

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

In Re:

Mark John McGowan
Debtor.

CHAPTER 13

Bky. 97-30606

ORDER

This matter came before the Court for hearing on confirmation of Mark John McGowan's proposed Chapter 13 plan; and, on the U.S. Trustee's motion to convert the case to Chapter 7. Objections to confirmation were filed by both the U.S. Trustee and Norwest Bank, an unsecured creditor. The hearing was held on July 15, 1997. This ORDER is now entered pursuant to the Federal and Local Rules of Bankruptcy Procedure.

I.
FACTS

The Debtor experienced a nasty divorce during 1995 and 1996, which, according to him, resulted in the ruin of his business and caused the need for his personal bankruptcy filing. The Petition was filed under Chapter 7 on January 31, 1997.

During the divorce proceedings, the Debtor's former spouse occupied the home of the parties. At conclusion of the case, the Debtor was awarded the home, and he took possession (but not occupancy) in September of 1996. In October, Mr. McGowan entered into a year lease with third parties, renting the premises to them through October of 1997 for \$700 a month. He did not live in the house after taking possession in September of 1996, and did not reside there when the petition was filed. The property was valued at \$100,000. There were no liens against it at filing. Unsecured debt was scheduled at \$85,033.56(1F)

The Debtor claimed a homestead exemption for the property on his Schedule C, and listed the address of the property as his residence on the Petition.(2F) He did not disclose receipt of the \$700 monthly rent on Schedule I; nor did Mr. McGowan schedule any other income.(3F)

At the Chapter 7 Section 341 meeting, held in April 1997, Mr. McGowan testified that he had resided at the property since September, 1996; and, that he had rented it to a third party only within the previous two months after bankruptcy filing. Mr. McGowan told the trustee that he continued to reside on the property, with the new tenant as his roommate. This was his testimony, in pertinent

part:

TRUSTEE RIES: And where did you reside at the time of filing?

MR. MCGOWAN: 409 East Broadway, Owatonna.

TRUSTEE RIES: Okay, and do you still reside there?

MR. MCGOWAN: Yes.

Transcript of Chapter 7 Section 341

Meeting, April 11, 1997, p 3.

TRUSTEE RIES: Do you own your homestead?

MR. MCGOWAN: Yes.

TRUSTEE RIES: How long have you owned it?

MR. MCGOWAN: A little over 4 years.

TRUSTEE RIES: What did you pay for it?

MR. MCGOWAN: I believe 95.

TRUSTEE RIES: If you were going to sell it, you couldn't get more than -- you don't believe you could get more than 100 for it?

MR. MCGOWAN: That's about the market value, yes.

TRUSTEE RIES: Okay. Do you have it listed for sale or anything?

MR. MCGOWAN: No, I don't.

TRUSTEE RIES: Are you trying to rent it?

MR. MCGOWAN: I am renting it right now. I have a roommate.

TRUSTEE RIES: Who is that?

MR. MCGOWAN: Brent [phonetic] Johnson.

TRUSTEE RIES: How long has he lived there?

MR. MCGOWAN: About 2 months.

TRUSTEE RIES: How long have you lived there?

MR. MCGOWAN: Well, I've lived there for 4 years. During the time I was separated, I didn't live there, and she vacated the house back in August of last year. That's when I moved back in.

TRUSTEE RIES: You moved back in when?

MR. MCGOWAN: Early fall of last year.

TRUSTEE RIES: What month?

MR. MCGOWAN: September.

TRUSTEE RIES: Of 1996?

MR. MCGOWAN: Hm-hmm.

TRUSTEE RIES: And you lived there since then?

MR. MCGOWAN: Yes.

TRUSTEE RIES: And the tenants moved in when? Or Brent moved in?

MR. MCGOWAN: About 2 months ago.

TRUSTEE RIES: So you're talking what? February?

MR. MCGOWAN: Yes.

TRUSTEE RIES: Prior to that time, you lived there alone?

MR. MCGOWAN: Yes.

TRUSTEE RIES: Let's see. I was told that that was -- that that's been leased to somebody else and that you do not live

there. You're saying that that's not true?
MR. MCGOWAN: That's not true.
TRUSTEE RIES: Okay. Where else have you lived in the last 2 years?
MR. MCGOWAN: Ah, I've lived --
TRUSTEE RIES: In fact, let's back up. You lived there for the last 6 months or so, right?
MR. MCGOWAN: Right.
TRUSTEE RIES: Prior to that, where did you live?
MR. MCGOWAN: I've stayed off and on with friends in Minneapolis.
TRUSTEE RIES: Okay, who are they?
MR. MCGOWAN: Cindy Stegman.
TRUSTEE RIES: How do you spell that?
MR. MCGOWAN: S-T-E-G-M-A-N.
TRUSTEE RIES: And what's that address?
MR. MCGOWAN: I was just living there temporarily. I don't know what her address is. I can provide that to you if you want.
TRUSTEE RIES: Okay. How long did you live with her?
MR. MCGOWAN: Just -- I mean, just -- it was a periodic thing. I was seeing her at the time.
TRUSTEE RIES: So, I mean, a couple nights a week or something like that?
MR. MCGOWAN: Yah.
TRUSTEE RIES: Where did you keep your clothes?
MR. MCGOWAN: I keep them in Owatonna.
TRUSTEE RIES: And you -- well, okay, but we're talking about prior to September of '96.
MR. MCGOWAN: Hm-hmm.
TRUSTEE RIES: Where did you keep your clothes? You still kept them in Owatonna?
MR. MCGOWAN: Yes.
TRUSTEE RIES: At that address? So they were with your --
MR. MCGOWAN: Well, prior to me occupying my own home, I kept them -- I actually kept them at the store in my office.
TRUSTEE RIES: So you're saying that prior to September of '96, you didn't have a permanent address?
MR. MCGOWAN: No.
TRUSTEE RIES: And when did you move out prior to -- I understand you say you moved back in -- prior to that time
MR. MCGOWAN: April of '95.
TRUSTEE RIES: Okay, so you moved out in April of '95 and moved back in in September of '96?
MR. MCGOWAN: Yes.
Transcript, at 13-16.

The trustee knew that Mr. McGowan had filed false schedules, and that he lied at the Section 341

meeting, because the Debtor's former spouse blew the whistle on him long before the meeting. The trustee filed an objection to the claimed exemption on April 23, 1997. He also filed an adversary proceeding objecting to discharge under Section 727. Mr. McGowan responded by converting the case to Chapter 13.

At the Chapter 13 Section 341 meeting, Mr. McGowan lied about lying at the Chapter 7 meeting. He testified:

And 30 seconds into the meeting, Trustee Ries pulled out his notes from phone conversations with my "ex," Holly Hofschild, and Holly had interfered in this process, and it was at that point that, you know, I was brain dead, and I wasn't sure on the dates. It was not the intent to mislead anyone, and it was at that point that I -- you know, it probably became crystal clear in my mind that [lawyer] had given me very, very poor advice and that very possibly my equity in my home could be gone. That was a significant day...

Trustee Creasey: But at the time that you were talking to Mr. Ries in the 341 Meeting, did you believe that what you were telling him was the truth?

Mr. McGowan: Yes, I did.(4F)
Transcript of Chapter 13 Section 341
Meeting, June 20, 1997, pp. 49, 50.

The first plan provided for full payment to creditors over five years. The United States Trustee and Norwest Bank objected. The U.S. Trustee objected on grounds of bad faith and moved to convert the case. Norwest joined in the objections of the U.S. Trustee, and also objected to the length of the plan. The Debtor responded by modifying the plan, first to require sale of the claimed exempt property with distribution of the proceeds to creditors during the plan; and, next to pay interest on the allowed amount of claims at the judgment rate of 5%. The objectors were not satisfied.

II. DISCUSSION

A requisite for confirmation of a Chapter 13 plan is a finding that the plan has been proposed in good faith. 11 U.S.C. Section 1325(a)(3). Good faith is considered in the context of:

[w]hether the debtor has stated his debts and expenses accurately; whether he has made any fraudulent misrepresentations to the bankruptcy court; or whether he has unfairly manipulated the Bankruptcy Code.

Education Assistance Corp. v. Zellner, 827 F.2d 1222, 1227 (8th Cir.1987); see also, Handeen v. LeMaire, 898 F.2d 1346 (8th Cir. 1990).

The filing of false schedules in a Chapter 7 case can constitute "fraudulent misrepresentations" and "unfair manipulation of the Bankruptcy Code" in later consideration of "good faith" in the context of the converted case in Chapter 13. In re Kilker, 155 B.R. 201, 203- 204 (Bankr. W.D. Ark. 1993). So can the giving of false testimony at the earlier Chapter 7 Section 341 meeting.

Here, the Debtor intentionally deceived the Court, through the filing of false schedules and by lying at the Chapter 7 Section 341 meeting, both regarding his income and living arrangements, in order to keep valuable property from his estate. When the fraud and deceit were discovered, the Debtor sought escape to, and refuge in, Chapter 13. The conversion had nothing to do with fresh start or payment to creditors. It had to do with: avoiding the potential stigma of a judgment barring the discharge in Chapter 7; and, at least originally, with the protection of his interest in the property against potential disallowance of the exemption in the Chapter 7 case. The case was converted in bad faith, and the plan was proposed in bad faith. Confirmation, therefore, must be denied.

The case should also be reconverted to Chapter 7. While a debtor has an absolute right to convert a previously unconverted case from Chapter 7 to Chapter 13, there is no absolute right to remain in the converted case. The commission of fraud in connection with the earlier case, can be grounds for reconversion from the later case. Finney v. Smith, 992 F.2d 43 (4th Cir. 1993); Texas Extrusion Corp. v. Lockheed Corp., 844 F.2d 1142 (5th Cir. 1988); In re Kilker, 155 B.R. 201 (Bankr. W.D. Ark. 1993); In re McNallen, 197 B.R. 215 (Bankr. E.D. Va. 1995). So it is here. Preservation of the integrity of the bankruptcy process requires that the case be reconverted to Chapter 7.

III. DISPOSITION

Based on the foregoing discussion, it is hereby ORDERED:

1. Confirmation of the Debtor's Chapter 13 plan is denied; and,
2. The U.S. Trustee's motion to convert the case back to a case under Chapter 7 is granted, and the case is hereby converted to Chapter 7.

Dated: August 29, 1997 By The Court:

DENNIS D. O'BRIEN

U.S. BANKRUPTCY JUDGE

(1) The schedules were subsequently amended upon conversion to Chapter 13 to reflect \$40,546 unsecured debt. Apparently, nonguaranteed business debt was deleted.

(2) The exemption was claimed, using Minn. Stat. sec. 510.01. To qualify under the statute, a claimant must reside on the property at the time the exemption is claimed.

(3) Mr. McGowan arranged for the tenants to receive one month free rent for the month of February. He testified that his lawyer told him that, under those circumstances, he need not schedule the receipt of rent. He did disclose on Schedule I: "I expect to rent my homestead in the near future." In his amended Schedule I, filed May 15, 1997, upon conversion to Chapter 13, Mr. McGowan scheduled \$2100 monthly income. At hearing, he testified that he expected to receive a minimum income in the monthly amount of \$4,000, representing a draw from commissions from professional placement employment.

(4) Mr. McGowan essentially blamed everything on his first lawyer, who was no longer representing him at the time. Mr. McGowan was on his third lawyer at confirmation hearing.