IN THE UNITED STATES BANKRUPTCY COURT EASTERN DISTRICT OF ARKANSAS LITTLE ROCK DIVISION

IN RE: Mark D. and Peggy L. Schutzius, Debtors 3:03-bk-24233E Chapter 13

ORDER SUSTAINING OBJECTIONS TO CONFIRMATION

Now before the court are two objections to confirmation of the Debtors' chapter 13 plan as

amended on June 5, 2004. Ray Campbell and Ralph Baltz object to the confirmation of Debtors'

plan as not having been filed in good faith, and also because it does not provide for their debts which

they assert should be treated as individual debts of the Debtors, and not strictly debts of the Debtors'

corporation, SGard, Inc. (hereinafter referred to as "SGard"). Simmons First National Bank

(hereinafter "Simmons") also objects to confirmation of the Debtors' plan as not having been filed

in good faith and as exceeding the debt limit allowed in chapter 13 (due to the Debtors' alleged

personal liability on debts owed to Campbell and Baltz). These objections to confirmation were

heard October 20, 2004, at which time the Court took the matters under advisement.

This is a core proceeding under 28 U.S.C. § 157(b)(2)(L), and the Court has jurisdiction to

enter a final ruling in this case. The following constitutes findings of fact and conclusions of law

in accordance with Federal Rule of Bankruptcy Procedure 7052. For the reasons set forth herein,

the Court finds that Debtors are not eligible for relief under chapter 13 of the Bankruptcy Code, and

therefore the objections to confirmation heard on October 20, 2004, are sustained.

¹Simmons raised the eligibility argument at trial and not in its pleadings; however, no objection was made at trial to the addition of this argument or evidence entered in support of it.

FACTS

Debtor has a high school education, two years of college courses in electronics and worked at Hyster Company, a fork lift manufacturer, for 22 years. Debtor worked as a Sales Coordinator the majority of his career and was ultimately promoted to General Manager for the California Southwestern regional branch. Debtor's wife, separate debtor Peggy Schutzius, operates a business called "Skies Unlimited" which according to Debtor, sells dish network receivers, installs and also sells European Satellite Receivers, and does programming and service work to maintain satellites.

SGard

Debtor² is the owner/inventor of a patent for a device called the "SGard" which is used to protect satellite dishes from interference due to the weather. Debtor testified that his patent attorney advised him to set up a corporation and assign the SGard patent to it. Debtor then hired attorney Jim King, who is now deceased, to incorporate SGard and handle the assignment of the patent. The patent was assigned to SGard on July 14, 1997. Accordingly, although Debtor could not remember when SGard was incorporated, it must have been on or before July 14, 1997. Debtor and his wife Peggy are the sole shareholders and officers of SGard. Debtor stated that for the first few years, SGard did no business other than making business contacts and setting up appointments. Debtor testified that SGard has made no profit the past three years, that SGard has not sold anything since May 2003, and that SGard has basically been out of business for about two years. Debtor testified that SGard sold European Satellite Receivers in addition to SGard; these receivers are manufactured in Korea and shipped directly from Korea to the customer's address. Debtor testified that SGard's

²In this Order, "Debtor" refers only to separate Debtor Mark Schutzius because the joint Debtor, Peggy Schutzius, did not testify, and her involvement in these matters was not described at trial.

only employees have been Debtor, his wife, Ethan White, Joe Evertson (who was actually a subcontractor), and Mark Beagle (there is no indication from the testimony at trial that Beagle was working with Debtor or SGard during any of the relevant time periods described in this Order).

After filing bankruptcy, Debtor learned that SGard was not a corporation in good standing. After learning this, Debtor paid franchise taxes for SGard for years 2002, 2003 and 2004, and it is now in good standing. Debtor paid these franchise taxes out of his own personal funds, and plans to pay a CPA for preparation of SGard's tax returns from personal funds as well. Debtor was not sure if SGard had ever filed a tax return, but knew that it had not in at least the past three years. Debtor indicated that he relied on King to handle the filing of tax returns on behalf of SGard, and only learned that the tax returns had not been filed after King's death. Debtor does not anticipate that SGard will owe any taxes in connection with the past returns currently being prepared by a CPA.

SGard had a checking account at First Community Bank; Simmons subpoenaed bank statements from that account from May 1, 2002, through June 8, 2004; however, only statements from May 1, 2002, through September 30, 2002, were produced. Debtor testified that SGard's account was closed at some point but he did not remember when. In any case, from May 1, 2002, through September 30, 2002, there was no activity in this account, and the account maintained a zero balance. Although SGard opened a Merchant Bank Card account with Simmons, which allowed SGard to process credit card purchases and is discussed in more detail below, the checking account given to Simmons for deposits from SGard's credit card transactions was in the name of the Debtors, Mark and Peggy Schutzius, d/b/a Skies Unlimited. That account was at First Community Bank, number 0982187819. This is also the account where Debtor deposited some of the funds received

on SGard's behalf from Baltz and Campbell (specifically, the first two \$2,500 checks on December 23, 2002, less \$500 in cash, and one \$10,000 check from Baltz on March 23, 2004). This is ascertained from the backs of the cleared checks put into evidence.

SGard had an employee, according to Debtor, named Ethan White whom Debtor met while White's brother was in 4-H with Debtor's sons. Debtor testified that White was in his twenties. Debtor was told by a Dr. Hayes that White was very intelligent and good with websites and computers. Debtor did no other background checks on White and made no other inquires about him. White then volunteered to help Debtor create a website for SGard, and Debtor said White later "took care of all my computer work, all my invoices, all the negotiations as far as with customers, the whole – the whole nine yards." However, Debtor testified he never paid White for his services nor discussed compensation with White other than White telling him that he did not want to receive money he had to account for but would rather work it out on an exchange basis. The exchange consisted of Debtor referring website business to White through his business contacts. Debtor testified that he moved SGard's credit card terminal to White's home in August or October of 2002. Debtor testified that White had access to both his personal and business checking accounts, but did not have signing privileges on those accounts. While Debtor testified that he checked on SGard's business at White's home as needed, Debtor admitted that he did not supervise White's work. According to Debtor, White died in December 2003 from complications associated with Multiple Sclerosis.

Debtor testified that SGard tried to have two annual meetings per year, and that he thought he or his wife took minutes and the minutes were kept in the corporate record book at their attorney's office, and that those records were forwarded to an attorney named John Thrush when Jim

King died. Debtor testified that Thrush's office says that Debtor must have picked up the corporate record books because they were not at Thrush's office. Debtor claims they did not pick up the corporate record books. At one point, Debtor testified that he had no books or records for SGard, but that all SGard's records were kept on White's computer. Later, he testified that he does have records of SGard's sales, expenses and checking account statements.

The Baltz & Campbell Loans

Late in December 2002, Debtor approached Baltz and Campbell seeking financing for the production of a steel mold for the SGard. Debtor presented Baltz and Campbell with a purchase order showing that he intended to produce approximately 40,000 SGards, and told them he needed a steel mold to produce that many SGards. Before lending Debtor these amounts, Baltz and Campbell checked with the patent office and confirmed that Debtor had a patent for the SGard. Debtor presented Baltz and Campbell with an invoice from Northern Technologies, Inc. dated December 20, 2002, showing that the mold would cost \$23,000 (the "December 2002 Invoice"). After reviewing the December 2002 Invoice and deciding the amount was appropriate for such a mold, Baltz and Campbell drew up a draft of a contract between themselves and SGard providing such financing and taking certain security interests in the SGard patent and also royalties on SGards sold (the "Contract"). Debtor did not execute the contract individually and made no personal guarantee. Baltz and Campbell advanced some funds to Debtor at the end of December and additional sums were loaned as Debtor told them he needed more money. Baltz testified that on March 24, 2003, Debtor contacted them and indicated that the mold was ready but he could not produce the SGard because the press was not large enough, and that he had found a used press but needed additional financing to go forward with production, and that they each loaned him an

additional \$10,000. Amounts were advanced to Debtor on the dates as indicated on the chart below; the checks were made out to either Mark Schutzius alone or to Mark Schutzius and SGard as indicated; all checks were endorsed by Debtor individually (Debtor testified that he did not know he needed to endorse the checks as president of SGard), with some marked "for deposit" as indicated below.

Date	Baltz	Made To	Endorsed	Campbell	Made To	Endorsed
12/23/02	\$2,500	Schutzius	Schutzius	\$2,500	Schutzius	Schutzius
01/03/03	\$14,500	Schutzius & SGard	Schutzius	\$14,500	Schutzius	Schutzius
01/27/03	\$5,000	Schutzius	Schutzius – for deposit	\$5,000	Schutzius	Schutzius – for deposit
02/05/03				\$5,000	Schutzius	Schutzius – for deposit
02/11/03	\$5,500	Schutzius & SGard	Schutzius – for deposit	\$ 500	Schutzius	Schutzius – for deposit
03/24/03	\$10,000	Schutzius & SGard	Schutzius	\$10,000	Schutzius	Schutzius – for deposit

Pursuant to the Contract, Baltz and Campbell were paid \$900 each in royalties on May 1, 2003, for SGards sold.

After the March 24 advance, Baltz testified that he and Campbell wanted more information but could not get in touch with Debtor. Baltz testified that Campbell then contacted Mr. Bill Williams, president of Northern Technologies Manufacturing Corporation ("Northern Technologies"), and learned that Northern Technologies was not in fact making anything for Debtor, although it was holding a block of steel for Debtor. Williams testified that he had no agreement with Debtor to build a mold for him, although at one time, he had given Debtor a quote

for a mold. Williams confirmed that Northern Technologies was holding a block of steel for Debtor at its Pocahontas plant. According to both Williams and Debtor, Northern Technologies had previously built an aluminum mold for Debtor and SGard. Williams testified that Debtor bought the block of steel for a steel mold and had it delivered to their factory; he estimated such a block of steel would cost approximately \$20,000 to \$25,000. Debtor testified he did not know how much was paid for the block of steel and that he did not deliver it there – that it was purchased through Northern Technologies. Debtor testified that White and Josh Williams handled all the negotiations for the production of the steel mold.

Williams further testified that the December 2002 Invoice was not in fact an invoice from his company and that they had never used an invoice like that; he also pointed out the difference in the company's name – that his company is not "Northern Technologies, Inc." but "Northern Technologies Manufacturing Corporation". A copy of Northern Technologies' actual invoice, which looks nothing like the December 2002 Invoice, was introduced into evidence. Williams testified that the logo on the December 2002 Invoice matched the logo on their website which was developed by Carrie Ludwick at PC Coral with the assistance of White who also worked at PC Coral at that time. Although Baltz testified the December 2002 Invoice was the invoice they reviewed before agreeing to loan SGard funds, Debtor testified that White gave him the invoice to take to Baltz and Campbell when the mold was half-finished.

Debtor testified that the money he received from Baltz and Campbell was put into SGard's account which White managed. Debtor later testified that he did not know exactly which account the money was put into but none of it was deposited in his individual account at Union Planters account. However, by examining the backs of the Baltz and Campbell checks (introduced into

evidence), it appears that all but \$15,000 was in fact deposited in a Union Planters bank. Debtor claimed that some of the checks were cashed and the money given to White either in cash or by check because White needed to pay back some chargebacks³ he incurred on E-Bay. Debtor testified that he believed this money went to Jim Hayes, owner of PC Coral, 4 to whom White owed monies for these E-Bay chargebacks. Debtor also testified that at some point, he learned that White was advertising or selling products on EBay, but that White did not have the items he purported to sell. Debtor indicated that he learned about White's EBay problems after White's death when he "got with" Dr. Hayes (its not clear whether Dr. Hayes and Jim Hayes are the same person). Debtor also testified that he learned about White's E-Bay chargeback problems and other problems with White and his own bank account about three months after presenting the invoice to Baltz and Campbell, and that although he kept White on as an employee, he no longer allowed White to deal with financial matters. He also testified that he first became aware of White taking money from his account when he got an e-mail regarding some monies allegedly paid to the Minister of Finance of Nigeria. Debtor testified he confronted White about it, and White told him he would try and pay him back for a deposit he made using SGard funds to cover a fee for the transaction described in the email (which involved a promise from the Minister of Finance of Nigeria to pay \$10,000,000 in exchange for this fee). Debtor could not clearly testify as to when any of this happened, however.

³A "chargeback" is the action taken by a merchant bank to debit the account of a merchant when a customer disputes a credit card charge.

⁴Hayes and his wife obtained a default judgment against Debtors and SGard in September 2003 for \$121,000, for an unrelated debt incurred in 1999 according to Debtor. This judgment is listed on Debtors' schedules as an undisputed, liquidated, noncontingent unsecured debt.

Simmons Chargebacks

In June 2002, Debtor, on behalf of SGard, opened a Merchant Bank Card account with Simmons to process credit card transactions, and in connection with that account, signed a personal guarantee. Prior to June 2002, SGard had a merchant account with Simmons through Planters Bank in Pocahontas, and when that bank was purchased, chose to continue its relationship with Simmons and opened a new account at Simmons. The Merchant Bank Card account allowed SGard to accept credit card payments for the merchandise it sold. SGard was given a credit card terminal which was initially placed in Debtor's residence, and SGard would run credit card numbers through the terminal to place charges. It should be noted that Debtor testified that he did not know how to place credit card transactions on the terminal without getting help over the phone. It was Simmons understanding that these transactions would be "non-card present" – that is, SGard would manually enter the credit card numbers and would not actually have in its possession the customer's credit card (such that it could compare the customer's signature with that on a receipt). Simmons would then credit the payment to the account at First Community Bank in the name of Debtors d/b/a Skies Unlimited. The customer's credit card company would then forward the necessary funds to Simmons to cover the transaction. A "chargeback" occurs when the customer or holder of the credit card disputes the charges, and the customer's credit card company refuses to forward funds to the merchant bank. The merchant bank then pulls funds back out of the account holder's bank account to cover the chargeback.

Prior to June 2002, Billy Smith, who is in charge of Simmons' Merchant Service Department, testified that SGard had no unusual chargebacks nor an unusual number of chargebacks, and when it did have a chargeback, handled it properly. According to Smith, the first unusual

chargeback on SGard's account occurred in October 2002 when SGard attempted to place an internet credit card transaction; because SGard was not set up to accept credit card purchases through the internet, Smith spoke to Debtor who said he would not do that again. The next unusual incident with respect to chargebacks and SGard occurred on April 11, 2003. On that date, Smith noticed that SGard had placed eight transactions for the same dollar amount from the same bank (i.e., the bank issuing the credit cards) as identified through the bank's "BIN" or Bank Identification Number. (It should be noted here that Debtor testified he did not know what a BIN was.) Smith testified that such transactions normally indicate fraud. The transactions were for \$5,000 each, and the issuing credit card bank was located in Turkey. Smith contacted Debtor and told him the transactions would not be processed because no one at the Turkey bank could verify that they were authorized credit card transactions; Smith informed Debtor that he should not ship the purchased merchandise if he had not done so already. On May 23, 2003, Smith noticed that some of the same credit card numbers had been used again but for different amounts, along with some other credit card numbers from an issuing bank in Milan, Italy that appeared suspicious. Smith confirmed that at least one of the Milan, Italy credit card transactions was unauthorized. Smith had some trouble contacting Debtor this time, but when he did, he told Debtor that the same credit card numbers should not have been run through again, and Debtor responded that the ladies in his office must have run them through. On June 20, 2003, Debtor put a stop payment on the checking account at First Community Bank where Simmons deposited monies from credit card transactions and where Simmons would pull back monies from transactions that were "charged back." Thus, Simmons was unable to get the monies back that it had previously deposited in Debtors' account for these transactions, and at that point, Simmons disconnected SGard's credit card terminal. Smith testified that between June 11,

2002, and May 20, 2003, approximately \$13,000 in good charges and approximately \$36,000 in bad charges were run through the credit card terminal.

Smith then arranged a meeting with Debtor and John Raimer, Smith's immediate boss in the Merchant Service Department. This meeting took place on June 27, 2003, at Simmons Bank. Debtor claimed he needed to run some more purchases through the merchant account, and Simmons agreed to reconnect the credit card terminal to allow him to do that. However, Simmons required him to open a checking account for SGard at their bank so they could monitor funds in and out of the account. Simmons agreed to keep some money to pay itself back for the chargebacks and to allow Debtor to keep some money to operate his business. To explain the chargebacks, Debtor stated that a gentleman from England, Joe Evertson, whom he met at a Consumer Electronic Show in Las Vegas, was responsible for the transactions that were charged back, and that Evertson was getting the credit card numbers and customers' signatures while selling European Satellite Receivers at shows in England, and that Debtor would provide Simmons with copies of the sales drafts from these sales. However, Debtor never provided Simmons with such sales drafts. Debtor also testified that he believed a man in Ghana might be behind the suspicious charges after examining records of credit card purchases on White's computer. Debtor testified that four months after the charges were made, they came back so he put a stop payment on his account. At that time, June 2003, he took White's money privileges away. Debtor testified that he also stopped doing business altogether because he wanted proof that all credit card transactions were authorized so that he would not incur any more chargebacks, and obtaining such proof was not possible in his line of business. Although the credit card terminal was turned on again after the June 27, 2003 meeting with Simmons, no charges were made since then.

The Debtors' Bankruptcy

Debtor and his wife filed bankruptcy on November 25, 2003. Due to multiple objections to confirmation, including the two at issue here, the Debtors' plan has not been confirmed. Their schedules listed a total of \$320,244.85 in unsecured debt, including \$70,000 owed to Baltz and Campbell (which was listed as a joint debt of the Debtors). Their schedules reflected another \$92,706 of unsecured debt representing the undersecured portion of secured debts (based on the amounts owed and values listed only on Debtors' schedules – not claims filed). Debtor valued his and his wife's interest in SGard at a total of \$200 on their bankruptcy schedules; he testified he did not know how this value was determined. The patent is listed on Debtor's bankruptcy schedules with a value of \$500. The \$500 value was determined, according to Debtor, after discussing the value with a loan officer at First Community Bank. He claimed the patent was not worth much because SGard was not operating and putting the product into the market. Debtor testified that he had some talks with individuals regarding purchasing the patent, but has not pursued it in the past year and a half. Debtor did not include the block of steel held for SGard on his bankruptcy schedules. He claimed this was an unintentional omission.

Baltz and Campbell filed unsecured claims on January 10, 2004, and filed their first objection to confirmation on January 22, 2004 (which was continued by agreement four times until finally withdrawn after Baltz and Campbell filed a second objection to confirmation which was set for a later date). The Trustee filed an objection to confirmation on January 26, 2004, which challenged the Debtors' eligibility based on the amount of unsecured debt reflected in their schedules. This objection was announced as settled in Court on April 7, 2004, and an Order sustaining the Trustee's objection and requiring the Debtors to modify their plan was entered on

April 8, 2004. No modification was filed, and the Trustee filed a motion to dismiss for failure to modify (docket #77) which was announced as settled on May 24, 2004, and subsequently withdrawn (by order belatedly entered February 7, 2005). The Trustee also filed a motion to dismiss on May 17, 2004 (docket #84), which again challenged the Debtors' eligibility based on the amount of unsecured debt reflected in their schedules. On June 5, 2004, Debtors filed an amended chapter 13 plan which altered the treatment of certain secured creditors and removed Baltz and Campbell as creditors of the Debtors, claiming that they were creditors of SGard instead. The Debtors did not, however, file amended schedules reflecting this change. On June 21, 2004, an Order was entered withdrawing the Trustee's motion to dismiss.

The Trustee filed another objection to confirmation including the same challenge to Debtors' eligibility on June 28, 2004, which was sustained by Order dated August 3, 2004, requiring Debtors to modify their plan within thirty days. On October 8, 2004, the Trustee filed a motion to dismiss alleging that Debtors' plan had not been modified in accordance with the August 3, 2004 Order; that motion to dismiss is still pending. Pursuant to the Trustee's Motion Combined With An Order Allowing Claims, entered on September 8, 2005, Baltz and Campbell each have an allowed unsecured claim for \$37,500 in this case. Baltz and Campbell filed a second objection to confirmation on June 15, 2004, which was subsequently continued until October 20 and is the subject of this Order.

LAW AND ANALYSIS

Good Faith Objection to Confirmation & Discharging Otherwise Nondischargeable Debts in a Chapter 13

Although the creditors demonstrated that the debts owed them would almost certainly be nondischargeable in a chapter 7 case (having been incurred under false pretenses or through actual

fraud), the nondischargeability of debts under Chapter 7 is only one of several factors to be examined in determining whether a debtor has filed a chapter 13 plan in good faith. In sum, a creditor has to show that the plan itself was not filed in good faith, not that underlying debts were incurred fraudulently or in bad faith. The Court finds the testimony of Debtor Mark Schutzius patently incredible. However, while the Debtor's lack of credibility is a factor that could illustrate bad faith in filing a chapter 13 plan, this factor, even when combined with the attempted discharge of otherwise nondischargeable debts, is not enough to warrant a finding that the plan was not filed in good faith. See In re Wilcox, 251 B.R. 59 (Bankr. E.D. Ark. 2000) (Mixon, J.) (containing a thorough review of the relevant Eighth Circuit case law concerning good faith in filing chapter 13). There was no evidence introduced that Debtors did not sincerely intend to pay their debts according to the plan they filed or were otherwise untruthful in their schedules. Accordingly, the Court does not find that the Debtors' plan was filed in bad faith solely because Debtor Mark Schutzius was not a credible witness and is attempting to discharge debts that would most likely be nondischargeable in a chapter 7 case. However, the Court finds, as explained below, that Debtors are ineligible for relief under chapter 13 of the Bankruptcy Code.

Chapter 13 Eligibility Based on Debtors' Schedules and Statement of Financial Affairs

Pursuant to 11 U.S.C. § 109(e), only an individual (or an individual and his or her spouse) with regular income may be a debtor under chapter 13 subject to certain debt limitations. One limitation is that an individual (or an individual and his or her spouse) must have less than \$290,525 in noncontingent, liquidated, unsecured debts. In determining whether an individual is eligible for chapter 13 relief, the Court should rely primarily on the information provided in the debtor's schedules, provided such schedules were filed in good faith. *See Barcal v. Laughlin (In re Barcal)*,

213 B.R. 1008, 1015 (B.A.P. 8th Cir. 1997) (*citing Comprehensive Accounting Corporation v. Pearson (In re Pearson)*, 773 F.2d 751 (6th Cir. 1985)). *See also Gould v. Gregg, Hart, Farris & Rutledge*, 137 B.R. 761, 765 (W.D. Ark. 1992) (generally agreeing with *Pearson* but holding that the Court is not bound by Debtor's schedules even if they are filed in good faith). Eligibility under chapter 13 should be determined at the time the debtor's schedules are filed, and generally, postpetition events, such as amendments to schedules, should not be considered. *See In re Rigdon*, 94 B.R. 602, 604 (Bankr. W.D. Mo. 1988). However, if amendments to schedules are considered for eligibility purposes, it follows that such amendments must also be filed in good faith just as the initial schedules must be.

The Debtors schedules, which have never been amended, show that they are ineligible for chapter 13 relief. Nevertheless, the parties in this case seem to have accepted the Debtors' amended plan as amended schedules effectively removing the unsecured debt owed to Baltz and Campbell and thereby creating chapter 13 eligibility for the Debtors. The Court questions whether a proposed

⁵Because some courts consider certain post-petition events in determining eligibility but not all post-petition events, whether amended schedules may be considered in determining chapter 13 eligibility depends on the circumstances of each case. See e.g., Soderlund v. Cohen (In re Soderlund), 236 B.R. 271 (B.A.P. 9th Cir. 1999) (court looked beyond debtor's amended schedules where debtor filed three versions of schedules reducing noncontingent unsecured debt; instead, court considered allowed unsecured claims to which debtor did not object as well as conflicting statements in debtor's plan regarding the amount of his unsecured debt); In re Hatzenbuehler, 282 B.R. 828 (Bankr. N.D. Tex. 2002) (court considered amended schedules correcting mistaken classification of debt as unsecured, which were filed 12 days after petition, but court would not consider post-petition reclassification of debt as noncontingent due to settlement of claim); In re Hanson, 282 B.R. 240 (D. Colo. 2002) (court found debtor ineligible for chapter 13 relief where debtor listed judgment liens as unsecured and only amended his schedules to show debt as secured when his eligibility under Chapter 13 was challenged; Debtor also failed to amend his plan to pay these creditors as secured, and their liens were clearly subject to avoidance); In re Faulhaber, 269 B.R. 348 (Bankr. W.D. Mich. 2001) (court considered amended schedules upon conversion to chapter 13).

amended or modified plan can act as a substitute for amended schedules; however, assuming for purposes of this Order only that an amended plan might effectively reduce a chapter 13 debtor's unsecured debt, the Court holds that, under the circumstances of this case, the Debtors' attempt to create eligibility by filing an amended plan is not in good faith, and must therefore fail.

In this case, the Debtors filed their petition and schedules on November 25, 2003, listing the debts owed to Baltz and Campbell as joint unsecured debts of the Debtors. Debtors never amended these schedules but attempted to remove Baltz and Campbell as unsecured creditors by filing an amended plan more than seven months after filing bankruptcy. Specifically, Debtors chose to invoke the corporate shield of SGard (by filing the amended plan on June 5, 2004) after the Trustee filed an objection to confirmation (on January 26, 2004) and a motion to dismiss (on May 17, 2004), both of which challenged the Debtors' eligibility based on the amount of unsecured debt reflected in their schedules. Baltz and Campbell had also filed an objection to confirmation on January 22, 2004. It appears that Debtors only amended their chapter 13 plan on June 5, 2004, to remove Baltz and Campbell as creditors. Debtors also failed to object to the unsecured claims filed by Baltz and Campbell on January 10, 2004, which were subsequently allowed by the Trustee's Motion and Order Allowing Claims entered on September 8, 2004.

In light of the applicable law and these facts, the Court finds that the Debtors are not eligible for relief under chapter 13. Debtors' initial schedules clearly indicated that the Debtors' unsecured debt exceeded the applicable chapter 13 limitation. Debtors' attempt to lower their unsecured debt via an amended plan is not in good faith under these circumstances. Debtors, who have never filed amended schedules, filed an amended plan removing Baltz and Campbell's unsecured debt seven months after filing bankruptcy, filed such amended plan only in the face of multiple eligibility

challenges, and failed to object to Baltz and Campbell's unsecured claims in their bankruptcy. Accordingly, their attempt to cure the excessive unsecured debt listed on their schedules by filing an amended plan must fail, and the Court may determine their eligibility based on the schedules they initially filed. However, due to the posture of this case, particularly the length of time it has been pending,⁶ and the fact that evidence has been submitted to the Court seeking a determination of the Debtor's individual liability on the debt to Baltz and Campbell, the Court may also determine the Debtor's individual liability at this stage.

Debtors Are Ineligible Due to Debtor's Individual Liability on SGard's Debts

It is undisputed that the loans to Debtor Mark Schutzius by Baltz and Campbell were made according to a contract between Baltz and Campbell and SGard, rather than the Debtors individually. However, the creditors assert that SGard is merely the alter ego of Debtor, and accordingly, Debtor should be held responsible for debts incurred by SGard. With respect to disregarding the corporate form, the Arkansas Court of Appeals recently held:

It is a nearly universal rule that a corporation and its stockholders are separate and distinct entities, even though a stockholder may own the majority of the stock. In special circumstances, the court will disregard the corporate facade when the corporate form has been illegally abused to the injury of a third party. The conditions under which the corporate entity may be disregarded or looked upon as the alter ego of the principal stockholder vary according to the circumstances of each case. The doctrine of piercing the corporate veil is founded in equity and is applied when the facts warrant its application to prevent an injustice. Piercing the fiction of a corporate entity should be applied with great caution.

Quinn-Matchet Partners, Inc. v. Parker Corp., Inc., 147 S.W.3d 703 (Ark. App. 2004) (citations omitted). It is not necessary for the Court to make any actual finding that Debtor committed fraud

⁶The Court notes that the Debtors have received the benefit of the automatic stay since filing bankruptcy on November 25, 2003.

in order to hold him personally liable for SGard debts. *See Heating & Air Specialists, Inc. v. Jones*, 180 F.3d 923, 935 (8th Cir. 1999) (*citing Arkansas Bank & Trust Co. v. Douglass*, 318 Ark. 457 (1994)). In *Heating & Air Specialists*, the Eighth Circuit found sufficient evidence supported the lower court's finding that the shareholder was "siphoning funds from the faltering company for his own personal expenses to the detriment of its creditors." *Id.* at 936. The Court further stated, "To permit a shareholder to use the corporate form as a shield in such circumstances would unjustly elevate the corporate fiction over the substantive relationships between the parties." *Id.* In that case, the evidence showed that the shareholder was paid thousands of dollars in dividends while the company had a deficit in earnings; the shareholder's salary was far above the average for managers of similar businesses; the company gave the shareholder blank expense checks which were never documented, and the company paid the shareholder's credit card bills and supplied him with a boat, and two cars for his personal use. *Id.*

Like the shareholder in the *Heating & Air* case, the Court finds that Debtor ignored the corporate form of SGard to such an extent that its corporate status was in fact a fiction that cannot be allowed to shield him from personal liability on debts incurred by SGard. The Debtor's lack of credibility coupled with his failure to account for large sums paid to SGard or to produce any evidence that SGard was a legitimate business, weighs heavily in deciding whether his corporation, SGard, was a valid corporation with a separate existence or merely an alter ego of himself. Debtor not only contradicted himself on numerous occasions, but failed to adequately explain any of the events about which he testified. At best, his testimony would indicate he had no clue as to what was going on with his business, and that instead, White, an unpaid employee in his early twenties, who is now deceased, managed SGard and conducted all of its business (such as negotiating the

production of a steel mold). Debtor would also have the Court believe that SGard's former attorney, Jim King (also deceased), made all decisions regarding whether SGard would file a tax return and kept control of its corporate record books (which have also disappeared, like the \$75,000 loaned to Debtor by Baltz and Campbell). Yet, Debtor's version of events defies logic. The only logical conclusion that can be drawn from the facts presented at trial is that SGard was a shell corporation created for the sole purpose of assigning the SGard patent to a corporation, that if Debtor ever engaged in any business on behalf of SGard, it was sporadic in nature, and the corporate form of SGard was not respected even while any such business activities were conducted.

The testimony and documentary evidence introduced at trial revealed little evidence that SGard has ever conducted business operations. Debtor admitted that SGard has made no profit in the past three years, has been out of business the past two years, and did no business whatsoever the first few years of its existence. This implies that SGard at most conducted some business between 2000 and 2002. It does appear that Debtor was involved in the sale of some merchandise, perhaps the sale of European Satellite Receivers and some SGards (produced with an aluminum mold). Some valid charges appear to have been run through the credit card terminal provided by Simmons, according to Smith's testimony. Additionally, SGard did in fact have an aluminum mold made on its behalf, and presumably sold some SGards on which it paid royalties to Baltz and Campbell in May 2003. Nonetheless, the fact that Debtor may have sold some SGards or conducted some business in SGard's name does not negate the fact that Debtor ignored the corporate form of SGard.

There is no evidence SGard has ever maintained a checking account or kept its monies separate from the Debtors or their sole proprietorship, Skies Unlimited. Even though Simmons subpoenaed SGard's bank records from May 2002 through June 2004, the only records produced

indicated that the account in SGard's name maintained a zero balance and had absolutely no activity between May 2002 and September 2002 (at which time it was presumably closed by the bank according to Debtor). Debtor had no other banking accounts besides the one at First Community Bank in the name of himself and his wife d/b/a Skies Unlimited, and an individual account at Union Planters. Funds received on behalf of SGard from Baltz and Campbell were deposited, according to the backs of the cleared checks, into the First Community Bank account or the Union Planters account (even though Debtor was fairly certain NONE of the loan proceeds were deposited in the Union Planters account). The checking account Debtor designated as the recipient of credit card transactions on SGard's merchant bank account with Simmons was the Skies Unlimited account, not a separate SGard account. Additionally, according to Debtor's testimony and Debtor's schedules, SGard has virtually no assets other than the SGard patent and a block of steel located at Northern Technologies' Pocahontas plant. Debtor testified he personally paid SGard's corporate franchise taxes after filing bankruptcy and plans to pay for the preparation of SGard's tax returns.

Debtor's total ignorance regarding the operations of SGard also leads the Court to conclude that SGard was not in fact a legitimate operational corporation. While Debtor maintained a merchant banking relationship with Simmons in the name of SGard, Debtor did not even know how to run credit card transactions through its credit card terminal without phone help – yet, he did not explain that someone else, such as another employee, performed these functions and otherwise managed the business before he inexplicably turned all business matters over to White, an unpaid individual barely in his twenties with no business experience whom Debtor admitted he did not supervise. Debtor also claims to have had no idea that SGard had failed to pay corporate franchise taxes for three years, and Debtor pleads ignorance with respect to the filing of corporate tax returns

– alleging that he did not realize the tax returns had not been filed until after his former attorney's death. Given Debtor's business experience as general manager for a regional branch of a fork lift manufacturer, his alleged hands-off approach to the operation and management of SGard is simply not credible.

Finally, and most importantly, Debtor used the corporate form of SGard to obtain a \$75,000 loan from Baltz and Campbell, misrepresenting to Baltz and Campbell that SGard had engaged Northern Technologies to produce a steel mold on SGard's behalf and presenting Baltz and Campbell with a fake invoice from Northern Technologies regarding the production of such a steel mold. And while Debtor alleges to have innocently made such misrepresentations, again having relied on White regarding the production of the mold and the legitimacy of the invoice, Debtor obtained these funds on behalf of SGard, yet did nothing with them in furtherance of SGard's business in general, or the purpose of the Contract with Baltz and Campbell in particular (i.e., the production of a steel mold). Instead, the money just disappeared. Again, Debtor's ignorance is incredulous – how could Debtor not know what happened to \$75,000 loaned to his alleged corporation? Debtor implies that White, who had access to his checking accounts but no signatory authority (the ability of White to obtain funds from the accounts without such authority was not explained by Debtor), may have taken some of the money, and that Debtor simply handed over some of the money to White, without recalling exactly how much, or whether it was in the form of cash or a check.

Given the evidence presented on October 20, the Court finds that Debtor abused the corporate form of SGard, and accordingly, SGard is the alter ego of Debtor such that Debtor is personally liable for any debts incurred by SGard. As a consequence, even if the Court had not found

that Debtors lacked chapter 13 eligibility on the face of their schedules and that the filing of the amended plan was a bad faith attempt at curing such schedules, Debtors were not eligible for chapter 13 relief because their unsecured debts did in fact exceed the applicable debt limitation found in § 109 at the time they filed.

CONCLUSION

In determining whether the Debtors' plan was filed in good faith, evidence relating to the Debtor's fraud in incurring the debts at issue is not sufficient to find that the plan itself was filed in bad faith, even when coupled with the lack of credibility on separate Debtor Mark Schutzius' part. However, under the specific facts presented in this case, the Court finds that the Debtors' bad faith attempt to create eligibility by filing an amended plan omitting creditors Baltz and Campbell failed to cure their initial schedules which listed too much unsecured debt for chapter 13 eligibility purposes. The Court further finds, given the evidence presented, that SGard is in fact the alter ego of the Debtor, and accordingly, the Debtor cannot escape personal liability on debts incurred by SGard. As a result, at the time of filing, the Debtors exceeded the debt limit allowed in a chapter 13 bankruptcy case under 11 U.S.C. § 109(e), and are therefore, not eligible for relief under chapter 13 of the Bankruptcy Code. Accordingly, the Court sustains the objections to confirmation filed by creditors Baltz, Campbell and Simmons, and the Debtors have fifteen (15) days from the entry of this Order in which they must move to dismiss this case or convert it to a case under Chapter 7.

For these reasons, it is hereby

ORDERED that the Second Objection to Modified Plan filed by Baltz and Campbell is **SUSTAINED**; it is further

ORDERED that the Objection to Confirmation filed by Simmons is **SUSTAINED**; and it

is further

ORDERED that the Debtors have fifteen (15) days from the entry of this Order in which they must move to dismiss this case or convert it to a case under Chapter 7.

IT IS SO ORDERED.

HONORABLE AUDREY R. EVANS UNITED STATES BANKRUPTCY JUDGE

andrey REwes

DATED: February 10, 2005

cc: Mike DeLoache, attorney for Debtors Warren Dupwe, attorney for Baltz and Campbell Rosalind Mouser, attorney for Simmons David Coop, Chapter 13 Trustee