

SIGNED.



Dated: July 06, 2004

Randolph J. Haines

RANDOLPH J. HAINES
U.S. Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF ARIZONA

In re)	Chapter 13
)	
RANDY ALBERT PARSONS,)	CASE NO. 2-04-00952-PHX-RJH
)	
Debtor.)	MEMORANDUM DECISION
)	ON MOTION TO DISMISS

Randy Albert Parsons ("Debtor"), has filed a plan under Chapter 13 of the Bankruptcy Code. Jose and Maria Sorto ("Movants") object to the confirmation of the plan and have filed a Motion to Dismiss the bankruptcy case. Oral argument was heard on the motion to dismiss only, at the conclusion of which the Court took the matter under advisement.

Movants argue that the plan is proposed in bad faith because the payments are nominal and the Debtor's pre-bankruptcy activity that caused the debt was fraudulent and egregious. Therefore, they argue, it fails the good faith requirement of 11 U.S.C. § 1325(a)(3). Because Congress permits such debts to be discharged in Chapter 13 cases, and because this Debtor's plan does significantly more for creditors than the minimum required by Chapter 13, the Court denies the motion.

Facts

In July of 2002, Movants sued Debtor in Arizona state court for conversion of \$42,838 worth of wooden pallets from the Movants' pallet company. Movants received a judgment of \$50,000

1 against Debtor, which included over \$7,000 in punitive damages. Movants then commenced wage
2 garnishment proceedings against Debtor, and Debtor filed this case under Chapter 13.

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4 Debtor's total unsecured claims, including Movants' judgment, are \$82,607.61. Debtor's
5 initial Chapter 13 plan proposed to commit all of Debtor's disposable income of \$100 a month for 36
6 months, a total of \$990 to unsecured creditors. Debtor subsequently found a higher-paying job and
7 amended his plan to pay \$202 a month and extended the payments from 36 months to 55 months for a
8 total dividend of \$7,236.24 to unsecured creditors, or 8.8%. The plan continues to call for all of
9 Debtor's available disposable income. Debtor has a total of \$150 in non-exempt assets that would be
10 available to unsecured creditors in a Chapter 7 liquidation.

11 **Analysis**

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13 Under 11 U.S.C. § 1325, confirmation of Chapter 13 plan requires, among other things,
14 that "the plan be proposed in good faith and not by any means forbidden by law." 11 U.S.C. §
15 1325(a)(3). In addition, if the holder of an allowed unsecured claim objects to the confirmation, then the
16 court may not approve the plan unless "(A) the value of the property to be distributed under the plan on
17 account of such claim is not less than the amount of such claim; or (B) *the plan provides that all of the*
18 *debtor's projected disposable income to be received in the three-year period...will be applied to*
19 *make payments under the plan."* § 1325(b)(1) (emphasis added).

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21 While the Bankruptcy Code provides that all of a debtor's disposable income must be
22 applied to a Chapter 13 plan, the Code does not provide a specific percentage of claims that needs to
23 be paid under a Chapter 13 plan. The Code does provide a minimum payout level, which requires "the
24 value . . . of property to be distributed under the plan [to unsecured creditors]" not be less than "the
25 amount that would be paid on such claim[s] if the estate of the debtor were liquidated under Chapter 7."
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1 11 U.S.C. § 1325(a)(4). In addition, the Ninth Circuit has held that a plan that provides nominal or zero
2 payments to unsecured creditors does not, by itself, indicate bad faith. *E.g.*, *In re Metz*, 820 F.2d 1495,
3 1498 (9th Cir. 1987); *In re Gregory*, 705 F.2d 1118, 1121 (9th Cir. 1983); *In re Warren*, 89 B.R. 87,
4 92 (9th Cir. B.A.P. 1988); *In re Slade*, 15. B.R. 910, 912 (9th Cir. B.A.P. 1981). The Debtor’s plan
5 satisfies the minimum payout level required by the Code. He is paying a total of \$7,236.24 to unsecured
6 creditors under the Chapter 13 plan, versus the \$150 in non-exempt assets unsecured creditors would
7 receive under Chapter 7.
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10 In regards to pre-bankruptcy activity, the Bankruptcy Code provides exceptions to the
11 discharge of certain debts incurred through various egregious acts. 11 U.S.C. § 523(a). For example,
12 debts incurred through fraud, larceny, or intentional destruction of property cannot be discharged in a
13 Chapter 7 case. § 523(a)(2), (4) & (6). However, Congress specifically provided that these debts may
14 be dischargeable under Chapter 13.¹ 11 U.S.C. § 523(a)(2)(4)(6) & 1328(a). Because of this statutory
15 provision, the Ninth Circuit Bankruptcy Appellate Panel has held that bad faith cannot be found “based
16 merely upon the existence of such debts among the liabilities of an erstwhile Chapter 13 debtor.” *Slade*,
17 15 B.R. at 912; *see also Warren*, 89 B.R. at 93 (finding that a nondischargeable debt under Chapter 7
18 does not necessarily prevent a discharge under Chapter 13.) Debtor’s plan does not violate any
19 provisions of the Bankruptcy Code by seeking the discharge of a debt that would not be dischargeable
20 in a Chapter 7 case, even if this debt arose from a conversion.
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26 ¹ 11 U.S.C. 1328(a)(2) specifically forbids discharge of debts “specified in paragraph (5), (8), or (9) of
27 section 523(a),” which involve child support and alimony, student loans, and injuries related to drunk driving.
28 However, the Code explicitly omits the other exemptions included in section 523(a). Specifically, for
purposes of this case, paragraph (4) which deals with fraud and larceny, was omitted from the list of
chapter 13 exceptions to discharge.

1 While the court in *Warren* recognized that nominal payments and the nondischargeability
2 of debt in a Chapter 7 case may *not* indicate bad faith *by themselves*, the Panel did hold that bad faith
3 can be found based on a “totality of the circumstances” when all of these factors are considered *together*.
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5 *Warren*, 89 B.R. at 92. *Warren* established 11 factors to consider in determining the good faith of a
6 proposed Chapter 13 plan.² Movants argue that considering all of the factors, especially the nominal
7 dividend (assuming less than 10% may be considered nominal) and the Debtor’s pre-bankruptcy
8 behavior, leads to a conclusion of bad faith. However, the Debtor asserts that considering all of the
9 factors, emphasizing his best efforts to pay into the plan, leads to a conclusion of good faith. So the
10 primary issue is whether bad faith exists in the plan proposal when the nominal dividend and pre-
11 bankruptcy behavior are considered along with the Debtor’s best efforts.

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14 Debtor primarily focuses on his best efforts in making payments to the plan. For example,
15 Debtor points out that he is paying all of his disposable income to the plan³ and has extended the plan
16 payments from 36 to 55 months. Debtor argues that his intentions are genuine and that he is honestly
17 pursuing Chapter 13 in order to repay his unsecured creditors whatever he can. (Debtor’s Response to
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20 ² The Court in *Warren* enumerated the following eleven factors to consider in determining good faith: (1)
21 The amount of the proposed payments and the amounts of the debtor’s surplus; (2) The debtor’s
22 employment history, ability to earn and likelihood of future increases in income; (3) The probable or
23 expected duration of the plan; (4) The accuracy of the plan’s statements of the debts, expenses and
24 percentage of repayment of unsecured debt, and whether any inaccuracies are an attempt to mislead the
25 court; (5) The extent of preferential treatment between classes of creditors; (6) The extent to which
26 secured claims are modified; (7) The type of debt sought to be discharged, and whether any such debt is
27 nondischargeable in Ch. 7; (8) The existence of special circumstances such as inordinate medical expenses;
28 (9) The frequency with which the debtor has sought relief under the Bankruptcy Reform Act; (10) The
motivation and sincerity of the debtor in seeking Ch. 13 relief; and (11) The burden which the plan’s
administration would place upon the trustee.
Warren, 89 B.R. at 93.

³At least for purposes of their motion to dismiss, Movants do not dispute that all disposable
income is committed to the plan. They do not, for example, argue that Debtor’s lifestyle is extravagant
or that he could reduce expenses to generate more disposable income.

1 Motion to Dismiss at 5.). Debtor asserts that taking these factors into consideration along with the other
2 relevant *Warren* factors establishes his good faith in proposing the plan. (*Id.* at 2, 5.).

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4 On the other hand, the Movants assert that according to *Warren*, best effort by itself is
5 not enough to establish good faith. (Movants' Motion to Dismiss at 4-5.). They argue that when the
6 nominal amount of the dividend and the Debtor's pre-bankruptcy activity are taken into consideration,
7 good faith is clearly lacking from the Debtor's proposal. (*Id.* at 5.).

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9 Although the *Warren* court does state that a debtor's best effort by itself is not enough
10 to show good faith, the court also suggests that best effort is a significant indication of good faith.
11 *Warren*, 89 B.R. at 94, 95. In fact, the court in *Warren* cites favorably to *In re Slade*, which has
12 similar facts to the Debtor's situation. *Id.* at 94.

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14 In *Slade*, the appellant held a judgment for embezzlement against the debtor totaling
15 \$37,667. *Slade*, 15 B.R. at 910. The Debtor subsequently filed a petition under Chapter 13, which
16 proposed payments totaling \$1,708, or less than 5% of the total unsecured claims. *Id.* However, the
17 payments represented all of the debtor's disposable income and his best efforts to pay. *Id.* at 912. The
18 appellant argued that there was a lack of good faith because the plan's dividend was nominal and by
19 utilizing Chapter 13, the debtor was obtaining a discharge that would not be available under a Chapter
20 7. *Id.* at 910. The court recognized that taken individually these factors would not be sufficient to find
21 bad faith. *Id.* at 912. Nevertheless, taking these factors into consideration, the court held that "the fact
22 that a debtor's plan represents his best effort is a *significant indication of good faith* on his part. *Id.*
23 (emphasis added). The court went on to state that "[a]bsent any showing of a willful attempt to misuse
24 Chapter 13 in defraud of creditors, best effort plans should normally satisfy the good faith requirement."
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28 *Id.*

1 Similar to *Slade*, Movants have a judgment against the Debtor for an egregious act,
2 conversion of property. The plan's dividend is considered nominal by the Movant (less than 9% of
3 unsecured claims), and the Debtor's debt to Movant would not be dischargeable under Chapter 7.
4 However, Movants do not dispute that Debtor is making his best effort to pay into the plan. In fact,
5 Debtor is proposing to pay all of his disposable income into the plan and even extended the plan from
6 36 months to 55 months. And Movant has not shown a willful attempt by the Debtor to misuse Chapter
7 13 in fraud of creditors. While Debtor may be gaining a benefit under Chapter 13 that he wouldn't
8 have under Chapter 7, simply exercising a legal right granted by Congress by filing for Chapter 13 under
9 the Bankruptcy Code is not misusing the Code or defrauding creditors.

10 Although Movant relies heavily on *Warren*, the holding in *Warren* does not support
11 dismissal on a motion to dismiss. The primary purpose of the *Warren* decision and its stated conclusion
12 was to make sure Debtors were not filing "Chapter 13 plans that are in essence veiled Chapter 7 cases."
13 *Warren*, 89 B.R. at 95. For example, the court stated, "[w]here there is an absence of any significant
14 factual element distinguishing the circumstances of a Chapter 13 petition with a substantial
15 nondischargeable debt from those attendant to a Chapter 7 petition, the debtor should not be permitted
16 to nullify major provisions of 11 U.S.C. § 523 merely by paying an insignificant portion of the
17 nondischargeable debt." *Id.* Here, this is not the case. The Debtor is paying significantly more to
18 unsecured creditors under Chapter 13 than he would under Chapter 7. Although the dividend is only
19 8.8% to unsecured creditors, the \$7,236 that will go to unsecured creditors is substantially more than the
20 \$150 that would be divided up under Chapter 7. The result under Chapter 13 is significantly
21 distinguishable from a Chapter 7 plan, thus, the Debtor's Chapter 13 plan is more than a "veiled Chapter
22 7."
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Legislative Intent

Although it may appear unfair that a Debtor may evade a judgment for fraud or conversion under Chapter 13 by paying a fraction of the total owed, this was the intent of Congress which the Court may not change.

The Code does not prohibit Chapter 13 filings by debtors who incurred the debt through egregious behavior. In fact, the Code implicitly invites such cases by explicitly leaving them out of the exclusions under 11 U.S.C. § 1328(a)(2). This section states that upon completion of the payments under the plan, “the court shall grant the debtor a discharge of all debts provided for by the plan . . . , except any debt: (2) of the kind specified in paragraph (5), (8), or (9) of section 523(a) of this title.” If Congress did indeed want to exclude debts associated with all egregious behavior, it could have very easily added paragraphs (2), (4) and (6) of § 523(a) which deal with fraudulent acts, larceny, and intentional destruction of property. Or it could have very easily provided a condition to the discharge of such debts, such as a minimum payment. But it did not. Although this may be unfair, it is the job of this Court to apply the law as Congress intended, not according to our own interpretation of fairness.

Conclusion

Debtor has incurred a debt owed to Movants as a result of converting their property. Although through Chapter 13 he is paying a fraction of the debt owed, he is meeting the requirement of the Code by paying more than unsecured creditors would receive under a Chapter 7 liquidation. As the court in *Slade* said, “Chapter 13 has no minimal ‘entrance fees’ beyond those set forth in 11 U.S.C. § 1325(a)(4).” *Slade*, 15 B.R. at 913. In addition, the fact that the debt was incurred through fraud and will be discharged under Chapter 13 does not indicate bad faith. Congress specifically provided an incentive for such debtors to file for Chapter 13 and have these debts discharged by explicitly leaving such

1 debts out of the exceptions to discharge under 11 U.S.C. § 1328(a). While the Ninth Circuit provides
2 a “totality of the circumstances” test for determining good faith, it also found a debtor’s best efforts to pay
3 into a Chapter 13 plan as a strong indication of good faith. So absent evidence of Debtor’s intent to
4 misuse the bankruptcy process, the Court cannot find that the Debtor proposed his plan in bad faith.
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6 Therefore, the Motion to Dismiss is denied, without prejudice to reconsideration of the
7 same issues in connection with an evidentiary hearing on the Movants’ objection to confirmation.
8

9 DATED AND SIGNED ABOVE

10 Copy of the foregoing mailed this
11 7th day of July, 2004, to:

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