UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

GORDON A. STREGER and
MARIE E. STREGER,

Debtors.

Case No. 87-2755-D H

Chapter 11

JUDGMENT

The issues of this proceeding having been duly considered by the Honorable Russell J. Hill, United States Bankruptcy Judge, and a decision having been reached,

IT IS ORDERED AND ADJUDGED that the confirmation of Debtors' plan, as amended, is denied.

IT IS FURTHER ORDERED that FLB's motion to dismiss is granted, and the case is dismissed.

IT IS FURTHER ORDERED that Debtors pay to the United States Trustee the appropriate sum required pursuant to 28 U.S.C. § 1930(a)(6) within ten (10) days of the entry of this Judgment and simultaneously provide to the United States Trustee an appropriate affidavit indicating the cash disbursements for the relevant period.

IT IS FURTHER ORDERED that the Court retain limited jurisdiction to consider any professional fee applications.

Dated this 18th day of April,1989.

Mary M.Weibel
Clerk of U.S. Bankruptcy Court

By:_____
Deputy Clerk

SEAL OF U.S. BANKRUPTCY COURT
ENTRY OF JUDGMENT
Dated: April 18,1989

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

GORDON A. STREGER and
MARIE E. STREGER,

Debtors.

Case No. 87-2755-D H

Chapter 11

ORDER -- OBJECTION TO CONFIRMATION OF PLAN AND MOTION TO DISMISS

On December 13, 1988, a hearing was held on the confirmation of Debtors' Chapter 11 plan and the motion to dismiss. The following attorneys appeared on behalf of their respective clients: Ronald Schnack for Debtors; Eric W. Lam for creditor Federal Land Bank of Omaha (hereinafter "FLB"); and David P. Miller, Attorney for the United States Trustee. At the conclusion of said hearing, the Court took the matter under advisement upon a briefing deadline of January 13, 1989. Briefs were timely filed and the Court considers the matter fully submitted.

This is a core proceeding pursuant to 28 U.S.C. §§157(b) (2) (A) and (L). The Court, upon review of the pleadings, arguments of counsel, evidence presented and briefs submitted, now enters its findings and conclusions pursuant to Fed.R.Bankr.P. 7052.

FINDINGS OF FACT

1. On August 15, 1978, Debtors borrowed approximately $213,000.00 from FLB for the purchase of a tract of real estate. Debtors signed a promissory note which required them to pay FLB

$3,550.00 plus interest on a semi-annual basis for 30 years. Said note was secured by a mortgage on 286 acres of Debtors' land.

2. After Debtors became delinquent on their obligation, FLB filed on April 30, 1987, a foreclosure petition against Debtors in the Iowa District Court for Muscatine County.

3. On October 30, 1987, FLB filed a motion for summary judgment, and the hearing was scheduled for November 10, 1987.

4. On November 9, 1987, Debtors filed a Chapter 11 petition.

5. In their schedule A—2, Debtors listed a debt of $195,000.00 owed to FLE. Said debt was listed as not contingent, unliquidated or disputed. In their schedule B-2 (q), Debtors listed no "contingent and unliquidated claims of every nature, including counterclaims."

6. On December 18, 1987, FLB filed a proof of claim in the total amount claimed of $287,434.22. Said claim arose out of the previously mentioned note and mortgage.

7. On July 11, 1988, Debtors filed a Chapter 11 plan of liquidation, which plan was amended on October 24, 1988. Paragraph 4.01(a) of said plan provides that FLBs claim is impaired and shall be satisfied in full as follows:

> The amount of this allowed secured claim shall be determined by the Court. On or before August 1, 1988, Debtors shall file in this Court, or in some other form [sic] of appropriate jurisdiction, an action to determine the allowed amount of the Federal Land Bank's secured claim.

In addition, paragraphs 4.01(d) and (e) provide FLB will either (1) receive cash on February 1, 1989, equal to its allowed

secured claim, or (2) receive a deed on February 2, 1989, of all the real estate (286 acres) pledged by Debtors to FLB minus 2 acres.

8. On July 29, 1988, Debtors filed in the Iowa District Court for Muscatine County a petition for declaratory judgment to determine the amount due pursuant to paragraph 4.01(a) of their bankruptcy plan.

9. On August 15, 1988, FLB answered the petition for declaratory judgment and also requested the court to determine the amount due pursuant to the plan.

10. On December 1, 1988, FLB filed a motion for summary judgment against Debtors on their state court petition for declaratory judgment.

11. On July 11, 1988, Debtors filed a disclosure statement. On August 11, 1988, FLB filed an objection to the disclosure statement and requested in the alternative that Debtors supplement their disclosure statement with information concerning whatever claim they may have against FLB.

12. On September 15, 1988, Debtors filed a response to FLB's objection to disclosure statement which stated in relevant part:

> Attached to this response is a copy of a Petition for Declaratory Judgment, Equity No. C4161-487, filed in the Iowa District Court for Muscatine County, which sets forth all pertinent information concerning Debtors' claim against the Federal Land Bank. [emphasis added]

Said response was silent as to any counterclaim Debtors had against FLB. FLB signed said response and by doing so acknowledged satisfaction of its objection to Debtors' disclosure statement.

13. On October 20, 1988, the Court approved Debtors' disclosure statement and noticed out the confirmation hearing. The approved disclosure statement and Debtors' amended plan, when noticed for acceptance or rejection, did not contain any reference to any claim held by Debtors against FLB.

14. On October 31, 1988, Debtors filed a counterclaim and jury demand against FLB in FLB's state court foreclosure suit. The filing of the counterclaim is in addition to and separate from Debtors' declaratory judgment action to determine the amount of the debt owed to FLB.

DISCUSSION

FLB has objected to confirmation of Debtors' plan and argued Debtors' case should be dismissed. The Court will address each matter individually.

A. Confirmation of Plan

Bankruptcy Code §1129(a) sets out 13 requirements that must be met before the Court can confirm a Chapter 11 plan. FLB argues Debtors' plan cannot be confirmed because it violates §§1129(a) (3) and (10). The Court will separately address each subsection.

1. §1129(a)(l0)

Section 1129(a) (10) provides:

> If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.

11 U.S.C. §1129(a)(l0) (emphasis added). In the case at bar, Debtors' plan contains four classes but only three deal with claims, namely Classes I, II and III. Both parties agree Classes II and III are unimpaired. Thus, the only issue is whether FLB's allowed secured claim in Class I is impaired.

Section 1124 defines when a claim is "impaired" and provides:

> Except as provided in section 1123(a)(4) . . . a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan-—
>
> (1) leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest;
>
> (2) notwithstanding any contractual provision or applicable law that entitles the holder of such claim or interest to demand or receive accelerated payment of such claim or interest after the occurrence of a default——
>
> (A) cures any such default that occurred before or after the commencement of the case .
>
> (B) reinstates the maturity of such claim or interest as such maturity existed before such default;
>
> (C) compensates the holder of such claim or interest for any damages incurred as a result of any reasonable reliance by such holder on such contractual provision or such applicable loss; and
>
> (D) does not otherwise alter the legal, equitable, or contractual rights to which such claim or interest entitles the holder of such claim or interest; or
>
> (3) provides that, on the effective date of the plan, the holder of such claim or interest receives, on account of such claim or interest, cash equal to——

(A) with the respect to a claim, the allowed amount of such claim. .

11 U.S.C. §1124 (emphasis added). A lump sum payment upon sale of property alters a creditor's contractual rights to payments on a fixed interval and violates §1124(1). See In re Otero Mills. Inc., 31 B.R. 185, 186 (Bankr. D. N.M. 1983) (lump sum payment upon sale of property altered creditor's contractual rights in requiring monthly payments). If rights are altered for purposes of §1124(1), then they are also altered for purposes of §1124(2)(D). In re Barrington Oaks Gen. Partnership, 15 B.R. 952, 955 (Bankr. D. Utah 1981)

In the case at bar, FLB's contractual rights include semiannual payments of $3,550.00 plus interest for 30 years. Debtors' treatment of FLB's allowed secured claim in Class I provides for a lump sump payment in cash on or before February 1, 1989, or alternatively a deedback on February 2, 1989, of FLB's real estate collateral. The Court finds said treatment alters FLB's contractual rights to semi—annual payments and thus violates §1124(1). Given this violation, said treatment also violates §1124(2) (D). In addition, §1124(2) (A) is violated because Debtors have not proposed a cure of the default. Therefore, since neither §1124(1) or (2) is met, Class I is impaired unless the requirements of §1124(3) are met.

Upon review, the Court finds Debtors have also failed to comply with §1124(3) for the following reasons. Paragraphs 4.01(d) and (e) provide FLB will either (1) receive cash equal to its

allowed secured claim on February 1, 1989, or (2) receive a deed on February 2, 1989, of all the real estate (286 acres) pledged by Debtors to FLB minus 2 acres. Section 1124 (3) (A) provides that FLB is not impaired if it receives cash equal to the allowed amount of its claim on the plan's effective date. Because the deedback option does not involve any cash, it is irrelevant for purposes of the Court's analysis under §1124(3) (A).

Concerning Debtors' other option for FLB to receive cash equal to its allowed secured claim on February 1, 1989, the Court concludes §1124(3)(A) is not met for three reasons. First, the date on which Debtors propose to pay cash--February 1, 1989--is not the effective date of the plan because pursuant to paragraphs 1.04 and 1.07 of the plan, the effective date is 144 days after the Court enters a confirmation order. Assuming for the sake of argument Debtors' plan was confirmed today, the effective date would be 144 days from now, and such date obviously would not be February 1, 1989.

Second, the parties' dispute over the amount of the indebtedness Debtors owe FLB is currently pending in the Iowa District Court for Muscatine County. Assuming again Debtors' plan was confirmed today, there is no certainty that on the 144th day from now, the Iowa District Court or the Iowa Supreme Court would have rendered a final decision on the amount of indebtedness Debtors owe FLB. The possibility that FLB will not receive cash on the effective date of Debtors' plan equal to the allowed amount

of its secured claim convinces the Court that Debtors' plan does not comply with §1124(3) (A).

Finally, and most importantly, Debtors are not obligated under the plan's terms to even pay cash because of the deedback option. Assuming for the sake of argument that February 1, 1989, is the plan's effective date and that the allowed amount of FLB's claim is determined by the courts before that effective date, paragraph 4.1(e) of Debtors' plan provides that if FLB's allowed secured claim is not paid in cash, then on February 2, 1989, Debtors will deed to FLB portions of the real estate pledged as collateral to FLB. As a result, Debtors' plan could be consummated without FLB receiving any cash, and such a result clearly violates §1124(3) (A).

In conclusion, because Debtors' plan treatment of FLB's Class I claim does not comply with §1124, said class is impaired. Thus, because FLE is the only impaired class and has not accepted the plan, Debtors' plan violates §1129 (a) (10) which makes confirmation impossible.

2. §1129(a) (3)

Section 1129(a) (3) requires that a debtor's plan "has been proposed in good faith and not by any means forbidden by law." 11 U.S.C. §1129(a)(3) (emphasis added). "Good faith" under §1129 (a) (3) means there exists "a reasonable likelihood that the plan will achieve a result consistent with the objectives and purposes of the Bankruptcy Code." In re Madison Hotel Associates, 749 F.2d 410, 425 (7th Cir. 1984) (citations omitted). The court must look to debtor's plan and determine, based on the particular

facts and circumstances, whether it will achieve a result consistent with the Code. Id.

In the case at bar, FLB argues Debtors' plan was not proposed in good faith and cites two cases for the proposition that a plan is not proposed in good faith if the debtor simultaneously pursues the confirmation of a plan and prosecutes a state court claim against a creditor. See In re Lewis Industries, 75 B.R. 862 (Bankr. D. Mont.) and Oneida Motor Freight. Inc. v. United Jersey Bank, 848 F.2d 414 (3rd Cir. 1988).

In Lewis Industries, the debtor filed a plan that impaired the objecting creditor's claim. See id. at 866—67 (interest rate and term were modified). While seeking to restructure the debt, the debtor simultaneously was maintaining and pursuing a state court cause of action against the creditor for, among other things, breach of contract and fraud. Id. at 871-72. The bankruptcy court refused to confirm the debtor's plan, finding that "it is not good faith under this Plan from all the circumstances for the Debtor to invoke cram-down against [creditor], while independently prosecuting its state court claim against the Creditor." Id. at 872. However, the court cautioned that a plan could be confirmed under the §1129(a) (3) "good faith" requirement if such litigation was "essential" (recovery of assets through litigation to refinance or restructure the business) to the plan. Id. at 872-73. Thus, Lewis Industries stands for the proposition that a plan is not proposed in good faith under §1129(a)(3) if the debtor simultaneously

pursues confirmation of a plan and non—essential state court litigation against a creditor.

In Oneida Motor Freight. Inc.. v. United Jersey Bank, 848 F.2d 414 (3rd Cir. 1988), the debtor filed a voluntary Chapter 11 petition on July 10, 1985, and on August 14, 1986, the bankruptcy court entered an order confirming the debtor's plan. Id. at 415. Approximately seven months later, the debtor commenced an action against the creditor bank in state court, alleging breaches of credit agreements, of the parties' course of dealing, and of the bank's duty of good faith. Id. at 416. The creditor filed a motion to dismiss the state court complaint, and the federal district court granted the dismissal motion. Id; see 75 B.R. 235.

No where in the debtor's bankrutpcy case in Oneida was there any mention of the debtor's claim against the creditor. Indeed, the Third Circuit observed:

> Here, "the silence" in the Oneida bankruptcy record concerning this present claim, as they say in the vernacular, "is deafening." In Schedule A-2 of the Statement of Financial Affairs required by section 521, Oneida acknowledged its debt to the bank in the amount of approximately $7.7 million, without any mention of a setoff. The debt to the bank in part represented principal and interest due on the lending agreements, the alleged breach of which Oneida now seeks to place at issue. In the portion of the Statement requiring enumeration of "contingent and unliquidated claims of every nature, including counterclaims...", Oneida listed only an unrelated accounts receivable claim....

Id. at 417-418. Based on such "silence," the Third Circuit held that the post-confirmation state court suit filed by the debtor

should be dismissed based on "judicial estoppel" which precludes a party from assuming a position in a legal proceeding inconsistent with one previously asserted. Id. at 419. The Third Circuit expressly concluded that "Oneida's failure to list its claim against the bank worked in opposition to the preservation of the integrity of the system which the doctrine of judicial estoppel seeks to protect." Id.

Upon review of the above authorities and the facts and circumstances in this case, the Court concludes Debtors' plan violates §1129(a) (3) as not being proposed in good faith. It is undisputed that the parties "agree to disagree" on the amount of FLB's secured claim. FLB knew and agreed that Debtors would file the declaratory judgment action and that such a ruling would be necessary in order to determine the amount of its allowed secured claim under the plan. Standing alone, this tends to distinguish Oneida (no undisclosed surprise state court action here) and Lewis Industries (state court suit essential to plan—-meets the Lewis Industries exception). However, FLB is objecting to Debtors' counterclaim filed in FLB's foreclosure action, not to Debtors' declaratory judgment action. Debtors did not list any counterclaim on their schedules or on their disclosure statement, and it was only after the Court's approval of the disclosure statement and the issuance of the plan confirmation notice that Debtors filed their counterclaim in FLB's state court foreclosure action. The parties' "agreement to disagree" went to the declaratory judgment action, not to any counterclaim. Moreover, Debtors' explanation that the

counterclaim in the foreclosure action "is but a continuation of the on-going dispute as to what is owed to FLB" is suspect due to Debtors' failure to disclose the counterclaim until such a late date. This resurrects the Oneida silence/failure to disclose concerns and makes the Lewis Industries exception inapplicable because the essential litigation is the declaratory judgment action, not this counterclaim.

B. Dismissal

Bankruptcy Code §1112(b) sets out ten non-exclusive "for cause" grounds on which the Court, upon request of the party in interest, may dismiss a case if in the best interest of creditors and the estate, including:

> (2) inability to effectuate a plan;
>
> (3) unreasonable delay by the debtor that is prejudicial to the creditors....

11 U.S.C. §§1112(b) (2) and (3). A dismissal for cause rests within the Court's sound discretion. In re Economy Cab & Tool Co., Inc., 44 B.R. 721, 724 (Bankr. D.Minn. 1984). The moving party has the burden of proof of showing "cause" exists. Id.

FLB's first ground for dismissal is §1112(b) (2)——inability to effectuate a plan. Under said section, the movant must show the debtors lacks all ability to formulate or carry out a plan. Economy Cab, 44 B.R. at 725. The Court can dismiss under said section if it determines it is unreasonable to expect that a plan can be confirmed. In re Zahniser, 58 B.R. 530, 537 (Bankr. D. Cob. 1986). In the case at bar, Debtors' plan, as amended, cannot

be confirmed because it violates §§1129(a)(3) and (10). As a result, the Court concludes dismissal is warranted under §1112(b) (2)

FLB's second ground for dismissal is §1112(b) (3)——unreasonable delay by the debtor that is prejudicial to the creditors. In determining whether delay has been unreasonable, the Court must look to the totality of the circumstances. In re Galvin, 49 B.R. 665, 669 (Bankr. D.N.D. 1985). In addition, "[c]ourts will often combine §1112(b)(2) and (3) and hold that the Debtor made an unreasonable delay that is prejudicial to the creditors because the Debtor did not or cannot effectuate a plan within a certain time period." Moody v. Security Pacific Business Credit, Inc., 85 B.R. 319, 351 (W.D. Pa. 1988) (citations omitted). In the case at bar, Debtors' plan is not confirmable, and the case has been pending since November 1987. Based on the totality of these circumstances, the Court concludes dismissal is warranted under §1112(b) (3).

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes Debtors' plan, as amended, is not confirmable because it violates 11 U.S.C. §§1129(a) (3) and (10).

FURTHER, the Court concludes FLB has met its burden of proving "cause" to dismiss exists under 11 U.S.C. §§1112(b) (2) and (3).

FURTHER, the Court concludes dismissal renders FLB's motion to reopen record and to introduce additional evidence, filed April 11, 1989, moot.

IT IS ACCORDINGLY ORDERED that confirmation of Debtors' plan, as amended, is denied.

IT IS FURTHER ORDERED that FLB's motion to dismiss is granted.

IT IS FURTHER ORDERED that Debtors pay to the United States Trustee the appropriate sum required pursuant to 28 U.S.C. §1930(a)(6) within ten (10) days of the entry of this Order and simultaneously provide to the United States Trustee an appropriate affidavit indicating the cash disbursements for the relevant period.

IT IS FURTHER ORDERED that the Court retain limited jurisdiction to consider any professional fee applications.

Dated this 18th day of April, 1989.

RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE