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 U.S. BANKRUPTCY COURT
 EASTERN DISTRICT OF TX
 IN THE UNITED STATES BANKRUPTCY COURT
 FOR THE EASTERN DISTRICT OF TEXAS
 LUFKIN DIVISION

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CLERK, U.S. BANKRUPTCY COURT

IN RE: BASEL SLATTER Debtor	§ § § § § §	Case No. 02-92312 _____ DEPUTY Chapter 13
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MEMORANDUM OF DECISION¹

This matter is before the Court to consider the Motion to Dismiss or Convert (the “Motion”) filed by C&W Acquisition, LLC (“C&W”), a creditor in the above proceeding, as well as the objection filed thereto by the Debtor, Basel Slatter (“Debtor”).² A hearing was held on the Motion on January 30, 2003. Upon the conclusion of the hearing, the parties were given the opportunity to submit additional briefing to the Court and, upon the receipt of such briefing, the Court took the matter under advisement. This memorandum of decision disposes of all issues pending before the Court.³

¹ This Memorandum of Decision is not designated for publication and shall not be considered as precedent, except under the respective doctrines of claim preclusion, issue preclusion, the law of the case or as to other evidentiary doctrines applicable to the specific parties in this proceeding.

² A similar “Motion to Dismiss” was filed by Michael Gross, the standing Chapter 13 Trustee for the Eastern District of Texas (“Trustee”). As in the C&W Motion, the basis for the Trustee’s Motion was the dispute over the eligibility of the Debtor for relief under Chapter 13 of the Bankruptcy Code. Because the hearing on the C&W Motion was held subsequent to the hearing on the Trustee’s Motion, the evidence at the second hearing was more developed. Accordingly, the Court will rule upon the C&W Motion and, because it shall be granted, the Trustee’s Motion will be dismissed as moot.

³ This Court has jurisdiction to consider the Motion pursuant to 28 U.S.C. §1334(b) and 28 U.S.C. §157(a). The Court has the authority to enter a final order in this contested matter since it constitutes a core proceeding as contemplated by 28 U.S.C. §157(b)(2)(A) and (O).

Factual Background

The issues raised by the Motion involve the eligibility of the Debtor for relief under Chapter 13 of the Bankruptcy Code, as well as the alleged bad faith of the Debtor in filing the petition solely to prevent an adverse state court ruling on a summary judgment motion which was set for consideration a few days subsequent to the petition date.⁴

The Debtor filed his Chapter 13 petition on June 27, 2002, and subsequently filed his original schedules and Chapter 13 plan on July 26, 2002. The Debtor's original "Schedule D – Creditors Holding Secured Claims" listed only one secured creditor, while his original "Schedule F – Creditors Holding Unsecured Nonpriority Claims" listed a total of \$325,949.56 in unsecured debt, including a "contingent" debt of \$96,000 owed to Tony Gullo ("Gullo") based upon a "personal guarantee" involving Center Autoplex, Inc.⁵ In addition, the Debtor's original schedule of personal property (Schedule B) listed the value of his 250 shares of common stock in Center Autoplex, Inc., as "unknown."

On September 25, 2002, the Debtor amended his schedules by switching the debt owed to Gullo from Schedule F to Schedule D, and therein indicated that such debt was secured by 1000 shares of Center Autoplex, Inc. stock. Likewise, the Debtor amended his Schedule B to reflect that the value of his 250 shares of stock was \$24,000. The Debtor testified that he originally listed the Gullo debt as unsecured because he incorrectly thought that such debt was a guaranty

⁴ Because the Debtor has been found ineligible for Chapter 13 relief, the Court need not address the issue of bad faith.

⁵ Center Autoplex, Inc., is a Dodge dealership located in Center, Texas. The Debtor owns 250 shares of common stock of this corporation, and also serves as the general manager of the company. The remaining 750 shares of common stock are owned by Revis Whitmire.

obligation, and that he subsequently amended his Schedules D and F after realizing that he was personally obligated to Gullo based upon a promissory note signed by both the Debtor and Revis Whitmire (“Whitmire”) as makers, with Gullo as the payee. The Debtor and Whitmire executed this note, in the original amount of \$150,000, to purchase Center Autoplex, Inc., from Gullo.⁶ Under the agreement between the Debtor and Whitmire, the Debtor, in exchange for 250 shares of stock in Center Autoplex, Inc., was to manage the day-to-day operations of the company. Whitmire, on the other hand, received the remaining 750 shares of stock in consideration of his financial support in purchasing and running the company.⁷

On November 1, 2002, Whitmire also filed a proof of claim in the Debtor’s bankruptcy indicating that he holds an unsecured claim for \$294,000 based on the Debtor’s failure to pay certain financial obligations. Although he has not formally objected to this proof of claim by Whitmire, the Debtor argued at the hearing before this Court that he and Whitmire had an oral agreement that the Debtor would never become liable for more than 25% of the purchase price of the business, or \$37,500, and that he had already satisfied \$10,000 of this obligation.

It is in this context that the Court must determine the Debtor’s eligibility for relief under Chapter 13 of the Bankruptcy Code.⁸

⁶ The terms of this note require a \$3,000 monthly payment due on the first day of each month.

⁷ Both parties testified that the Debtor was to run the business, while Whitmire was the “money man.”

⁸ Because the Debtor is ineligible based upon the consideration of the proper scheduling of claims owed by him, the Court need not address the relevance of the \$294,000 proof of claim filed against the estate by Whitmire or the dispute regarding its validity.

Discussion

11 U.S.C. §109(e) sets forth the debt limitations for an individual Chapter 13 debtor. Under §109(e), “[o]nly an individual with regular income that owes, on the date of the filing of the petition, noncontingent, liquidated, unsecured debts of less than \$290,525 . . . may be a debtor under chapter 13 of this title.” As evidenced by this language, an unsecured debt owed as of the petition date that is either unliquidated or contingent may not be counted toward the unsecured debt limitations in §109(e), although a disputed debt is counted. *See In re Horne*, 277 B.R. 712, 714-15 n. 2 (Bankr. E.D. Tex. 2002) [“The general rule is that disputed debts should be included in the §109(e) debt calculations. . . . The existence of a dispute over part or all of a debt does not convert the debt from a liquidated one to an unliquidated one.”] (*quoting In re Visser*, 232 B.R. 362, 364-65 (Bankr. N.D. Tex. 1999)).

The Debtor’s amended Schedule F lists a total of \$233,319.29 in liquidated and noncontingent unsecured debt without reference to the Gullo claim.⁹ Therefore, if it is appropriate for the Court to divide the \$96,000 claim of Gullo¹⁰ into secured and unsecured portions based upon the value of Gullo’s collateral, the Debtor is ineligible for Chapter 13 relief because the resulting unsecured portion of Gullo’s claim, when added to the \$233,319.29 already

⁹ The amended Schedule F lists a total of \$233,320.29 in unsecured debt, but a \$1.00 obligation owed to Chrysler Financial is listed as contingent; hence, it may not be counted for eligibility purposes.

¹⁰ Although the Debtor scheduled the obligation owed to Gullo at \$96,000, Gullo’s proof of claim reflects that he is only owed \$81,000 by the Debtor. This proof of claim #9, however, was not filed until November 25, 2002, some five months after the Debtor filed his Chapter 13 petition on June 27, 2002. The \$15,000 difference appears to reflect the receipt by Gullo of five additional \$3,000 monthly payments under the terms of the note. Because 11 U.S.C. §109(e) is concerned with debts existing “on the date of the filing of the petition,” the Court will properly consider the \$96,000 amount that was owing as of the June 27, 2002, filing date.

listed, causes the unsecured debt level to exceed the \$290,525 limit in §109(e).¹¹

The Debtor argues that, for eligibility purposes, “[a] court should rely primarily upon the debtor’s schedules, checking only to see if the schedules were made in good faith.” *See Comprehensive Accounting Corp. v. Pearson (In re Pearson)*, 773 F.2d 751, 756 (6th Cir. 1985).

As stated by one recognized treatise in this area:

The U.S. Court of Appeals for the Sixth Circuit [*Pearson*, 773 F.2d 751] is the leading proponent that claims should not be split for purposes of eligibility.

The Sixth Circuit found it was ‘relatively immaterial’ that claims litigation might later establish the amounts of secured and unsecured claims different from those listed in the debtor’s Chapter 13 Statement so long as the debtor prepared the documents in good faith.

See 1 KEITH M. LUNDIN, CHAPTER 13 BANKRUPTCY ¶ 14.1 at p. 14-1 (3^d ed. 2000 & Supp. 2002).

Because the obligation owed to Gullo was scheduled solely as a secured debt, and because there has been no evidence that the Debtor did so in bad faith, the Debtor apparently believes that the Court is prohibited from splitting the Gullo claim into secured and unsecured amounts in order to gain a more accurate picture of the estate as of the date of the petition. The Fifth Circuit,

¹¹ Despite the Debtor’s initial scheduling of this obligation as an unsecured debt, it is clear that as of the petition date, the obligation to Gullo was secured by 1000 shares of Center Autoplex, Inc. stock. *See* Debtor’s deposition, p.70, lines 1-12 [“It’s my understanding that Mr. Gullo holds the originals (original stock certificates) as security on that note.”]. The Debtor and Whitmire executed the promissory note and the accompanying security documents on December 21, 2000, well before the June 2002 petition date. In addition, the Debtor testified that, at the time he filed his original Schedule F listing Gullo as an unsecured creditor, the Debtor incorrectly believed that his obligation to Gullo was based on a contingent “personal guarantee,” rather than a promissory note upon which both he and Whitmire were primarily liable. After realizing his mistake, the Debtor subsequently amended his original Schedules D and F to correctly identify the Gullo obligation as secured. Consequently, the Court need not focus on the Debtor’s erroneous original schedules in determining eligibility, but rather on the schedules as amended on September 25, 2002, which accurately reflect the true state of affairs as of the original petition date.

however, has not adopted *Pearson* as the controlling standard, so it is at best offered as persuasive authority.

Yet, “[a] strong majority of courts approve of the Seventh Circuit’s view [*In re Day*, 747 F.2d 405 (7th Cir. 1984)]¹² and hold that §506(a) applies in an eligibility dispute in a Chapter 13 case to split claims into their secured and unsecured portions.” See 1 LUNDIN, CHAPTER 13 BANKRUPTCY at ¶ 14.1; see also *Scovis v. Henrichsen (In re Scovis)*, 249 F.3d 975, 983-84 (9th Cir. 2001) [“Through the inclusion of a §506(a) analysis to define ‘secured’ and ‘unsecured’ in the §109(e) context, a vast majority of courts, and all circuit courts that have considered the issue, have held that the unsecured portion of undersecured debt is counted as unsecured for §109(e) eligibility purposes. . . . The listed value of Debtors’ residence is \$325,000. After considering the \$249,026.91 first deed (of) trust, only \$75,973.09 remains as possible equity to which liens could attach. Since (the creditor’s) judgment lien is for \$208,000, at least \$132,026.91 of the judgment lien is undersecured. There is no question that this undersecured debt is to be counted as unsecured for eligibility purposes.”]; *Brown & Co. Sec. Corp. v. Balbus (In re Balbus)*, 933 F.2d 246 (4th Cir. 1991) [“In determining whether (a debtor) has less than \$100,000 in unsecured debts under 11 U.S.C. §109(e), the court must add the amount of unsecured debt and the amount by which secured creditors are undersecured.”]; *In re Visser*, 232 B.R. at 364 [“The undersigned agrees with the following court’s disagreement with . . . *In re Pearson*.”]; *In re Mason*, 133 B.R. 877 (Bankr. N.D. Ohio 1991) [stating that the “debtor’s ineligibility for Chapter 13 relief is facially evident upon review of their petition. . . . (F)ollowing

¹² This is the correct citation to the *Day* opinion, which was incorrectly cited by the author of the referenced treatise.

§506, and using debtor's figures, (the secured creditor) has an unsecured claim exceeding \$100,000 (the debt limitation)" because the debtor's schedules listed the secured creditor's claim as approximately \$270,000 secured by real property valued at only \$77,000]; *In re Rifkin*, 124 B.R. 626 (Bankr. E.D.N.Y. 1991) ["(T)he view adopted by a majority of jurisdictions is correct and . . . the unsecured portion of an undersecured debt should be included in the §109(e) determination."].

In *In re Day*, a creditor had purchased the debtor's accounts receivables for \$73,000, and had created a lien on those same accounts by signing a security agreement. 747 F.2d at 406. However, at the hearing on eligibility, the court determined that the collateral was worthless. In applying the §506(a) test and deeming the full \$73,000 debt to be unsecured, the Seventh Circuit made two important statements. First, it recognized that "[c]ourts have consistently examined the true value of collateral securing a debt when evaluating a debtor's eligibility for Chapter 13 relief under 11 U.S.C. §109(e)." *Id.* Secondly, it acknowledged that a failure to apply §506(a) in the context of an eligibility challenge would "raise form over substance" and would allow debtors to "easily circumvent" the debt limitations in §109(e). *Id.* at 407. Thus, finding that it was proper to add the \$73,000 obligation to the other unsecured debts acknowledged by the debtor, the Seventh Circuit affirmed the dismissal of the Debtor's Chapter 13 case based upon ineligibility. *Id.*

In a similar manner, this Court believes it appropriate to utilize the §506(a) test to determine the correct characterization of the Gullo obligation. This determination necessarily requires a valuation of the stock of Center Autoplex, Inc., which serves as collateral under the note to Gullo.

Even by accepting the Debtor's schedules at face value and adopting the Debtor's proposed \$24,000 value for the Center Autoplex, Inc. stock, the Debtor still exceeds the eligibility requirements imposed by §109(e). The Debtor testified that he amended his Schedule B to include this \$24,000 collateral value in response to a demand by the Chapter 13 Trustee for a valuation of that asset, and he asserts that he does not really know what the true value of the stock might be. While those doubts may be legitimate, they cannot be used to assist the Debtor's efforts to avoid the debt limitation ceilings. The Debtor signed his amended schedules under oath and, in this context, it is appropriate for the Court to rely on this \$24,000 figure as the Debtor's best estimate of the value of his 250 shares of stock.¹³ Furthermore, despite the fact that the Gullo obligation is secured by stock owned by both the Debtor and by Whitmire, the §506(a) test only considers the value of the Debtor's stock in determining whether Gullo is secured or undersecured as to this Debtor. *See* 11 U.S.C. §506(a) ["An allowed claim of a creditor secured by a lien on property in which the estate has an interest . . . is a secured claim to the extent of the value of such creditor's interest *in the estate's interest in such property*, . . . and is an unsecured claim to the extent that the value of such creditor's interest (*in the estate's interest in such property*) . . . is less than the amount of such allowed claim."] (emphasis added).

Utilizing the Debtor's \$24,000 valuation,¹⁴ the Debtor's \$96,000 obligation owed to

¹³ The Court notes that the Debtor owns 25% of the corporate stock securing the Gullo obligation, and that the Debtor's estimated value of \$24,000 for his 250 shares is exactly 25% of the \$96,000 obligation owed to Gullo.

¹⁴ Actually, on this topic, the Court finds greater credibility in the testimony of Revis Whitmire, the majority (75%) shareholder of Center Autoplex, Inc., who testified that the stock of Center Autoplex Inc.'s was worth \$0 as of the petition date. The Debtor admitted that Mr. Whitmire had much greater access to the corporate books and records and was in a better position to know the actual value of the corporate stock. Further, Whitmire's valuation is buttressed by the substantial testimony adduced regarding the financial troubles experienced by this corporation and its constant need for larger capital

Gullo is still undersecured by \$72,000. The Court must therefore re-calculate the amount of unsecured debt by including the additional \$72,000. As mentioned earlier, the Debtor's amended schedules indicated \$233,320.29 in unsecured debt, of which \$233,319.29 is both liquidated and noncontingent. After adding the \$72,000 unsecured Gullo obligation to the \$233,319.29 reflected on the Debtor's Schedule F, the Court finds that the Debtor has a total of \$305,319.29 in non-contingent, liquidated unsecured debt.

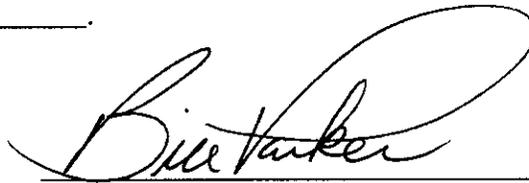
Therefore, because the Debtor has clearly exceeded the \$290,525 unsecured debt limit contained in §109(e)'s eligibility requirements, the Court must grant the Motion to Dismiss or Convert because the Debtor is ineligible for relief under Chapter 13 of the Bankruptcy Code. In order to provide the Debtor an opportunity to consider whether he wishes to remain under the protection of the Court, the Court shall enter an order granting the Motion which provides that, in the event that the Debtor fails to file, on or before Thursday, April 10, 2003, a proper motion to convert this Chapter 13 case to another chapter under Title 11, United States Code, for which the Debtor is eligible, this Chapter 13 case will be dismissed without further notice.

This memorandum of decision constitutes the Court's findings of fact and conclusions of law¹⁵ pursuant to Fed. R. Civ. P. 52, as incorporated into contested matters in bankruptcy cases by Fed. R. Bankr. P. 7052 and 9014. A separate order will be entered which is consistent with this memorandum.

infusions. Obviously, the Debtor exceeds the eligibility limits if a \$0 value is given to the stock; however, as set forth above, he exceeds those limits even under his own valuation.

¹⁵ To the extent that any finding of fact is construed to be a conclusion of law, it is hereby adopted as such. To the extent any conclusion of law is construed to be a finding of fact, it is hereby adopted as such. The Court reserves the right to make additional findings and conclusions as necessary or as may be requested by any party.

SIGNED: APR 1 2003

A handwritten signature in cursive script, appearing to read "Bill Parker", written over a horizontal line.

BILL PARKER
UNITED STATES BANKRUPTCY JUDGE

cc: Bill Pedersen, Jr., Atty for Debtor
Bruce Akerly, Atty for Movant
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COMMENTS:

Memorandum of Decision.