

FINDINGS OF FACT

1. On January 6, 1994, Debtors, Robert and Ruth Ann Hatcher, executed a warranty deed, conveying their real property to Allison Financial Corporation (“Allison”). In April 1994, Debtors sued Allison, and other defendants, in Iowa District Court, Pottawattamie County, for reformation of the warranty deed and for damages for breach of fiduciary duty and fraudulent misrepresentation. On January 13, 1995, the Iowa District Court issued findings of fact, conclusions of law and decree denying Debtors’ claims. Relevant excerpts from that opinion include:

11. A new buyer, Allison, was located by Moyer of McClure Land. A second purchase agreement for the property was signed by the Hatchers and Allison Financial Corporation on the 3rd of January, 1994. The purchase price was \$69,300 and the Plaintiffs had a right to buy back the property by March 30, 1994.

The terms and conditions of the sale of the Hatchers’ land to Mr. Guilford and to Allison Financial was explained fully in the written real estate sales agreements. It was explained orally by Ron Moyer of McClure Land. It is without question that Robert E. and Ruth Ann Hatcher freely and of their own accord executed a warranty deed in the presence of a notary public transferring title of the real estate to Allison Financial Corporation.

...
14. The option period has expired without Hatchers exercising their rights to repurchase the property.

...
Plaintiffs have failed to establish that a fiduciary relationship existed between them and Defendant Allison Financial Corporation. Nor have Plaintiffs established any misrepresentation on behalf of Defendant Allison Financial Corporation.

...
This Court opines that Plaintiffs’ current status is due to the elusive and unrealistic dream of Robert E. Hatcher. At all times Robert Hatcher maintained a dream or wish that someone with unlimited finances would pay an exorbitant price for his farm. Upon receiving this unreasonable sum, Robert E. Hatcher further fantasizes of paying all his debts and purchasing a different and better farm. This delusion was the reason the Plaintiffs attempted at any cost to purchase additional period of time to allow Robert E. Hatcher to locate his imaginary buyer. Ultimately, the cost of this fantasy was the Plaintiffs’ home. Although sympathetic

to them, this Court cannot rewrite the law to further Robert E. Hatcher'[s] wistful unrealistic dream.

2. On February 8, 1995, the Iowa District Court issued a further order and ruling in response to post-trial motions. Pertinent portions include:

Plaintiffs assert that the Court has failed to adequately address the issue of reformation. In its findings of fact paragraphs 6 and 11 set forth that Plaintiffs negotiated the contract terms later reduced to writing. It is clear that the purchase agreement entered between Plaintiffs and Allison was intended as an absolute sale of the subject property for fair and adequate consideration. The relationship between Plaintiffs and Allison was as seller and buyer only.

3. On February 8, 1995, Debtors filed a Notice of Appeal to the Supreme Court of Iowa and subsequently perfected the appeal. Their appeal was based on their claim that the evidence supports a finding of breach of fiduciary duty and fraudulent misrepresentation and reformation of the documents to reflect a secured transaction. The matter was referred to the Court of Appeals of Iowa, which considered the entire record de novo and heard oral arguments. The Court of Appeals affirmed the decision of the Iowa District Court in its entirety on July 26, 1996. Relevant portions include:

We have carefully reviewed the record and agree with the trial court Allison, Moyer, McClure, and Scow made no false representations to the Hatchers which would support the claim for fraudulent misrepresentation. In particular, no evidence indicated any of the defendants expressed or implied the real estate transaction was a loan. The relevant documents clearly indicate the parties entered into a sales agreement and any contrary understanding by the Hatchers was not due to any false representations made by Allison, Moyer, McClure, or Scow. In fact, the Hatchers had attempted to sell their farm to another person prior to the Allison sale, with terms nearly identical to the Allison transaction. Their claim they didn't understand the transaction was a sale was not reasonable under the circumstances.

...

We agree the evidence is insufficient to support reformation. Our goal is to ascertain the intent of the parties. The evidence clearly shows the parties intended the transaction to be a sales agreement.

We observe the Hatchers first contacted Scow for a loan, and were referred to Moyer is they wanted to sell their property. The Hatchers contacted

Moyer, and were later informed by Scow a loan could not be made. Thus, from the inception the Hatchers knew a sales transaction was contemplated. The Hatchers and Allison never maintained a debtor-creditor, mortgagor-mortgagee relationship. In fact, it was necessary for Allison to obtain a loan to purchase the farmland from the Hatchers.

Furthermore, the purchase price was adequate considering all the circumstances and risks, associated with the farmland, as well as the buy-back provision. The Hatchers did retain possession of the farm after the agreement was executed, but only during the option period. We also observe the language of the agreement leaves little doubt the transaction was a conditional sale.

4. Further review of the case was denied by the Supreme Court of Iowa on October 4, 1996.

5. Debtors did not voluntarily vacate the property and Allison initiated eviction proceedings in the Iowa District Court for Pottawattamie County.

6. The state court proceedings were stayed by Debtors' filing of a chapter 11 bankruptcy petition, short filing, and plan of reorganization on October 21, 1996. Debtors propose to fund their plan with income from their continued farming business and from land development.

7. Pursuant to Local Rule 10, Debtors were given until November 5, 1996 to file documents not included in their bankruptcy petition. On November 5, 1996, Debtors filed a Motion for an extension of time for filing the schedules and statement of financial affairs. This Court granted Debtors' motion and the missing documents were filed on November 20, 1996.

8. Debtors scheduled the nature of their joint interest in the real property, valued at \$300,000, as "Subject to Fraudulent Conveyance Action." They schedule a homestead up to 40 acres and valued at \$150,000 as exempt. Allison is scheduled as being a fully secured creditor in the amount of \$62,900, with "Debtors Land" as the collateral.

9. Debtors schedule \$62,885 in personal property, of which \$19,951.44 is collateral for secured claims. Debtors have scheduled no creditors holding unsecured priority claims. Unsecured non-priority claims total \$46,384.81. Of that amount, \$34,284.81 is owed to the law firm that handled much of Debtors' state court actions.

10. Under Debtors' plan, Allison is listed as a creditor in the amount of \$69,000.00. Allison is treated as holding a disputed secured claim constituting an impaired class. The plan provides that Allison's claim is to be paid, when allowed, with annual payments of principal and interest at 8.5% based on a twenty-year amortization.

11. Allison filed a Motion to Dismiss on October 24, 1996. Allison asserts that the best interest of creditors and Debtors would be better served by dismissing this case. Allison argues that the bankruptcy was filed for improper purposes and for the purpose of delay. Debtors resist the motion to dismiss, conceding that a transfer of assets occurred on January 6, 1994, but arguing that a fraudulent conveyance action exists that is valuable property of the bankruptcy estate and that their plan has a feasible basis of confirmation.

12. Allison also filed a Motion for Relief from Stay on October 24, 1996. Allison seeks relief from the automatic stay in order to pursue its state law rights and remedies to gain possession and enjoyment of the property which Debtors continue to occupy. Debtors resist this motion on the bases that a fraudulent conveyance action constitutes valuable property of the estate, the real property is necessary to an effective reorganization, and that Allison is adequately protected by equity in the property.

13. The United States Trustee filed a Motion to Dismiss on October 30, 1996, on the basis that the bankruptcy petition was not a good faith filing.

14. Debtors' report of operations for the period of October 21, 1996 to November 30, 1996 shows income of \$3814.13 and expenses of \$2707.61, resulting in a net income of \$1,106.52.

DISCUSSION

Debtors deeded their real property to Allison. After exhausting their state court efforts to have the agreement reformed to reflect a mortgage of the home and farm and to collect damages for breach of fiduciary duty and fraudulent misrepresentation, they faced eviction proceedings set for 3:30 on October 21, 1996. At 1:26 p.m. on that same date, Debtors filed for protection under chapter 11 of the Bankruptcy Code, thereby staying Allison's efforts to gain physical control of the property. Allison seeks relief from the automatic stay to proceed with the eviction. Allison and the Trustee claim Debtors' bankruptcy was not filed in good faith and seek dismissal of the case. Debtors argue that the bankruptcy estate has a fraudulent conveyance cause of action against Allison that will restore their legal rights in the property.

Federal courts are required to afford the same full faith and credit to a state court judgment as would apply in that state. See 28 U.S.C. § 1738; See also In re McNallen, 62 F.3d 619, 624 (4th Cir. 1995)(citing Allen v. McCurry, 449 U.S. 90, 96 (1980)). If state law would preclude litigation, the court must then determine whether any federal statute provides an exception to the application of collateral estoppel in this case. See In re Asbury, 195 B.R. 412, 415 (Bankr. E.D.Mo. 1996). Iowa law on issue preclusion, or collateral estoppel, bars relitigation if four elements are met:

- (1) the issue concluded be identical in the two actions;

- (2) the issue be raised and litigated in the prior action;
- (3) the issue be material and relevant to the disposition of the prior action; and
- (4) the determination made of the issue in the prior action be necessary and essential to the judgment.

Hall v. Barrett, 412 N.W.2d 648, 650 (Iowa Ct. App. 1987)(citing Ideal Mut. Ins. Co. v. Winker, 319 N.W.2d 289, 294 (Iowa 1982)).

Mr. Hatcher expressed his desire that this Court find that the transaction with Allison was a loan rather than a sale of the property. This Court cannot do that. The issue of the validity of the warranty deed executed by Debtors was litigated in state court. The district court decision was appealed and affirmed by the Court of Appeals of Iowa. Debtors were denied further review by the Supreme Court of Iowa. The issue of the validity of the transaction has conclusively been determined; Debtors' transaction with Allison was not a loan. This Court finds no federal statute that provides an exception to the application of collateral estoppel and therefore affords full faith and credit to the Iowa state court judgments in this case.

Motions to Dismiss Case

Allison asks the Court to dismiss Debtors' bankruptcy case pursuant to 11 U.S.C. § 305 (a)(1). Specifically, Allison asserts that the interests of creditors and Debtors would be better served by dismissal of this case, citing reasons of judicial economy and efficiency, the availability of the Iowa courts to resolve the controversy, and the improper purposes for which bankruptcy jurisdiction was invoked. The Trustee urges the Court to invoke its authority under 11 U.S.C. § 105 (a) to dismiss the case because it was filed without the requisite "good faith." Debtors argue that cause does not exist under 11 U.S.C. § 1112 (b) to dismiss this chapter 11 case.

The Eighth Circuit follows other courts that hold that bad faith filings can be cause for dismissal under the non-exhaustive list of 11 U.S.C. § 1112 (b). See In re Kerr, 908 F.2d 400,

404 (8th Cir. 1990). This Court requires a finding that the reorganization is both subjectively filed in bad faith and objectively futile before dismissal is warranted. See Matter of Unternahrer, No. 94-38-D, J.Hill Decision Book # 266 (Bankr. S.D.Iowa Mar. 17, 1994). Factors that may be indicative of a bad faith filing are:

- (1) whether the debtor owns but one primary asset, which asset is encumbered by a secured creditor's lien;
- (2) whether the debtor employs an insignificant number of non-insider employees;
- (3) whether the debtor generates insignificant cash flow;
- (4) whether the debtor lacks available sources of income to sustain a reorganization plan and/or make adequate protection payments;
- (5) whether the debtor has few unsecured creditors, with relatively small claims;
- (6) whether the debtor's primary asset has been posted for foreclosure; and
- (7) whether bankruptcy offers the only possibility for forestalling loss of the asset.

Unternahrer, at 6-7 (citing In re Reiser Ford, Inc., 128 B.R. 234, 237 (Bankr. E.D.Mo. 1991).

In this case, Debtors do not own the real property that is central to their reorganization. Debtors' plan depends upon them keeping the land. Debtors were on the brink of being forcibly removed from Allison's property. Debtors state they filed their chapter 11 petition to save the house and farm and to retain possession of the property. Debtors, operating as the debtor-in-possession, employ no non-insider employees. While the report of operations through November 30, 1996, shows a net income, a significant portion of the income was from the sale of assets (sixteen percent of the hay and straw, and ten percent of the cattle scheduled). Debtors scheduled nine unsecured creditors with relatively small claims, with the exception of the debt owed Debtors' former counsel. Even though ownership of the land has been conclusively decided against them, Debtors continue to occupy the land and fight efforts to evict them. The bankruptcy was filed as a litigation tactic after Debtors lost their fight in the Iowa state courts. Debtors continue to pursue their starry-eyed dream that the land is theirs and that they can develop it. A reorganization without Allison's land would be futile; there can be no development

business without the land and Debtors cannot continue their farming operation on this land. This Court cannot and will not rewrite the sale of Debtors' land to Allison, in essence mandating Allison's assets be placed into involuntary servitude for the exclusive use of Debtors. This Court finds that Debtors' bankruptcy case and plan of reorganization were filed in bad faith and are objectively futile.

Debtors argue that the bankruptcy estate includes the right to file a cause of action under the State of Iowa Fraudulent Conveyance Statute. The Iowa Uniform Fraudulent Transfer Act, Iowa Code Chapter 684, became effective January 01, 1995 and applies only to causes of action arising on or after that date. Because the transaction at the base of this litigation occurred on January 6, 1994, Debtors have no right of action under the Iowa UFTA. If Debtors do have a cause of action under the Iowa common law of fraudulent conveyances, their physical removal from the property would not prohibit them from pursuing any such cause of action in the state courts. As an aside, the Court notes that Mr. Hatcher adamantly testified that they had no intent to defraud anyone when they entered into the transaction with Allison and that Debtors had a full and fair opportunity and incentive to litigate this theory that arises out of the same operative facts.

After giving preclusive effect to the Iowa court judgments and considering all the attendant circumstances and procedural posture of the pending eviction action, this Court finds that Debtors filed their chapter 11 petition without the requisite good faith. Bankruptcy was filed as a litigation tactic unrelated to the legitimate goal of reorganization in chapter 11. If successful in regaining ownership of the property, Debtors might then, in good faith, seek protection of the bankruptcy courts for reorganization purposes. Dismissal of this case is in the best interests of creditors and the estate at this time.

Because this Court finds cause for dismissal of this case, it need not reach Allison's argument for abstention under 11 U.S.C. § 305 and 28 U.S.C. § 1334 (c)(1), nor the Trustee's request that the court invoke its general equitable powers under 11 U.S.C. § 105..

Motion for Relief from Automatic Stay

Allison's efforts to gain physical possession and control of the property from Debtors are stayed by 11 U.S.C. § 362 (a)(1) and Allison seeks relief from the automatic stay. Debtors resist these efforts, claiming that Allison is adequately protected by the equity in the property and that the property is necessary for an effective reorganization.

Because the Court has determined that this case should be dismissed pursuant to 11 U.S.C. § 1112 (b), Allison's motion for relief from the automatic stay is denied as moot. Had this case not been dismissed, this Court would grant the desired relief from stay, for cause shown, under 11 U.S.C. § 362 (d)(1). Debtors filed bankruptcy in an effort to frustrate the judgment of the state court. They filed a plan that is dependent upon their continued use of Allison's property. Because Allison's real property is not property of the estate, relief from stay would not be based on the equity and prospective reorganization requirements of § 362 (d)(2).

ORDER

IT IS THEREFORE ORDERED that the Motions to Dismiss filed by the United States Trustee and Allison Financial are SUSTAINED; this case is dismissed for cause pursuant to 11 U.S.C. § 1112 (b).

IT IS FURTHER ORDERED that Allison Financial's Motion for Relief from Stay is DENIED as moot.

Dated this _____ day of July, 1997.

RUSSELL J. HILL, CHIEF JUDGE
U.S. BANKRUPTCY COURT