

**UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW HAMPSHIRE**

In re:

Bk. No. 01-12120-JMD
Chapter 7

Walter M. Marsico, Sr.,
Debtor

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MEMORANDUM OPINION

I. INTRODUCTION

On May 30, 2003, the Court held a hearing on an Application for Administrative Expenses (Doc. No. 115) and Motion to Dismiss Case (Doc. No. 153) filed by Canopache Cottages Association and Walter Morgner, Jr. (the “Creditors”). The Creditors, pursuant to sections

105(a), 349(a) and 707(a)¹ of the Bankruptcy Code, have requested that the Debtor's case be dismissed as a bad faith filing. The Creditors have further requested that such dismissal: (1) be with prejudice to the refiling by the Debtor of any bankruptcy petition; (2) be subject to a prohibition against the Debtor's refiling any bankruptcy petition for a year; (3) provide for compensation in the amount of \$3,690 to the Chapter 7 Trustee and his counsel, to be paid from the funds currently held by the Chapter 13 Trustee and (4) be accompanied by an in rem order allocating the remainder of the funds held by the Chapter 13 Trustee in equal amounts to the moving Creditors.

This Court has jurisdiction of the subject matter and the parties pursuant to 28 U.S.C. §§ 1334 and 157(a) and the "Standing Order of Referral of Title 11 Proceedings to the United States Bankruptcy Court for the District of New Hampshire," dated January 18, 1994 (DiClerico, C.J.). This is a core proceeding in accordance with 28 U.S.C. § 157(b).

II. FACTS

The Debtor has had a long and tortured history with this Court spanning three years, consisting of two separate bankruptcy filings and producing three judicial opinions. Because of the convoluted chronology of this case, the Court will only discuss the facts relevant to the issue of a bad faith filing. Further elaborations on the facts of this case are contained in In re Marsico, 2001 BNH 47 ("Marsico I"), In re Marsico, 2002 BNH 15 ("Marsico II"), and In re Marsico, 2002 BNH 34 ("Marsico III"). The Creditors have alleged that the Debtor and his wife Beverly Marsico (the "Spouse") have acted in concert to defraud the Debtor's creditors. Accordingly, the

¹ Unless otherwise indicated, all references to "section" refer to Title 11 of the United States Code.

Court must examine evidence regarding both the Debtor's actions in this Court and the Spouse's actions in various New Jersey courts.

A. Time Line

On January 19, 2000, the Debtor filed his first Chapter 13 bankruptcy petition with this Court. See Bk. No. 00-10112-JMD. On March 23, 2001, the Debtor's case was dismissed on motion by the Chapter 13 Trustee. Bk. No. 00-10112-JMD, Doc. No. 87.

On April 11, 2001, his Spouse filed a "Certification" with a New Jersey state court in an attempt to adjourn a foreclosure sale of her home in New Jersey.² Exhibit 121.³ The first paragraph of the Certification states:

This Certification is submitted in support of an application by my husband, Walter Marsico, and me for an Order to Show Cause which requests that the Court adjourn the sale set for April 16, 2001, until further order of the Court and at least until I can file a motion to vacate judgment.

Exhibit 121. Paragraph four states that, "We own a home out of state. It has equity in excess of the amount the plaintiff now says we are behind." Then in paragraph five the Spouse states that:

Another reason that this judgment should be set aside relates to my husband. I do not know exactly what rights he has because the property is in my name alone. We live together and I certainly have looked upon the house and his right to live there as something I agreed to and would respect.

² The court caption on the Certification lists Walter Marsico, the Debtor, as a co-defendant. In addition, attached to the Certification is a "letter brief" submitted by an attorney on behalf of the Debtor and the Spouse. Paragraph A of the letter brief states that there is "equity in another home which could be applied to defendant's obligation . . . [on their New Jersey residence]."

³ The April 11, 2001, New Jersey state court Certification was subsequently attached to a bankruptcy court pleading dated April 12, 2002 filed by the Spouse in the District of New Jersey. The Court notes that there has been some confusion over this document. The Debtor's counsel at the May 30, 2003, hearing and in various pleadings incorrectly stated that the Certification was actually signed on April 11, 2002, relying on the Bankruptcy Court date stamp, however, a thorough reading of the Certification reveals that the Spouse was trying to adjourn a foreclosure sale from commencing on April 16, 2001. The Court finds that the Certification was signed on April 11, 2001, or one year before it was filed as an attachment to a pleading in the bankruptcy court in the District of New Jersey.

Exhibit 121. In paragraph thirty the Spouse states, “My husband, our children and I have resided in the house [the New Jersey Property] and have a longstanding history with it.” What is even more interesting is the statement contained in paragraph thirty-one:

My husband suffers from a condition that has caused his eyesight to deteriorate and he is now legally blind. He was treated in New England and we were staying for extended periods of time in the New England area. We fixed up the house we own in New Hampshire. We are willing to turn over whatever the proceeds are of the sale of that property directly to the bank. In addition, now that we are back in New Jersey we have entered into an arrangement where my husband and I can work together in a business similar to what we have done before.

Exhibit 121.

On June 22, 2001, two months after the Spouse filed the Certification, the Debtor filed his second Chapter 13 bankruptcy petition with this Court. On July 12, 2001, the Debtor filed a Motion to Sell the Property (Doc. No. 5) and an Emergency Motion to Reduce Time and Schedule a Hearing on the Motion to Sell (Doc. No. 7). A hearing was held on July 19, 2001, and the Court granted the Debtor’s Motion to Sell the Property. Doc. No. 15. The New Hampshire Property was subsequently sold and resulted in net proceeds in the amount of \$31,338.07 which has since been held by the Chapter 13 Trustee, pending further order of this Court.

Additionally, on July 19, 2001, the Debtor filed his schedules and statements. Doc. No. 10. In Schedules I and J the Debtor used his Spouse’s income in order to create enough disposable income to qualify for Chapter 13. Id. In Schedule C, the Debtor claimed a homestead exemption in the house he owned in Wolfeboro, New Hampshire (the “New Hampshire Property”) pursuant to section 522(b)(2) and the New Hampshire Revised Statutes Annotated, Chapter 480 (the “State Exemption”).⁴ The Creditors objected to the State Exemption on the ground that the Debtor was

⁴ The Debtor actually claimed the State Exemption for himself and his non-debtor spouse.

not domiciled in New Hampshire. After an evidentiary hearing the Court issued a memorandum opinion dated December 10, 2001, sustaining the objection to the State Exemption on the ground that the Debtor was not a domiciliary of New Hampshire. See Marsico I.

On December 12, 2001, the Spouse filed a Chapter 13 petition with the United States Bankruptcy Court for the District of New Jersey. See Exhibit 119. In Schedules I and J the Spouse used the Debtor's income in order to create enough disposable income to qualify for Chapter 13. Id. Additionally, the Spouse claimed a federal exemption in the New Jersey Property for herself and for the Debtor. Id.

In response to the Court's decision in Marsico I., on December 21, 2001, the Debtor filed an amendment to Schedule C and claimed a federal exemption in the New Hampshire Property pursuant to section 522(d)(1) (the "Federal Exemption"). Doc. No. 62. The Creditors again objected. The Creditors claimed that the Debtor could not claim an exemption in the New Hampshire Property because the Court had previously ruled that the Debtor was not domiciled in New Hampshire. The Debtor contended that the terms "residence" and "domicile" have two separate meanings under the Bankruptcy Code and that this Court's ruling in Marsico I did not preclude the Debtor from claiming the Federal Exemption. On April 26, 2002, the Court issued a memorandum opinion wherein it determined that the meaning of the word "residence" for purposes of the Federal Exemption was not identical to the meaning of the word "domicile" for purposes of the State Exemption. See Marsico II. Based upon the factual record in Marsico I, the Court held that as of the end of 2000 the Debtor either had not established the New Hampshire Property as his residence or had abandoned the New Hampshire Property as his residence. See id. The Court left for further evidentiary hearing the question of whether the Debtor had established or abandoned the

New Hampshire Property as his residence after 2000 and before the commencement of this case. See Marsico III.

Meanwhile, on February 22, 2002, the Debtor's case was converted to Chapter 7 by motion of the Chapter 13 Trustee. Doc. No. 76. At the Motion to Convert hearing the Chapter 13 Trustee stated that the Debtor only made one plan payment since the plan was filed on July 27, 2001. See Doc. No. 21.

On April 12, 2002, the Spouse filed in her bankruptcy case in New Jersey an Answer and Objection to Movant's [Homeside Lending] Motion for Relief From Automatic Stay (the "Answer"). Exhibit 121. In paragraph eight of the Spouse's Answer she states that, "The [New Jersey] property is our family homestead . . ." Exhibit 121.

On August 23, 2002, the Court held a further evidentiary hearing on the issue of whether the Debtor had established a residency for purposes of the Federal Exemption during 2001. On November 7, 2002, the Court issued a memorandum opinion sustaining the objection to the Federal Exemption on the ground that the Debtor did not physically occupy the New Hampshire Property as his principal residence. See Marsico III.

III. BAD FAITH AS "CAUSE" FOR DISMISSAL OF CHAPTER 7 PETITION

One of the primary purposes of bankruptcy is to relieve an honest debtor from the weight of oppressive indebtedness and permit him to start afresh. Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934). A fresh start is afforded through discharge of all or a portion of his debts. Chapter 7 of the Bankruptcy Code allows discharge in exchange for liquidation of the debtor's assets for the benefit of his creditors, while under Chapter 13 a debtor may adjust the amount of his unsecured debts in exchange for dedicating to creditors a portion of his future income. The bankruptcy laws

are grounded on the fresh start concept. In re Jones, 114 B.R. 917, 926 (Bankr. N.D. Ohio 1990).

There is no right, however, to a head start. Id.

A. Section 707(a)

Section 707(a) provides that a Chapter 7 case may be dismissed “for cause.” 11 U.S.C. § 707(a). The section further provides that “cause” includes unreasonable delay which is prejudicial to creditors, nonpayment of fees and charges, and failure to file the lists and schedules required by section 521(1). Id. The examples set forth in section 707(a) are merely illustrative of “cause” and are not exhaustive. See In re Zick, 931 F.2d 1124, 1126 (6th Cir. 1991). Creditors are not restricted from filing motions to dismiss under section 707(a) except on the grounds of failure to timely file lists and schedules. See 11 U.S.C. 707(a)(3). While the majority of courts have found that “bad faith” or “lack of good faith” will constitute cause for dismissing a case under section 707(a), the First Circuit has not addressed this issue. See, e.g., Zick, 931 F.2d at 1126-27 (collecting section 707(a) dismissal cases based on bad faith and lack of good faith).

No two concepts within the Bankruptcy Code are more ambiguous or elusive than those of “bad faith” and “good faith.” Black’s Law Dictionary begins the definition of bad faith by stating, “[t]he opposite of ‘good faith’” which is not particularly helpful. Black’s Law Dictionary 139 (6th ed. 1990). In 1964, Justice Potter Stewart of the United State Supreme Court stated, “. . . faced with the task of trying to define what may be indefinable. I have reached the conclusion . . . that . . . I know it when I see it.” Jacobellis v. Ohio, 378 U.S. 184, 197 (1964). He was talking about obscenity. He might as well have been talking about bad faith. The anomalous nature of these concepts has resulted in various courts constructing tests that rely on numerous factors, in an attempt to objectify what is essentially a subjective analysis. Parties, in general, and courts, in particular, tend to prefer objective, black letter tests. Objective tests produce uniform and

predictable decisions. While subjective tests are more reliant on a court's mood, morality, attitude and opinions.

B. Case Law

It is obvious that any analysis of bad faith must be undertaken on an ad hoc basis. There are two prevailing “tests” that various courts have adopted when evaluating the bad faith of a debtor: (1) the more narrow and aptly named “bad faith test” and (2) the “smell test.” See In re Keobapha, 279 B.R. 49, 52 (Bankr. D. Conn. 2002).

1. The Bad Faith Test

The “bad faith test” has been described as follows:

[T]here are those courts that favor adoption of a bad faith test, but only in the face of egregious debtor actions. Here, “bad faith in the filing of a Chapter 7 petition would be evidenced by a pervasive and orchestrated effort on the part of the debtor to obtain the benefits of a bankruptcy filing while at the same time intentionally and fraudulently taking action to avoid any of the detriments.” In re Khan, 172 B.R. 613, 625 (Bankr. D. Minn. 1994).

These actions may include “manifest dishonesty toward a legal tribunal” such as: [S]ystematic and deliberate misstatements or omissions on bankruptcy schedules; knowingly false testimony at a meeting of creditors or a court hearing; and intentional acts to hinder the trustee in the administration of the estate and the investigation in connection with it. To taint the whole filing, there should be something more than an isolated instance or two of such conduct. Id. at 625 fn. 23. In addition, dismissal for bad faith may “be prompted by a vindictive motivation to use bankruptcy solely as a ‘scorched-earth’ tactic against a pressing creditor or opponent in litigation.” Id. at 625.

Keobapha, 279 B.R. at 52.

2. The Smell Test

Other courts have adopted the “smell test” in determining whether the debtor had acted in bad faith. This involves the weighing of such factors as:

(1) the debtor reduced his creditors to a single creditor in the months prior to filing his petition; (2) the debtor failed to make lifestyle adjustments or continued living an

expansive or lavish lifestyle; (3) the debtor filed the case in response to a judgment pending litigation . . . ; (4) the debtor made no effort to repay his debts; (5) the unfairness of the use of Chapter 7; (6) the debtor has sufficient resources to pay his debts; (7) the debtor is paying debts to insiders; (8) the schedules inflate expenses to disguise financial well-being; (9) the debtor transferred assets; (10) the debtor is over- utilizing the protection of the Code to the unconscionable detriment of creditors; (11) the debtor employed a deliberate and persistent pattern of evading a single major creditor; (12) the debtor failed to make candid and full disclosure; (13) the debts are modest in relation to assets and income; and (14) there are multiple bankruptcy filings or other procedural gymnastics.

In re Spagnolia, 199 B.R. 362, 365 (Bankr. W.D. Ky. 1995); see also Zick, 931 F.2d at 1128.

“Generally, the presence of only one of these factors is not sufficient to support a section 707(a) dismissal.” Id. at 365.

C. First Circuit

As has been mentioned previously, the First Circuit has not defined bad faith under section 707(a). Accordingly, this Court is free to adopt either of the two above-mentioned tests. However, the Court shall not adopt either the bad faith test or the smell test. This Court views the “bad faith test” as setting an almost impossibly high standard for bad faith, a standard which permits much more than the honest, but unfortunate, debtor to obtain the benefits of the Bankruptcy Code. On the other hand, the “smell test” is too permissive and raises the specter of decisions based upon the application of “individualized standards of moralistic decision making reserved only for Congress.” In re Keach, 243 B.R. 851, 867 (B.A.P. 1st Cir. 2000). Instead, this Court shall adopt a less rigid and more objective standard for determining if bad faith exists and is sufficient to constitute cause for dismissal of a Chapter 7 petition under section 707(a). The criteria adopted by the Court shall be based upon the rationale established by the United States Bankruptcy Appellate Panel of the First Circuit (the “BAP”) decision in Keach and its progeny.

Keach dealt with the issue, among others, of a bad faith filing under Chapter 13 of the

Bankruptcy Code. The court in Keach criticized the use of “individualized standards of moralistic decision making” in determining whether a debtor is proceeding in good faith and observed that “many courts have interpreted ‘good faith’ to mean fairness to creditors as determined by the court.” Keach, 243 B.R. at 867. The BAP concluded by stating that “The meaning of good faith is simple honesty of purpose.” Id. at 868.

In Cabral, the BAP expanded Keach by adopting a totality of the circumstances’ approach in determining lack of good faith. In re Cabal, 285 B.R. 563, 572 (B.A.P. 1st Cir 2002). In determining whether a Chapter 13 petition has been filed in bad faith, the court set four primary factors to consider:

- (1) whether the debtor misrepresented facts in his petition, unfairly manipulated the Bankruptcy Code, or otherwise filed his Chapter 13 petition in an inequitable manner;
- (2) the debtor’s history of filings and dismissals;
- (3) whether the debtor only intended to defeat state court litigation; and
- (4) whether egregious behavior is present.

Id. at 573. Furthermore a finding of bad faith does not require fraudulent intent by the debtor. Id.

This Court acknowledges that the standard of conduct needed to reach bad faith under section 707(a) may be different from that under Chapter 13 because of the control over the case given to a Chapter 13 debtor that a Chapter 7 debtor does not have.⁵ However, the Court believes that the factors outlined in Cabral can and should be applied to determining whether bad faith constitutes cause for dismissal under section 707(a).

⁵ For example, a Chapter 13 debtor can dismiss his case as a right, 11 U.S.C. § 1307(b), while a Chapter 7 debtor must show “cause” in order to dismiss his case, 11 U.S.C. § 707(a). A Chapter 13 debtor retains control over his assets, while Chapter 7 debtor must turnover all nonexempt assets to a trustee.

IV. DISCUSSION

This case is about nothing more than a dispute between the Debtor and two very tenacious creditors. Both the Canopache Cottages Association⁶ and Walter Morgner, Jr.⁷ were aggressively pursuing the Debtor prepetition in various state courts. The only other creditor who took an interest in the case, the Veterans Administration,⁸ was paid out in full after the sale of the New Hampshire Property. It was due solely to the Creditors' diligence and efforts that the Debtor's State and Federal Exemptions were defeated. See Marsico I; Marsico II; and Marsico III.

It is unmistakable that there are personal animosities between the Debtor and both of the Creditors. Walter Morgner, Jr. is the brother-in-law of the Debtor, who is married to Mr. Morgner's sister. Mr. Morgner is a creditor of the Debtor pursuant to a 1993 New Jersey superior court judgment. See Doc. Nos. 33 and 34. On June 14, 2001, Mr. Morgner commenced an action in a New Hampshire superior court to enforce the New Jersey judgment and obtained an attachment on the New Hampshire Property. See id. That action was stayed by the Debtor's current bankruptcy filing.

The Canopache Cottages Association is the homeowners' association where the New Hampshire Property is located. The Debtor failed to pay various assessments and dues resulting in the Canopache Cottages Association filing a civil action on May 26, 2001, in a New Hampshire superior court and obtaining an attachment on the New Hampshire Property. Throughout the various pleadings and hearings in this case it has become clear that the Debtor and the board of

⁶ On March 26, 2001, the Canopache Cottages Association perfected an attachment on the New Hampshire Property in the amount of \$11,000 for unpaid association dues.

⁷ On June 14, 2001, Walter Morgner, Jr. recorded an attachment of \$23,500 on the Property in connection with an action to collect upon a 1993 New Jersey judgment debt.

⁸ The holder of the mortgage on the New Hampshire Property.

trustees of the Canopache Cottages Association have been at odds for quite awhile. In fact the relationship between the two was so noxious that Ken Brown, treasurer of the Canopache Cottages Association and neighbor to the Debtor maintained a detailed log of all activity involving the New Hampshire Property, including the coming and going of the Debtor and his family members. See Marsico III.

While not indicative of bad faith by itself, it is of interest that the Debtor filed his second bankruptcy petition on the eighty-ninth day after the dismissal of his first case.⁹ The Court can infer that this was done in order to challenge the Creditors' liens on the New Hampshire Property. Additionally, the record is clear that the Debtor was willing to do anything and everything to avoid paying any proceeds from the sale of the New Hampshire Property to the Creditors by claiming and litigating both a New Hampshire Exemption and Federal Exemption in the proceeds. The Court made it clear in Marsico I and Marsico III that it found these claims of homestead exemptions to be without any merit. The Court finds that the Debtor has attempted to use the Bankruptcy Code in this case as a "scorched-earth" tactic against two aggressive Creditors solely for the benefit of himself and his Spouse.

Additionally, the Court finds that the Debtor has acted in a pervasive and orchestrated effort to obtain the benefits of a bankruptcy filing while at the same time intentionally and fraudulently taking action to avoid any of the detriments. In Marsico III, the Court characterized the Debtor's actions as a "shell game," in that the Debtor repeatedly claimed specious homestead

⁹ The Court notes that the purchase and sales agreement on the New Hampshire Property was signed on May 5, 2001, signifying to the Court that a foreclosure was not the impetus for the second filing and there is nothing in the record that would indicate that any other creditor was pursuing the Debtor. See Doc. No. 5.

exemptions for the sole purpose of saving his true homestead in New Jersey. The record is clear that:

1. On April 11, 2001, the Debtor and his Spouse intended to sell the New Hampshire Property and use the proceeds obtained thereof to save their New Jersey Property. See Exhibit 121, Certification.
2. On May 5, 2001, the Debtor signed a purchase and sales agreement for the New Hampshire Property, wherein he listed his address as New Jersey.
3. On June 22, 2001, the Debtor filed his second Chapter 13 petition, after the Creditors obtained attachments on the New Hampshire Property.
4. The Debtor has made two attempts to shield the nonexempt proceeds of the New Hampshire Property from his creditors by claiming exemptions to which he was not entitled.
5. As of December 12, 2001, the Debtor and his Spouse simultaneously had Chapter 13 proceedings active in two districts, both claiming each other's income and both claiming a homestead exemption for the other.

A Chapter 7 discharge is only appropriate for those debtors who liquidate their nonexempt assets for the benefit of their creditors. Here, the Debtor has attempted to obtain a Chapter 7 discharge without incurring the detriment of liquidation. The Court finds that the Debtor, in concert with his Spouse, filed his current bankruptcy petition in a systematic effort to shield nonexempt assets, the proceeds from the New Hampshire Property, from his creditors.

The evidence is clear that the Debtor has not acted with simple honesty of purpose, has misrepresented facts in his petition, unfairly manipulated the Bankruptcy Code and filed his original Chapter 13 petition in an inequitable manner. Accordingly, under the standards articulated in Cabral, the Debtor's case shall be dismissed for cause under section 707(a) of the Bankruptcy Code.

V. RELIEF

The motion seeking dismissal of this case (Doc. No. 153) was filed on March 6, 2003, approximately twenty months after the Chapter 13 petition was filed and twelve months after the case was converted to Chapter 7. Under some circumstances, such a delay might be unfair or unjust to a debtor, trustee or other party in interest resulting in denial based upon laches. However, in this case, the Creditors were not sleeping on their rights. The Creditors presented evidence on the Federal Exemption issue at a hearing on August 23, 2002, and filed their motion to dismiss four months after this Court's decision in Marsico III.

However, the Chapter 7 Trustee has been serving in that capacity for a year prior to the filing of the Creditors' motion. Accordingly, in order to avoid prejudice to the Chapter 7 Trustee, the Court shall consider any application for compensation which he may file within the time specified in a separate order to be issued contemporaneously with this memorandum opinion. After a decision on any such application, this case shall be dismissed. Since the Creditors held prepetition attachments on the New Hampshire Property, those attachments shall remain as liens upon the proceeds of sale of that property held by the Chapter 13 Trustee. After payment of any sums awarded to the Chapter 7 Trustee and dismissal of the case, such remaining proceeds shall become property of the Debtor, subject to the attachment liens of the Creditors. See 11 U.S.C. § 349(b). In addition, in order to avoid prejudice to the Creditors, and to permit them to pursue their state law remedies, the case shall be dismissed with prejudice. Pursuant to sections 105 and 349(a) of the Bankruptcy Code, the Debtor shall be prohibited from filing a bankruptcy petition in any district of the United States for a period of one year from the date of the order dismissing the case.

VI. CONCLUSION

For the reasons set forth above, the Court shall enter a separate order setting deadlines for the filing of an application for compensation by the Chapter 7 Trustee and objections thereto.

After consideration of any such application, the Court shall enter an order dismissing this case with prejudice. This opinion constitutes the Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052. The Court will issue a separate order consistent with this opinion.

Dated: January 5, 2004

/s/ J. Michael Deasy
J. Michael Deasy
Bankruptcy Judge