IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

IN RE:	)	
	)	
RICK DEAN JOHNSON,	)	**Case No. 02-15275**
	)	**Chapter 13**
	)	
Debtor.	)	
	)	

MEMORANDUM OPINION

The debtor Rick Dean Johnson ("Johnson") seeks an order confirming his Chapter 13 plan. His secured creditors, Bennington State Bank (BSB) and Bank of Tescott (BOT) each object, contending that Johnson's prepetition conduct demonstrates his lack of good faith and that his plan is, in any event, neither feasible nor his best effort.[1] The Court conducted an evidentiary hearing on these issues on November 10, 2003 and is now ready to rule.

Findings of Fact

Johnson filed this case on October 21, 2002. At the time of filing, Johnson was self-employed in a lawn business and, in the winter months, he supplemented his income with snow removal and home remodeling work. Prior to operating his own business, Johnson was employed by Tony's Pizza in Salina, Kansas from October of 1984 until June of 2001, where he accumulated a profit sharing account which is one of the items in dispute here.

In his Chapter 13 plan, Johnson proposed to pay the Trustee $300 per month for 48 months.[2]

[1] *See* 11 U.S.C. § 1325(a)(3) (good faith); § 1325(a)(6) (feasibility); and § 1325(b)(1)(B) (best efforts).

[2] Dkt. 9.

These funds were to be used to pay his attorney's fees of $1,900, an Internal Revenue Service priority claim of $6,110, a Kansas Department of Revenue priority claim of $2,325, with the remainder directed toward trustee's fees and unsecured creditors. Johnson also proposed to surrender a vehicle, a trailer, and two mowers to creditor BSB. He intended to surrender a 1997 Ford to creditor Auto One. He also intended to surrender two vehicles to co-makers: a 1993 Ford to Andrea Haynes and a 2002 cargo trailer to David Purdham. Ms. Haynes, who is Johnson's companion, will also pay BOT outside the plan for a 1999 Chevy Tahoe which secures one of its notes.

On July 15, 2003 Johnson filed his Amended Plan.[3] He increased his monthly plan payment to $400 and the plan term to 60 months. Johnson added a $5,000 child support arrearage claim to the plan. In all other respects, the Amended Plan did not differ from his initial chapter 13 plan. According to the Court's calculations, of the $24,000 to be paid through the Amended Plan, $17,735 will go toward administrative expenses, tax claims, and child support arrearage, leaving about $6,265 for unsecured creditors.

Johnson began his dealings with BSB several years before his filing. Johnson gave the Bank a number of notes, all of which remained unpaid and owing as of the filing date. The circumstances surrounding the last note he made in May 2002 are particularly troubling.[4] While Johnson was overdrawn by some $16,000 at BSB, he applied for further operating credit in the amount of $20,000. He provided BSB a financial statement dated May 5, 2002 incident to this extension of credit.[5] That statement includes references to some $25,422 in accounts and a $233,000 retirement account with

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[3] Dkt. 50.

[4] Ex. F. This was a 60-day note in the amount of $20,000.

[5] Ex. G.

Tony's Pizza. Unfortunately, by the time this statement was made, Johnson had cashed out his $*17,000* retirement benefit at Tony's some 10 months earlier. In fact, according to a letter from the administrator of Tony's profit sharing plan, Johnson withdrew some $17,664.59 on August 17, 2001, effectively closing his retirement account.[6] Nevertheless, Johnson told the banker, Bill Stenfors, that he intended to repay the $20,000 note with the proceeds of his retirement account and a $32,000 account receivable he was owed for work done for the City of Clyde, Kansas. Johnson has never accounted for the Clyde receivable.

Johnson's earlier dealings with BSB were also tinged with collateral accounting issues. For instance, in June of 2001, the Bank loaned him $3,600 secured by, among other things, a Troy-Built mower and a Mac toolbox with tools.[7] Johnson cannot account for the mower but does concede that he pawned the toolbox prior to the loan being made. A February 2002 loan was to be secured by an account receivable from Wardcraft, but Johnson never accounted for this receivable.[8]

As Stenfors admitted on cross-examination, a number of these loans were made by BSB without obtaining financial statements or credit reports and each note made subsequent to the first was made while Johnson was behind on his obligations to the Bank. In fairness, the Bank did secure co-

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[6] Ex. R. The Court notes that the referenced letter is from the profit sharing plan administrator for Schwan's Shared Services, L.L.C. Although the relationship between Schwan's Food Company and Tony's Pizza was not explained at trial, Tony's Pizza apparently is under the umbrella of Schwan's Family of Businesses. Since no issue was raised that Exhibit R pertains to any retirement account other than Johnson's profit sharing account from Tony's Pizza and only one profit sharing account is at issue here, the Court will assume that Exhibit R indeed pertains to Johnson's profit sharing account with Tony's Pizza.

[7] *See* Ex. B and Ex. C.

[8] *See* Ex. D.

makers for two of the loans,[9] but the Court nonetheless questions BSB's motivation in repeatedly lending money to a borrower who, by all appearances, was less than a sterling customer even before the May 2002 false financial statement was given.

Stenfors testified that the current indebtedness to BSB as of the date of the confirmation hearing was $66,997.[10] However this figure includes post-petition interest of $4,755. If the post-petition interest is backed out, the amount of BSB's claim is $62,242. Stenfors also testified that as of the time of hearing, the only collateral that remained and that had not been liquidated was a 1998 trailer valued at approximately $800. Accordingly, the Court concludes that the amount of BSB's claim is $61,442 and is unsecured. The chapter 13 trustee also estimated BSB's unsecured claim to be approximately $50,000 to $60,000.

Johnson's borrowing relationship with BOT, while less extensive, is no less troubled. Johnson made two notes, one dated May 30, 2002 secured by a Chevy Tahoe truck,[11] and the other made November 3, 2002 secured by accounts, contract rights, general intangibles and certain equipment to have been acquired with the loan proceeds.[12] The Tahoe note was co-signed by Andrea Haynes, who drives the Tahoe. The other note was made to enable Johnson to buy a seamless guttering machine, a break machine, and to pay insurance. The commercial security agreement given in support of the latter note includes specific reference to the machines and equipment as well as a

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[9] *See* Ex. A ($5,800 note) and Ex. B ($3,600 note), both co-signed by Johnson's father, Dean Johnson.

[10] On redirect, Stenfors stated that prepetition overdrafts of approximately $10,000 were included in BSB's claim. Although not entirely clear, it appears that this sum is different from the $16,000 in overdrafts covered by the May 2002 note of $20,000.

[11] Ex. J (principal amount of $15,233).

[12] Ex. K (principal amount of $15,005).

receivable from Maxine Haist of Miltonvale for home remodeling.[13]

BOT required neither a financial statement nor a credit report in support of these loans. Johnson did submit a credit application dated May 30, 2002 reflecting the ownership of various assets including the by-then non-existent Tony's retirement account.[14] He omitted any reference to the pre-existing debt to BSB. Indeed, according to BOT's bank officer, Mike Sample, BOT knew nothing of the BSB debt until a BSB representative called Sample after seeing a report of the UCC filing.

Sample relied on the contents of Johnson's credit application in making his lending decisions. In Sample's mind, the purported presence of the retirement account evidenced Johnson's discipline and thrift. The presence of the Miltonvale receivable assured BOT of cash flow to come and Johnson's ability to repay.[15] Sample testified that he based his lending decision on the Tahoe note primarily on the 75 percent loan-to-value ratio of the vehicle and the presence of a co-maker who maintained an account at BOT. Unfortunately, Johnson only purchased the break machine and never obtained the guttering machine. Johnson never accounted for the Miltonvale receivable.[16]

As of the date of filing, BOT was owed approximately $15,305 on the commercial note. However, the commercial note was unsecured unless the Miltonvale receivable and break machine

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[13] *See* Ex. L.

[14] Ex. Q.

[15] The Court observes that the Miltonvale receivable was not listed as an asset on the credit application.

[16] As it turned out, the Miltonvale remodeling state contract never came to fruition. Johnson could not obtain a performance bond required to qualify for this state contract job and the contract was voided.

existed.[17] At the time of trial, $11,452 was owed on the Tahoe note, but Haynes had brought the Tahoe note current.

In sum, Johnson was less than forthright in his dealings with both BSB and BOT. In each case, his financial information was at best, misleading, and at worst, patently false. He offered no explanation for this at trial, and instead only argued that these lenders' reliance on the bad information was irrational, unreasonable or misplaced.

The facts bearing on the feasibility of Johnson's Amended Plan are as follows. As noted above, Johnson proposes to make sixty $400 monthly payments, yielding a $24,000 payout that would be distributed first to administrative expenses, then to priority claims and, finally to unsecureds. The unsecured creditors would receive about $6,265 or around 6 % per cent of their claims. Non-bank unsecured claims amount to some $25,316 and the Banks' unsecured claims are approximately $76,747 in the aggregate.[18] A distribution of $6,265 to a claim pool of approximately $102,000 only yields a 6.14 per cent dividend. This is particularly troublesome in those months when the debtor clears $18,000 in income.[19]

Feasibility analysis is made more difficult by the Court's inability to reconcile Johnson's various financial disclosures with one another. He testified that his expenses were quite varied and his profit and loss statements bear that out. However, there is substantial difference between what is shown on Johnson's profit and loss statements and what appears on his 2002 Federal Income Tax

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[17] The chapter 13 trustee likewise calculated that the amount of BOT's unsecured claim was $15,305.

[18] $15,305 (BOT's unsecured claim) + $61,442 (BSB's unsecured claim)

[19] *See* Debtor's Ex. A, May 2003 profit and loss statement.

Return, Schedule C.[20] Moreover, he provided the Court with only the first five months of 2003 profit and loss statements and presented virtually nothing concerning his financial performance from May until November, the time of trial.

His profit and loss statements reflect repairs of $386.18 from January to May of 2003. His 2002 tax return reflects repairs of only $52 for the year. Contrast this with the projections in his bankruptcy Schedules I and J where repairs are projected at $1,000 per *month*. Similarly, Johnson's profit and loss statements show job materials of $3,424.83 for the first five months of 2003 while his 2002 tax return shows $22,634 for the year. This translates to an average of $684 per month from the profit and loss statements versus $1,886 per month from the tax return. Johnson's Schedule J reflects an even lower monthly expense for materials – $500.

The income projections are equally questionable. Johnson's 2002 tax return reports gross business income of $87,141. His Schedule I projects income of $8,400 per month or $100,800 per year.[21] The profit and loss statements introduced at trial suggest an average gross profit of $10,335 per month or $124,020 per year. Net loss reported on the 2002 tax return amounted to -$31,435 while an annual net income per Schedules I and J would show debtor netting some $1,727 per month from his business or $20,724 per year. His profit and loss statements would suggest an average monthly net income of $5,429 which would amount to some $65,148 per year. With this degree of variance, it is very difficult to attribute any level of accuracy to debtor's projections. If the tax return is a fair estimate of how he will perform, he will be unable to make the payments contemplated under the

[20] *Cf.* Debtor's Ex. A and Ex. B.

[21] Johnson conceded that he currently earned no wages so that Schedule I's reference to monthly wages of $921 was incorrect. His monthly income was derived solely from his business.

plan.[22]

If his projections or profit and loss statements are correct, his plan provides for less than his best effort to repay his creditors. While Schedules I and J purport to demonstrate that Johnson has monthly disposable income of only $300, these schedules do not take into account the substantially overstated repair expense of $1,000 per month, the fact that Johnson's monthly child support obligation would be reduced by about one-half in month 8 of the plan,[23] and other admittedly high monthly expenses such as cell phone expense of $400. With adjustment of these expenses alone, Johnson could easily have disposable income of $1,400 per month.

This Court cannot "split the difference." It can only make findings based on what is in evidence. The Court is thus unable to conclude either one, that Johnson is likely to show a net profit sufficient to fund his plan, or two, that Johnson is giving his best effort to repay his creditors.

Conclusions of Law

At confirmation, the debtor bears the burden of proving that his plan complies with the provisions of 11 U.S.C. § 1325.[24] Section 1325(a)(3) requires the plan to be proposed in good faith and not by any means prohibited by law. Section 1325(a)(4) requires that payments on secured claims provide either for a stream of payments to the claimant having a value equal to the claimant's collateral or a surrender of the collateral to the claimant. Section 1325 (a)(6) requires a finding that the debtor will be able to make all of the payments under the plan. If an unsecured creditor objects,

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[22] The Court notes Johnson's testimony that he currently had no remodeling contracts and no longer could obtain state contracts due to his inability to qualify for and obtain a performance bond.

[23] Johnson testified that in April or May of 2003, his monthly child support obligation was reduced by court order from $665 to $328 per month.

[24] *In re Mason*, 300 B.R. 379, 382 (Bankr. D. Kan. 2003).

the debtor must demonstrate that the plan provides for either payment in full of the claim or the distribution of all of the debtor's disposable income to the unsecured creditors over the first three years.[25]

Good Faith

In determining whether a plan has been proposed in good faith, the Court looks to the eleven factors listed by the Tenth Circuit Court of Appeals in *In re Young*.[26] These are the *Flygare* factors enunciated in *Flygare v. Boulden*.[27] The relevant factors to be considered in this case are: (1) the amount of proposed payments and degree of debtor's surplus; (2) the likelihood of increases in debtor's income; (3) the accuracy of the plan's statement of debt and how it will be repaid; (4) the type of debt to be discharged and its dischargeability in a chapter 7 case; (5) the frequency of relief sought; and (6) the motivation and sincerity of the debtor.

Here, if one believes Johnson's evidence, he will generate a substantial surplus for unsecured creditors, rendering what he has proposed as payment to them inadequate. His income information is sufficiently questionable that it is impossible to determine with any degree of certainty whether or when it might increase or decrease. And Johnson has previously sought bankruptcy relief. While these three factors weigh against Johnson, standing alone, they would not likely support a finding of lack of good faith. However, adding in the factors of dischargeability and "motivation and sincerity" dictate another conclusion.

Johnson materially misled both BSB and BOT with regard to his retirement account. He made materially false financial statements to BSB and a false credit application to BOT. He has no

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[25] 11 U.S.C. § 1325(b)(1)(B).

[26] 237 F.3d 1168 (10th Cir. 2001).

[27] 709 F.2d 1344, 1347 (10th Cir. 1983).

explanation for this conduct. Moreover, Johnson has failed to account to either bank for accounts receivable and a tax refund he has received and apparently spent. In the case of BOT, he did not even acquire some of the property (*i.e.* the guttering machine) that was the basis for that bank's purchase money security interest. There is a substantial likelihood that some portion of each of the bank debts would be excepted from discharge under either or both 11 U.S.C. § 523(a)(2) (actual fraud or false financial statement) or 11 U.S.C. § 523(a)(6) (willful and malicious injury).

As noted above, Johnson offered no explanation for his conduct toward these banks and he was not particularly remorseful. At trial, he did not supply current financial information, relying instead on 6-month old, incomplete financial information to buttress his case for confirmation. The financial information he did supply was contradictory and irreconcilable. Johnson also suggested in the course of trial that he is willing to increase his plan payments further to satisfy his creditors, but he came forward with no concrete figures. All of this reflects poorly on his motivation and sincerity in seeking this relief. This Court cannot find that Johnson acted in good faith in proposing the Amended Plan.

With regard to Johnson's proposed treatment of secured claims by surrendering collateral to co-makers and guarantors, this proposal clearly violates the express terms of § 1325(a)(5)(C) requiring that secured claimants' collateral be surrendered to the holder of the secured claim. These proposed treatments run afoul of that subsection.

Feasibility and Best Efforts

Similarly, this Court cannot see that a persuasive case has been made for feasibility of this plan. As noted in the findings of fact, it is very difficult to determine what Johnson's cash flow was, is, or will be. His previous tax return indicates a loss in 2002. Johnson no longer has any state contracts for remodeling jobs in the forseeable future due to his inability to qualify for a performance

bond. The expenses he discloses on his tax return differ significantly from what he projected on his schedules and what he reported for the first five months of 2003. This Court cannot find that Johnson will be likely to complete all the plan payments contemplated.[28]

In the same vein, Johnson's uncertain income and expense prospects render his plan vulnerable to a "best efforts" objection. Because the Court cannot accurately determine what Johnson's income is likely to be, it cannot determine what his best effort should involve. Section 1325(b)(1) requires that when an unsecured creditor does not accept the debtor's proposed treatment, debtor must either pay that creditor in full or provide for the payment to the trustee of all his disposable income for 36 months.[29] Under either Johnson's scheduled projections or his profit and loss statements, the proposed $400 payment is far short of what he could arguably contribute to the plan. On the other hand, if Johnson's performance mirrors that of his 2002 tax return, he could easily justify a "zero" plan (assuming all other § 1325 requirements were met). Johnson had the burden to demonstrate compliance with § 1325(b)(1) by a preponderance of the evidence. He did not meet this burden.

In conclusion, because Johnson has failed to meet his burden of proof on the above-cited requirements of § 1325, the objections of the Trustee and the Banks are sustained and confirmation of debtor's plan is DENIED. Debtor is granted 10 days from the date of this order to amend his plan or convert to chapter 7. Otherwise, the case will be dismissed.

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[28] *See* §1325(a)(6).

[29] The trustee provided the Court with her baseline analysis. If the total plan payments of $24,000 are calculated over the minimum term of 36 months, Johnson's effective monthly payment is $667. If this is compared to Johnson's monthly plan payments of $400 adjusted to account for the approximate $300 reduction in Johnson's child support obligation in month 8, his actual plan payments over 36 months would be $22,800 [($400 x 8 mos.) + ($700 x 28 mos.)]. While this analysis suggests that Johnson meets the best efforts test under the baseline analysis, it does not take into account the additional disposable income that would result from reducing the excessive $1,000/month repair expense or the $400/month cell phone expense. Adjustment of these two items alone would yield an additional $900/month in disposable income.

Dated this day of February, 2004

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ROBERT E. NUGENT
CHIEF BANKRUPTCY JUDGE
UNITED STATES BANKRUPTCY COURT
DISTRICT OF KANSAS

CERTIFICATE OF SERVICE

The undersigned certifies that a copy of the **Memorandum Opinion** was deposited in the United States mail, postage prepaid on this day of February, 2004, to the following:

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