

In the United States Bankruptcy Court

for the Northern District of Iowa

ELAINE SCHAEFER
Debtor(s).

Bankruptcy No. 99-02868M
Chapter 11

Appealed to U.S.D.C. 11-03-00

ORDER RE: MOTION TO DISMISS

The matter before the court is the motion to dismiss the case filed by creditor Land O'Lakes. Hearing was held August 22, 2000 in Mason City, Iowa. Appearing for Land O'Lakes was Jonathan C. Miesen. Debtor Elaine Schaefer was represented by Dale L. Putnam. This is a core proceeding under 28 U.S.C. § 157(b)(2)(O).

Findings of Fact

Elaine Schaefer filed a Chapter 11 petition on October 29, 1999. She filed her bankruptcy schedules and statement of financial affairs November 15, 1999, and amended schedules and statement of financial affairs on March 1, 2000. An amended Schedule F (schedule of "creditors holding unsecured nonpriority claims") was filed July 14, 2000. The court takes judicial notice of statements made in these filings.

Schaefer has been married for more than 30 years to Larry Schaefer. In 1996, Land O'Lakes brought an action against him for breach of grain contracts in the Iowa District Court for Cerro Gordo County. On March 11, 1998, Land O'Lakes obtained judgment on its claims in the amount of \$127,125 plus interest from and after August 28, 1996. On the date of the judgment, Elaine Schaefer was not indebted to Land O'Lakes.

On March 27, 1998, Larry Schaefer transferred Oklahoma farm land to Elaine Schaefer by quit claim deed for no consideration. One of the quit claim deeds was corrected April 2, 1998. On April 6, 1998, Elaine Schaefer agreed to sell the Oklahoma real property to King-Boswell Enterprises, L.L.C. She realized net proceeds of approximately \$290,000 from the transaction.

Land O'Lakes brought a fraudulent transfer action in the United States District Court for the Eastern District of Oklahoma (the "Oklahoma litigation") against the Schaefers, King-Boswell and Guaranty National Bank, which was King-Boswell's secured lender for the transaction. On September 28, 1999, the district court granted Land O'Lakes's motion for summary judgment on its claim against the Schaefers that the transfers of the Oklahoma farm land were fraudulent transfers under the Oklahoma Uniform Fraudulent Transfer Act. The district court also granted summary judgment in Land O'Lakes's favor on the Schaefers' counterclaims. The court reserved ruling on the remedy to which Land O'Lakes would be entitled until the claims against the remaining defendants were resolved.

On September 30, 1999, a pretrial conference was held in the Oklahoma case. Schaefer did not attend. King-Boswell and Guaranty Bank were dismissed without prejudice pursuant to stipulation. On October 13, 1999, Land O'Lakes moved for entry of money judgment against Elaine Schaefer. On October 25, 1999, judgment entered against her in the amount of \$161,749.19. On October 29, four days after judgment entered, Schaefer filed objections to Land O'Lakes's October 13 motion for entry of judgment. On November 17, 1999, Schaefer appealed the judgment. They did not post a supersedeas bond in connection with the appeal; Elaine Schaefer did not move for relief from the automatic stay in her bankruptcy case to pursue the appeal.

At the time of her filing, Elaine Schaefer had income from wages, rental property, businesses, and farming. She was employed at ABCM Corporation, a nursing home. Her monthly gross income from wages was approximately \$722. The job was eliminated in May 2000. Her non-wage income was listed in her initial Schedule I as \$7,000 per month. On an attachment to her amended Schedule I, she identified the sources of that income as follows:

Apartments	\$3,000	
Johnson	540	
Heartland	504	1,250
Movies	520	1,400
Storage 27 plaza	850	
Farm	1,250	
Lievrouw	425	

Schaefer was questioned at the hearing on Land O'Lakes's motion to dismiss about the two figures shown for Heartland. She did not know what they meant.

Schaefer amended her schedule of personal property and statement of financial affairs to disclose a 100% interest in a used auto dealership called Heartland Auto valued at \$90,000. She acquired the business in September 1998 from her husband. She did not pay anything for Heartland Auto. She assumed all the debt against the business and refinanced the debt with Clear Lake Bank and Trust. Schaefer claims there is no equity in the property and that all proceeds of sales go to the bank.^(u) Larry Schaefer was listed as the sole proprietor of the business on the Schaefer's 1995 and 1996 income tax returns. He reported profit of \$7,640 for 1995 and \$13,546 for 1996. In their 1998 income tax return, Elaine Schaefer was listed as the sole proprietor. She reported gross receipts of \$196,225 and net profit of \$22,001 for the year.

Larry Schaefer is the sole proprietor of a business called Heartland Auto Brokers. He reported gross receipts of \$288,256 and net profit of \$9,428 for 1998. Elaine Schaefer does not know the difference between the two businesses. In connection with the Oklahoma litigation, Larry Schaefer prepared a financial statement as of May 1, 1998 (Exhibit 9), a date supposedly prior to the transfer of the auto dealership to his wife. He listed an interest in "Heartland Auto Brokers," but not "Heartland Auto." The statement showed equity of \$130,000 in his Heartland inventory and business, and equity in his half interest in the "Heartland Building property."

Schaefer's Schedule A listed 15 parcels of real property with a total value of \$915,500. The property includes Iowa farm land owned jointly with her husband, Oklahoma farm land, and rental property, storage units, and commercial property in Clear Lake, Iowa. The rental property, storage units and a

commercial building were acquired with the proceeds of the 1998 sale of the Oklahoma farm land. At various times pre-petition, the Schaefer's gave Clear Lake Bank and Trust financial statements listing real property worth approximately \$1.3 million. Exhibits 15, 16, 19.

An attachment to Schedule A labels the Iowa parcels with letters "A" through "N." There was testimony that the Iowa farm land totals approximately 200 acres and that the homestead is on a 40-acre parcel within the farm. The farm was identified by Schaefer's counsel, in response to the court's question, as parcels A, K, L, M and N. He stated that the homestead is parcel K. The legal descriptions of these parcels are as follows:

Parcel A	NE NW 28-95-20
Parcel K	NW NW 28-95-20 "AG DWELLING ONLY"
Parcel L	NE NE 29-95-20
Parcel M	SW NW 28-95-20
Parcel N	SE NW 28-95-20

The tax statements attached to amended Schedule A show that parcels A, L, M and N total approximately 160 acres. The assessed value of each parcel of land is approximately \$30,000. The tax statement for parcel K shows an assessed value of \$12,750 for buildings and zero for land. Schaefer claimed a homestead exemption in "NW NW 28-95-20, Cerro Gordo County, Iowa" and valued the claimed exemption at \$175,000.

Scheduled debt to secured creditors in this case totals \$539,500 owed to three banks and three real estate vendors. (The total shown on amended Schedule D is incorrect.) No priority debt is listed. Schaefer listed four unsecured creditors. Land O'Lakes is scheduled as having a claim of \$165,000. At filing, the debt to Clear Lake Bank and Trust was scheduled as \$1,057.40, and after amendment, \$48,000. The debt to the other two creditors totals \$13,600. Schaefer was current on all her debts at the time of filing, with the exception of a payment due to Naomi Rayhons on a real estate contract. Schedule H states that Larry Schaefer is jointly liable on all scheduled debts.

The first question of the statement of financial affairs asks for income from employment or operation of a business during the current year and the two preceding years. Elaine Schaefer stated that she had income of \$15,000 each year for 1998 and 1999. She also disclosed income of \$22,000 from the car dealership. In her amended statement of financial affairs, the answer to question one was as follows:

1998	See tax return
1999	\$120,000.00
1997	\$206,050.00

No tax return was attached. The amended statement again showed income of \$22,000 from the car dealership as a separate item.

On March 6, 2000, the U.S. Trustee filed a motion for the court to set a status conference. The exclusivity period in 11 U.S.C. § 1121(b) had expired, and Schaefer had not filed a plan. She had submitted monthly reports for November and December, 1999, but not for January or February, 2000.

(Schaefer may be filing monthly reports with the U.S. Trustee; she has not filed any with the court.) On August 22, 2000, a status conference was held. Schaefer was given a deadline of September 6 to file a plan and disclosure statement. She filed the documents on September 5, 2000.

Discussion

Land O'Lakes seeks dismissal of the case pursuant to 11 U.S.C. § 1112(b), which states that the court may convert a Chapter 11 case to a case under Chapter 7 or may dismiss the case for cause. "Cause" includes the specific grounds set out in the subsections of § 1112(b), but is not limited to those grounds. Land O'Lakes alleges that Schaefer filed her case not to reorganize, but to avoid its valid judgment, an improper purpose. It alleges further that Schaefer has not made a complete or meaningful disclosure of her assets. Land O'Lakes argues that these circumstances indicate bad faith in filing the petition, which constitutes cause to dismiss the case.

Although not expressly listed in § 1112(b), bad faith is widely recognized as a ground for dismissal of a Chapter 11 case. First National Bank of Sioux City v. Kerr (In re Kerr), 908 F.2d 400, 404 & n.9 (8th Cir. 1990) (citing five circuit court decisions). Moreover, bad faith in filing the petition is a factor that may warrant dismissal of the case. Hatcher v. U.S. Trustee (In re Hatcher), 218 B.R. 441, 448 (B.A.P. 8th Cir. 1998), aff'd, 175 F.3d 1024 (8th Cir. 1999); In re Morris Plan Co. of Iowa, 62 B.R. 348, 352 (Bankr. N.D. Iowa 1986) (Melloy, J.); see also Janet A. Flaccus, *Have Eight Circuits Shorted? Good Faith and Chapter 11 Bankruptcy Petitions*, 67 Am. Bankr.L.J. 401 (1993) (discussing cases enforcing an implied good faith filing requirement).

Some courts have placed the burden of proving good faith on the debtor, once the movant has made a *prima facie* showing of bad faith. See, e.g., In re Hartford Run Apartments of Buford, Ltd., 102 B.R. 130, 132 (Bankr. S.D. Ohio 1989). This court, however, believes that the burden of proving grounds for dismissal of the case remains with the movant. The burden should not shift merely because the motion is based on a claim of bad faith. In re New Batt Rental Corp., 205 B.R. 104, 106-07 (Bankr. N.D. Ohio 1997); see also In re Harker, 1996 WL 905910 (Bankr. S.D. Iowa 1996) (burden of proof in motion to dismiss for bad faith under § 1307(c) is on movant) (citing In re Love, 957 F.2d 1350 (7th Cir. 1992)), aff'd by Harker v. United States, 1996 WL 905909 (S.D. Iowa 1996).

The Bankruptcy Appellate Panel for the Eighth Circuit identified the following factors that may be evidence of bad faith:

- (1) the debtor has only one asset, the property, in which it does not hold legal title;
- (2) the case is essentially a two-party dispute capable of prompt adjudication in state court;
- (3) there are only a few unsecured creditors;
- (4) the debtor's property has been posted for foreclosure, and the debtor has been unsuccessful in defending against the foreclosure in state court;
- (5) the filing of the petition effectively allows the debtor to evade court orders;
- (6) the debtor has no ongoing business to reorganize;
- (7) the debtor has few employees;
- (8) the timing of the debtor's filing evidences an intent to delay or frustrate the legitimate efforts of the debtor's secured creditor to enforce their rights.

In re Hatcher, 218 B.R. at 448. In In re Harker, the court listed factors for determining whether bad faith exists for purposes of a motion to dismiss a Chapter 13 case under 11 U.S.C. § 1307(c):

- (1) whether the debtor has stated his debts and expenses accurately;
- (2) whether he has made any fraudulent misrepresentation to mislead the bankruptcy court;
- (3) whether he has unfairly manipulated the bankruptcy code;
- (4) whether the debt would be nondischargeable under Chapter 7;
- (5) the timing of the petition;
- (6) how the debt arose;
- (7) the debtor's motives in filing the petition;
- (8) the treatment of creditors; or
- (9) whether the debtor has been forthcoming with the court and creditors.

In re Harker, 1996 WL 905910 at *2-3 (citing In re Molitor, 76 F.3d 218, 220 (8th Cir. 1996); In re Love, 957 F.2d at 1357).

The Eighth Circuit warns that the lower courts should proceed cautiously in determining that a debtor has acted with improper motives that would justify dismissal for bad faith. In re Kerr, 908 F.2d at 404. "Debtors often wish to shelter whatever assets they can from their creditors, and the Bankruptcy Code permits them to do so." Id. Filing a bankruptcy petition to stop collection efforts is an everyday occurrence and one that 11 U.S.C. § 362 contemplates. The overriding concern of the good faith inquiry is "whether the filing is 'fundamentally fair to creditors and, more generally, is the filing fundamentally fair in a manner that complies with the spirit of the Bankruptcy Code's provisions.'" In re Harker at *3 (citing In re Love, 957 F.2d at 1357). A central purpose of the Bankruptcy Code is to provide a fresh start to the honest but unfortunate debtor. Grogan v. Garner, 111 S.Ct. 654, 659 (1991).

The court first addresses Land O'Lakes's claim that bad faith is indicated by Schaefer's failure to disclose property and her general dishonesty in preparing her schedules. The initial schedules and statement of financial affairs, filed about two weeks after the petition, omitted Schaefer's interest in Heartland Auto. She had no explanation for this omission. She has never disclosed inventory of the dealership. The initial Schedule I did not identify the source of income of \$7,000 per month. Schedule A listed farm land without indicating that the value was for her half interest. The amended filings cured some of these defects. Schedule A is still not clear.

Land O'Lakes argues that Schaefer understated the value of her property on her schedules compared to the values the Schaefer's placed on their property at various times prior to the bankruptcy petition. The difference in values perhaps shows that the Schaefer's inflated figures they presented elsewhere, rather than that Elaine Schaefer consistently understated the scheduled values. Her response to Land O'Lakes's argument, however, does not resolve whether her schedule of real property is accurate.

Schaefer attached copies of tax statements to her amended Schedule A. She claims the real property values were taken from these tax records. This is not true. The values on the tax records and the scheduled values do not match for a single parcel.⁽²⁾ Compared to the assessed values, the scheduled values of some of the parcels, such as the storage units and the 8-plex (parcel I), are high. The values of others are close, and some are low. The meaning of the values of the farm land is not clear. Parcel K is valued at \$125,000 on Schedule A for a house assessed at \$12,750. The homestead parcel is valued at \$175,000 on Schedule C. The value perhaps includes 40 acres of farm land. The value is high, especially if it represents Elaine's one-half interest in the claimed homestead property.

Land O'Lakes contends that Schaefer has understated her income from rental properties. It points to a financial statement given to Clear Lake Bank and Trust in 1998 and another given in 1999, showing

annual rental income of \$122,620 and \$130,320, respectively. In contrast, Schedule I shows annual business and rental income of \$84,000. The court agrees that Schaefer has understated her income, but arrives at this conclusion by a different method.

The third page of Land O'Lakes's Exhibit 19, the financial statement dated July 28, 1999, shows that after "Payments (P & I)," which the court assumes are for principal and interest, Schaefer's net annual rental income is \$62,770. This figure is also on the first page, identified as income from rent. It appears directly under the figure \$22,000, identified as income from Heartland Auto. These two figures total \$84,770 or \$7,064 per month, which corresponds approximately to the monthly figure on Schedule I. Although the figure for rental income is shown as a net figure on the financial statement, Schaefer's bankruptcy schedules treat it as a gross figure. Schedule J includes an item for "land, tax payments" in the amount of \$6,203 per month and an expense of \$750 for "operation of business, profession or farm." This duplicates at least the mortgage payments, which are \$5,629 per month according to Exhibit 19. Schaefer no longer has wage income. She has effectively reported total net income, after all real estate and business expenses, of \$47 per month.

Schaefer's schedules and statement of financial affairs contained misleading and incorrect information. Her interest in Heartland Auto was not scheduled initially, the values of some of the real estate may not be accurate, her income was understated. Schaefer had no satisfactory explanation for these inaccuracies. It appears that inaccuracies may be caused by others. Ms. Schaefer appeared to know little about the financial affairs of her business and about documents prepared on her behalf. Even so, she knew that Heartland Auto and her rental properties had been disclosed elsewhere as significant sources of revenue. Her failure to file accurate documents is a factor indicating bad faith in filing.

Land O'Lakes further argues Schaefer has made a false homestead claim. Schaefer claimed a homestead in farm property locally known as 15183 180th Street, Rockwell, Iowa. Land O'Lakes contends that Schaefer has not established this property as her homestead because she has never actually lived there. Technically, it appears that Schaefer has made a homestead claim in property that she has not listed on Schedule A. She scheduled a real property interest in the house at the 180th Street address, but not the 40 acres on which it supposedly is situated. It is clear that she made the homestead claim in order to maximize her use of exemptions, which, in itself, is not improper. It is not certain, however, whether the farm property was her homestead at the time of filing. Schaefer's own statements on the matter have been equivocal. In her meeting of creditors, she stated that she also maintains a residence at 1106 South Shore Drive, Clear Lake, and lives at the farm property "off and on." Exhibit 14 at 15-17. It is not necessary, however, to decide the homestead issue, because the court concludes that sufficient other evidence supports Land O'Lakes's claim that the case was filed in bad faith.

This case is not a good faith effort by Elaine Schaefer to reorganize her assets and debts. It is bankruptcy by proxy--it is Larry Schaefer's effort, acting through his spouse, to shield his assets from the judgment obtained against him by Land O'Lakes. Land O'Lakes brought a state court action against Larry Schaefer in 1996. It does not appear that prior to that time Elaine Schaefer had any significant financial problems. It is likely that at the time Land O'Lakes filed suit against Larry Schaefer, Elaine Schaefer's only significant debt was her obligation on the mortgage against what she calls the "home farm."

The nature and value of her assets and the amount of her debts changed significantly in 1998, after Land O'Lakes obtained judgment against her husband. It was then that he transferred to her farmland in Oklahoma and an interest in Heartland Auto. She sold the Oklahoma land and bought other

property. Nearly all of the creditors holding secured claims in her case became her creditors when she purchased property using the proceeds of the Oklahoma land sale. She appears to have few unsecured debts which existed before 1998.

Schaefer's Chapter 11 filing is one to reorganize assets obtained from her husband in his effort to shield property from his creditor, Land O'Lakes. Her debt to Land O'Lakes, amounting to nearly three quarters of her scheduled unsecured debts, arose only because of her husband's effort to shield property from that creditor. Her lack of knowledge about Heartland Auto supports the inference that this is her spouse's attempt to reorganize using her as a front. It appears that she accepted the transfer of the auto business from her husband without any personal analysis or knowledge of the value of the transaction to her.

If this were merely a Chapter 7 case, the court would not be as concerned. Assets would be liquidated promptly, and creditors would be paid a share of the estate based on their allowed claims. But Chapter 11 cases are significantly different. They can have a significant effect on creditors as to how and when they are paid. Most of Elaine Schaefer's creditors voluntarily entered into debtor-creditor relationships with her. Land O'Lakes did not. Permitting Elaine Schaefer to reorganize assets and liabilities would put the bankruptcy system's imprimatur on her husband's efforts to evade payment of the Land O'Lakes' claim. It would turn his fraudulent conveyance into a long-term obligation from Elaine Schaefer to Land O'Lakes. Also, confirmation of a Chapter 11 plan which permitted payment of unsecured creditors over time also would likely vest scheduled assets in Elaine Schaefer and permit her to deal with those assets as she willed during the payout period. Her unchecked reorganization would take place with no analysis of Larry Schaefer's financial status and with no requirement that he meet the confirmation requirements of the Bankruptcy Code.

Because of the options available to Elaine Schaefer in Chapter 11, and their effect on Land O'Lakes, it is important that this case be filed in good faith. I find, however, that it was not properly motivated. I find that this case was filed primarily for the purpose of helping Larry Schaefer to evade or to delay payment of his judgment obligation to Land O'Lakes. It was filed for the purpose of reorganizing what in essence was another's debt, and for the purpose of keeping assets which were wrongfully obtained out of the reach of a legitimate claimant to those assets. Schaefer's Chapter 11 petition was not a filing that is fundamentally fair to creditors in a manner that complies with the spirit of the Code. In re Harker 1996 WL 905910 at *3. This case was not filed in good faith and that is cause for dismissal of the case under 11 U.S.C. § 1112(b). As I am dismissing this case, I believe it is not necessary to rule on Land O'Lakes' objection to Elaine Schaefer's homestead claim.

ORDER

IT IS ORDERED that the motion is granted. The debtor's case is dismissed.

SO ORDERED THIS 12th DAY OF OCTOBER 2000.

William L. Edmonds
U.S. Bankruptcy Judge

1. At the time of the hearing, the bank had moved for relief from the stay to recover inventory at Heartland Auto. On September 15, 2000, the unresisted motion was granted.

2. The scheduled values do match values handwritten in red ink on the copies of the tax statements filed with amended Schedule A. Any argument that the handwritten figures are a part of the county tax statement would be frivolous.