustee or a party in interest objects; 2) the plan does not provide for full payment of the objector's claim; and 3) the debtors do not dedicate their entire disposable income to the plan. 11 U.S.C. §1325(b). Under §1325(b), the objecting party bears the "'initial burden of producing satisfactory evidence to support the contention that the debtor is not applying all of [the debtor's] disposable income' to the plan payments." Zellner, 827 F.2d at 1226 (quoting In re Fries, 68 B.R. 676, 685 (Bankr. E.D. Pa. 1986)).

A debtor's income tax refund is relevant to the disposable income analysis even when the refund would be exempt in a Chapter 7 liquidation. In re Freeman, 86 F.3d 478, 481 (6th Cir. 1996). Debtors have not devoted their $6,000 income tax refund to the Plan. This entire refund is relevant to the disposable income analysis, despite the potential $2,000 exemption available in a Chapter 7 proceeding.

Debtors do not provide for the proceeds of a lawsuit that they have valued at $98,000. (Attachment to Sch. B.) Mr. Wilker has also deducted a voluntary Federal Thrift Savings Plan contribution of $86 per month from his gross income. This is a voluntary contribution that Mr. Wilker could eliminate.

In addition, although the Plan provides for $3,143 of net monthly income, evidence at trial established that Debtors' actual net monthly income is $3,525.30. (Trustee's Ex. A.) Debtors' prior income tax refunds also indicate substantial over-withholding. Adding in the approximately $6,000 of over-withholding from 1997, Debtors' net monthly income rises to over $4,000 per month. By their own account, Debtors' "reasonable and necessary" expenditures total $1,792 per month. (Plan Ex. A.) Without accounting for Debtors' current tax refund, lawsuit, and voluntary Thrift Savings Plan contributions, Debtors have disposable income in excess of $1,800 per month. Of this $1,800, Debtors dedicate only $149 per month to the Plan.

Mr. Wilker testified that Mrs. Wilker's current medical expenses consume all of their disposable income. While unexpected medical expenses are a legitimate concern, Debtors have offered no evidence indicating the precise amount of Mrs. Wilker's medical expenses. Mr. Wilker admits that he could not place an exact amount on this liability. Mr. Wilker's vague assertion that his wife's medical bills will consume all disposable income is insufficient to satisfy his burden. Therefore, Debtors have failed to establish that the Plan dedicates all of their disposable income to creditors.

Because Debtors have not carried their burden of establishing that they are devoting all of their disposable income to the Plan, the Plan does not satisfy the requirements of §1325(b) and is unconfirmable.

Best Interests (1325(a)(4))

If the present value of the debtor's payments under the plan is less than the amount creditors would receive in a Chapter 7 liquidation, the plan cannot be confirmed. 11 U.S.C. §1325(a)(4). The Court must perform this liquidation analysis as of the effective date of the plan. Zellner, 827 F.2d at 1225; In re Hayes, No. 96-21384KD, slip op. at 3 (Bankr. N.D. Iowa Dec. 30, 1998).

The Plan proposes to pay unsecured creditors a total of $3,476.36 over three years. In a chapter 7 liquidation, the trustee could liquidate the non-exempt boat that Debtors valued on their schedules at $1,000. The trustee could liquidate the $15,000 obligation Debtors' son owes to them. Unsecured creditors would benefit from the liquidation of Debtors' claim for pesticide damage that Debtors valued at $98,000. The trustee could liquidate the cattle that remain in Debtors' possession and potentially recover, as an avoidable fraudulent transfer, the cattle Debtors have given away. Unsecured creditors would benefit from the $4,000 of Debtors' income tax refund that is not exempt. Even without accounting for the time value of money, the non-exempt portion of Debtors' tax refunds, coupled with the boat, are sufficient to provide payments to unsecured creditors in excess of the payments the Plan contemplates. Assuming even a nominal value for the other non-exempt assets, it is clear that unsecured creditors would receive more in a Chapter 7 liquidation than they would under the Plan. The Plan is, therefore, not confirmable pursuant to §1325(a)(4).

CONCLUSION

Debtors have failed to establish that the Plan is confirmable pursuant to §1325. The totality of the circumstances indicates Debtors filed the Plan in bad faith. The Debtors do not dedicate all of their disposable income to the Plan. Debtors' unsecured creditors would receive more in a Chapter 7 liquidation than they would under the Plan.

WHEREFORE, confirmation of Debtors' Second Modified Chapter 13 Plan is DENIED and this case is DISMISSED.

SO ORDERED this 27th day of October, 1999.

Paul J. Kilburg
Chief Bankruptcy Judge