NOT FOR COMMERCIAL PUBLICATION[1]

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re:	)	Case No. 08-20123
	)	
J.M. CAPITAL, LTD.,	)	Chapter 11
	)	
Debtor.	)	Judge Pat E. Morgenstern-Clarren
	)	
	)	**MEMORANDUM OF OPINION**

The debtor J.M. Capital, Ltd. was operating under a state court receivership when it filed this chapter 11 case. Secured creditors CapFinancial III, LLC and CapFinancial Properties III, LLC move to dismiss, or alternatively, for this court to abstain so that the receiver may continue with his responsibilities.[2] The debtor opposes the motion.[3] For the reasons that follow, the motion to dismiss is granted.

I. JURISDICTION

Jurisdiction exists under 28 U.S.C. § 1334 and General Order No. 84 entered by the United States District Court for the Northern District of Ohio. This is a core proceeding under 28 U.S.C. § 157(b)(2)(A) and (O).

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[1] This written opinion is entered to decide the issues presented in this case and is not intended for commercial publication in an official reporter, whether print or electronic.

[2] Docket 12.

[3] Docket 18.

II. THE POSITIONS OF THE PARTIES

CapFinancial III, LLC and CapFinancial Properties III, LLC (collectively, CapFinancial) seek to dismiss this case under 11 U.S.C. § 305(a) so that the state court receiver, who has been in place for more than seven months, may continue to administer the debtor's assets. They contend that this is in their best interests because it is the most economical way to proceed. Alternatively, CapFinancial argues that the case should be dismissed under 11 U.S.C. § 1112(b), claiming that the debtor will not be able to rehabilitate itself and the case was filed in bad faith. Two other secured creditors, and the receiver, support the motion.

The debtor argues that it filed the chapter 11 case because it was dissatisfied with the receiver's efforts to increase revenue and locate a buyer. The debtor contends that the bankruptcy proceeding will permit it to increase income, begin to pay the secured debt, and ultimately sell its real estate for enough money to pay all debt.

III. FACTS

A. The Evidentiary Hearing

The court held an expedited evidentiary hearing on the motion to dismiss on January 12, 2009.[4] CapFinancial presented its case through these witnesses: Myron Muldur (from PrinsFinancial, the managing member of CapFinancial), Robert Weltman (representing Dennis Gehrisch), Michele Wickman (from Park View Federal Savings Bank), Mark Dottore (state court receiver); cross-examination of the debtor's witnesses; and documents. The debtor presented its case through the testimony of John MacDonald (the debtor's sole member), John Deskins (a

[4] At that time, the court also heard evidence relating to the state court receiver's motion to excuse turnover of property to the debtor. (Docket 11). That motion is moot in light of the decision reached in this memorandum.

contractor who does work on the debtor's property), and Bernard Martin (the debtor's leasing agent and property manager); cross-examination of the movant's witnesses; and documents.

These findings of fact are based on that evidence and reflect the court's weighing of the evidence presented, including determining the credibility of the witnesses. "In doing so, the Court considered the witnesses' demeanor, the substance of the testimony, and the context in which the statements were made, recognizing that a transcript does not convey tone, attitude, body language or nuance of expression." *In re The V Cos.*, 274 B.R. 721, 726 (Bankr. N.D. Ohio 2002). *See* FED. R. BANKR. P. 7052 (incorporating FED. R. CIV. P. 52 and applicable in contested matters under FED. R. BANKR. P. 9014). When the court finds that a witness's explanation was satisfactory or unsatisfactory, it is using this definition:

> The word satisfactory may mean reasonable, or it may mean that the Court, after having heard the excuse, the explanation, has that mental attitude which finds contentment in saying that he believes the explanation—he believes what the [witness] say[s] with reference to the [issue at hand]. He is satisfied. He no longer wonders. He is contented.

United States v. Trogdon (In re Trogdon), 111 B.R. 655, 659 (Bankr. N.D. Ohio 1990) (internal citations and quotation marks omitted).

B. The Debtor's Assets

The debtor's only significant asset is a group of townhouses in Warrensville Heights, Ohio in an area known as Miles Landing. The entire Miles Landing area consists of approximately 375 units built in the 1940s; of those, the debtor currently owns 77 units. The debtor's units (the property) are scattered over 6-8 residential streets. J.M. Capital purchased the property in 1999 with financing obtained from The Peoples Banking Company, as evidenced by

promissory notes secured by mortgages on the property. John MacDonald is a personal guarantor on the notes.

The units were in disrepair when purchased and Mr. MacDonald's plan was to renovate the units and sell them, either individually or as a group. Although J.M. Capital invested about $3 million in the property, the financial plan did not work out, in part—as admitted by Mr. MacDonald—due to his bad management. In 2005, The Peoples Banking Company transferred the notes to CapFinancial and assigned the mortgages to it as well, in exchange for a payment that was not quantified at the hearing. The notes were in default at the time, and Mr. MacDonald's business plan was to refinance the debt.

J.M. Capital sold some of the units after that, with the last sale taking place in July 2007. Everyone involved agrees that the real estate market has deteriorated and potential buyers generally are not able to get financing to purchase the units either individually or in bulk. When CapFinancial purchased the notes, the units were selling for about $80,000.00–$95,000.00. Today, CapFinancial estimates that each unit might be worth in the range of $20,000.00 in a bulk sale of the property. The auditor's market value averages about $15,000.00–$25,000.00 per unit.

An association known as the Miles Landing Homeowners Association exists to address issues of common concern among the owners of units. J.M. Capital owes the association about $600,000.00 in maintenance fees.[5]

[5] There was testimony at the hearing about actions taken by Keith Barton, counsel to Mr. MacDonald personally and former general counsel to the association. That evidence was tangential to the issues presented here, and so is not recounted.

J.M. Capital's overall financial situation did not improve. Although it made some payments on the debt, it remained in default. CapFinancial called the notes in June 2007.

C. The State Court Proceedings

On March 14, 2008, CapFinancial obtained a state court judgment against the debtor in the principal amount of $1,215,490.23 plus interest; the amount owed as of the hearing is about $1.4 million. CapFinancial then filed a state court complaint to foreclose on the mortgages that secured the notes.[6] The complaint named as defendants other parties claiming an interest in the property, including Park View Federal (secured debt of about $830,600.00), Dennis Gehrisch (secured debt of about $1.15 million), George Guider (secured debt of about $125,000.00), and the Cuyahoga County Treasurer (tax liens). CapFinancial also moved to appoint a receiver to safeguard the property, given the failure to pay the secured debt, the decline in the property's value, and the failure to maintain insurance.

On May 20, 2008, J.M. Capital, John MacDonald, CapFinancial, Dennis Gehrisch, and Park View Federal entered into an agreed order appointing Mark Dottore as receiver for J.M. Capital. The order authorized the receiver to operate the business, manage the property, and market the property for sale or lease.

When the receiver took over, he found that the real estate taxes were in default, some utility bills were unpaid, CapFinancial was paying for expensive force–placed insurance, and there were life safety issues in a few units. He negotiated a payment schedule for the taxes (a process initiated by Mr. MacDonald), arranged to pay the delinquent water and sewer bills, and—when funds became available—used rental income to pay for insurance. All of the rental

[6] Case No. CV 08 659315, Cuyahoga County Court of Common Pleas.

income is being devoted to renovation, maintenance, taxes, and utility payments, with no funds currently available to pay the secured creditors.

The monthly rent is $655.00 for a two bedroom unit and $765.00 for a three bedroom unit. Of the 77 units owned by the debtor, about 56 are rented; the remaining units are vacant either because they need work or because a tenant has not yet been found. Of the 56 occupied units, at least 22 tenants are in default of their rent obligations for January 2009. In addition to trying to find renters, the receiver has been looking for buyers for the property. This poses many challenges: the units making up the property are spread out over several streets (rather than being physically consolidated), there are issues with crime, there are many competing units in the neighborhood, and the lending environment is frozen. At the time of the hearing, the receiver had two purchase offers, one for $1.8 million and another in the range of $2.1 to $2.5 million. In the receiver's opinion, both potential buyers have access to financing.

The receiver has filed short monthly reports with the state court. He only put two of them into evidence; each states broad categories of activity and lists expenses, without invoices. The fees paid by the receiver to himself are listed in one report as a total amount for the month, without a breakdown of actor, time, and activity.

The secured creditors who testified believe that the receiver has stabilized the situation and they are satisfied with his performance. Although the property does not yet generate enough income to support making payments on the secured debt, these creditors agreed that the priority was to make necessary repairs first, with debt payments following. They all ask that the bankruptcy case be dismissed so that the receiver may remain in place.

Mr. MacDonald's dissatisfaction with the receiver stems from two issues: the amount of the receiver's monthly fees (too high) and the amount of the purchase offers under negotiation (too low).

D. The Bankruptcy Case

The debtor filed this chapter 11 case on December 24, 2008 to regain control of the property and market it for a higher price. The filing had these omissions and errors:

(1) The debtor estimated that funds would be available for distribution to unsecured creditors, yet the assets are listed at 0–$50,000.00 and the liabilities at $1 million to $10 million. Mr. MacDonald testified that he did not think the asset value included the real property value.

(2) The only creditor listed as holding an unsecured claim is Gerri Burch, who Mr. MacDonald testified is not actually a creditor. The debtor knew about, but did not include, the Miles Landing Homeowners Association claim of more than $600,000.00.

(3) The debtor did not list as secured creditors CapFinancial, Park View Federal, or Dennis Gehrisch.

(4) The debtor did not give notice of the filing to the receiver.

(5) The debtor did not file these documents with the petition: disclosure statement, corporate ownership statement, schedules A through H, statement of financial affairs, and summary of schedules.

CapFinancial is not prepared to offer debtor-in-possession financing, and there was no evidence that such financing would be available from another source. The debtor did not file a motion to use cash collateral and did not reach agreement with the secured creditors to do so. Nevertheless, in the three weeks between the case filing and the hearing, Mr. MacDonald either

signed or authorized the issuance of five checks on the debtor-in-possession account, including one to pay his personal child support payment.

Mr. MacDonald testified as to the components of his intended chapter 11 plan:

(1) immediately rent the vacant units, thus increasing the cash flow;

(2) do a better job of collecting the rent on time;

(3) use the increased cash flow to pay some amount to the secured creditors, starting in a few months;

(4) hold the property until the broader financial situation improves and credit is more readily available to individuals and investors;

(5) at that point, sell the property either to individuals buying a single unit or an investor buying the property as a whole, at a price per unit of about $47,000.00;

(6) pay all creditors in full with the sale proceeds; and

(7) retain some value for himself and his family.

IV. DISCUSSION

A. 11 U.S.C. § 305(a)

After notice and a hearing, a court may dismiss a case or suspend all proceedings under 11 U.S.C. § 305(a)(1) when "the interests of creditors and the debtor would be better served by such dismissal or suspension." 11 U.S.C. § 305(a)(1). "The decision to dismiss or suspend under 305(a) is discretionary and must be made on a case-by-case basis." *In re Fortran Printing, Inc.*, 297 B.R. 89, 94 (Bankr. N.D. Ohio 2003) (citation omitted). The factors used to determine whether dismissal or suspension is appropriate include:

(1) economy and efficiency of administration;

(2) whether another forum is available to protect the interests of both parties or there is already a pending proceeding in state court;

(3) whether federal proceedings are necessary to reach a just and equitable solution;

(4) whether there is an alternative means of achieving an equitable distribution of assets;

(5) whether the debtor and the creditors are able to work out a less expensive out-of-court arrangement which better serves all interests in the case;

(6) whether a non-federal insolvency has proceeded so far in those proceedings that it would be costly and time consuming to start afresh with the federal bankruptcy process; and

(7) the purpose for which bankruptcy jurisdiction has been sought.

Id. at 94-95. Where a state court receivership is in place before the bankruptcy case is filed, the best interests of the debtor and its creditors are generally served by dismissal. *See, e.g., Monsour Medical Center, Inc. v. Stein (In re Monsour Medical Center, Inc.)*, 154 B.R. 201, 207 (Bankr. W.D. Penn. 1993); *In re Michael S. Starbuck, Inc.*, 14 B.R. 134, 135 (Bankr. S.D.N.Y. 1981); *In re Sun World Broadcasters, Inc.*, 5 B.R. 719, 722 (Bankr. M.D. Fla. 1980).

In this case, it is clear that the best interests of all concerned will be served by dismissal. The receiver, with the debtor's consent, has had custody and control of the debtor's only significant asset since May 20, 2008. He has employed professionals to repair and maintain the properties and collect rent since his appointment. The secured creditors who testified are all

satisfied with the manner in which the receiver has applied the rent payments to date. He has pursued additional tenants and solicited purchase offers for the property. The state court is available as a forum to achieve an equitable distribution of the debtor's assets. Mr. MacDonald is free to participate in the state court process by continuing to identify potential renters, as well as to solicit competing offers for the property. Any sale will be done under state court supervision, so Mr. MacDonald will be able to object to the price if he wishes to do so.

Mr. MacDonald filed for bankruptcy protection so that he may rehabilitate the debtor. He does have a plan for doing that, but there was little or no credible evidence that the plan is realistic and can be carried out within a reasonable time frame. His first action point is to fill all the rental vacancies. This is the same focus that he had before the receiver was appointed and has also been a target area for the receiver. This leads the court to conclude that the plan is unlikely to succeed now when it did not succeed before. Bernard Martin, the property manager, hopes to increase the number of tenants by soliciting tenants eligible for federal housing subsidies. He testified, however, that he has been focusing on this tenant population for several months. Mr. Martin also hopes to build on the rent-to-own market by encouraging rental tenants to begin to rehabilitate their credit so that they will be positioned to get financing when the credit market thaws. Additionally, the debtor wants to work with existing renters to obtain FHA financing to purchase their residences. Since about half of the renters are currently in default, they do not seem to be a promising borrower population. These are all good ideas, but there was no credible evidence that these can be put into effect in a way that would make an appreciable difference any time in the near future.

Mr. MacDonald's plan also calls for selling the property for about $4 million after the credit market recovers. He has not had any conversations with potential buyers willing to pay this price. The court cannot, therefore, credit this part of the plan as anything other than a hope.

The evidence also showed that the disputes between the parties will proceed more economically before the state court. The receiver has been filing monthly reports with the state court. If this chapter 11 case continues, the debtor will have to duplicate some of that financial work when it complies with the United States trustee's reporting requirements, and will also have to pay quarterly administrative fees. Mr. MacDonald is unhappy with the fees being charged by the receiver and the receiver's attorney. This court does not have a factual basis to assess that issue because the fee statements were not in evidence. In any event, the state court appointed the receiver and presumably will be available to hear any issues relating to the claimed compensation.

In sum, the court finds that time and resources will be wasted by continuing this chapter 11 case, when the state court receivership has been operating effectively since May of 2008, and Mr. MacDonald's purpose for seeking bankruptcy protection appears to be that he regrets his choice to proceed in state court. "[A] disgruntled player should not be heard to complain at the end of the fourth quarter that the game would have been better played in another stadium." *In re Sun World*, 5 B.R. at 722-23. Because the interests of both the debtor and its creditors would be best served by allowing the state court receivership to continue, CapFinancial's motion to dismiss under 11 U.S.C. § 305(a) is granted.

B. 11 U.S.C. § 1112(b)

Alternatively, the court may for "cause" dismiss a chapter 11 case or convert it to chapter 7. 11 U.S.C. § 1112(b). The relevant part of § 1112(b) provides:

> (b)(1) . . . [O]n request of a party in interest, and after notice and a hearing, absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate, the court shall . . . dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause.

Section 1112(b)(4) lists several situations that amount to "cause", but the list is not exclusive. *In re Gonic Realty* Trust, 909 F.2d 624, 628 (1st Cir. 1990); *In re The V Cos.*, 274 B.R. at 725. *See* 11 U.S.C. § 102(3) (the words "includes" or "including" are not limiting). Cause to dismiss may also exist, for example, where the debtor filed the case in bad faith. *In re The V Cos.*, 274 B.R. at 725.

Lack of good faith is determined on a case-by-case basis, and often includes an analysis of these factors:

(1) the debtor has one asset;

(2) the pre-petition conduct of the debtor has been improper;

(3) there are only a few unsecured creditors;

(4) the debtor's property has been posted for foreclosure, and the debtor has been unsuccessful in defending the foreclosure in state court;

(5) the debtor and one creditor have proceeded to a standstill in state court litigation, and the debtor has lost or has been required to post a bond which it cannot afford;

(6) the filing of the petition effectively allows the debtor to evade court orders;

(7) the debtor has no ongoing business or employees; and

(8) the lack of possibility of reorganization.

Trident Assocs. Ltd. Partnership v. Metropolitan Life Ins. Co. (In re Trident Assocs. Ltd. Partnership), 52 F.3d 127, 131 (6th Cir. 1995), *cert. denied* 516 U.S. 869 (1995) (citing *Laguna Associates Ltd. Partnership v. Aetna Casualty & Sur. Co. (In re Laguna Associates Ltd. Partnership)*, 30 F.3d 734, 738 (6th Cir. 1994)). Cause to dismiss may exist where the debtor has insufficient capital with which to bear administrative expenses of reorganization or fund a plan. *In re Imperial Heights Apts. Ltd.*, 18 B.R. 858, 863-64 (Bankr. S.D. Ohio 1982) (dismissal appropriate where debtor's only asset was an apartment complex, its creditors were either secured by the property or owed for utility service to the property, and there was no capital to fund reorganization). The party seeking dismissal has the burden of proving that cause exists by a preponderance of the evidence. *In re Woodbrook Assocs.*, 19 F.3d 312, 317 (7th Cir. 1994). Once cause is established, the court must decide whether dismissal or conversion is in the best interests of the creditors and the estate by comparing the creditors' rights in a chapter 7 case with their rights under state law upon dismissal. *In re The V Cos.*, 274 B.R. at 740.

CapFinancial asserts that cause exists because the case was filed in bad faith, and the debtor lacks the ability to reorganize. Applying the relevant factors, the court agrees. The debtor has only one asset, the property. Mr. MacDonald conceded that some of the debtor's historical problems stem from his poor management. There are few unsecured creditors, and it is unlikely that the property would be sold in a bankruptcy proceeding for an amount high enough to pay the

secured debt and costs of administration with any funds left for the unsecured creditors. The filing of the petition allowed the debtor to evade the effect of the state court order, in the face of the debtor's own agreement. In the three weeks that the debtor has been under the protection of the bankruptcy court, the debtor filed materially inaccurate information and used cash collateral without permission.

Additionally, the evidence showed that the debtor is unlikely to be able to reorganize. The debtor needs money to operate; CapFinancial will not provide debtor-in-possession financing and there was no evidence that any other lender would step in to do so. Based on CapFinancial's testimony, it will also oppose the debtor's plan as outlined by Mr. MacDonald. It is, therefore, unlikely that the debtor can propose a confirmable plan and be reorganized. Further, it appears Mr. MacDonald simply wants to regain control over his company because he believes the receiver is not properly marketing it for sale. Based on all of these factors, CapFinancial has shown that it is more likely than not that the debtor's petition was filed in bad faith. With cause to convert or dismiss being established, the court finds that dismissal is the appropriate action. Therefore, the motion to dismiss under 11 U.S.C. § 1112(b) is granted.

V. CONCLUSION

For the reasons stated, the motion of CapFinancial III, LLC and CapFinancial Properties III, LLC is granted and the case is dismissed under 11 U.S.C. §§ 305(a) and 1112(b). A separate order will be entered reflecting this decision.

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge

NOT FOR COMMERCIAL PUBLICATION

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
EASTERN DIVISION

In re:	)	Case No. 08-20123
	)	
J.M. CAPITAL, LTD.,	)	Chapter 11
	)	
Debtor.	)	Judge Pat E. Morgenstern-Clarren
	)	
	)	**ORDER GRANTING JOINT MOTION**
	)	**OF CAPFINANCIAL PROPERTIES III,**
	)	**LLC AND CAPFINANCIAL III, LLC**
	)	**TO DISMISS BANKRUPTCY**
	)	**PROCEEDING**

For the reasons stated in the memorandum of opinion entered this same date, the joint motion of CapFinancial III, LLC and CapFinancial Properties III, LLC to dismiss this case under 11 U.S.C. §§ 305(a) and 1112(b) is granted. (Docket 12).

IT IS SO ORDERED.

Pat E. Morgenstern-Clarren
United States Bankruptcy Judge