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## Chapters 9, 11 and 12 Case Law Update

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## CHAPTER 9

## Chapter 9 Case Law Update

## CHAPTER 9

### ***In re: Barnwell County Hospital, 471 B.R. 849 (Bankr. D.S.C. 2012)***

- eligibility of Debtor for relief under chapter 9 of the Bankruptcy Code challenged.
- Former board member contended that Debtor wrongfully filed for chapter 9 relief because members of the Board who instituted this action were holding such positions in violation of the South Carolina Constitution because the Board members were also members of the Barnwell County Council.
- In addition, eligibility challenged related to whether Debtor was specifically authorized under state law to file chapter 9 petition.

## CHAPTER 9

### ***In re: Barnwell County Hospital, 471 B.R. 849 (Bankr. D.S.C. 2012)***

#### Dual Office Holding:

- South Carolina Constitution generally prohibits an individual from holding two offices of honor or profit at the same time
- Discussion of "ex officio" or "incidental duties" exception to the dual office prohibition which provides that "double or dual office holding in violation of the constitution is not applicable to those officers upon whom other duties relating to their respective offices are placed by law."
- Court held that the incidental duty exception applied, thus, the hospital board's vote to file a chapter 9 petition was not invalid

## CHAPTER 9

### *In re: Barnwell County Hospital, 471 B.R. 849 (Bankr. D.S.C. 2012)*

#### Section 109(c) Issue:

- Section 109(c) sets forth certain requirements with respect to who may be a debtor under chapter 9. Among those requirements, the debtor must be: (1) a municipality; and (2) "specifically authorized in its capacity as a municipality or by name, to be a debtor under such chapter by State law, or by a governmental officer or organization empowered by State law to authorize such entity to be a debtor under such chapter." 11 U.S.C. § 109(c)(1)
- S.C. Code Ann. § 6-1-10 grants municipalities authority to file bankruptcy.
- Debtor, as an instrumentality of the state constitutes a "municipality" as defined by the Bankruptcy Code. Therefore, Debtor is authorized to file for chapter 9 relief.

## CHAPTER 11

# Chapter 11 Case Law Update

## CHAPTER 11

***In re: Hawkins, C/A No. 11-04495-DD (Bankr. D.S.C. February 22, 2013)***

- Secured Creditor asserted the proposed plan was not feasible, not filed in good faith, and did not provide adequate means for implementation.
- Debtor did not have a realtor or marketing plan with respect to his most significant asset- land with timber in Fairfield County. He had no schedule for liquidation of this asset to allow the court or creditors to determine if he was in compliance with the plan. Court also noted none of the property had been sold even though chapter 11 case had been pending for 18 months.
- Plan vested Debtor with “almost unfettered discretion” regarding marketing/sale of Fairfield property.

## CHAPTER 11

***In re: Hawkins, C/A No. 11-04495-DD (Bankr. D.S.C. February 25, 2013)***

- Court denied confirmation because the plan filed to meet requirements of section 1129(a)- not feasible, not proposed in good faith, and fails to provide adequate means for implementation
- Also denied confirmation under section 1129(b) because plan failed to meet one of three conditions in order to be considered fair and equitable with respect to a class of secured claims.

***In re: Hawkins, C/A No. 11-04495-DD, 2012  
Bankr. LEXIS 3973 (Bankr. D.S.C. 2012).***

• **Facts:**

- Debtor initially filed his schedules on July 18, 2011 and listed the Bank's claim on his Schedule F as disputed.
- Debtor amended schedules on September 2, 2011 and failed to check the box that listed the Bank's claim as disputed.
- Bank filed proof of claim approximately three weeks after the deadline and asserted that the claim was an amended claim because Debtor had failed to indicate that the claim was still disputed.

***In re: Hawkins, C/A No. 11-04495-DD, 2012 Bankr. LEXIS  
3973 (Bankr. D.S.C. 2012).***

• **Issue:**

- Whether Bank's failure to file a secured proof of claim before the deadline is excused when Debtor's initial Schedule F listed Bank as an unsecured creditor with a disputed claim, but then did not check the disputed claim box on an amended Schedule F.

• **Holding:**

- When schedules are amended and no longer reflect that a Bank's claim as disputed, then the claim is deemed allowed and it is not necessary for the Bank to file a proof of claim unless it disagreed with the amount listed.
  - *Even when the statement of change does not list the change of the claim from disputed to undisputed, because the statement of change "is not a substitute for the amended schedules."*
- Also, Bank's untimely filed proof of claim should be treated as an amendment because the court has ample discretion and should freely grant an amendment to a proof of claim.

## CHAPTER 11

### ***In re: Low Country Land, LLC, C/A No. 11-07554-DD, 2012 Bankr. LEXIS 4137 (Bankr. D.S.C. 2012)***

- Facts:
  - Debtor's amended plan proposed a sale of assets to an entity whose only members were the son and daughter of the Debtor's members. Also, the proposed sale price was less than the Bank's valuation.
  - Bank first objected that Debtor's members did not have the authority to sell the Debtor's assets because a receiver had been appointed and, in the alternative, could not sell at a price lower than its valuation.
  - Bank also argued that Debtor's plan violated 11 U.S.C. § 1129 because it had not been proposed in good faith. Bank asserted that the plan lacked good faith because it proposed transfer of Debtor's assets to new entity controlled by members' children for less than full value.
    - Note: The difference in value surrounded the fact that Debtor's appraiser did not attribute any value to undeveloped portion of land stating it was excess and had no utility.

## CHAPTER 11

### ***In re: Low Country Land, LLC, C/A No. 11-07554-DD, 2012 Bankr. LEXIS 4137 (Bankr. D.S.C. 2012)***

- Issue 1:
  - Whether, pursuant to S.C. Code Ann. § 33-44-601, members are disassociated from an LLC when the receiver is appointed and therefore lose their authority to sell the debtor's assets?
- Holding:
  - S.C. Code Ann. § 33-44-601(7)(iv) provides that a member's dissociation does *not* occur until a member fails to have an appointment vacated or stayed within 90 days *after* the appointment of the receiver. As a result, members may freely exercise their rights as members until that date.

***In re: Low Country Land, LLC, C/A No. 11-07554-DD, 2012 Bankr. LEXIS 4137 (Bankr. D.S.C. 2012)***

- Issue 2:
  - Whether Debtor's plan was not in good faith because it proposes sale of Debtor's assets to members' children for less than the value of land owned?
- Holding:
  - Because the Bank's appraisal considered the undeveloped portion of land in its appraisal of its value, it was entitled to greater weight and confirmation of the plan was denied.

***In re: Christ Revival Center Church, C/A No. 12-02769-DD, slip op. (Bankr. D.S.C. 2012).***

- Facts:
  - Debtor continually failed to file complete and accurate monthly operating reports since the bankruptcy filing and lacked the income to fund the current plan.
  - Debtor's principal also admitted he had been filing documents without the benefit of counsel after consulting a group of individuals at his church.

## CHAPTER 11

### ***In re: Christ Revival Center Church, C/A No. 12-02769-DD, slip op. (Bankr. D.S.C. 2012).***

- Issue:
  - Whether case should be dismissed from Chapter 11 protection or converted to one under Chapter 7 when the Debtor failed to comply with the court's instructions after the bankruptcy filing and did not have enough income to fund current plan?
- Holding:
  - The Trustee met his burden of proof and established caused under 11 U.S.C. 1112(b)(4)(A), (F), (H).
  - The debtor's refusal to file accurate and complete financial reporting and analysis of what financial information was provided indicated that the debtor's plan was not feasible and confirmation of the plan would result in eventual default and subsequent litigation.
  - Court further held that because the unsecured debt totaled less than \$3,000, the conversion of the case to a case under Chapter 7 would "not serve the best interests of creditors and the [bankruptcy] estate" and, as such, dismissed the case to allow creditors to pursue other remedies

## CHAPTER 11

### ***In re: Clemson Grande Lakefront Condominiums, LLC, 472 B.R. 703 (Bankr. D.S.C. 2012).***

- Facts:
  - Plaintiff filed adversary proceeding against Defendant on January 4, 2012 and deadline for answers passed without response.
  - Plaintiff filed for Default Judgment (though by faulty process and was admonished by the Court) to avoid a fraudulent transfer under 11 U.S.C. § 548(a)(1)(B).
  - The complaint alleged that on December 3, 2007, Plaintiff transferred \$10,000 to Defendants to secure a \$1,200,000 loan.

## CHAPTER 11

### ***In re: Clemson Grande Lakefront Condominiums, LLC, 472 B.R. 703 (Bankr. D.S.C. 2012).***

- Issue:
  - Whether Plaintiff is entitled to a Default Judgment on an adversary proceeding when the complaint seeking to avoid a fraudulent transfer?
  
- Holding:
  - The Motion for Default Judgment is denied because 11 U.S.C. § 548(a)(1)(B) provides that a trustee may avoid any transfer incurred by a debtor that was made or incurred within 2 years before the date of filing the petition.
  
  - The statute also sets forth other requirements; however the court held that the mere fact that the transfer had to have occurred within two years from the date of the bankruptcy petition filing was dispositive and the Plaintiff was not entitled to default judgment.

## CHAPTER 11

### ***In re: Congaree Triton Acquisitions, LLC, C/A No. 12-00456-JW, slip op. (Bankr. D.S.C. 2012).***

- Facts:
  - Movants entered a motion seeking an order for conversion or dismissal of Debtor's case pursuant to 11 U.S.C. § 1112(b)(1).
  
  - Movants asserted in support of its claim:
    - Debtor's books and records were inadequate;
    - Debtor's filed monthly operating reports were misleading;
    - Debtor incurred a significant loss of inventory due to theft;
    - Debtor incurred significant on-going losses since the commencement of the Chapter 11 case;
    - Debtor failed to comply with guidelines set by the Trustee;
    - Debtor made improper payments to insiders prepetition; and
    - Debtor failed to pay certain taxes in a timely fashion;
  
  - Debtor argued there was reasonable justification to excuse its conduct under 11 U.S.C. § 1112(b)(4) and that dismissal or conversion was not in the best interest of the creditors.

***In re: Congaree Triton Acquisitions, LLC, C/A No. 12-00456-JW, slip op. (Bankr. D.S.C. 2012).***

- Issue 1: Cause for Conversion or Dismissal
- Holding:
  - Party seeking order of conversion or dismissal bears the burden of establishing cause.
    - Examples set forth in § 1112(b)(4) are non-exhaustive.
  - Movants satisfied burden by showing cause existed on the following grounds:
    - Substantial or continuing loss to or diminution of the state and the absence of reasonable likelihood of rehabilitation
    - Gross mismanagement of estate
      - Inventory loss,
      - The Debtor's failure to file accurate monthly operating reports,
      - Timely compliance with the Examiner's requests, and
      - Insider payments made from prepetition accounts that "appear[ed] to be unfair to Debtor's other creditors."
    - Failure timely to pay taxes owed
    - Non-enumerated Grounds
      - Failure to fully cooperate with Examiner
      - Failure to file accurate monthly operating reports
      - Prepetition distributions.

***In re: Congaree Triton Acquisitions, LLC, C/A No. 12-00456-JW, slip op. (Bankr. D.S.C. 2012).***

- Issue 2: Debtor's Exceptions to Conversion or Dismissal
- Holding:
  - Burden now shifts to Debtor to show: 1) a reasonable likelihood that a plan will be confirmed; and 2) the ground for granting relief includes conduct (i) for which there exists a reasonable justification and (ii) the conduct will be cured within a reasonable time. 11 U.S.C. § 1112(b)(2).
    - Test is conjunctive.
  - First, court must find "unusual circumstances" that would make dismissing not in the best interest of the creditors and the estate to justify further examination. § 1112(b)(2).
  - Debtor could not provide enough information to satisfy its burden.

## CHAPTER 11

***In re: JK Harris & Co., LLC, 475 B.R. 470 (Bankr. D.S.C. 2012).***

- Debtors filed Amended Schedules which included a cover document entitled, "General Notes and Statement of Limitations, Methodology and Disclaimer Regarding the Debtors' Schedules and Statements" (the "Disclaimer").
- The Disclaimer provides, in pertinent part, that:
  - [B]ecause the Schedules and Statements contain unaudited information that has not otherwise been verified and is subject to further review and potential adjustment, and which comes from unclosed books contained on a computer system controlled by the Chapter 7 Trustee, there can be no assurance that the Schedules and Statements are wholly accurate and complete, the Schedules and Statements shall remain subject to further review and verification by the Debtors as the Court may deem necessary and appropriate.

## CHAPTER 11

***In re: JK Harris & Co., LLC, 475 B.R. 470 (Bankr. D.S.C. 2012).***

- Court held "there should be a showing of compelling circumstances to justify the use of a disclaimer in connection with the filing of schedules and statements."
- Court noted that disclaimer was objected to by Trustee and there were questions about Debtor's cooperation with the Trustee.
- "In addition, a court should not have to parse a lengthy disclaimer to determine whether it has the effect of reducing or qualifying the signer's assurances regarding the veracity of the schedules or statement."
- Court held the Disclaimer should not be allowed as part of Debtors' schedules and statements of financial affairs and that they should be amended

# Chapter 12 Case Law Update

***In re: Sandifer, 448 B.R. 382 (Bankr. D.S.C. 2011).***

• **Facts:**

- Unsecured Creditor filed a motion to dismiss Debtor's Chapter 12 case.
- Debtors are husband and wife. Husband started a farming operation with his son and incorporated under an LLC and elected to treat it as a Subchapter S corporation for tax purposes.
- Unsecured Creditor argued that Debtors do not meet the eligibility requirements for Chapter 12 relief for two reasons:
  - Debtors do not receive more than 50% of their income from farming and do not meet the Chapter 12 income requirement;
  - Debtors have operated at a loss for the last three years and do not have "regular annual income" which is required for a Chapter 12 debtor.

## CHAPTER 12

### ***In re: Sandifer, 448 B.R. 382 (Bankr. D.S.C. 2011).***

- Issue 1:
  - Whether Debtors satisfied the Chapter 12 50% Income Requirement when the Debtors conducted business through an LLC that was treated like an S-Corp. for tax purposes.
- Holding:
  - Court adopted the Internal Revenue code definition for “Gross income” - “all income from whatever source derived.” 26 U.S.C. § 61.
  - For the purposes of the 50% Income Requirement, the LLC’s gross income should pass through to its members and be considered income of those members and not of the LLC, as was argued by the Creditor.
    - Other courts have held that the corporation’s profits (or membership interest) passes through to the shareholders (or members), but the income is retained by the corporation.
  - Court relied on the purpose of Chapter 12 to provide farmers with a chance to save their farms, restructure debt, and continue farming in holding that the Court’s approach to Chapter 12 eligibility issues will be flexible and consider the totality of the circumstances.

## CHAPTER 12

### ***In re: Sandifer, 448 B.R. 382 (Bankr. D.S.C. 2011).***

- Issue 2:
  - Whether Debtors had a regular annual income, as required by the statute, when they showed a monthly deficit and have reported farm income losses for the past two years?
- Holding:
  - Definition of “family farmer with regular annual income” is exceedingly broad and designed to allow almost anyone identified as a family farmer to be eligible for Chapter 12 relief.
  - Court looked to Debtors non-farm income and testimony as to improving financial conditions to hold that they will be able to make Chapter 12 plan payments.

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# QUESTIONS?

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DAVE COVERLY  
"I WAS LOOKING FOR A LITTLE STRONGER  
MISSION STATEMENT THAN THAT."