UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLORADO
Bankruptcy Judge Elizabeth E. Brown

In re: Louis John Sullivan, Debtor.	Bankruptcy Case No. 20-11876 EEB Chapter 11 (Subchapter V)

ORDER DENYING CONFIRMATION AND CONVERTING CASE TO CHAPTER 7

THIS MATTER is before the Court following a combined trial on confirmation of the Debtor's Second Amended Sub-Chapter V Plan of Reorganization and his ex-wife's Motion to Convert. The U.S. Trustee objects to the plan, asserting that the Debtor does not meet the definition of a "small business debtor." If he lacks eligibility, then he cannot take advantage of the different provisions of that sub-chapter in his plan. Central to this dispute is whether the Debtor's property settlement debt to pay his ex-wife a share of his business' value constitutes a business debt. If it is not, then less than fifty percent of his debts are business debts and he is not eligible for this form of relief. Second, his ex-wife contends that, even if the Debtor is eligible for subchapter V relief, he must still satisfy the confirmation requirements of good faith (§ 1129(a)(3)), feasibility (§ 1129(a)(11)), and a showing that he is current on all postpetition domestic support obligations (§ 1129(a)(14)).[1] She asserts that he cannot carry his burden of proof on these three elements. She further requests conversion to chapter 7 because the Debtor lacks any reasonable likelihood of rehabilitation and he has failed to pay postpetition domestic support obligations. 11 U.S.C. § § 1112(b)(4)(A) & (P).

I. BACKGROUND

The driving force behind this bankruptcy filing was the parties' divorce. The Debtor was a very successful businessman, owning and operating a chain of Spanish-language theaters. At the time of the divorce, he was earning a high income (calculated at $573,397 per year) and the business had significant value. Based on these circumstances, the divorce court awarded Ms. Stefani Sullivan ("Stefani") a sizeable maintenance award and an "equalization payment" to compensate her for her share of the business' value, as well as many other marital assets, while allowing the Debtor to retain the business itself. Shortly before this bankruptcy filing, the Debtor sought to modify this award and the divorce court reduced it but still left the Debtor owing her over $15,500 per month in maintenance and over $550,000 in an equalization payment.

[1] All references to "section" or "§" refer to Title 11, United States Code, unless expressly stated otherwise.

Then immediately after the bankruptcy filing, the COVID-19 pandemic hit. The Debtor had to close the theaters. Overnight, he lost his only source of income and was reduced to unemployment benefits.[2] He initially delayed filing a plan in hopes that the theaters would reopen, but the long-term nature of this pandemic forced the business into liquidation. Eventually he secured another job, with an annual salary of $90,000. While that would certainly be a comfortable living for most, it makes it virtually impossible for him to pay Stefani $15,500 per month in maintenance, let alone the equalization payment. He has filed another modification request with the divorce court, but it has been pending for over one year with no trial date set. That may reflect the backlog in the state courts due to COVID or other factors, or it may reflect the divorce court's perception that the Debtor has already gone to the well too often or too recently seeking modification. He certainly has a valid reason to do so now, but that might not be enough to move his case up in priority. In the meantime, this bankruptcy filing has served to delay payment of his divorce obligations, but unfortunately the bankruptcy world is unable to provide him with a permanent solution in the form of an alteration of these court-ordered debts.

Stefani recognizes his business no longer exists and his income is substantially reduced, but she also sees that he is still living the same lifestyle he previously enjoyed. He still lives in the same expensive home and drives the same expensive car. Granted the home has no value above the secured debts owed against it and he has needed his mother's financial support to make mortgage payments recently. She is currently living in the home with the Debtor. Moreover, Mother Sullivan is contemplating either purchasing the home from him or purchasing the bank's note secured against it. She also bought his car from him, while allowing him to continue to drive it. So presumably his mother has substantial means. Of course, Stefani has no legal right to require his mother to support her needs, but perhaps Stefani believes if she exerts enough legal pressure on the Debtor, the mother will provide him with the means to end the fighting. That is only the Court's speculation. What is clear is that Stefani recognizes eventually the divorce court will reduce her award, but she does not agree with the Debtor as to the likely amount of that reduction.

Unable to obtain a timely modification of the divorce debts, the Debtor is attempting through his proposed plan to alter these obligations during its term. He proposes to pay his administrative claims and Ms. Sullivan's $38,361 priority claim for prepetition maintenance by liquidating a portion of his exempt 401k account. That

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[2] Prior to the petition date, the Debtor also financed his living expenses through gambling. The Debtor testified that he does not consider himself a professional gambler but that it is "more than a hobby." He financed his gambling by taking out cash advances on credit cards. Although he claimed over $250,000 in gambling income on his 2019 tax return (offset by nearly equal losses), he claims he no longer gambles because he does not have credit cards to fund such endeavors and instead only takes his mother to gamble. Stefani is suspicious that he is still gambling and may have undisclosed income from this source, but she provided no evidence to support her suspicion.

account currently has a balance of $204,000. As to his postpetition maintenance payments of $15,500 per month, he offers to pay only $40 per month, which is the amount he believes the divorce court will retroactively order once it hears his motion for modification.

The Debtor has substantial debts other than the amount owed to Stefani. Some of these debts will be discussed further below. But the proposed plan's treatment of the other claims is not at issue.

II. ELIGIBILITY FOR SUBCHAPTER V RELIEF

Subchapter V of chapter 11 offers many advantages to small business debtors. It has a more streamlined process, which translates into less administrative costs. For example, the Debtor does not have to submit a disclosure statement for court approval. It also eliminates some of the most difficult hurdles of chapter 11, like satisfaction of the absolute priority rule. Instead of wiping out the ownership interests in a small business, it merely requires a showing that the debtor is paying its projected disposable income over the life of the plan. But to be able to take advantage of these and other benefits, a debtor must satisfy subchapter V's eligibility requirements.

In relevant part, the Bankruptcy Code defines a "small business debtor" as:

> (A) . . . a person engaged in commercial or business activities . . . that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the filing of the petition or the date of the order for relief in an amount not more than $2,725,625 . . . **not less than 50 percent of which arose from the commercial or business activities of the debtor** . . . .

11 U.S.C. 101(51D)(A) (emphasis added) (footnote omitted). No one disputes that this Debtor was engaged in commercial or business activities on the petition date or that his debts fall below the ceiling amount. The U.S. Trustee has challenged eligibility solely on the basis that less than fifty percent of his debts are attributable to business activities.

The U.S. Trustee and the Debtor agree that his total debts on the petition date were $2,299,872, including debts owed to insiders and affiliates. They also agree that the debt he owes to his own 401(k) account for a prepetition loan in the amount of $19,066 should not be included in the total debt amount.[3] After subtracting that debt, the total debt amount is $2,280,805. Half of that amount is $1,140,403.

Thus, this controversy boils down to whether this Debtor has at least $1,140,403 in business debts. The parties have stipulated that $961,598 of his debts did not arise from commercial or business activities but are instead consumer debts. But they do not

[3] The U.S. Trustee argues there are other insider/affiliate debts that should be deducted but the Court need not decide that issue as it would not change the result here. Even including these allegedly insider debts, as the Debtor urges, he does not meet this eligibility requirement.

agree on the character of the remaining debts. The largest of the disputed debts is the equalization payment in the amount of $620,995 (including interest). If this debt is determined to be a non-business debt, then the Debtor cannot meet the required fifty-percent-business-debt threshold because his consumer debts would total $1,582,593 ($961,598 + $620,995), which exceeds the fifty percent threshold of $1,140,403. Thus, for the Court to resolve this eligibility dispute, it need not consider all the disputed debts, but only the character of the equalization debt. And in doing so, it notes that the Debtor bears the burden to demonstrate satisfaction of the eligibility requirements for subchapter V. *See In re Wright*, 2020 WL 2193240, at *2 (Bankr. D. S.C. Apr. 27, 2020).

The Bankruptcy Code does not define when a debt arises from "commercial or business activities." However, it does define "consumer debts" as "debts incurred by an individual primarily for a personal, family, or household purpose." 11 U.S.C. § 101(8). This general definition, however, does not flesh out what makes a debt a personal, family, or household debt. Courts have stepped into the breach to provide further guidance. Many courts focus on the debtor's purpose in incurring the debt. *In re Garcia*, 606 B.R. 98, 106 (Bankr. D.N.M. 2019). If the debtor incurred the debt with a "profit motive" or an "eye toward profit," then it is not a consumer debt. *Stewart v. U.S. Trustee (In re Stewart)*, 175 F.3d 769, 806 (10th Cir. 1999); *In re Booth*, 858 F.2d 1051, 1055 (5th Cir. 1988).

However, even with this added guidance, the definition remains elusive. For example, in *Stewart v. United States Trustee (In re Stewart)*, 175 F.3d 796, 807 (10th Cir. 1999), the debtor had large student loan debts and domestic support obligations. The Tenth Circuit could have reasoned that the student loan debt was a business debt insofar as the expected outcome of furthering one's educational goals is to obtain higher income in the job market. In that light, student loan debt could be viewed as arising from a profit motive. But the Tenth Circuit concluded that, because the funds went to pay "family expenses," they were consumer debts. *Id*. at 807. It also ruled that a $250,000 debt the debtor owed to his ex-wife for alimony was a consumer debt because the evidence showed that the debt was owed for the ex-wife's "support and benefit, and not for any profit motive." *Id*. Many other courts have held that divorce-related debts are consumer debts. *E.g., Kestell v. Kestell (In re Kestell)*, 99 F.3d 146, 149 (4th Cir. 1996); *In re Garcia*, 606 B.R. 98, 105 (Bankr. D.N.M. 2019); *In re Traub*, 140 B.R. 286 (Bankr. D.N.M. 1992).

Despite this authority, the Debtor raises a novel argument. He asserts that the equalization payment arose from business or commercial activity because it represents a transfer of a portion of the business' value. It is akin to one partner buying out another partner's interest in a business. And this illustrates the difficulty with the Code's definition of consumer debts. In this manner, it is possible to characterize this debt as a business debt and it is possible to recast many otherwise personal or family debts as debts incurred with an eye toward profit. Probably all courts would agree that the home mortgage debt is a consumer debt and yet the family home is the asset that most families view as their greatest investment–the one that they purchase with an eye toward appreciation in value.

The legislative history of § 101(8)'s definition of "consumer debt" indicates that it was "adapted from the definition used in various consumer protection laws." H.R. Rep. No. 95-595, 95th Cong. 1st Sess. (1977); S. Rep. No. 95-989 2nd Sess. 22 (1978), *as reprinted in* 1978 U.S.C.C.A.N. 5787, 5808. In fact, the Bankruptcy Code's definition mirrors the definition that appears in the Truth in Lending Act ("TILA") at 15 U.S.C. § 1602(h)(i). TILA contains a definition of "consumer debt" because it applies only to consumer transactions. It specifically exempts credit transactions involving extensions of credit "primarily for business, commercial, or agricultural purposes." 15 U.S.C. § 1603(1). Courts interpreting TILA's definition focus on the purpose of the loan transaction under review.

In *Sundby v. Marquee Funding Group, Inc*., 2020 WL 5535357 (S.D. Cal. Sept. 15, 2000), the court employed a multi-factor test to aid in its analysis of whether the loan in question was a consumer or business loan under TILA's definition.

> Whether [a credit transaction] is for a personal or a business purpose requires a case by case analysis. A court must look at the entire transaction and surrounding circumstances to determine a borrower's primary motive. Courts typically analyze five factors:
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> > (1) The relationship of the borrower's primary occupation to the acquisition. The more closely related, the more likely it is to be business purpose.
> > (2) The degree to which the borrower will personally manage the acquisition. The more personal involvement there is, the more likely it is to be business purpose.
> > (3) The ratio of income from the acquisition to the total income of the borrower. The higher the ratio, the more likely it is to be business purpose.
> > (4) The size of the transaction. The larger the transaction, the more likely it is to be business purpose.
> > (5) The borrower's statement of purpose for the loan.

Sundby, 2020 WL 5535357, at *8-9 (internal quotations and citations omitted).

If the Court were to extend this test beyond the context of a loan transaction and apply it to the equalization payment, factors one through four would favor the Debtor's argument. "Buying out" his ex-wife's marital interest in the business with the equalization payment directly concerned his primary occupation at the time, it was for a business that he personally ran, the business provided his primary source of income, and it involved a large transaction. But was the stated purpose for this transaction a business purpose? While the Debtor characterizes the equalization payment as payment for the theater business, the separation agreement does not describe it in that fashion. Rather, it states that it was a payment "to equalize the division of marital property . . . .", and the theater business was only one asset of their marital property. Ex. 4, ¶ 28.

The United States Tax Code is another body of federal law that distinguishes between "business" and "personal" payments. It allows a deduction for "ordinary and necessary business expenses" but generally does not allow deductions for personal expenses, with certain exceptions.[4] In an older Supreme Court case, *United States v. Gilmore*, 372 U.S. 39 (1963), the Court had to resolve a split over whether legal fees incurred during the division of marital property rights in the husband's business interests qualified as deductible expenses incurred "for the conservation of property held for the production of income." *Id*. at 40. The Court determined that the pivotal issue was whether the legal fees were "a 'business' rather than a 'personal' or 'family' expense[.]" *Id*. at 46. While the taxpayer argued his divorce-related legal fees were a business expense because he was trying to protect his stock interests in various corporations, the Court flatly rejected his argument. It held that the focus should be on "the origin and character of the claim with respect to which an expense was incurred, rather than its potential consequences upon the fortunes of the taxpayer." *Id.* at 49. Because the wife's claims stemmed entirely from the marital relationship, and not from income-producing activity, the Court denied the deduction and concluded "none of respondent's expenditures in resisting [her] claims can be deemed 'business' expenses." *Id.* at 52. In a footnote, it further stated that the "marriage relationship can hardly be deemed an income-producing activity." *Id*. at 52 n.22.

The Colorado Supreme Court has described dissolution proceedings as follows: "Where two parties have undertaken the obligations implicit in the marriage relationship, it becomes the duty of the courts upon the dissolution of that relationship to ensure that neither is forced to suffer unduly as a consequence of its termination." *In re Marriage of Franks*, 542 P.2d 845, 851–52 (Colo. 1975). Dissolution is inherently an equitable proceeding, including the division of marital property, which seeks to "allocate to each spouse what equitably belongs to him or her." *In re Marriage of Graham*, 574 P.2d 75, 76 (Colo. 1978). A court dividing marital property must consider various factors, including the contribution of each spouse to the acquisition of the marital property (including the contribution of a spouse as homemaker), the economic circumstances of each spouse, any increases or decreases in the value of each party's separate property during the marriage, and the depletion of that separate property for marital purposes. *See* Colo. Rev. Stat. § 14-10-113. The marital property awarded to each spouse is then a factor to be considered when awarding maintenance. *See* Colo. Rev. Stat. § 14-10-114(3)(A)(I)(B).

In this case, the equalization payment debt is rooted and grounded in the equitable termination of their marriage. The equitable distribution of their marital property was not a business or commercial transaction–it did not stem from a profit motive. Instead it was a method of ensuring that each spouse received their fair share of marital property. This is inherently a personal and family-related purpose. *See Stewart v. United States Trustee (In re Stewart)*, 175 F.3d 796, 807 (10th Cir. 1999). The fact that the parties' marital property included a business does not alter the

[4] One of those exceptions is that a taxpayer can deduct alimony paid to a spouse (generally considered a personal expense).

underlying purpose of the property division. *In re Traub*, 140 B.R. 286, 289 (Bankr.D.N.M.1992) (noting that "any debt to a former spouse which reflects the distribution of the net value of the community should always be classified as a consumer debt").

Accordingly, the Court concludes that the equalization debt does not arise from a business or commercial purpose. Including the equalization debt as a consumer debt means that a majority of the Debtor's debts on the petition date did not arise from his commercial or business activities as required by § 101(51D). Therefore, the Debtor does not qualify for subchapter V and his plan cannot be confirmed on this basis.

III. CONSEQUENCES OF PAST-DUE, POSTPETITION DSO OBLIGATIONS

Although there are unique confirmation requirements for subchapter V plans, most of the standard confirmation requirements of § 1129(a) still apply. This includes the good faith requirement of § 1129(a)(3), the feasibility requirement of § 1129(a)(11) and § 1129(a)(14)'s requirement that a debtor be current on all postpetition domestic support obligations. Ms. Sullivan argues that the Debtor's proposed plan cannot meet these three requirements and that the Debtor's only purpose in filing this case was to avoid paying his court-ordered domestic support obligations. Nor does the plan appear to contemplate payment of the equalization payment, on which payments are scheduled to begin in 2023. She argues the plan is not feasible because there is no assurance that the Debtor will win in divorce court and be able to significantly lower his domestic support obligations. If he loses in state court, Ms. Sullivan contends this case will require further liquidation.

The Debtor does not dispute that he has failed to pay all his postpetition domestic support obligations as required by § 1129(a)(14). Nevertheless, Debtor argues the Court should confirm the plan because his failure to pay is due to circumstances beyond his control—namely, the loss of his business, the pandemic, and the backlog in divorce court. He cannot possibly pay his current obligations because those obligations—$15,500/month maintenance and $1,135/month child support—well exceed his current gross monthly income of $7,600. He asserts that he can modify his plan at a later date to accommodate a future ruling by the state court. In the meantime, the Debtor has proposed a monthly budget that has him paying what he believes, or at least hopes, the modified amounts will be. Those amounts are significantly lower—$40/month maintenance and $956/month child support.

The problem with his argument is that accepting it would require the Court to rewrite the plain statutory language of § 1129(a)(14):

> If the debtor is required by a judicial or administrative order, or by statute, to pay a domestic support obligation, the debtor has paid all amounts payable under such order or such statute for such obligation that first become payable after the date of the filing of the petition.

11 U.S.C. § 1129(a)(14). The statute does not make this confirmation requirement dependent on a debtor's ability to pay. It does not limit its command to payment of any "reasonable" support obligation.

This same requirement appears in every type of reorganization chapter available to individual debtors in the Bankruptcy Code. *See* 11 U.S.C. §§ 1225(a)(7), 1325(a)(8). It even persists in small business debtor cases. *See* 11 U.S.C. § 1191 (which provides exceptions to other § 1129(a) confirmation requirements, but not to § 1129(a)(14)). And nonpayment of postpetition support obligations constitutes "cause" for dismissal or conversion of a reorganization case. *See* 11 U.S.C. §§ 1112(b)(1), 1112(4)(P), 1208(c)(10), 1307(c)(11). Of course conversion options may be limited due to a debtor's eligibility to proceed under another chapter.

Several other provisions of the Bankruptcy Code give preferred treatment to the holder of a domestic support obligation claim. The otherwise broad scope of the automatic stay in § 362(a) does not extend to the postpetition collection of a domestic support obligation from property that is not property of the estate. 11 U.S.C. § 362(b)(2)(B). Nor does it prohibit the withholding of income that is property of the estate or property of the debtor for payment of a domestic support obligation. 11 U.S.C. § 362(b)(C). Section 507(a)(1)(A) gives the holder of such a claim the highest priority of distribution from the estate, second only to the trustee's allowed administrative expenses that make a distribution to the support creditor possible. 11 U.S.C. § 507(a)(1)(C). And to the extent that the estate does not pay a support claim in full, then the bankruptcy discharge under any of its chapters will not discharge the support obligation.

In short, Congress has evidenced in numerous ways that bankruptcy cannot prejudice the rights of the support creditor. It makes no exception when it is impossible for the debtor to perform. Nor was the chapter 11 process meant to create a long-term shelter for debtors while they await the outcome of contested divorce litigation.

Having established that "cause" exists under § 1112(b)(4)(P) for either conversion or dismissal, the Court must now consider the other requirements of § 1112. Under this statute, once cause exists, it mandates the dismissal or conversion of the case unless one or more factors exist. First, it requires the court to consider whether the appointment of a trustee or examiner would better serve the interests of the creditors or the estate. 11 U.S.C. § 1112(b)(1). Here there has been no suggestion nor does the Court find that such an appointment would adequately address the concerns posed by this case. An appointment would not facilitate the confirmation of any chapter 11 plan because even a trustee's proposed plan could not surmount the hurdle of unpaid, postpetition support debt.

Second, § 1112(b)(2) prevents the dismissal or conversion to chapter 7 if there are unusual circumstances establishing that conversion or dismissal is not in the best interests of creditors and the estate. But the unusual-circumstances exception requires further findings that:

> (A) there is a reasonable likelihood that a plan will be confirmed within the timeframes established in sections 1121(e) and 1129(e) of this title, or if such sections do not apply, within a reasonable period of time; and
>
> (B) the grounds for converting or dismissing the case include an act or omission of the debtor other than under paragraph 4(A) [substantial and continuing losses or the absence of a reasonable likelihood of reorganization] –
>
> (i) for which there exists a reasonable justification for the act or omission; and
>
> (ii) that will be cured within a reasonable period of time fixed by the court.

11 U.S.C. § 1112(b)(2)(A)-(B).

There is an unusual circumstance in this case, namely the impossibility of performance of the support obligation, but that circumstance does not establish that conversion or dismissal is not in the best interests of creditors or the estate. Moreover, it is a circumstance that will prevent the confirmation of any plan, until the divorce court revisits the support award. There is nothing on the horizon to indicate that the divorce court will revisit this issue within a reasonable period of time, as it has already been pending for more than one year, with no hearing date set.

This brings the Court to the last inquiry required by § 1112, which is whether conversion or dismissal is the better option. The Court is given broad discretion in making this determination. *In re P. Rim Investments, LLP*, 243 B.R. 768, 772 (D. Colo. 2000). In assessing this, the statute instructs the Court to weigh the best interests of the creditors and the estate, not the Debtor. Here the moving creditor requested conversion to chapter 7, not an outright dismissal. Neither the U.S. Trustee nor any other creditors requested dismissal instead. Therefore, the Court presumes that Stefani knows which option best suits her needs. And while the Court is not required to consider the Debtor's best interest, it notes that conversion over dismissal is better for the Debtor as well. While his business debts do not constitute fifty percent of his overall debts, he does have substantial business-related debts that presumably will be dischargeable in chapter 7.

IV. CONCLUSION

For the reasons stated, the Court hereby ORDERS:

1. The objections to confirmation are SUSTAINED and confirmation of the Debtor's plan is DENIED; and

2. Ms. Sullivan's Motion to Convert is GRANTED and this case is hereby converted to chapter 7.

3. The Debtor in possession shall:

a. forthwith turn over to the Chapter 7 Trustee all records and property of the estate in its possession or control as required by Fed. R. Bankr. P. 1019(4);

b. within 14 days of the date of entry of this order, file a schedule of all unpaid debts incurred after the commencement of the Chapter 11 case, including the name and address of each creditor, as required by Fed. R. Bankr. P. 1019(5);

c. within 30 days following the entry of the order of conversion, file and transmit to the United States Trustee a final report and account.

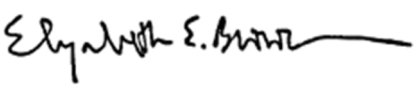
4. Within 15 days of the date of entry of this order, the Debtor in possession shall file the statements and schedules required by Fed. R. Bankr. P. 1019(1)(A) and 1007(b), if such documents have not already been filed.

5. Within 30 days of the date of entry of this order, or before the first date set for the meeting of creditors, whichever is earlier, the Debtor in possession shall, if required, file a statement of intention with respect to retention or surrender of property securing consumer debts, as required by 11 U.S.C. § 521(2)(A) and Fed. R. Bankr. P. 1019(1)(B); and, it is

6. The Debtor and his agents, servants, employees, and attorneys are herein enjoined from taking any action with respect to any assets or records of the Debtor, save and except to preserve the same and to forthwith turn over the same to the Chapter 7 trustee appointed herein pursuant to Fed. R. Bankr. P. 1019(4).

Dated this 30th day of March, 2021.

BY THE COURT:



Elizabeth E. Brown, Bankruptcy Judge