The relief described hereinbelow is SO ORDERED.

SIGNED this 23rd day of January, 2020.

Robert D. Berger
United States Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

In re:

TERRY LEE CALLAGHAN and
BERTHA CALLAGHAN,

Debtors.

Case No. 18-22299
Chapter 13

ORDER SUSTAINING TRUSTEE'S OBJECTION TO CONFIRMATION AND GRANTING DEBTORS' MOTION TO DISMISS

This matter comes before the Court on (1) the Chapter 13 trustee's amended objection to confirmation of Debtors' Chapter 13 plan[1] and (2) Debtors' motion to dismiss.[2] Because Debtors have not met their burden under 11 U.S.C. § 1325(a)(3)

[1] ECF 45.

[2] ECF 56.

of proving that they filed the plan in good faith, the Trustee's objection will be sustained. Debtors' motion to dismiss will thus be granted as well, with the condition that Terry is barred from refiling for 180 days.

I. FACTUAL FINDINGS

Debtors Terry and Bertha Callaghan live in Topeka and have been married for 38 years. Terry is on disability, but he previously worked in technical writing; Bertha works full-time as an accounts payable clerk. Their combined monthly income is below the Kansas median for a two-person household.

The Callaghans filed their first Chapter 13 bankruptcy petition on April 6, 2018. Their confirmed plan in that case provided for monthly payments of $100, with no distribution to unsecured creditors. However, on July 28, 2018, while in Florida for temporary work (which Debtors did not disclose during the first bankruptcy), Terry was injured in a car accident. As a result, Terry incurred approximately $250,000 worth of medical debt.[3] The new debt was not covered by Debtors' insurance.

Debtors received an unsolicited settlement offer and $25,000 check from Progressive Auto Insurance in September 2018. They executed Progressive's release form, with signatures witnessed by their bankruptcy attorney, on October 4th. Five days later, their attorney emailed a notice of dismissal to the Trustee's office; Debtors deposited the $25,000 settlement check into their bank account that same day. On October 11th, Debtors used the $25,000 to buy two vehicles: a 2005

[3] Debtors received the medical bills in August and September 2018.

Ford Explorer and a 2018 Nissan Altima. Debtors' attorney filed a notice of dismissal with this Court four days later, and the Court entered a dismissal order the following day, October 16th.

Debtors filed their second Chapter 13 bankruptcy petition on November 5, 2018, claiming the two newly-purchased vehicles as exempt property. Their Statement of Financial Affairs stated (inaccurately) that the purchase had occurred on October 23rd. Like their confirmed Chapter 13 plan in the first case, Debtors' new plan provided for monthly payments of $100, with no distribution to unsecured creditors. Although Debtors' net income was—according to the Schedule J filed concurrently with their second bankruptcy petition—only $100.60 per month, Debtors incurred a new $215 monthly expense just five days later, when they signed a contract for burial insurance. Debtors did not disclose that new contract to the Trustee during the § 341 meeting of creditors conducted on November 28th.

On December 23, 2018, Terry began working part-time in food service at the VA, with gross earnings of $815 per month. Both debtors testified that Terry had received the job offer before their second Chapter 13 petition was filed; however, Debtors did not disclose the job[4] or the new burial-insurance expense until April 8, 2019, when they amended their Schedules I and J. Debtors also increased other expenses on their amended schedules at that time, such that their monthly net

[4] In fact, during a status conference on February 7, 2019—more than a month after Terry started the job—Debtors' attorney told the Court that Terry's only income was from social security disability, and that he would likely not be able to find new work due to his injuries.

income remained virtually the same ($103.23 versus $100.60) despite Terry's increased income.

The Trustee filed an amended objection to plan confirmation on April 26, 2019.[5] In his objection, the Trustee pointed out that Debtors had spent the $25,000 settlement without court authorization while their first bankruptcy case was still pending (not, as indicated by Debtors' SOFA, one week after the case was dismissed). The Trustee also raised concerns with Debtors' self-prepared 2016, 2017, and 2018 tax returns, wherein Debtors claimed substantial business losses (thus offsetting their income) as the proprietors of a company called Techcom Xchange, LLC. He reiterates these points in objecting to confirmation of the plan currently before the Court.

Debtors amended their 2017 tax returns on August 9, 2019. According to those returns, which were professionally prepared at the request of Debtors' attorney, Debtors (who received an $881 refund under their original federal return) now owe $4,445 to the Internal Revenue Service and $798 to the Kansas Department of Revenue. Debtors filed an amended Chapter 13 plan (the one at issue here) on August 12, 2019, increasing their proposed monthly payments to $190 to cover the new tax debts.[6] At the same time, they filed newly-amended Schedules I and J—this time adjusting their expenses downward—to report a

[5] ECF 45.

[6] ECF 62.

monthly net income of $197.77, sufficient to accommodate the increased plan payments.

Debtors' conveniently-timed adjustments to their expenses would probably not, standing alone, call Debtors' good faith into question. However, those adjustments are suspect in light of other evidence before this Court. For instance, Debtors' 2016 and 2018 tax returns,[7] which Terry prepared, remain unreviewed by any professional and contain a number of perplexing entries, including:

- Claimed expenses of $23,278 on gross receipts of just $3,226 for Techcom Xchange in 2016;
- Claimed expenses of $22,890 on gross receipts of just $445 for Techcom Xchange in 2018;
- Deducted $12,353 in home mortgage interest twice in 2016; and
- Reported the same home sold in 2016 and 2017.

When asked about these items, Terry either pled ignorance or blamed TurboTax. For example, when the Trustee asked about certain expenses from 2018:

> Q If you go to Part 2 it says, Car and Truck Expenses, do you see that, line 9?
>
> A 9, yes.
>
> Q How much were those?
>
> A Says 9,364.
>
> Q What was that from?

[7] According to their self-prepared returns, Debtors received federal refunds of $1,607 in 2016 and $5,838 in 2018.

> A All I know is I give TurboTax the numbers and they do whatever they do with them.
>
> Q And go over to line 20A . . . Vehicle, Machinery and Equipment, 2,238, did you buy any vehicles, machinery or equipment for that amount of money?
>
> A I don't know.[8]

Such responses are not credible, particularly in light of Terry's admission that his 2017 QuickBooks entries did not match the entries on his self-prepared 2017 tax returns.[9] Terry was also unable to explain a number of questionable items on Debtors' bank statements, including:

- Payments to Capital City Pawn totaling nearly $3000 between January 2018 and February 2019;
- A $314 payment on September 27, 2018, to Spirit Airlines;
- A "credit prenotification" on March 15, 2019 from Zen-Noh Grain Co. Payroll; and
- A $1,045.83 deposit on April 11, 2019, from Zen-Noh Grain Co. Direct Deposit.

It appears that Terry was also less than forthcoming about the number and value of his musical instruments. On Line 9 of Schedule A/B, which requires a debtor to describe, and list the current value of, any "[e]quipment for sports and hobbies," including "musical instruments," Debtors listed a "12 string guitar and

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[8] Tr. 89-90.

[9] More precisely, Terry testified that "[M]y attorney said that [the QuickBooks figures] did not match the tax return." Tr. 92.

base [sic] guitar" worth—together—$100. However, less than three months earlier, on August 16, 2018, Debtors had insured certain musical instruments—five guitars plus three amps and a noise suppressor pedal—for $5,475, including a 12-string guitar for $500 and a bass guitar for $450. Terry's testimony did not adequately explain this discrepancy.[10]

Terry even provided inconsistent information as to Debtors' past *address*. At first, Terry told the Court that Debtors had lived in Kansas since January 5, 2015. However, when questioned about the square footage listed on his 2016 Schedule C for home-business expense purposes, he muddied the water: "2016 we were Floridians, this is our condo in Florida. . . . We started our move in 2016. We were still Florida residents until we took possession of the home September 3rd 2016."[11] All of these inconsistencies inform the Court's analysis.

II. ANALYSIS

Section 1325(a) of the Bankruptcy Code provides that the Court shall confirm a Chapter 13 plan if certain conditions are met, among them that "the plan has been proposed in good faith" and "the action of the debtor in filing the petition was

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[10] Terry testified that Debtors' Schedule A/B discloses his acoustic guitars as "musical instruments" and his electric guitars, with their associated equipment, as "household electronics." Tr. 35-36. However, (1) the bass guitar listed in Debtors' insurance policy is electric, not acoustic; and (2) the two acoustic guitars listed on that policy are collectively insured for a combined $1,200, not $100. While insurance value is not the same as actual value, this discrepancy is excessive. Thus, neither Schedule A/B nor Terry's testimony is credible in light of the insurance policy.

[11] Tr. 97. According to Debtors' Statement of Financial Affairs, they lived in a Topeka apartment between January 2015 and September 2016, when they moved to their present Topeka house.

in good faith." *See* 11 U.S.C. § 1325(a)(3), (7). A Chapter 13 debtor has the burden of proving the elements of § 1325(a). *See Alexander v. Hardeman (In re Alexander)*, 363 B.R. 917, (B.A.P. 10th Cir. 2007). Thus, the Callaghans have the burden of proving here that they filed their second Chapter 13 petition and amended Chapter 13 plan in good faith.

As to Debtors' petition, the Court finds that Debtors have met their burden under § 1325(a)(7). Terry's accident occurred during Debtors' first Chapter 13 case; as a result of the accident, he accumulated roughly a quarter-million dollars' worth of medical debt that his insurance did not cover. Faced with such a large amount of post-petition debt, Debtors would have been irrational *not* to dismiss and refile their Chapter 13 bankruptcy. Thus, the Court finds credible Terry's testimony that Debtors dismissed and refiled because of the new medical debt. And while Debtors did technically spend the $25,000 settlement before this Court entered an order dismissing their first case, they did not do so until after agreeing to dismiss the case, as evidenced by the notice of dismissal their attorney's office sent to the Trustee. Under these circumstances, the Court finds that Debtors filed their second Chapter 13 petition in good faith.[12]

[12] The Trustee argues that under *In re McDiffett*, Case No. 13-21930, and *In re Perry*, Case No. 14-20101, good faith would require Debtors to pay out the $25,000 settlement under their proposed plan. However, the debtors in those cases had no legitimate reason to dismiss their prior bankruptcies; rather, they had dismissed their earlier cases solely to avoid paying nonexempt tax refunds to the Chapter 7 trustee. Because the Callaghans had a legitimate reason to dismiss their prior bankruptcy, this case is distinguishable from *McDiffett* and *Perry*.

However, the Court finds that Debtors have not met their burden under § 1325(a)(3) regarding their proposed plan. To determine whether a Chapter 13 plan was filed in good faith, courts in the Tenth Circuit look to the totality of the circumstances. *See Anderson v. Cranmer (In re Cranmer)*, 697 F.3d 1314, 1318 & n.5 (10th Cir. 2012) (citing *Flygare v. Boulden*, 709 F.2d 1344, 1347 (10th Cir. 1983)).[13] "A bankruptcy court must consider 'factors such as whether the debtor has stated his debts and expenses accurately; whether he has made any fraudulent misrepresentation to mislead the bankruptcy court; or whether he has unfairly manipulated the Bankruptcy Code.'" *Cranmer*, 697 F.2d at 1318 n.5 (quoting *Educ. Assistance Corp. v. Zellner*, 827 F.2d 1222, 1227 (8th Cir. 1987)). Pre-petition conduct by the debtor may also be relevant. *See Pioneer Bank of Longmont v. Rasmussen (In re Rasmussen)*, 888 F.2d 703, 704 (10th Cir. 1989) (citing *Neufeld v. Freeman*, 794 F.2d 149, 150 (4th Cir. 1986).

Here, Debtors provided misleading information to the Court by stating that they spent the $25,000 settlement on October 23rd (i.e., after dismissal of their first bankruptcy). They incurred a $215 monthly expense just five days after stating that their monthly net income was only $100.60. They did not disclose that expense to the Trustee at the § 341 hearing two weeks later. They knew when they filed their second petition that Terry had been offered a job at the VA but did not disclose

[13] *Flygare* enumerated eleven non-exclusive factors to be considered in determining whether a debtor filed his Chapter 13 plan in good faith. However, after *Flygare* was decided, the Bankruptcy Code was amended to include § 1325(b), which subsumes most of the *Flygare* factors. *See Cranmer*, 697 F.3d at 1318 n.5. Thus, the good-faith inquiry "now has a more narrow focus." *Id.*

that job until five months after filing. They did not disclose Terry's Florida job during their first bankruptcy. They provided inaccurate information as to the number and value of Terry's musical instruments. They did not explain their payments to Capital City Pawn or how their income could accommodate those payments. They claimed improbable business expenses on their 2016 and 2018 federal tax returns and assigned all responsibility to TurboTax. Terry testified that Debtors had been Florida residents in 2016 just hours after testifying that they had lived in Kansas since 2015. And—most tellingly—Terry declined to explain the more than one thousand dollars deposited by Zen-Noh Grain Company into Debtors' bank account. In light of these facts, and under the totality of the circumstances, the Court cannot find that Debtors' plan was proposed in good faith. Debtors have thus not met their burden under § 1325(a)(3).

III. CONCLUSION

The Court recognizes that human memory is imperfect, and that the completion of bankruptcy schedules is not an exact science. However, the record before this Court contains too much evidence of untruthfulness to ignore. The Court therefore denies confirmation of Debtors' proposed Chapter 13 plan.

Debtors requested that this case be dismissed if the Court did not confirm their Chapter 13 plan. In opposing dismissal, the Trustee requested that a non-dischargeable $25,000 judgment be entered against Debtors, or (in the alternative) that Debtors be permanently barred from refiling for bankruptcy, if this Court

grants Debtors' motion.[14] While the Court declines to impose such restrictions,[15] the Court does find cause pursuant to § 349(a) to bar Terry from refiling for 180 days. With that condition, Debtors' motion to dismiss is granted.

IT IS SO ORDERED.

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[14] ECF 59.

[15] *Cf. Frieouf v. United States (In re Frieouf)*, 938 F.2d 1099 (10th Cir. 1991).