

**United States Bankruptcy Court
District of New Mexico**

Document Verification

Case Title: Brian Keith Dudney and Heather Helen Hall-Dudney
Case Number: 98-17570
Chapter : 7
Judge Code: SS
First Meeting Location: Santa Fe
Reference Number: 7 - 98-17570 - SS

| Document Information | | | |
|---|--|---|------------------------------|
| Number: | 95 | | |
| Description: | Memorandum Opinion re: [43-1] Motion To Convert Case From Chapter 7 to Chapter 13 by Heather Helen Hall-Dudney, Brian Keith Dudney . | | |
| Size: | 32 pages (52k) | | |
| Date Received: | 01/16/2001 01:48:42 PM | Date Filed: | 01/16/2001 |
| | | Date Entered On Docket: 01/17/2001 | |
| Court Digital Signature | | | View History |
| 23 cf 2f 1e c5 f1 2e 7b a2 de 69 20 5e 96 ee 38 d2 b5 3f 6c e9 14 3a 19 5b 06 9d d1 c3 65 52 69 4a b0 4a af ab 0d 5f fd 1e 31 f8 2e 34 ab 35 a3 b5 1f 8c 59 81 eb dd b0 04 6b b0 7c 75 3c 97 19 51 4a 70 c1 d6 3d 3a d7 39 d9 d1 7a 78 8b 11 5f e3 2f 0b 29 01 e7 e3 4e 16 ea ca 01 9a 8f e4 37 9a 8a 47 ce a6 e9 1e 13 31 bc ae 2f 2b 56 af 8f 33 3f 73 16 28 67 63 f3 49 9d 30 3e 6f e9 c4 e3 | | | |
| Filer Information | | | |
| Submitted By: | | | |
| Comments: Memorandum Opinion on Motion to Convert to Chapter 13 | | | |

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:

BRIAN KEITH DUDNEY and
HEATHER HALL - DUDNEY,
Debtors.

No. 7-98-17570 SS

**MEMORANDUM OPINION ON
MOTION TO CONVERT TO CHAPTER 13**

This matter came before the Court on a Motion to Convert Case from Chapter 7 to Chapter 13 filed by the Debtors, doc. 43, and the objection thereto by Wilderness Exchange, Inc. ("WEI"), based in part on 11 U.S.C. §706(d).¹ Doc. 45. The Court conducted an evidentiary hearing on the motion on August 23-24, 2000, and closing argument on August 28, 2000. This is a core proceeding. 28 U.S.C. § 157(b)(2)(A). The debtors appeared through their attorney Thomas Rice. WEI appeared through its attorney James Jurgens. Having considered the testimony and the arguments, and being otherwise sufficiently advised, the Court finds that the Motion is well taken and should be granted.

The primary issue before the Court is whether the Debtors' total noncontingent, liquidated unsecured debts

¹ "Notwithstanding any other provision of this section, a case may not be converted to a case under another chapter of this title unless the debtor may be a debtor under such chapter."

exceed \$269,250.² WEI has also objected on the grounds of good faith and lack of "regular income." See 11 U.S.C. § 109(e). The Court will consider these issues in the order listed.

DEBT LIMITATION

SCHEDULE D DEBTS

The unsecured portion of undersecured debts is counted in the unsecured total for purposes of 109(e). "As a matter of law and as a matter of logic and fairness, calculation of bona fide deficiency claims of undersecured creditors is appropriate in determining total unsecured debt of a Chapter 13 debtor." In re Clark, 91 B.R. 570, 572-73 (Bankr. D. Co. 1988). Furthermore, postpetition transfers, even if accepted in full satisfaction of a claim, do not retroactively extinguish a deficiency claim as of the date of the petition. Id. at 573.

Debtors' original Schedule D included the following secured debts:

| Creditor | Security | Claim | Unsecured Portion |
|-----------------|-----------------|--------------|--------------------------|
| FFB | deposit | \$ 350.00 | \$ 0.00 |

² Pursuant to 11 U.S.C. § 104(b), the unsecured debt limit was raised from \$250,000 to \$269,250 effective for cases commenced on or after April 1, 1998. This case was filed December 16, 1998.

| Creditor | Security | Claim | Unsecured Portion |
|------------------------|------------------------|--------------|--------------------------|
| Providian ³ | deposit | - | --- |
| Toyota Motor | 96 Toyota ⁴ | 25,000.00 | 2,000.00 |
| Western Bank | CD | 9,409.76 | 0.00 |
| Western Bank | CD | 10,874.34 | 0.00 |
| Western Bank | 85 BMW ⁵ | 9,700.00 | <u>2,450.00</u> |
| Total | | | <u>\$ 4,450.00</u> |

Debtors' First Amended Schedule D, filed March 22, 2000, adds the following:

| Creditor | Security | Claim | Unsecured Portion |
|----------------------|-----------------|--------------|--------------------------|
| Crider | 76 Toyota | \$ 600.00 | \$ 0.00 |
| Garcia | 88 Lincoln | 700.00 | 100.00 |
| Freeman ⁶ | inventory | --- | <u>---</u> |
| Total | | | <u>\$ 100.00</u> |

Debtors' Second Amended Schedule D, filed June 16, 2000, adds:

³ Providian filed a proof of claim, and is considered below.

⁴ The automatic stay was terminated on this claim on August 5, 1999.

⁵ The automatic stay was terminated on this claim on September 14, 1999.

⁶ Freeman is the principal for WEI. WEI's claim is included in the proofs of claim below.

| Creditor | Security | Claim | Unsecured Portion |
|------------|-----------|--------------|---------------------|
| Helen Hall | inventory | \$123,000.00 | \$ <u>75,000.00</u> |

WEI argued that the inventory was overvalued on the schedules. At trial, Ms. Hall-Dudney testified that the total inventory was worth \$47,500, including her estimate of the value of inventory repossessed by WEI. Specifically, she testified that the value of inventory located in Florida was \$25,000. Presumably, therefore, her value for the WEI inventory was \$22,500. WEI filed a proof of claim, however, setting out the collateral value in its possession at \$5,715.00. The Court will use WEI's proof of claim for that portion of the collateral (see below). With respect to Helen Hall's inventory, the Court will accept the value of \$25,000; her unsecured claim then would be \$98,000, not the \$75,000 listed on Schedule D. In other words, the Court will adjust the deficiency claims upward by \$23,000 (\$98,000 - \$75,000). Therefore, the total unsecured portions of the secured claims (other than WEI's claim) is \$102,550 (\$4,550 + \$100 + \$75,000 + \$23,000).

SCHEDULE E DEBTS

The Debtors scheduled their tax liability as a contingent, disputed, unliquidated debt in the amount of

\$1.00. Under Mazzeo v. United States (In re Mazzeo), 131 F.3d 295, 304 (2nd Cir. 1997), a state tax liability of a person responsible for employee withholding taxes is not contingent or unliquidated. The Court finds that a federal liability of the same nature should also not be considered contingent or unliquidated. Internal Revenue Code § 6672 imposes a penalty on responsible persons for withheld taxes. WEI established at trial that the debtors had control of the business, the payroll, the checkbooks, and the bank accounts and that they were the persons responsible for making payroll tax deposits, in other words a prima facie case of responsible person liability under I.R.C. § 6672. Exhibit B shows federal unpaid withholding taxes for Hydro, Inc. of \$1,135.84 (for quarter 3/31/98) and \$1,004.14 (for quarter 6/30/98), for a total of \$2,139.98. The Court will use this figure.

SCHEDULE F DEBTS

The Debtors owned and operated Hydro, Inc., which did business as Wild River Sports. Upon advice of counsel, when they filed their Chapter 7 petition they included not only all of their personal debts in the schedules, but virtually all of the corporation's debts whether they had personally guaranteed the debts or not. These debts were listed, generally, as contingent debts. In their first amended Schedule F Debtors

omitted the majority of the contingent debts. On the basis of these changes, WEI has challenged the credibility of the Debtors, particularly Ms. Hall-Dudney. In essence, WEI argues that schedules once executed under penalty of perjury could not be changed in a wholesale manner without leading to the conclusion that at one stage or the other, the Debtors must be in effect falsely swearing. WEI's argument is not well taken.

Individual debtors who list corporate debts are only using the provisions of the Code in a practical and permissible manner. To not list such claims leaves an individual debtor open to collection litigation from corporate creditors. By listing these claims in the individual case, the debtor forces the creditor of the corporation to assert whatever claim it has against the individual and get it resolved in the individual bankruptcy case, rather than to require the debtor, post-discharge, to engage in expensive litigation to resolve the issue, where the debtor may well be right on the issue of liability but not have the means to defend that position. In other words, it is simply good practice to avoid the time, expense and stress of future litigation by putting the creditors of the corporation on notice that the debtor does not consider those debts to be individual debts. And those creditors are thereby put on

notice and given the opportunity to file a proof of claim in the individual case. Indeed, that is precisely what several of the corporate creditors, such as Royal Robbins and Patagonia, have done.⁷

Should an individual include corporate debts, disputed as to personal liability, in his or her schedule, such debts should be listed as contingent or, more accurately, valued at "\$0.00". And for the most part, Debtors listed the corporate debts as contingent. But there is nothing that requires an individual debtor to list corporate debts at all. So there is nothing contradictory about the Debtors in this instance not listing corporate debts in their amended schedules.

WEI's implicit criticism of Debtors for amending their schedules is also not justified given the Debtors' testimony, particularly that Ms. Hall-Dudney, of the way they ran the business after taking it over from Mr. Freeman, the owner of WEI who sold the business to the Debtors. What emerges from the testimony is of two people with poor credit histories (suggesting previous problems in managing their financial affairs⁸) struggling to manage a business subject to seasonal

⁷ The Court has treated those proofs of claim as disputed debts included in the §109(e) total.

⁸ The Court assumes that conducting his due diligence before the sale of the business to the Debtors, Mr. Freeman

changes, employee theft, poor inventory and financial controls, and other problems. In this context it is not surprising that the state of the records of the business were such that it took more than one try for the Debtors to put together schedules that were increasingly accurate. That is not to say that debtors do not have an obligation to do their best to get their schedules right the first time. But it is appropriate for debtors to amend to correct their schedules to make them more accurate when further investigation, on their part or on the part of a creditor, brings inaccuracies to light. The Court believes that is what has happened here. In addition, the Court is hesitant to in effect punish the Debtors for amending their schedules, even when those amendments are beneficial to the Debtors, if the effect of that action might be to discourage future debtors from filing amendments to make schedules and other filings more accurate. And in any event, "[A] voluntary petition, list, schedule, or statement may be amended by the debtor as a matter of course at any time before the case is closed." FRBP 1009(a).

It is true that Ms. Hall-Dudney testified at her deposition that the Debtors were personally liable for certain

made himself aware of this fact and took it into account in considering whether to make the sale.

corporate debts that the subsequently amended schedules do not list as individual debts at all. Nothing in many of the trial exhibits themselves suggests any individual liability. Ms. Hall-Dudney testified that after her deposition, she searched and examined the records again, and for a number of the debts for which she admitted personal liability in the deposition, she could not find a personal guarantee or other evidence of personal liability. The Court finds specifically that the Debtors, including Ms. Hall-Dudney, exhibited sufficient credibility at trial.⁹ If Ms. Hall-Dudney testified incorrectly at her deposition that a debt was a personal one, that "admission" did not convert a non-individual debt to an individual one. With this background, the Court will now consider each of the debts listed or claimed to be owed by anyone in this case.

The Debtors list the following as unsecured debts in their Schedule F, as amended by the first and second amended

⁹ The Court is, however, troubled by the fact that the creditor would have gone through the expense and time of the deposition process and received answers that turned out not to be accurate upon the Debtors conducting further research. Although the Court does not see a basis for awarding discovery sanctions against the Debtors for this behavior, the Debtors need to understand that in any future proceedings in this case, the time to "do their homework" is before a deposition, not afterward.

schedules (and the Court has adjusted several based on the testimony and exhibits at trial as described below):

| Creditor (Items marked * are stipulated 109(e) debts, per Trial Exhibit J) | Contingent or Unliquidated | Amount for § 109(e) |
|---|----------------------------------|------------------------|
| A-1 Collection | x | |
| Accounting Dept - <u>see</u> NuCity below | x | |
| Advanta ¹⁰ | | \$ 0.00 |
| Adventure 16 ¹¹ | x | |
| Adventure Medical | x | |
| Airborne Express | x | |
| Aire ¹² | x | |

¹⁰ At trial Ms. Hall-Dudney's testimony was that this was a corporate debt and that there was no personal guarantee. The only contrary evidence was from her deposition. The debt was originally listed at \$9,400.00 on Schedule F, as neither contingent or unliquidated, apparently in error. This was only one of the several debts that Ms. Hall-Dudney testified at her deposition were personal debts but at trial asserted were only business debts. Others include Air Touch Cellular, SF Accommodations, Steve Gellis Sports, Inc., Zardo LLC, B-Line Snowboards and Oobe, Inc.

¹¹ This creditor filed a proof of claim, and is discussed below.

¹² Exhibit L is an invoice to "Wild River Sports" and appears to be a corporate debt. There was no testimony at trial directly about this exhibit.

| | | |
|---|---|----------|
| Air Touch Cellular ¹³ | | 0.00 |
| Airwalk | x | |
| Akona | x | |
| Alan Rogers * | | 13.04 |
| Albuq. Collection (St. Vincent) ¹⁴ | | 1,119.00 |
| Albuq. Collection (Anesthesia) * | | 55.00 |
| Aloe Up ¹⁵ | x | |
| Alpen Books | x | |

¹³ Ms Hall-Dudney testified that this was a corporate debt and that there was no personal guarantee. At her deposition she had said it was a personal debt. The debt was originally listed at \$1,933.47 on Schedule F as neither contingent or unliquidated, also apparently in error.

¹⁴ Debtors stipulated at trial that this debt is includable for 109(e).

¹⁵ Exhibit M is an invoice to "Wild River Sports" and appears to be a corporate debt. Ms. Hall-Dudney's testimony was that this was a Hydro debt because the invoice was sent to Wild River Sports, the trade name used by Hydro, even though she had no documents specifically identifying this invoice as a Hydro debt. Ms. Hall-Dudney provided the same testimony for Exhibits O (Cascade Designs), P (Dagger Canoe), Q (Earth and Ocean Sports), R (Extrasport), S (Five Ten), T (ICS Books), Z (Northwest River Supplies), AA (Old Town Canoe), and BB (Planetary Gear) as well.

| | | |
|--------------------------------------|---|--------|
| Animal USA Ltd ¹⁶ | x | |
| Apollo Credit | | 51.00 |
| B-Line Snowboards | x | |
| Better Business Bureau ¹⁷ | | 0.00 |
| Bic Sport | x | |
| Bryant Sales | x | |
| CAFS * | | 311.00 |
| Canoe & Kayak | x | |
| Carlisle Paddles | x | |
| Cascade Designs ¹⁸ | x | |
| Chaco, Inc. | x | |
| Checkrite * | | 450.00 |
| Colorado Rivers | x | |
| Congress Talcott | x | |
| Credit Bureau of Espanola * | | 63.00 |

¹⁶ Exhibit N is a demand letter to "Wild River Sports" and appears to be a corporate debt. Ms. Hall-Dudney testified at trial that the invoice makes no mention of Hydro, but that Wild River Sports was the trade name for Hydro and that is how she knows it was a Hydro debt. The Court took her testimony afterward to make this statement applicable to Exhibits O (Cascade Designs), P (Dagger Canoe), Q (Earth and Ocean Sports), R (Extrasport), S (Five Ten), T (ICS Books), Z (Northwest River Supplies), AA (Old Town Canoe), and BB (Planetary Gear) as well.

¹⁷ This claim was omitted from the amended schedules.

¹⁸ Exhibit O is a bill to "Katie c/o Wild River Sports" and appears to be a corporate debt. Sending the invoice to "Katie" rather than to one or both of the individual debtors is evidence that the creditor did not consider the debt to be a personal one.

| | | |
|------------------------------------|---|----------|
| Dagger Canoe ¹⁹ | x | |
| Dry Creek Distributing | x | |
| Earth & Ocean Sports ²⁰ | x | |
| El Gancho * | | 291.86 |
| Extrasport ²¹ | x | |
| Fastrak Systems | x | |
| First Security Bank * | | 850.00 |
| Fiskars | x | |
| Five Ten ²² | x | |
| Greenlight Premium | x | |
| GTE Southwest * | | 1,322.65 |
| Helen Johnson Hall ²³ | | --- |
| Honor Creditors ²⁴ | | |
| IC Systems * | | 164.00 |

¹⁹ Exhibit P is a statement to "Wild River Sports" and appears to be a corporate debt.

²⁰ Exhibit Q is a statement to "Wild River Sports", "Att: Katie", and appears to be a corporate debt.

²¹ Exhibit R is a demand letter to "Wild River Sports" and appears to be a corporate debt.

²² Exhibit S is a statement to "Wild River Sports" and appears to be a corporate debt.

²³ This claim was subsequently included as a secured debt and is treated above.

²⁴ This is a duplicate entry as collection agent for GTE.

| | | |
|----------------------------------|---|--------|
| ICS Books ²⁵ | x | |
| Insty Prints ²⁶ | | 0.00 |
| Integrated Finance * | | 362.00 |
| Jack's Plastic Welding | x | |
| Jacobs & Fine | x | |
| James Arslanian ²⁷ | | 0.00 |
| Kali's Sport | x | |
| Kathy Vanderrossen ²⁸ | | 0.00 |
| L-Fam Partners ²⁹ | x | |

²⁵ Exhibit T is a statement to "Wild River Sports" and appears to be a corporate debt. As WEI's questioning emphasized, "Heather" appears five (not six) times on the invoice, but merely as confirmations of the individual who authorized the purchase. Nothing in the invoice suggests that the creditor was intending to invoke Ms. Hall-Dudney's personal liability.

²⁶ This claim was omitted from the amended schedules.

²⁷ This debt is a post-petition debt to Debtors' prior bankruptcy attorney. It is listed in the Amended Schedules at \$5,000.00, but appears to have been \$0.00 on the date of the petition. In addition, to the extent that the Court can take judicial notice of the Statement of Affairs in the file - that is, can consider the contents of the sworn statements as evidence - answer #9 shows a \$1,500 payment to Mr. Arslanian in October 1998, presumably for the prepetition work done for the debtors and their corporation. The petition was filed December 15, 1998. To the extent that this may be an administrative priority claim in the chapter 13 case, see In re Bottone, 226 B.R. 290, 298 (Bankr. D. Ma. 1998), the Court finds it contingent (upon application and Court approval) and unliquidated.

²⁸ This claim was omitted from the amended schedules.

²⁹ This is the landlord for the business premises, and the claim is discussed below.

| | | |
|-------------------------------------|---|------|
| Lightning Paddles | x | |
| Los Alamos County ³⁰ | | 0.00 |
| Los Alamos Monitor | x | |
| Lotus Design ³¹ | x | |
| Mad River Canoe ³² | x | |
| Mail Call of Santa Fe ³³ | | 0.00 |
| Maravia ³⁴ | x | |

³⁰ This claim was omitted from the amended schedules.

³¹ Exhibit U is a statement from Lotus Designs, Inc. that has no information that identifies the account debtor, other than "Attn: Katy". At trial, under cross examination, Ms. Hall-Dudney testified that the debt to Lotus Designs, as well as exhibits V (Mad River Canoe), W (Maravia) and X (Maywest Manufacturing), and the debt to Mail Call of Santa Fe, had no name on them but was a business debt. In fact, there are names on some of the invoices. The discrepancies illustrate how unreliable at times oral testimony can be, including (or perhaps especially) when the questioning is conducted by opposing counsel.

³² Exhibit V is a facsimile transmission to "Katie at Wild River Sports" and appears to be a corporate debt.

³³ This claim was omitted from the amended schedules.

³⁴ Exhibit W is a statement to "Wild River Sports" and appears to be a corporate debt.

| | | |
|-------------------------------------|---|-----------|
| Marshall Hall ³⁵ | | 0.00 |
| Maywest Manufacturing ³⁶ | x | |
| McNett Corporation | x | |
| Mitchell Paddles | x | |
| Morton Enterprises ³⁷ | x | |
| Mountain Surf, Inc | x | |
| Names and Numbers | x | |
| Neckar Sales | x | |
| New Mexico Taxation & Revenue | x | |
| NM Educational Assistance * | | 12,000.00 |
| NM Educational Assistance * | | 6,000.00 |

³⁵ This creditor is Ms. Hall-Dudney's father. He testified at trial that he did not consider the transaction, whereby the Debtors used his certificate of deposit as collateral and lost it to Western Bank, to be a debt, at least not one owed by the Debtors. The creditor testified similarly that practically speaking he did not consider the debt incurred by the Debtors using his credit card (with his permission) necessary to be repaid. The Court finds that Mr. Marshall Hall testified credibly. Thus the Court treats these advances as a gift. This claim is omitted from the amended schedules.

³⁶ Exhibit X is a statement to "Wild River Sports/Wilderness Exchange, Inc." that appears to be a corporate debt.

³⁷ Exhibit G is an "Advertising Agreement" listing "Advertiser" as Wild River Sports, and "contact person" Heather. It was signed by Heather Hall-Dudney, with no reference to capacity. The Court finds this to be a corporate debt.

| | | |
|--|---|----------|
| NM State Police ³⁸ | | 55.00 |
| North Sports ³⁹ | x | |
| Northwest River Supplies ⁴⁰ | x | |
| Novare Collection * | | 950.00 |
| NuCity Publications ⁴¹ * | x | 1,699.00 |
| Old Town Canoe ⁴² | x | |
| Oobe, Inc | x | |
| Orosi | x | |
| Patagonia ⁴³ | x | |
| Pelican Products | x | |
| Pinon Fast Print ⁴⁴ | | 0.00 |

³⁸ Exhibit Y is an advertising confirmation addressed to "Brain [sic] Dudney/Owner, Wild River Sports". While this appears to be a debt on behalf of the corporation, the Court will, because Mr. Dudney's name appears as buyer, include this debt as a personal obligation.

³⁹ Exhibit H is an invoice to "Wild River Sports" that appears to be a corporate debt.

⁴⁰ Exhibit Z is a statement to "Wild River Sports" that appears to be a corporate debt.

⁴¹ In Exhibit J, Debtors stipulated that this was a personal obligation that should be included in their unsecured debts.

⁴² Exhibit AA is a statement to "Wild River Sports" that appears to be a corporate debt. Neither this exhibit nor exhibits BB (Planetary Gear), DD (Wellborn Paints) and EE (Wyoming Woolens) contain any mention of Hydro.

⁴³ This creditor filed a proof of claim, and is discussed below.

⁴⁴ This claim was omitted from the amended schedules.

| | | |
|-----------------------------------|---|----------|
| Planetary Gear ⁴⁵ | x | |
| PMI Petzel | x | |
| PNM | x | |
| PNM | x | |
| Presbyterian Physicians Billing * | | 58.00 |
| Providian ⁴⁶ | | --- |
| PUR | x | |
| Quick-n-Easy | x | |
| Quicksilver ⁴⁷ * | x | 5,286.60 |
| Reef ⁴⁸ | x | |
| Richard Freeman ⁴⁹ | | |
| Ride, Inc. ⁵⁰ | | 0.00 |
| Riot Kayak | x | |
| Ripzone Co. | x | |
| River Magazine | x | |
| Rocky Mountain Sports Publishing | x | |

⁴⁵ Exhibit BB is a statement to "Wild River Sports" with "Katie" and phone number written on it. It appears to be a corporate debt.

⁴⁶ This creditor filed a proof of claim, and is discussed below.

⁴⁷ In Exhibit J, Debtors stipulated that this was a personal obligation that should be included in their unsecured debts.

⁴⁸ This creditor filed a proof of claim, and is discussed below.

⁴⁹ This creditor was included as a secured creditor in the amended schedules, and the claim is dealt with above.

⁵⁰ This claim was omitted from the amended schedules.

| | | |
|---------------------------------------|---|----------|
| Roger Miller | | 4,000.00 |
| Royal Robbins ⁵¹ | x | |
| Ruffwear | x | |
| Salomon/North America ⁵² * | | --- |
| Santa Fe Pediatric Associates * | | 124.00 |
| Santa Fe Printing ⁵³ | | 0.00 |
| Savage Designs | x | |
| Sea Kayaker | x | |
| Sevylor USA | x | |
| SF Accommodations ⁵⁴ | | 0.00 |
| SF Reporter | x | |
| Simple Shoes | x | |
| South Fork Custom Canoe | x | |
| Southern Directory | x | |
| Sports Helmets | x | |
| SPY | x | |
| Starlight Publishing | x | |

⁵¹ This creditor filed a proof of claim, and is discussed below. Absent the proof of claim, and based on Exhibit K, the Court would have found this to be a corporate debt.

⁵² In Exhibit J, Debtors stipulated that this was a personal obligation that should be included in their unsecured debts. This creditor filed a proof of claim, and is discussed below.

⁵³ This claim was omitted from the amended schedules.

⁵⁴ Ms. Hall-Dudney's trial testimony, contrary to her deposition, was that this was a corporate debt and that there was no personal guarantee. It was originally listed at \$1,200.00 on Schedule F.

| | | |
|---|---|----------|
| Steve Gellis Sports, Inc. ⁵⁵ | | --- |
| Stohlquist Waterware | x | |
| Take It Outside | x | |
| Target * | | 195.00 |
| Teck 9 | x | |
| The Billing Center | x | |
| Thrifty Nickel | x | |
| Thule ⁵⁶ | | 2,706.70 |
| Tim Lopez ⁵⁷ | | 0.00 |
| Transworld Publications ⁵⁸ | x | 104.85 |
| Travel W/ Us ⁵⁹ | | |

⁵⁵ Ms. Hall-Dudney's trial testimony, contrary to her deposition, was that this was a corporate debt and that there was no personal guarantee. It was listed at \$7,660.42 on Schedule F. Creditor did file a proof of claim, however, and the claim is discussed below.

⁵⁶ Debtors stipulated that this debt is includable under 109(e). Exhibit GG is a facsimile letter requesting payment.

⁵⁷ This claim was omitted from the amended schedules. Ms. Hall-Dudney's trial testimony, contrary to her deposition, was that in December, 1998 she and her husband did not owe this debt.

⁵⁸ Exhibit CC is a past due notice addressed to "Heather Hill/Wild River Sports". Ms. Hall-Dudney denied at trial that this was a personal debt. The Court will include this as a 109(e) debt because it is addressed to one of the Debtors individually and thus does not clearly appear to be a corporate debt.

⁵⁹ This claim was omitted from the amended schedules.

| | | |
|---------------------------------|---|-------|
| Turk's Road House ⁶⁰ | | --- |
| US Long Distance ⁶¹ | | 0.00 |
| US West | x | |
| Vans Inc. | x | |
| Wellborn Paints ⁶² | x | |
| Western Bank ⁶³ | | 0.00 |
| Wild Oats ⁶⁴ * | | 51.00 |
| Wildwasser Sport USA | X | |
| Worldwide Outfitter | x | |
| Wyoming Woolens ⁶⁵ | x | |

⁶⁰ Ms. Hall-Dudney testified that this debt was incurred after the original petition was filed, but it was included in an amended Schedule F at \$3,500.00. Generally, this type of debt is not a claim in the chapter 13. See 11 U.S.C. § 348(d) (preconversion claims arising during chapter 11, 12, and 13 are treated as prepetition claims; no similar treatment for claim arising during chapter 7); 11 U.S.C. § 1305(a)(2) (debt arising post-conversion to chapter 13 may in certain circumstances be treated under plan); In re Bottone, 226 B.R. at 294-95. See also 3 Keith M. Lundin, Chapter 13 Bankruptcy § 8.30, at 8-49 (Code is silent concerning treatment of non-priority claims arising during chapter 7 in case subsequently converted to chapter 13.)

⁶¹ This claim was omitted from the amended schedules.

⁶² Exhibit DD is a transmittal letter and copies of NSF checks issued by Wild River Sports, and appears to be a corporate debt. The letter is addressed to "Wild River Sports (Heather)".

⁶³ This claim was omitted from the amended schedules.

⁶⁴ This claim was not listed on Schedule F, but included in Exhibit J as a debt.

⁶⁵ Exhibit EE is a statement addressed to "Wild River Sports" and appears to be a corporate debt.

| | | |
|------------------------------------|---|--------------|
| Your Host New Mexico ⁶⁶ | x | 206.33 |
| Zardoz LLC ⁶⁷ | | 0.00 |
| Zia Publishing | x | _____. |
| Total | | \$ 38,489.03 |

One or both debtors testified that the following debts were corporate debts for which no personal guarantees were issued: Adventure 16, Zardoz, North Sports, B-Line, Obee, Advanta, Air Touch, SF Accommodations, and Steve Gellis. This testimony was questioned (and that questioning at times led the Court to wonder about Ms. Hall-Dudney's testimony about particular debts), but not specifically contradicted. The Court also notes that WEI served subpoenas on many creditors requesting copies of "all credit or account applications, promissory note(s) or any personal guaranty the Dudneys signed." WEI did not introduce at trial any applications, notes, or guarantees signed by the Dudneys.

For the following debts, documented by invoices labeled as Exhibits L through HH, Ms. Hall-Dudney testified at trial

⁶⁶ Debtors stipulated that this debt is includable in 109(e). Exhibit FF is a statement from Your Host.

⁶⁷ Ms. Hall-Dudney testified this was an unguaranteed corporate obligation included as noncontingent in error, in amount of \$1,300.54 on the original schedules. Exhibit HH is a statement to "Wild River Sports" that appears to be a corporate debt.

that they were corporate obligations: Aire, Aloe Up Suncare, Animal USA, Cascade Designs, Dagger Canoe, Earth & Ocean Sports, Extrasport, Five Ten, ICS Books, Lotus Designs, Mad River Canoe, Maravia Corporation, Maywest Manufacturing, NM State Police Association, Northwest River Supplies, Old Town Canoe, Planetary Gear, Transworld Publications, Wellborn Paints (actually a transmittal letter for NSF checks), Wyoming Woolens, Your Host, Thule and Zardo. All of these exhibits are invoices or letters addressed to "Wild River Sports" (with the exception of Lotus Designs, which has no addressee except "Katy"), the d/b/a of the corporation.

The Debtors leased the business premises personally from L-Fam Partners. The original term of the lease was five years. Bill Layden, the manager of L-Fam Partnership, testified at the hearing. He testified that in December, 1998, the debtors owed \$3,300 in back rent, and that after five months he re-rented the premises and at that time the total rent owed was \$16,500. The debtors testified definitively that the lease had been terminated prepetition and that they were placed on a month to month tenancy which did not change once they became current again on the monthly payments. Mr. Layden testified that he may have sent a three-day notice to quit the premises with notice of a month to

month tenancy, but when Debtors cured the rent he believed the lease was again in force. The Court finds for purposes of this hearing that the Debtors had been placed on a month-to-month tenancy and remained that way up to when they vacated the premises.⁶⁸

The Debtors further testified that they had a \$3,300 deposit with the landlord which they had not received back. Under questioning Mr. Layden testified variously that some or all of the deposit was applied to repair of the premises and that he could not recall what happened with the deposit. However, he was clear the deposit was not returned to the Debtors.

The debtors also testified that they had claims back against the landlord or its principals for property damage to a vehicle of theirs. The fact that a debtor might have counterclaims, setoffs, affirmative defenses, or mitigating circumstances does not make the claim contingent because it "does not obviate the basic claim or negate the fundamental right to payment on the claim." In re Clark, 91 B.R. 570, 575 (Bankr. D. Co. 1988).

⁶⁸ This finding, different than the one suggested by the Court during oral argument, is a result of an examination of the Court's and staff attorney's notes in preparing this decision.

A debt is "liquidated" if the amount of the debt is "readily determinable." Slack v. Wilshire Insurance Company (In re Slack), 187 F.3d 1070, 1073 (9th Cir. 1999). A debt is "readily determinable" if it requires only "a simple hearing to determine the amount of a certain debt" as opposed to an "extensive and contested evidentiary hearing in which substantial evidence may be necessary to establish amounts or liability." Id. at 1073-74. See generally In re Drov dall, No. 13-99-11106, Memorandum opinion at 13-16 (Bankr. D. N.M. July 14, 2000). Even after this evidentiary hearing, it is still not clear what the Debtors' liabilities were to L-Fam Partnership, if indeed they owed anything at all. Therefore, estimating generously in favor of WEI, the Court finds, for purposes of this hearing, that the L-Fam Partnership claim was liquidated in the amount of \$3,300 as of the date of the petition, and that the balance of its claim, if any, was unliquidated.

The following proofs of claim are in the record:

| Creditor | Amount |
|-----------------------------|-------------|
| Royal Robbins | \$ 3,658.33 |
| Salomon/North America, Inc. | 31,618.74 |

| | |
|---|----------------------|
| Providian Financial ⁶⁹ | 54.76 |
| Reef Brazil | 1,763.90 |
| De Liesse/ Steven Gellis Sports, Inc. | 7,660.42 |
| Continental Insurance agent for Patagonia | 18,690.44 |
| Adventure 16, Inc. | 1,062.20 |
| Wilderness Exchange, Inc. ⁷⁰ | <u>47,719.09</u> |
| Total | \$ <u>112,227.88</u> |

Debtors dispute that they personally owe several of the creditors that have filed proofs of claim (e.g., Royal Robbins, Patagonia). And while WEI argues, based on inspection of the invoices, that a number of the creditors apparently were unaware of the existence of the corporation and thus billed the Debtors personally, mere ignorance of the existence of the corporation would not be a sufficient basis to pierce the corporate veil, see Scott v. AZL Resources, 107 N.M. 118, 121, 753 P.2d 897, 900 (1988). But disputed debts are counted toward the § 109(e) limitation. See In re Droydall, No. 13-99-11106, at 11. Therefore, even though

⁶⁹ This claim is filed as secured \$808.20 plus unsecured \$54.76, for a total claim of \$862.96. Only the unsecured portion is relevant.

⁷⁰ This claim is filed as secured \$5,715.00 plus unsecured \$47,717.09, for a total claim of \$53,432.09. Only the unsecured portion is relevant.

Debtors dispute liability, the proofs of claim should be counted for § 109(e) eligibility purposes.

In summary, the Court finds that unsecured, nonpriority debts for the purposes of § 109(e) total:

| | Amount |
|--|----------------------|
| Unsecured portion of secured debt | \$ 102,550.00 |
| Schedule E | 2,139.98 |
| Schedule F (not including proofs of claim) | 38,489.03 |
| Lease obligation | 3,300.00 |
| Proofs of Claim | <u>112,227.88</u> |
| Total | \$ <u>258,706.89</u> |

Debtors therefore meet the test of the debt limitation set out in 11 U.S.C. §109(e).

GOOD FAITH

WEI asserts that the motion to convert was filed in bad faith, based on the assertion that, according to Debtors' counsel, it was filed solely to avoid a determination of the adversary proceeding currently pending in this Court, Wilderness Exchange, Inc. v. Brian K. Dudney, No. 99-1125 (Bankr. D. N.M.), in which WEI has challenged both the discharge of the Debtors in general and the dischargeability of any debt specifically owed to WEI. WEI also argues, in effect, that the significant changes in the Debtors'

schedules, each of which were signed under penalty of perjury, evidence bad faith as well as a lack of credibility.

The argument is not well taken. With respect to the second point, as suggested by the discussion above about the credibility of the Debtors and their amendments to the their schedules, this Court does not find evidence of bad faith in the Debtors amending their schedules or testifying differently at their deposition and at trial.

With respect to the first point, WEI ignores other factors that go into the calculation of good faith. The Debtors have encountered significantly changed circumstances since this case has started. Mr. Dudney now has regular income. The Debtors have been through litigation that has been and continues to be both financially and emotionally exhausting. The toll taken by that litigation has been increased by the difficult communications (or lack of communications) accompanying Mr. Arslanian's move from New Mexico to Idaho. Ms. Hall-Dudney, on the date of the evidentiary hearing, was six months pregnant and still suffering nausea; presumably at the conclusion of that pregnancy the Debtors will have a newborn infant to deal with, which in the ordinary course of events will lead to further exhaustion for both Debtors. (Schedule I shows that the

Debtors already had a two year old and a one year old when they filed.)

Even given these changed circumstances, there is no doubt that a major part of the Debtors' motivation in filing the motion to convert is to be rid of the adversary proceeding. Debtors have not denied that. Rather, they argue that they do not have the financial or emotional reserves to continue with that litigation, and given their changed circumstances, they should be allowed to convert.

The Court agrees that the Debtors should be permitted to convert their case. Evaluating the facts of this case in light of Flygare v. Boulden, 709 F.2d 1344, 1347-48 (10th Cir. 1983), the Court finds that the request to convert was filed in good faith. Had the Debtors been eligible for Chapter 13 treatment at the outset of their case, and had their other circumstances not changed, the Court might well look askance on the Debtors defending a non-dischargeability action at length before converting. Such behavior would suggest to the Court that the Debtors had no intention of filing a Chapter 13 case until the last moment, and only after having forced the creditor to spend significant resources. But that is not the case here.

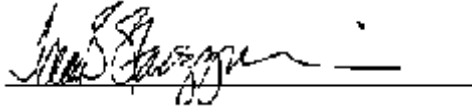
REGULAR INCOME

WEI objects that the Debtors do not qualify for Chapter 13 treatment "because they do not have any disposable income as required by 11 U.S.C. 1325." The eligibility requirements for Chapter 13 are addressed in 11 U.S.C. §109(e), which requires rather that a debtor have "regular income". 11 U.S.C. §101(30) in turn defines "individual with regular income" as an "individual whose income is sufficiently stable and regular to enable such individual to make payments under a plan under chapter 13 of this title,..." Debtors' amended schedules I and J, filed March 22, 2000, doc. 47, show that Mr. Dudney had been employed at Turk's Road House as a cook for six months prior to the filing of the amended schedules. And the amended Schedules I and J show monthly income in excess of expenses of \$141.00. (WEI's objection was filed a month earlier, and therefore understandably did not refer to this employment income.) This Court has confirmed plans with monthly disposable income of less than \$141.00, so on their face, the amended schedules establish sufficiently for eligibility purposes that the Debtors have "regular income". Of course, whether the Debtors will be able to meet the requirements of confirming a plan, including the tests of the best interests of creditors and disposable income, as required by 11 U.S.C. §1325(b), and feasibility, is an issue separate

from the test for eligibility, and can be addressed only when the Debtors have had the opportunity to propose a plan. And the fact that the Debtors did not have this regular income at the outset of the case does not preclude them from now seeking Chapter 13 relief. In re Baird, 228 B.R. 324, 328 (Bankr. M.D. Fla. 1999) (denying motion to dismiss Chapter 13 case; there are various dates at which to determine status of debtor's income); In re Troyer, 24 B.R. 727, 730 (Bankr. N.D. Ohio 1982) (granting motion to dismiss or convert Chapter 13 case on various grounds, but ruling that determination of regular income may be prospective); In re Mozer, 1 B.R. 350, 352 (Bankr. D. Co. 1979) (granting motion to dismiss for lack of regular income, but ruling that determination may be prospective and is not limited to determination on date of petition). Indeed, refusing to permit a debtor who becomes employed during a Chapter 7 case from converting to Chapter 13 would be at odds with the current congressional policy encouraging debtors to repay as much of their debt as possible.

CONCLUSION

The Debtors therefore meet the eligibility requirements set out in § 109(e), and conversion should be allowed. An Order granting the motion will be entered.



Honorable James S. Starzynski
United States Bankruptcy Judge

I hereby certify that, on the date stamped above, a true and correct copy of the foregoing was either electronically transmitted, faxed, delivered or mailed to the listed counsel and parties.

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