This document was signed electronically on September 22, 2016, which may be different from its entry on the record.

IT IS SO ORDERED.

Dated: September 22, 2016

ALAN M. KOSCHIK
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re	)	
	)	Case No. 14-52959
EARL HARRIS VAN PELT JR.,	)	
	)	Chapter 13
Debtor.	)	
	)	Judge Alan M. Koschik
	)	

MEMORANDUM DECISION REGARDING TRUSTEE'S MOTION TO DISMISS CASE

Now before the Court is the motion to dismiss this case for bad faith pursuant to 11 U.S.C. § 1307(c) filed by Keith Rucinski, the standing Chapter 13 trustee in this case (the "Trustee"). The Trustee originally filed his motion in the alternative seeking either turnover of certain funds or dismissal. The Trustee subsequently amended his position and now moves strictly for dismissal. For the reasons set forth herein, the Trustee's motion will be granted.

JURISDICTION AND VENUE

This Court has jurisdiction over this contested matter pursuant to 28 U.S.C. § 1334 and General Order No. 2012-7 entered by the United States District Court for the Northern District of Ohio on April 4, 2012. This is a core matter pursuant to 28 U.S.C. § 157(b)(2)(A). Venue is proper pursuant to 28 U.S.C. § 1409(a).

PROCEDURAL HISTORY

Debtor Earl Harris Van Pelt Jr. (the "Debtor") filed a petition for relief under Chapter 13 of the Bankruptcy Code on November 10, 2014. The Trustee filed his motion to dismiss the Debtor's case on February 20, 2015 (Docket No. 25) (the "Motion to Dismiss"). In the Motion to Dismiss, the Trustee sought dismissal of the case pursuant to 11 U.S.C. § 1307(c) on the grounds the Debtor filed his case in bad faith in light of the fact that he had gambled away a significant portion of his cash on the eve of bankruptcy. In addition, the Trustee also sought, in the alternative, the turnover of certain payments due the Debtor from his employer on the occasion of his recent retirement, payments related to accrued vacation and sick pay.

On March 3, 2015, the Debtor filed his response (Docket No. 28) (the "Response"), wherein he argued that prepetition gambling did not constitute bad faith or a proper ground for dismissal under Section 1307(c), and that the payments due to the Debtor from his employer were exempt and, therefore, not subject to turnover.

After the Court set a trial schedule, the parties filed Joint Stipulations of Fact on June 29, 2015 (Docket No. 42) and their respective proposed findings of fact and conclusions of law on July 31, 2015 (Docket No. 43) and August 3, 2015 (Docket No. 45).

Trial on the Motion to Dismiss was scheduled for, and commenced on, August 10, 2015, at 9:30 a.m. The Trustee, in his proposed findings and at trial, conceded the Debtor's point that

the accumulated vacation and sick pay were exempt and, therefore, he did not pursue his claim for turnover. The Trustee's claim to dismiss the Debtor's case pursuant to Section 1307(c) was tried before the Court and taken under advisement. At trial, the Trustee also raised the argument that Debtor's plan was unconfirmable under 11 U.S.C. § 1325(a)(7) as not being proposed in good faith, on the same grounds that the Trustee seeks dismissal of the case under Section 1307(c). However, this issue was not briefed or proposed in the Trustee's proposed findings of fact and conclusions of law.

FINDINGS OF FACT

The facts material to the Motion to Dismiss are relatively few. Oddly, even during a trial of short duration lasting little more than an hour, most of the testimony -- including virtually all of the testimony of the Debtor's ex-wife, Carol Snyder -- was of little value. With the exception of confirming the approximate date of her divorce from the Debtor, Ms. Snyder's examination by the Trustee concerned her observation of a motorcycle located at the Debtor's residence after he filed his bankruptcy petition. She did not know who owned it. She saw the Debtor ride it once. It remains unclear to the Court why this testimony was presented at all. Subsequent testimony revealed that that motorcycle was not owned by the Debtor and was not property of the bankruptcy estate.

However, the testimony of the Debtor, Mr. Van Pelt, both upon examination by the Trustee and, later, by his own attorney, elicited most of the few material facts. The remainder of the story was completed by the parties' stipulations of fact. In the late summer or fall of 2014, several months before his bankruptcy filing, the Debtor was granted a divorce from his wife of 34 years, Carol Snyder. The divorce proceedings began in 2013, at which time the Debtor's financial troubles began. During this same time period, the Debtor also retired from his job as a

custodian for Akron Public Schools, a position which he had held for 38 years. His income from the Akron Public Schools prior to retirement was approximately $43,000 per year. His pension income, by contrast, was only $24,000 per year ($2,000 per month). In addition, Debtor quit a second job, reducing his income still further. The Debtor had relied upon the income from the second job to make payments on a FirstMerit loan secured by his 2009 Harley-Davidson motorcycle, a different motorcycle than the one Ms. Snyder testified she had observed after this case was filed. The 2009 Harley had been owned by the Debtor. However, the Debtor surrendered the motorcycle to FirstMerit. FirstMerit sold the 2009 Harley at auction and pursued collection of the deficiency from the Debtor. The Debtor's Schedule F discloses $17,108.62 in unsecured debt, of which the FirstMerit deficiency is $12,867.62. The Debtor explained at trial that his retirement was compelled so that he could access his pension benefits that he was advised would have to be split with his soon-to-be ex-wife. The Debtor claimed that he could not have afforded this without retiring. The precise logic of being able to afford a property division and spousal support with lower retirement income while not being able to afford it with his higher income from two jobs is unclear to the Court. It was not challenged at trial, however.

The Debtor acknowledged at trial that at the time he was divorcing his ex-wife, surrendering the 2009 Harley, incurring a deficiency debt to FirstMerit, and retiring from his job, he was already contemplating the need for bankruptcy. Indeed, the financial difficulties caused by his reduced income, the judgment owed to FirstMerit, and the inevitable spousal support he would owe to his ex-wife, makes this testimony quite plausible.

Despite facing mounting debts that would inevitably require him to avail himself of the bankruptcy system, on October 11, 2014, the Debtor withdrew $4,000 in cash from his JPMorgan Chase deposit account. Two weeks later, on October 25, 2014, Debtor withdrew an

additional $8,000 in cash. (*See* Joint Stipulations of Fact, June 29, 2015, Docket No. 25, ¶ 4.) The Debtor's counsel conceded at trial that the substantial majority of this $12,000 total would have been nonexempt assets if they remained in the Debtor's account as of the November 10, 2014 petition date only a few weeks later. The Debtor lost all of the money gambling. (*See* J. Stipulations ¶ 5.) According to his own trial testimony, the Debtor gambled with the specific intent to "hit it big," pay off his creditors, and avoid the need to file for bankruptcy. Indeed, the Debtor further testified that he had already spoken to counsel about the necessity of, and the availability of, seeking bankruptcy relief under Chapter 13. The Debtor conceded that it was a "desperate move." It was unsuccessful.

Item 8 of his Statement of Financial Affairs ("SOFA") required Debtor to disclose "all losses from fire, theft, other casualty or gambling within one year immediately preceding the commencement of this case or since the commencement of this case." Instead of reporting the loss he later conceded at trial, the Debtor checked "none" in response to Item 8 in his SOFA (Docket No. 1.) Debtor never amended this SOFA.

Debtor's chapter 13 plan payments are currently $90.00 per month. (J. Stipulations ¶ 2.) The debtor's chapter 13 plan as proposed projects to pay all creditors $4,991.40 over five years. (J. Stipulations ¶ 7.) Of this, it appears that $3,700.00 of this is for Debtor's attorney,[1]

[1] Debtor and the Trustee stipulated that Debtor "listed on his schedules … $3,700.00 in priority claims." (J. Stipulations ¶ 6.) Debtor actually did not schedule any liquidated priority claims on his Schedule E, though he listed spousal support with "no arrears" and no liquidated dollar figure. (Docket No. 1.) In his chapter 13 plan, he disclosed the existence of domestic support obligations that were to end in December 2014, around a month after the petition date, and did not propose to pay the same through the plan. (Docket No. 2.) At trial, Debtor reaffirmed that his spousal support obligations ended in December of 2014. It is thus apparent that the stipulated "$3,700.00 in priority claims" is actually the administrative expense claim of Debtor's counsel, whose compensation was disclosed in Debtor's petition as $4,000, with $300 received prepetition and $3,700.00 due.

$1,203.50 is for payments to secured creditors,[2] and a grand total of $93.30[3] to unsecured creditors. *Id.*

LEGAL ANALYSIS

A. A Debtor's Bad Faith Are Grounds for Dismissal of a Chapter 13 Bankruptcy Case Pursuant to 11 U.S.C. § 1307(c).

Contrary to the Debtor's argument, a bankruptcy court has the power to dismiss a Chapter 13 petition upon a finding that the debtor did not bring it in good faith despite the fact that bad faith is not separately enumerated in Section 1307(c). *In re Alt*, 305 F.3d 413, 418 (6th Cir. 2002). The burden of showing a debtor's lack of good faith is borne by the party seeking dismissal. *Id.* at 420 (citing *In re Love*, 957 F.2d 1350 (7th Cir. 1992)). In considering whether a petition has been brought in good faith, courts employ factors similar to those relevant in determining whether a plan has been proposed in good faith under 11 U.S.C. § 1325(a)(7).[4] *Id.* at 419 (citing *Love* at 1357). In the Sixth Circuit, these factors include the following:

(1) the debtor's income;

(2) the debtor's living expenses;

(3) the debtor's attorney's fees;

(4) the expected duration of the Chapter 13 plan;

(5) the sincerity with which the debtor has petitioned for relief under Chapter 13;

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[2] While it has not been stipulated to and no evidence on this was presented at trial, it appears, based on the schedules and plan, that this represents total payments on the secured claim of Towpath Credit Union of $1,067.00 at 5% interest.

[3] Debtor and the Trustee appear to have stipulated that $4,991.40 - $3,700.00 - $1,203.50 = $93.30, not $87.90. (J. Stipulations ¶¶ 6-7.) This difference may have an innocuous explanation and is in either event insignificant and irrelevant to the Court's analysis of the issue.

[4] Formerly 11 U.S.C. § 1325(a)(3), prior to the adoption of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub L. 109-8, 199 Stat. 23, enacted April 20, 2005 ("BAPCPA").

(6) the debtor's potential for future earning;

(7) any special circumstances, such as unusually high medical expenses;

(8) the frequency with which the debtor has sought relief before in bankruptcy;

(9) the circumstances under which the debt was incurred;

(10) the amount of payment offered by debtor as indicative of the debtor's sincerity to repay the debt;

(11) the burden which administration would place on the trustee;

(12) the statutorily-mandated policy that bankruptcy provisions be construed liberally in favor of the debtor.

Id. (citing *Society National Bank v. Barrett (In re Barrett)*, 964 F.2d 588, 591 (6th Cir. 1992)). Other circuits enumerate the various factors differently, and in all circuits the list of such factors in nonexclusive, since the ultimate test is one based on the totality of the circumstances. *See In re Lilly*, 91 F.3d 491, 496 (3d Cir. 1996); *Eisen v. Curry (In re Eisen)*, 14 F.3d 469, 470 (9th Cir. 1994). "[G]ood faith is a fact-specific and flexible determination." *Alt* at 419; *see also In re Okoreeh-Baah*, 836 F.2d 1030, 1032-33 (6th Cir. 1988). While related to the good faith required for chapter 13 plan confirmation, the standard for dismissal of a chapter 13 case on the grounds of bad faith is a more exacting one. *In re Alt*, 305 F.3d at 420. "[T]he bankruptcy court should be more reluctant to dismiss a petition under Section 1307(c) for lack of good faith than to reject a plan for lack of good faith under Section 1325(a)." *In re Love*, 957 F.2d at 1356.

B. <u>The Debtor Filed His Case In Bad Faith Within the Meaning of Section 1307(c)</u>.

The Court turns first to the first, sixth, and tenth elements of the *Alt* test, which may be considered here as a group. Debtor's income is low based on his retirement from two jobs and his modest pension is fixed; in other words, he filed a Chapter 13 case just as his income experienced a nearly certainly permanent decline. It is almost certainly a futile hope that Debtor

will enjoy an increase in income later that could allow for a modification of the plan to distribute more to unsecured creditors in this case. This alone would not show bad faith, as many people may be forced into bankruptcy, including Chapter 13, by declines in income.

However, those facts combined with the $93.30 five-year grand-total payout to unsecured creditors juxtaposed with the $12,000 eve-of-bankruptcy gambling spree reveal something much less innocent. Pursuant to 11 U.S.C. § 1325(a)(4), a debtor's plan must distribute "on account of each allowed unsecured claim … [at least] the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date." Debtor had $12,000 additional cash a month prior to his petition date, which Debtor's counsel admitted at the hearing would have been largely nonexempt. This asset, if retained, would have required a minimum unsecured dividend of approximately 70 percent, instead of 1 percent, because a chapter 13 plan must provide creditors with at least as much as they would receive in a hypothetical chapter 7 filed by their debtor. 11 U.S.C. § 1325(a)(4). The Debtor's rapid dissipation of nonexempt assets, not for any personal necessity, but rather as a "desperate move" to avoid bankruptcy altogether and provide a cushion for retirement, is indicative of bad faith. This is particularly true given the extraordinary effect the gambling had on the unsecured dividend in this case given Debtor's comparatively small overall debt burden. The Debtor gambled his creditors' potential substantial dividend for a chance at personal solvency.

The Court turns next to the third and eleventh elements of the *Alt* standard. *Alt* also expressly contemplates that this Court may consider Debtor's attorney's fees. Debtor's counsel's proposed fee of $3,700 (not even counting the $300 already received prepetition) is nearly 70% of the entire proposed plan distribution, which weighs in favor of a finding of bad faith, particularly given that there is no special purpose for a Chapter 13 filing here, *e.g.*,

discharge of a debt or avoidance of a lien that cannot be discharged or avoided in a Chapter 7 case.

Meanwhile, the burden that administration would place on the Trustee in this case is substantial relative to the benefit of administering this plan for five years for a total payout to general unsecured creditors of less than $100. With plan payments of $90.00 per month and administrative expenses paid first, it will be years before any creditor other than Debtor's attorney receives any distribution in this case whatsoever.

Notably, the "sincerity with which the debtor has petitioned for relief under Chapter 13" is only one factor among many outlined in *Alt*. It is not set apart as an essential factor or otherwise placed on a plane apart from the others and identified as a prerequisite to dismissal. This necessarily implies that the Trustee need not prove the debtor's subjective state of mind to establish that the totality of the circumstances warrant dismissal of a Chapter 13 petition for bad faith. The Trustee can therefore carry his burden to prove that the case should be dismissed for bad faith with reference to the objective factors listed, including those discussed above, without proving that the debtor consciously sought to abuse the bankruptcy process to the detriment of his creditors.

The lack of any requirement to prove subjective sincerity is relevant in this case, given Debtor's testimony about his eve-of-bankruptcy gambling. Debtor may not have consciously intended to gamble away money that would have been available to creditors specifically to make it unavailable to creditors, though his denial of having suffered any recent gambling losses on his SOFA is suspicious. Regardless, the fact that he gambled away $12,000 on the eve of bankruptcy rendered him incapable of filing a Chapter 13 petition in good faith, for the reasons outlined above. Had he filed a month earlier or refrained from pursuing the big score, *i.e.*, had

he still had the money at the time of filing, the means test may have resulted in this case being filed under chapter 7, and it would have been an asset chapter 7 case with a respectable distribution to creditors. Alternatively, it may have forced the Debtor to make higher plan payments so as to comply with Section 1325(a)(4) and/or to have turned over some or all of the extra cash to the Chapter 13 Trustee for distribution pursuant to a plan. Instead, Debtor's income, which was recently and likely permanently reduced, is so low that his plan could potentially permit him to pay less than $100 in total to creditors over five years, and it will be more than three years before anything other than administrative expenses—Debtor's attorneys' fees—see any payment.

Even if Debtor were motivated exclusively by the desire to "hit it big" and not to dissipate assets to reduce creditors' recoveries, the good faith of Debtor's prepetition conduct would still be questionable. Debtor admitted at trial that he was already contemplating bankruptcy when he went on his gambling spree, and indeed, was already contemplating it before his divorce was concluded, even if he had not yet sought counsel. In that light, gambling with the intent to "hit it big" indicates bad faith: the creditors bore all of the downside risk, while their upside potential was limited, not just because of the poor odds all gamblers face, but because they were already in a position to make a substantial percentage recovery before Debtor relieved himself of all of his exempt cash.

The facts demonstrated by the evidence presented at trial establish enough of the bad faith elements identified by *Alt* to cause the Court to conclude that a dismissal pursuant to Section 1307(c) on the grounds of bad faith is appropriate here.

C. *In re Baum* Does Not Create a Gambling Safe Harbor for the Debtor.

A number of critical factors distinguish this case from *In re Baum*, 386 B.R. 649 (Bankr. N.D. Ohio 2008) (Kendig, J.), upon which Debtor relies. *Baum* was a chapter 7 case in which the United States Trustee (the "UST") moved to dismiss the case for abuse pursuant to 11 U.S.C. § 707(b)(3)(A). The UST's motion was based on a three- or four-month prepetition stretch of online gambling by the debtor on credit cards, which had concluded approximately six months prior to the petition date. After the gambling ended with great regret, the debtor unsuccessfully tried to manage the $40,000 in credit card debt she had amassed before throwing in the towel and filing for bankruptcy on the recommendation of one the debt consolidation services that had been unable to offer her a workable solution. The *Baum* court held that the debtor was not abusing the chapter 7 process in that case.

First and foremost, the facts of *Baum* are substantially different, particularly the amount of time between the gambling spree and the filing. In *Baum*, the debtor's gambling spree ended six months prior to the petition date, whereupon the debtor sought both psychological counseling and nonbankruptcy debt relief services, only filing bankruptcy when it became clear that no lesser measures were feasible. This is a major distinction. Here the Debtor conceded that he knew his finances required bankruptcy and only then did he gamble his assets in a last ditch effort with an avowed purpose of seeking to avoid bankruptcy.

In addition, this is a Chapter 13 case, and the standard for dismissal under 11 U.S.C. § 1307(c), drawing as it does from the standard for proposing a plan in good faith under 11 U.S.C. § 1325(a)(7), *see Alt*, 305 F.3d at 419, necessarily operates differently than the standard under 11 U.S.C. § 707(a)(3). It is true that the test in Chapter 7 is also one of the totality of the circumstances. *See In re Krohn*, 886 F.2d 123, 126 (6th Cir. 1989); *see also Industrial Ins. Svcs.,*

Inc. v. Zick (In re Zick), 931 F.2d 1124, 1128 (6th Cir. 1991). However, *Alt* and *Zick* express the relevant standards substantially differently, and even elements of the bad faith inquiry that are conceptually similar in Chapter 7 and Chapter 13 may be weighed differently depending on the chapter of the case.

For example, as discussed above, one element of the *Alt* test that was significant in the Court's decision in this case is the burden on the trustee of administering the case. The Chapter 13 Trustee in this case would spend years being little more than a pass-through entity from debtor to debtor's own counsel, and would ultimately distribute next to nothing to creditors, even secured creditors. The *Zick* standard does not expressly mention the administrative burden on the trustee at all, almost certainly because of the distinct structural differences between a Chapter 7 liquidation and a Chapter 13 wage earner plan. While the comparison between the facts in *Baum* to the facts of this case are useful, and the Chapter 7 analyses of bad faith may be informative, the fact is that the Court cannot rely on *Baum* to reach a blanket rule applicable in both Chapter 13 and Chapter 7 that a debtor's prepetition gambling is never bad faith regardless of the circumstances.

Part of the reason for the dismissal of this case is that the Debtor's balance sheet is virtually identical to what it would be if the Debtor had deliberately and rapidly dissipated exempt assets on the eve of bankruptcy to slash the minimum amount that 11 U.S.C. § 1325(a)(4) would require him to pay through a plan. As noted above, the Debtor neglected to mention his gambling losses on his statement of financial affairs (even though he was candid about the gambling losses both at the meeting of creditors and at trial). Such a concern was absent in *Baum*, which was a Chapter 7 and dealt with gambling on credit cards, not with nonexempt assets that creditors might actually have recovered. Moreover, although the issue

was not developed at trial in that case, the *Baum* court also cast doubt on the enforceability of the underlying gambling debts themselves, which in turn cast doubt on whether it could be abusive of chapter 7 to use it to escape an unenforceable debt. *Baum* at 656-59.

Debtor's proposed legal conclusions, based on *Baum*, that "the fact that he gambled away his prepetition earnings does not establish that the chapter 13 petition was filed in bad faith *per se*," and that "wagering in hopes of 'winning big' in order to avoid filing a bankruptcy … is not, in and of itself, sufficient to support a finding of bad faith" (Docket No. 45 at 2) are at least partially correct. The existence of gambling is neither bad faith *per se*, nor irrelevant to the bad faith inquiry. Gambling is part of the totality of the circumstances, and in this case, the totality of the circumstances reveals more evidence of bad faith than just gambling. The Debtor's income is low, recently reduced, and unlikely to increase in the future, which makes him a poor candidate for a Chapter 13 case. Indeed, he may have been unable to propose a confirmable Chapter 13 plan if the gambling spree had not largely, if not completely, dissipated his nonexempt assets. This, in turn, has led to a proposed plan with payments so low that general unsecured creditors will receive a grand total of less than $100 over five years. Even secured creditors will receive only a tiny portion of the total plan payments, while Debtor's attorney receives $3,700 of the less-than-$5,000 total to be distributed. In this case, the Debtor's gambling dramatically reduced his unsecured creditors' dividend and made possible a Chapter 13 case and plan requiring plan payments of less than $100 per month because of the Debtor's lower retirement income.

The outcome of this case might have been materially different if Debtor's income were higher. A debtor in the Debtor's position, but with sufficiently higher disposable income, would have to propose a plan that offered creditors a dividend coincidentally in excess of one that

would be yielded by a Chapter 7 case that included the $12,000 cash squandered here. Such a debtor would not prejudice his creditors in Chapter 13 as a result of his gambling losses simply because his resulting Chapter 13 plan would more than make up for it. Here, by contrast, the combination of the Debtor's financial condition and his gambling losses would materially prejudice his creditors. Permitting the Debtor to rely on Chapter 13 with only a meager plan payment as a fallback option in the event he fails to "hit it big" gambling creates a moral hazard that Chapter 13 does not permit.

CONCLUSION

The Trustee has carried his burden of demonstrating that, under 11 U.S.C. § 1307(c) and the Sixth Circuit's standard for dismissing Chapter 13 cases pursuant thereto, that Debtor's Chapter 13 case was not filed in good faith. The totality-of-the-circumstances test permits consideration and weighing both objective and subjective factors, and while the Court cannot find that Debtor's gambling was undertaken with the specific subjective purpose of denying creditors a potential recovery from those funds, his one-month, $12,000 gambling spree on the eve of bankruptcy rendered it impossible for him to then propose a Chapter 13 plan in good faith on his retirement income of only $2,000 per month, based on the facts of this case as set forth above and the law of the Sixth Circuit.

The Court will enter a separate order dismissing the case with prejudice consistent with this Memorandum Decision. Judgment on the Motion to Dismiss will not be deemed entered until the separate order has been entered by the Court.

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