Memorandum Decision re: Sustaining Debtor's Objection To Claim Of Yen In Part, And Overruling Yen's Objection to Confirmation of Plan

April 13, 1999

UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

In re

No. 96-56608

Chapter 11

BETTY LIN WANG

, Debtor. _____/

MEMORANDUM DECISION SUSTAINING DEBTOR'S OBJECTION TO CLAIM OF YEN IN PART, AND OVERRULING YEN'S OBJECTION TO CONFIRMATION OF PLAN

Before the Court are two matters in the above-captioned Chapter 11[(1)] case: 1/ An objection by Betty Lin Wang, Debtor in Possession ("Debtor") in the Chapter 11 case, to the claim of Robert Yen ("Creditor"); and 2/ An objection by Creditor to confirmation of the second amended plan of reorganization ("Plan") proposed by Debtor.

Both matters have been briefed and argued; in addition, an evidentiary hearing has been conducted, at which the only witnesses called were Debtor and Creditor.

Debtor is represented by Steven J. Sibley, Esq. of Dinapoli, Uzzi & Sibley; Creditor was previously represented by Dean Lloyd, Esq. but represented himself at the evidentiary hearing.

This Memorandum Decision constitutes the Court's findings of fact and conclusions of law, pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure ("FRBP").

I.

BACKGROUND

The facts stated in this section are undisputed.

Debtor filed a Chapter 13 petition on September 3, 1996; the case was converted to one under Chapter 11 on January 29, 1997, upon Debtor's motion prior to confirmation of a Chapter 13 plan.

On the date that Debtor filed her Chapter 13 petition, judgment was issued against her by the Santa Clara County Superior Court ("State Court Judgment"), awarding Creditor the sum of $148,486.45, plus attorney's fees and costs in an unstated amount. The State Court Judgment was issued upon Creditor's complaint ("State Court Complaint") seeking damages for Debtor's alleged breach of two real property leases; under the leases, Debtor was the tenant of two different business premises in Milpitas, which premises she had vacated prior to issuance of the State Court Judgment. Debtor's bankruptcy schedules list Creditor as holding a disputed unsecured claim for $148,486.45 and Debtor has filed an objection to allowance of that claim in the scheduled amount; Creditor has not filed a proof of claim.

When Debtor filed her Chapter 13 petition, she owned two businesses in Milpitas, each a sole proprietorship: "Betty's Arco", a gasoline service station; and "Gold Crown Mortgage", a mortgage loan brokerage. Debtor continues to own both businesses and has operated them during her bankruptcy case.

Debtor filed her Plan and its accompanying Disclosure Statement ("Disclosure Statement") in September 1997. The Plan is to be funded by revenues from Debtor's businesses at the rate of approximately $10,950 per month, with payments to creditors as follows: administrative claims are to be paid in full upon confirmation; secured claims are to be paid in full with interest at 7% by payments made monthly for thirty-six months commencing at confirmation; priority tax claims are to be paid in full with interest at 7% by payments made monthly for fifty months commencing at confirmation; general unsecured claims are to be paid to the extent of 30% without interest by payments made monthly for ten months commencing in the fifty-first month after confirmation.

Debtor's Plan was accepted by all classes that voted, with the possible exception of Class 4, an impaired class consisting of the claims held by all general unsecured creditors (including the claim of Creditor). Six members of Class 4 cast ballots and all voted to accept the Plan except Creditor, who voted to reject the Plan. The Class 4 creditors voting to accept hold claims totalling $160,000 so, if Creditor's claim were calculated at its full scheduled amount of $148,486.45, the claims in Class 4 would total $308,486.45 -- ?1126(c) requires affirmative votes by creditors with claims representing at least two-thirds in amount of the claims held by voters, and two-thirds of $308,486.45 is $205,740; since Class 4 creditors who voted to accept hold claims totalling only $160,000, the Plan would not be accepted by that class if Creditor's claim were calculated at its scheduled amount. However, Debtor

has objected to Creditor's claim as scheduled and, based on such objection, calculates Creditor's claim at no more than $60,000 -- if Creditor's claim were calculated at $60,000, Class 4 voting creditors would hold claims totalling $320,000 and two-thirds of that total is $148,000; affirmative votes were cast by Class 4 creditors holding claims totalling $160,000, which would exceed the two-thirds in amount that is required by ?1126(c). Accordingly, whether Class 4 has accepted Debtor's Plan depends upon whether Creditor's claim is allowed in the scheduled amount, or is instead allowed in an amount reduced sufficiently so that the affirmative votes by Class 4 members represent at least two-thirds in amount of the total claims included in Class 4.

In addition to voting to reject Debtor's Plan, Creditor filed an objection to confirmation of the Plan, alleging a lack of good faith on Debtor's part.

II.

DEBTOR'S OBJECTION TO CREDITOR'S CLAIM

Pursuant to ?1129(b)(1), a Chapter 11 plan that meets all applicable confirmation requirements of ?1129(a) other than the requirement of ?1129(a)(8) that each impaired class must vote to accept the plan may nevertheless be confirmed by means of "cramdown". In this case, if it were determined that Class 4 did not vote to accept the Plan, the cramdown process would require Debtor to demonstrate that the Plan does not "discriminate unfairly" as to Class 4 within the meaning of ?1129(b)(1), and also that it is "fair and equitable" to Class 4 within the meaning of ?1129(b)(2)(B). However, if it were determined that Class 4 did vote to accept the Plan, it would be unnecessary for Debtor to resort to cramdown and the Plan would be confirmable if it merely met all applicable requirements of ?1129(a). Therefore, if Debtor's objection to Creditor's claim were sustained (or sustained in sufficient part), Debtor would not have to make as extensive a showing as would be called for if Debtor's objection to Creditor's claim were overruled. Since the scope of the issues presented in connection with confirmation is determined by whether Debtor's objection to Creditor's claim is sustained, the matter of the claim objection will be addressed first.

As discussed below, the Court concludes that Creditor is entitled to a claim of $50,289.22. Adding this figure to the $160,000 in claims held by other voting members of Class 4, the total amount of claims held by Class 4 voters is $210,489.22 -- two-thirds of that amount is $140,326.14, which is exceeded by the $160,000 in claims held by members who voted to accept the Plan. Therefore, Class 4 has accepted Debtor's Plan.

A. Creditor's Claim Is Subject To ?502(b)(6).

Debtor's objection to Creditor's claim is based upon ?502(b)(6), which provides as follows:

... the court shall allow claims except to the extent that ... if such claim is the claim of a lessor for damages resulting from the termination of a lease of real property, such claim exceeds --

(A) the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remain- ing term of such lease, following the earlier of -- (i) the date of the filing of the petition; and (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus (B) any unpaid rent due under such lease without acceleration,

on the earlier of such dates....

At a hearing on November 20, 1997, this Court explained on the record why this statute applies to limit Creditor's claim, which is based on a judgment for damages caused by Debtor's breach of two real property leases. Creditor has attempted to raise this legal issue again in an untimely brief filed after commencement of the evidentiary hearing in these matters, but the answer remains the same.

As previously stated on the record, Creditor's contention that the subject real property leases were not terminated within the meaning of ?502(b)(6) is without merit, because he himself terminated them as of February 12, 1994 by giving notice pursuant to California Civil Code ?1951.3. See In re Lomax, 194 B.R. 862 (9th Cir.

BAP 1996), which contains a thorough analysis of applicable California law concerning the manner in which a lease is terminated under circumstances virtually identical to the facts of this case.

As further stated previously on the record, Creditor's argument that his claim is one for a judgment debt and entitled to collateral estoppel effect as to amount, rather than a claim "for damages resulting from the termination of a lease of real property" within the meaning of ?502(b)(6), lacks merit because the State Court Judgment is nothing more than a representation of the kind of damages referred to by ?502(b)(6). See In re Networks Electronic Corp., 195 B.R. 92, 97 (9th Cir. BAP 1996), concerning the same issue with respect to a judgment based on termination of an employment contract and the provisions of ?502(b)(7), which section limits such claims in the same manner that ?502(b)(6) limits claims for lease termination:

Once the bankruptcy court determined that the state court judgment resulted from breach of an employment contract, that claim was subject to the application of an exception to allowance provided in the Bankruptcy Code.... Disallowance of the claim under ?502(b)(7) is a matter of federal law, for it involves the extent to which Congress has exercised its constitutional power to establish "uniform Laws on the subject of Bankruptcies throughout the United States." U.S. Const., art. I, ?8, cl.4. To the extent that [claimant] argues that state law should prevail over the Bankruptcy Code, such is not the case under the Supremacy Clause, U.S. Const. art. VI, ?2. Fed- eral law preempts a state law or order which "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." Clark v. Coye, 60 F.3d 600, 603 (9th Cir.1995) (citing Edgar v. MITE Corp., 457 U.S. 624, 631, 102 S.Ct. 2629, 2634-35, 73 L.Ed.2d 269 (1982)).

The rationale of that case is equally applicable to a claim (such as Creditor's) based on a judgment for terminated real property leases, and the effect of ?502(b)(6).[(2)]

B. Amount Of Creditor's Claim

Debtor calculates Creditor's claim as follows:

The lease of premises at 110 S. Abel Street called for base rent of $1,950 per month, so Debtor contends that rent for one year post-termination would be that amount multiplied by twelve, or $23,400 -- Debtor shows that the 15% calculation called for by ?502(b)(6)(A) would be $6,727 and it is the greater of those two alternatives that applies, so Debtor asserts that Creditor is entitled to a claim of $23,400 (less Debtor's deposit of $5,000) for this lease.

The lease of premises at 98 S. Abel Street called for base rent of $1,800 per month, so Debtor contends that rent for one year post-termination would be that amount multiplied by twelve, or $21,600 -- Debtor shows that the 15% calculation called for by ?502(b)(6)(A) would be $8,370 and it is

the greater of those two alternatives that applies, so Debtor asserts that Creditor is entitled to a claim of $21,600 (less Debtor's deposit of $5,000) for this lease.

The sum of $23,400 plus $21,600 is $45,000 -- Debtor contends that such amount must be reduced by deposits totalling $10,000, for a total claim of $35,000.

Creditor does not dispute Debtor's contention that the one year post-termination alternative applies and that the 15% alternative of ?502(b)(6)(A) is inapplicable -- Creditor calculates his claim as follows (Creditor's calculations include charges other than rent for one year post-termination and those other charges will be discussed separately):

Creditor states that: (1) the lease of premises at 110 S. Abel called for base rent to be increased annually (a "cost of living adjustment", or "COLA") and also for reimbursement of property tax and insurance payments; (2) adjusted base rent plus reimbursements total $2,257.37 per month for 9.57 months and $2,370.24 per month for 2.43 months, [(3)] which amounts total $27,362.71 for a twelve month period; and (3) the lease also called for common area maintenance ("CAM") payments of $438 per month, which totals $5,256 for a twelve month period; the sum of those totals is $32,618.71.

Creditor states that: (1) the lease of premises at 98 S. Abel called for an annual COLA increase of base rent and also for reimbursement of property tax and insurance payments; (2) adjusted base rent plus reimbursements totals $1,984.50 per month for 5.57 months and $2,370.24 per month for 6.43 months, [(4)] which amounts total $11,053.67 for a twelve month period; and (3) the lease also called for CAM payments of $438 per month, which totals $5,256 for a twelve month period; the sum of those totals is $16,309.67.

(1) COLA

With respect to the COLA, Debtor argues that the leases are ambiguous as to whether such increases are provided for at all and, if so, in what amounts. The COLA provisions are contained at the top of page 9 of each lease in ?38, which consists of printed language followed by a handwritten notation that has not been initialled by anyone (although each page of each lease has been initialled "BW" at the bottom); each lease contains other handwritten entries and none of those are initialled either. The printed language provides for an increase "in the same percentage proportion that the revised Consumers Price Index for Pacific Cities and U.S. City Average All Items (1982-84 - 100) for the San Francisco-Oakland-San Jose metropolitan area, as published by the U.S. Department of Labor, Bureau of Labor Statistics, shall increase over the price index for the month nearest to the month in which this Lease is dated" -- however, the handwritten notation at the end of that paragraph states "RENTAL ADJUSTMENT ANNUALLY AT MINIMUM OF 5% AND MAXIMUM OF 8%". No evidence was presented as to the parties' intent concerning this provision and the provision is internally inconsistent unless it is interpreted to mean that, regardless of what adjustment may be called for by the Consumers Price Index, such adjustment is to be no less than 5% and no more than 8%. Debtor introduced a March 18, 1998 declaration by Creditor stating that written statements were not issued to tenants during Debtor's tenancy and tenants were told what to pay orally, or they calculated the adjustments themselves. In argument, Creditor stated that cancelled checks exist to show that Debtor did pay rent in amounts reflecting COLA adjustments, but the documents referred to are only copies of the fronts of checks payable to Creditor and do not specify what the amounts represent; Debtor did not testify as to whether she had ever made COLA payments. Creditor's calculations do not state the dollar amount attributable to COLA for each lease; they do refer to COLA charges being made at the rate of 5%, but do not show what the 5% is being applied to (i.e., whether to the base rent, or to the base rent as previously increased from year to year, or to some other figure).

Based on the record before it, the Court concludes that the most reasonable interpretation of the leases is that a COLA increase was intended by the parties in an amount of at least 5% per year, and that Creditor is entitled to include such charges as part of one year's worth of rent post-termination, from February 1994 through January 1995. The Court calculates adjusted base rent as follows:

For the lease of premises at 110 S. Abel, the Court calculates that a 5% annual increase in the base rent of $1,950 per month from the December 1990 commencement of the lease would yield adjusted base rent of $2,257.37 per month for December 1993 through November 1994, and adjusted base rent of $2,370.24 per month for December 1994 and thereafter. The post-termination period of February 1994 through November 1994 represents ten months at $2,257.37 each (or $22,573.70) and the post-termination period of December 1994 through January 1995 represents two months at $2,370.24 each (or $4,740.48), for a total of $27,314.18 in one year's post-termination adjusted base rent.

For the lease of premises at 98 S. Abel, the Court calculates that a 5% annual increase in the base rent of $1,800 per month from the August 1991 commencement of the lease would yield adjusted base rent of $1,984.50 per month for August 1993 through July 1994 and adjusted base rent of $2,083.75 per month for August 1994 and thereafter. The post-termination period of February 1994 through July 1994 represents six months at $1,984.50 each (or $11,907.00) and the post-termination period of August 1994 through January 1995 represents six months at $2,084.75 each (or $12,508.50), for a total of $24,415.50 in one year's post-termination adjusted base rent.

(2) Property Taxes, Insurance, And CAM

With respect to reimbursement of property taxes, insurance, and CAM, the leases do not expressly provide for such payments to be made by the tenant. Each lease contains a ?41.1 entitled "PARKING AND UTILITY CHARGES", which states that the tenant is to pay "its pro rata share, as may be reasonably established by Lessor, of any parking charges, surcharges or any other costs levied or assessed by local, state or federal governmental agencies, or public utility, in connection with the use of the parking facilities or utilities serving" the premises (emphasis supplied). That is the only provision of either lease calling for any payments to be made in addition to rent, and it pertains by its terms to "parking and utility charges", which are described as charges "levied or assessed ... in connection with" the use of parking facilities or utilities. Creditor's State Court Complaint alleges that Debtor was required to pay rent (including COLA) and "her pro rata share of utilities and operating expenses", without explanation of what was meant by "operating expenses" and with no express reference to taxes, insurance, or CAM. Creditor's March 18, 1998 declaration refers to CAM charges being paid by tenants, but no evidence was presented as to the parties' intent concerning extra charges of any kind, nor was any evidence presented to substantiate the amounts of such charges as claimed by Creditor. Though Creditor's calculations do state the amount being charged for CAM under each lease, they do not state what amount is attributable to property tax and insurance.

Creditor has not shown that the amounts he seeks for taxes, insurance, and CAM (or any of those) are attributable to parking and/or utilities as provided by ?41.1. Even if they were so attributable, Creditor has not shown that the amounts for which he seeks reimbursement from Debtor were in fact incurred by him, nor that such amounts represent Debtor's pro rata share of whatever costs may have been incurred by Creditor. Based upon the record before it, the Court concludes that Creditor has not demonstrated an entitlement to include charges for taxes, insurance, and CAM in calculating one year's worth of rent post-termination.

(3) Other Charges

In addition to the rent for one year post-termination that is permitted by ?502(b)(6)(A), a real property lessor is entitled under ?502(b)(6)(B) to recover "any unpaid rent due under such lease without acceleration" that accrued prior to the earlier of the date on which the tenant filed bankruptcy, or the date on which the property was repossessed by the lessor or surrendered by the tenant. In this case, Debtor vacated both premises in January 1994 but did not formally surrender them, and Creditor took possession of both premises on the termination date of February 12, 1994, which is prior to the date on which Debtor filed her Chapter 13 petition in 1996; Creditor is therefore entitled to claim any unpaid rent that accrued prior to February 12, 1994. Creditor asserts that the following amounts came due prior to that date:

For the premises at 110 S. Abel, a total of $8,151.52, consisting of:

Rent from January 1, 1994 in the amount of $3,224.81;

CAM from January 1, 1994 in the amount of $625.71;

"Cleaning and moving out repair expense" in the amount of $1,000.00; and

"Bounced check" dated April 30, 1993 "for equipments" in the amount of $3,301.00.

For the premises at 98 S. Abel, a total of $6,698.71, consisting of:

Rent from January 1, 1994 in the amount of $2,835.00;

CAM from January 1, 1994 in the amount of $625.71;

Rent for August 1991 in the amount of $1,800.00;

CAM for August 1991 in the amount of $438.00;

"Cleaning and moving out repair expense" in the amount of $1,000.00.

With the exception of the returned check for $3,301, Creditor offered no evidence in support of these figures and they differ from the damages alleged in the State Court Complaint. The State Court Complaint was filed on March 23, 1994 and alleges pre-termination arrears of $3,560.54 for the premises at 110 S. Abel and none for the premises at 98 S. Abel; it alleges nothing about expenses to clean or repair either of the premises.

The Court will accept the allegations of the State Court Complaint as corroboration of pre-termination rent for the premises at 110 S. Abel in the amount of $3,560.54, and Creditor is entitled to claim that amount under ?502(b)(6)(B). There is no corroboration of any pre-termination rent for the premises at 98 S. Abel and the Court considers it unlikely that, if rent arrears had existed in the large amounts now stated by Creditor (over $5,500), they would not have been reflected in the State Court Complaint, which was filed approximately six weeks post-termination.

As for the $2,000 in expenses to clean and repair both premises, there is no corroboration of those expenses having been incurred at all and, even if there were, Creditor is not entitled to claim them now, for the first time, by stating them in a supplemental trial brief. Creditor filed no claim in Debtor's bankruptcy case and his claim as scheduled by Debtor is described as a claim incurred by a real property lessee and stated in the amount of the State Court Judgment -- expenses of this kind do not constitute the "unpaid rent" for which a lessee is liable under ?502(b)(6)(B) and it is not apparent that

the amount of these expenses is included in the State Court Judgment, since recovery of them was not sought by the State Court Complaint. Creditor was scheduled in Debtor's Chapter 13 case and has never asserted that he lacked notice of the case or was otherwise unable to file a timely proof of claim; instead of filing a claim to assert this debt, Creditor relied upon the debt scheduled by Debtor, and that debt is limited to Debtor's liability under the real property leases.

A copy of the returned check for $3,301.00 is in evidence, but Creditor's calculations describe it as being "for equipments", rather than for unpaid rent. Creditor cannot now assert a claim for this debt that appears to be entirely unrelated to Debtor's liability as a lessee.

Creditor is entitled to claim $3,560.54 under ?502(b)(6)(B) as unpaid rent that came due prior to termination of the lease for the premises at 110 S. Abel. For the reasons stated above, Creditor is not entitled to claim the other amounts set forth in this section.

(4) Deposits

Debtor contends that she gave Creditor a deposit of $5,000 for each of the two real property leases, and that a total of $10,000 should therefore be deducted from the amount of Creditor's claim. Creditor agrees that he received a $5,000 deposit for the lease of the premises at 110 S. Abel (the first of the parties' two leases), but denies having received any deposit for the lease of the premises at 98 S. Abel (the second of the parties' two leases). Debtor's testimony was not corroborated by any proof that a deposit was paid for the second lease -- Creditor's testimony that no such payment was made is corroborated by his State Court Complaint, which alleges that, while a $5,000 deposit was made for the first lease, a deposit of only $1 was made for the second lease. Debtor is clearly in a better position to prove that she did pay a $5,000 deposit for the second lease than Creditor is in to prove a negative and show that such a payment was not made -- Debtor had ample opportunity to provide evidence in the form of a cancelled check or other proof of payment and claimed no inability to do so (indeed, when she was asked whether she had cancelled checks for both payments, she replied that she "should have, yes", but she did not offer them as evidence). Under these circumstances, the Court concludes that Debtor did pay a $5,000 deposit for the lease of the premises at 110 S. Abel, but paid a deposit of only $1.00 for the lease of the premises at 98 S. Abel.

Creditor testified that he did not return the $5,000 deposit to Debtor and instead applied it to "her account"; he did not testify as to what he did with the $1 deposit. Debtor's position is that security deposits must be deducted from the amount of the claim that is allowed by ?502(b)(6), rather than applied against the amount of the claim that is disallowed by ?502(b)(6). Although the Ninth Circuit has not ruled on the issue, Debtor's position is well supported:

Apparently stating a guide for future judicial determinations, the legislative comments [to the Bankruptcy Code] observe that the landlord "will not be permitted to offset his actual damages against his security deposit and then claim for the balance under [?502(b)(6)]. Rather, his security deposit will be applied in satisfaction of the claim that is allowed under [?502(b)(6)]." Accordingly, to the extent that a landlord will have a security de- posit in excess of the amount of the claim allowed under ?502(b)(6), the excess will be turned over to the trustee to be administered as part of the debtor's estate. To the extent that the security de- posit is less than the amount of the allowable claim as provided for by ?502(b)(6), the security deposit will be applied in satisfaction of the claim thus alowed. [footnotes omitted]

4 King, Collier on Bankruptcy (15th ed. rev., 1997), ?502.03[7][h], 502-49; and see Oldden v. Tonto Realty Co., 143 F.2d 916 (2d Cir. 1944), a case concerning the predecessor of ?502(b)(6) under the

former Bankruptcy Act. Accordingly, Creditor's claim must be reduced by the $5,000 deposit for the lease of the premises at 110 S. Abel and by the $1 deposit for the lease of the premises at 98 S. Abel.

III.

CREDITOR'S OBJECTION TO CONFIRMATION OF DEBTOR'S PLAN

As discussed above, Debtor's Plan has been accepted by each impaired class. Accordingly, Debtor need not resort to cramdown and it is only necessary that Debtor demonstrate compliance with all applicable provisions of ?1129(a) in order for the Plan to be confirmed.

One such requirement is that of ?1129(a)(3), that the Plan be proposed in good faith. The objection filed by Creditor is imprecise but appears to allege bad faith both in proposing the Plan and in filing bankruptcy at all, and/or in converting the case from chapter 13 to Chapter 11; at the evidentiary hearing, Creditor argued that Debtor acted in bad faith at all three stages of the case. Only the issue of whether the Plan has been proposed in good faith is before the Court at this time. Whether Debtor filed bankruptcy and/or converted the case in good faith is an issue that might be presented by a motion to dismiss the case or to appoint a trustee, but it is not an issue that bears directly upon confirmation of the Plan, see In re Stolrow's, Inc., 84 B.R. 167 (9th Cir. BAP 1988) ("Stolrow's").

A. Facts

Debtor testified that: (1) when she filed bankruptcy in September 1996, she was being sued by Creditor and was under pressure from the Internal Revenue Service ("IRS") and her secured creditor, while also owing "a lot of money" to several unsecured creditors; (2) her former accountant had made errors that caused Debtor to become delinquent in payment of federal diesel fuel tax in 1984 and she later also incurred liability for unpaid payroll and income taxes, plus interest and penalties; (3) IRS attached her bank accounts at various unspecified times, and levied on her residence and sold it in 1989; (4) Debtor also turned over to IRS proceeds from a lawsuit against the former accountant in approximately 1993 and paid IRS "a lot of money" starting in 1994; (5) IRS has never fully accounted to her for its disposition of funds received and it has filed claims in her bankruptcy case totalling approximately $300,000 (of which some $230,000 is stated to be entitled to priority status); and (6) she has always been afraid that IRS would seize her gas station business as it did her residence.

Debtor also testified that she owes a secured debt of $110,000 to Nicomedes Barreto and Haydee Morales ("Barreto/Morales"), which originated in 1992 when she bought a house from them and they took a note and second deed of trust for $110,000 of the purchase price. She said that, due to a lawsuit with a partner, she was not able to perform under the note and made only one payment of $10,000 for interest. Debtor stated that her daughter agreed to buy the house in 1994 and let Debtor live in it, but the sale would not produce enough to pay the second deed of trust in full and Barreto/Morales were not willing to have the property sold subject to their deed of trust. According to Debtor, Barreto/Morales wanted the deed of trust to be replaced with a security interest in the assets of Debtor's gas station business and Debtor did so; she said that Arco is aware of the encumbrance and "they don't care" because they are only concerned with being paid for the gasoline that is delivered to the station. Debtor said that Barreto/Morales "pressed" for payment in 1996, and Debtor told them that she would try to borrow or sell the gas station business to pay them. Creditor contended that Debtor has repaid this loan in full but did not produce evidence of any payment other

than the $10,000 payment that Debtor acknowledges having made. Creditor also pointed out that Barreto/Morales' UCC-1 Financing Statement will be five years old in 1999, and argued that it will lapse at that time and this creditor will then no longer be a secured creditor.

Debtor's general unsecured creditors include the five members of Class 4 who voted to accept the Plan: Van Do filed a claim for $30,000, attaching a copy of a promissory note dated May 31, 1995 signed by Debtor; Juno Lan filed a claim for $43,000, referring to an attached promissory note that is not attached; Antonia San Juan filed a claim for $20,000, attaching a copy of a promissory note dated June 13, 1993 signed by Debtor; Thio Pham did not file a claim but is scheduled as holding a promissory note for $42,000; Cindy Chuang did not file a claim but is scheduled as holding a promissory note for $22,200. Debtor testified that all of these creditors are either friends, relatives, or employees and that she borrowed from them to keep her businesses running and to make payments to IRS; she said that the loans were made in cash and she has no documentation of them. Creditor argued that none of these debts actually exists, but presented no evidence in support of that contention. When asked whether he had talked to any of these creditors, Creditor replied that he "did not have the chance", without explaining why he did not take discovery from them or subpoena them to appear as witnesses, other than to say that he did ask Debtor's attorney to call them as witnesses, which request was "refused".

Debtor testified that, from 1987 to 1995, Arco required her to pay for gasoline deliveries with money orders or cashier's checks because IRS had attached her bank accounts on occasion and Arco was not willing to accept personal checks; in late 1995, Arco commenced a program of automatic withdrawals from Debtor's bank account and the prior arrangement was no longer necessary. She said that she did not deposit all revenues of the gas station into the bank because she often needed cash to purchase money orders if a gasoline delivery had to be paid for when the bank was closed. Debtor testified that, in 1994, she was paying cash for money orders to Arco at the average rate of $300,000 per month, some of which funds came from the gas station revenues and some of which were borrowed from the unsecured creditors. Debtor also wrote checks on the gas station bank account for the purchase of cashier's checks to Arco and testified that she sometimes "borrowed" funds from the bank account of Gold Crown Mortgage (Debtor's mortgage brokerage) with which to pay Arco if the gas station account did not contain sufficient funds when a delivery was made. The evidence includes invoices from Arco showing what payments it received.

Debtor testified that her mortgage brokerage moved to smaller premises in April 1996 and began to break even at that point; prior to the move, that business was losing money at the average rate of $8,000 per month and lost $80,000 during one week in 1994. Debtor said that, while the mortgage brokerage was not profitable, the gas station was and, in 1994, had a gross income of $4,400,000 and a net income of $332,000. Debtor's bankruptcy schedules show an average monthly income of approximately $31,000 (all from the gas station) and she testified that the income has remained about the same, or less. Debtor's Disclosure Statement includes historical financial data showing no profit for the mortgage brokerage and an adjusted gross income as of September 1997 in the amount of $272,169 for the gas station. Debtor testified that the gas station's receipts and disbursements are recorded by an Arco computer as they occur and Arco furnishes her with itemized statements, which Debtor turns over weekly to the accountant appointed by the Court; using those statements, the accountant prepares the monthly operating reports that are required by the United States Trustee, and the financial data contained in Debtor's Disclosure Statement is based on the information in those reports. Debtor also testified that the State Board of Equalization conducted an audit of the gas station for the years 1995 through 1997, spending ten days going through 76 boxes of records, and concluded that there was "no problem" with the records of that business, which is confirmed by a May 15, 1997 letter to Debtor from the State Board of Equalization. Debtor has also filed federal income tax returns reporting all income reflected by her records. Creditor argued that Debtor has not

reported all income to the IRS and has not disclosed all property to the Bankruptcy Court but he produced no evidence that any such assets exist, and he acknowledged that he had no evidence of anything "specific". Creditor also contended that Debtor's Disclosure Statement undervalues the gas station at $273,000 and it should be valued at $630,000, but admitted that he has no experience or expertise in the appraisal of businesses; the Disclosure Statement actually values the business at $544,000.

Debtor testified that she sold her residence to her daughter in 1994 because Debtor could not afford the payments and her daughter would permit Debtor to continue to live in the house. Debtor said that she had purchased the house in 1992 for $350,000 but it was appraised at only $290,000 in 1994. She said that her daughter paid $225,000 for it, which was enough to pay the $216,000 first deed of trust, but not enough to pay the $110,000 Baretto/Morales second deed of trust. Debtor testified that, at the time of that sale, she owned three businesses -- the gas station and the mortgage brokerage, as well as a real estate agency -- which she valued at $350,000. She said that she sold the real estate agency but had to repossess it when the buyers defaulted, then closed it because it made no money; apart from that, she stated that she has transferred no assets other than the house.

Debtor testified that she drives a white Mercedes-Benz that belongs to her son who lives in Los Angeles.

B. Legal Analysis

Except as provided by FRBP 3020(b)(2), Debtor, as proponent of the Plan, bears the burden of establishing each element of ?1129(a), see In re Acequia, 787 F.2d 1352 (9th Cir. 1986), and must do so by a preponderance of the evidence, see In re Arnold and Baker Farms, 177 B.R. 648 (9th Cir. BAP 1994), aff'd, 85 F.3d 1415 (9th Cir. 1996), cert. denied, __ U.S. __, 117 S.Ct. 681 (1997). FRBP 3020(b)(2) provides that evidence of good faith is unnecessary in the absence of an objection to confirmation, but that exception does not apply when an objection has been made, as Creditor has done here. Debtor has met each other applicable requirement of ?1129(a), but must overcome Creditor's objection by demonstrating the good faith that is required by ?1129(a)(3).

The term "good faith" in the context of ?1129(a)(3) is not statutorily defined but has been interpreted by case law as referring to a plan that is "intended to achieve a result consistent with the objectives of the Bankruptcy Code", see In re Corey, 892 F.2d 829, 835 (9th Cir. 1989), cert. denied, 498 U.S. 815, 111 S.Ct. 56 (1990) ("Corey"), citing Stolrow's and In re Jorgensen, 66 B.R. 104 (9th Cir. BAP 1986) ("Jorgensen"). Further,

... there is a legal distinction between the good faith that is a prerequisite to filing a Chapter

11 petition for reorganization and the good faith that is required for confirmation of a plan pursuant to 11 U.S.C. ?1129(a)(3). [Citation omitted] [?] Good faith in proposing a plan of reorganization is assessed by the bankruptcy judge and viewed under the totality of the circumstances. [Jorgensen. Good faith requires that a plan will achieve a result consistent with the objectives and purposes of the Code. Jorgensen. It also requires a fundamental fairness in dealing with one's creditors. Id.

Stolrow's, at 172. The BAP cases of Stolrow's and Jorgensen are cited with approval by the Ninth Circuit case of Corey -- taken together, these cases provide a three part test by which to determine whether a plan has been proposed in good faith:

1/ It must intend a result that is consistent with the objectives of the Bankruptcy Code; and

2/ It must demonstrate fundamental fairness in dealing with creditors; and

3/ The totality of the circumstances must be considered.

Debtor's Plan meets this test. The Plan proposes to pay secured creditors and priority tax creditors in full with interest over a four year period, then to pay unsecured creditors a dividend of 30% within one year. Debtor's liquidation analysis shows that unsecured creditors would receive nothing under Chapter7, due to the amount of secured debt, the amount of priority tax debt, and the amount of capital gains tax and other administrative expense that would be incurred by liquidation. No one (including the United States Trustee) other than Creditor has disputed

Debtor's method of valuing the gas station business at twice the amount of its adjusted annual gross income and Creditor has not demonstrated that such an approach is flawed. In any event, even if the value were approximately $100,000 more as Creditor urges it should be, that larger amount would not exceed the sum of secured claims plus priority claims plus administrative expenses, so there would still be nothing left for unsecured creditors -- Creditor has not taken issue with the administrative expenses set forth in the liquidation analysis and they appear to the Court to be typical and accurate. A Chapter 11 debtor is not required to pay unsecured creditors any more than they would receive in Chapter 7, but Debtor's Plan proposes a dividend to general unsecured creditors of 30%, an amount that is generous when compared to zero.

Creditor has not supported his contention that Debtor's secured debt and general unsecured debt are not genuine. Two of the five unsecured creditors that Creditor considers to be suspect have filed claims with copies of promissory notes signed by Debtor attached, and the secured creditor and Debtor both signed a UCC-1 Financing Statement in 1994. Creditor's argument that the secured creditor will cease to be secured when the Financing Statement lapses in 1999 is legally incorrect, since California Commercial Code ?9403(3) permits a secured creditor to file a continuation statement without the consent of the debtor and thereby renew the original Financing Statement for another five years (and for subsequent five year periods, without limitation); further, the existence of a Financing Statement does not determine a secured creditor's status vis a vis a debtor, it merely operates to perfect a security interest as against other creditors. Creditor could have compelled discovery from the other creditors and could have compelled them to appear at the evidentiary hearing, but instead chose to rely on Debtor's counsel to produce them, which Debtor's attorney had no duty to do.

There is no evidence that these creditors' claims do not exist in the amounts stated by Debtor and by the creditors who filed claims, and Debtor's explanation of how and why she borrowed from friends, family, and employees was both credible and plausible.

Creditor argues that Debtor is able to pay all creditors in full, but he has not supported his contention that Debtor has income or assets other than as disclosed to the IRS and the Bankruptcy Court, and as confirmed by Debtor's records; those records are in large part created and maintained by Arco, and have been found by the State Board of Equalization to be accurate. Debtor's Disclosure Statement sets forth historical financial data that is confirmed by her records and monthly operating reports, together with what appear to be realistic projections based on past performance, which demonstrate both the feasibility of the Plan and the fact that Debtor is devoting available business revenue to it for five years. Pursuant to ?541(a)(6) and In re Fitzsimmons, 725 F.2d 1208 (9th Cir. 1984), post-petition business revenues are property of a bankruptcy estate but a debtor's post-petition earnings for personal services are not, so Debtor is under no obligation to devote income of that type to the Plan; further, as discussed above, Debtor is not required to pay unsecured creditors anything because they would receive nothing in Chapter 7, yet she proposes to pay them a 30% dividend. This is not a situation where de minimis payments to creditors are proposed by a debtor who enjoys substantial assets and income, and the Plan's provisions for general unsecured creditors do not suggest bad faith

under the circumstances.

Much of Creditor's evidence concerns events that occurred in 1994, which has little bearing on the state of affairs that existed when Debtor filed bankruptcy in September 1996 and proposed her Plan in September 1997. For example, the fact that Debtor sold her house to her daughter for $125,000 less than Debtor paid for it two years earlier, and for $65,000 less than its appraised value at time of sale, may or may not suggest an effort on Debtor's part to place assets beyond the reach of creditors, but it occurred over two years prior to commencement of the bankruptcy case and over three years prior to the filing of the Plan -- Debtor testified that she transferred no other assets, and the single transfer in 1994 sheds little light on whether Debtor acted in good faith when she proposed her Plan in 1997.

As discussed above, the issue of whether Debtor filed bankruptcy in good faith, and/or whether she converted the case from Chapter 13 to Chapter 11 in good faith is not before the Court, other than indirectly as part of the totality of the circumstances surrounding creation of the Plan. The Court considers that Debtor's stated reason for filing bankruptcy does not suggest a bad faith motivation: she owed $300,000 to the IRS, which had already levied upon her house and which she feared would seize her gas station business; she owed $110,000 to Baretto/Morales, who had a lien on the gas station and were pressing for payment; she was being sued by Creditor for some $150,000; and she owed over $100,000 to friends, relatives, and employees for loans. There is no requirement that one be hopelessly insolvent in order to be eligible for relief under the Bankruptcy Code, and it is not bad faith for one in Debtor's position to seek such relief as a means of reorganizing financial affairs.

Debtor has met the burden of demonstrating, by a preponderance of the evidence, that her Plan has been proposed in good faith.

CONCLUSION

For the reasons stated above:

1/ Debtor's objection to Creditor's claim is sustained in part and such claim is disallowed to the extent that it exceeds $50,489.22, and allowed in that amount as a general unsecured claim; and

2/ Creditor's objection to confirmation of Debtor's Plan is overruled.

Counsel for Debtor shall submit a form of order or orders so providing, after review by Creditor as to form.

Dated: April 13, 1999

_____

ARTHUR S. WEISSBRODT
United States Bankruptcy Judge

1. Unless otherwise noted, all statutory references are to Title 11, United States Code (the Bankruptcy Code), as amended on October 22, 1994.

2. Accordingly, it is unnecessary for this Court to reach the issue of whether the State Court Judgment is void as a violation of ?362(a), see In re Schwartz, 954 F.2d 569 (9th Cir. 1992). The record reflects that the State Court Judgment was filed on the same day as Debtor's bankruptcy petition, but does not show which was filed earlier in the day, nor when the State Court Judgment was

entered; depending on these facts, the State Court Judgment may or may not be void.

3. Creditor's calculations are based on a one year period commencing February 12, 1994, the date on which this Court has ruled that each lease was terminated by Creditor. Creditor's pleadings are not entirely clear, but he appears to use fractions of a year because the one year period commencing February 12, 1994 runs beyond the December 1, 1994 anniversary date of the lease and he contends that the lease calls for an annual increase in base rent on each anniversary.

4. Creditor's use of fractions in the calculations for this lease appears to have the same explanation as that noted in footnote 2 above. This lease's anniversary date is August 1.

Decision Date:
Friday, April 30, 1999
