FILED
U.S. Bankruptcy Appellate Panel
of the Tenth Circuit

May 12, 2005

Barbara A. Schermerhorn
Clerk

NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL

OF THE TENTH CIRCUIT

IN RE AC RENTALS, INC.,
An Oklahoma Corporation,

Debtor.

BAP No. WO-04-098

AC RENTALS, INC.,

Appellant,

v.

UNITED STATES TRUSTEE,
ASHLEY H. HOUGH, STEVE
POWELL, and JOLENE POWELL,

Appellees.

Bankr. No. 02-10540-WV
Chapter 11

ORDER AND JUDGMENT*

Appeal from the United States Bankruptcy Court
for the Western District of Oklahoma

Before CLARK, BROWN, and McNIFF, Bankruptcy Judges.

PER CURIAM

The parties did not request oral argument, and after examining the briefs and appellate record, the Court has determined unanimously that oral argument would not materially assist in the determination of this appeal. Fed. R. Bankr. P. 8012. The case is therefore ordered submitted without oral argument.

The debtor appeals an Order of the United States Bankruptcy Court for the Western District of Oklahoma dismissing its Chapter 11 case. For the reasons

* This order and judgment is not binding precedent, except under the doctrines of law of the case, res judicata, and collateral estoppel. 10th Cir. BAP L.R. 8018-6(a).

stated herein, the bankruptcy court's Order is AFFIRMED.

I. Background

The debtor corporation is owned by Charles Hough (Hough). The bankruptcy court's Order dismissing the debtor's Chapter 11 case is based on facts, which have not been disputed, related to Hough's divorce from Ashley Hough (Ashley), and the debtor's acts and omissions as a debtor in possession. These undisputed facts, as well as the procedural history giving rise to the bankruptcy court's Order dismissing the debtor's case, are summarized below.

1. The Divorce Lien

Hough and Ashley divorced in 2000. Pursuant to a settlement, Ashley was granted a lien against the debtor's real property in the divorce (Divorce Lien). However, before the Divorce Lien was finalized and recorded, Hough filed a Chapter 13 petition. Ashley was granted relief from the automatic stay in Hough's Chapter 13 case to finalize and perfect her Divorce Lien (Relief Order). Hough appealed the Relief Order, and this Court affirmed that Order. In January, 2002, several weeks after this Court issued its Order and Judgment,[1] the debtor filed its Chapter 11 petition.

The debtor commenced an adversary proceeding against Ashley, seeking to avoid the Divorce Lien pursuant to 11 U.S.C. § 544. The bankruptcy court entered judgment in favor of the debtor, avoiding the Divorce Lien. This Court affirmed the bankruptcy court's judgment,[2] and Ashley's appeal of our Order and Judgment is currently pending before the Court of Appeals.

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[1] In re Hough, BAP No. WO-01-059, 2002 WL 518687 (10th Cir. BAP Jan. 8, 2002).

[2] In re AC Rentals, Inc., BAP No. WO-03-096, 2004 WL 1182254 (10th Cir. BAP May 28, 2004).

2. Acts and Omissions of the Debtor in Possession

The debtor does business as "Outer Limits" (OL), a bar located in Oklahoma. OL, although possibly conceived by Hough prior to the filing of the debtor's Chapter 11 petition, commenced operation postpetition without obtaining bankruptcy court authorization. Neither OL nor its liquor licence is listed as an asset in the debtor's Schedules. OL maintains a non-debtor-in-possession checking account, and income and expenses in the account are not reported in the debtor's monthly operating accounts. Hough and Paula Edens (Edens), another former spouse of Hough, are the authorized signatories on OL's bank account. The debtor pays OL's labor expenses, including payments to Edens, but it does not keep records of time worked or cash paid.

From January, 2002, when the debtor's petition was filed, until at least June 2003, the debtor in possession made monthly payments averaging $4,000 in amount to "AC Air" (Air), a sole proprietorship owned by Hough, for "contract labor." The debtor in possession does not pay Hough a salary, but Hough has paid the trustee in his Chapter 13 case over $60,000. The debtor borrowed money from Air, but no records were maintained of inter-company transactions and bankruptcy court authorization was not obtained.

The debtor in possession failed to file tax returns, and was habitually late in filing its Monthly Operating Reports. Many checks issued by the debtor in possession were returned for insufficient funds, and insurance on some of its assets lapsed during the postpetition period. Although the debtor in possession proposed a Chapter 11 plan, numerous objections to its confirmation were filed, and the debtor has admitted that it cannot obtain confirmation of the plan.[3]

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[3] Objection to UST's Third Motion to Dismiss Case and Brief in Support, in Appellant's Appendix at 56; Appellant's Brief at 7.

3. Procedural History Related to Dismissal of the Debtor's Case

In July, 2002, seven months after the debtor filed its petition, the United States trustee (UST) sought to convert the debtor's Chapter 11 case to Chapter 7, or to dismiss the case (First Motion). The debtor objected to the First Motion, and shortly thereafter filed Monthly Operating Reports for the months of January through July, 2002. The bankruptcy court denied the First Motion.

Several months later, in May, 2003, the UST again moved to convert the debtor's Chapter 11 case to Chapter 7, or dismiss the case (Second Motion). The Internal Revenue Service (IRS) also moved to convert or dismiss the debtor's case at this time (IRS Motion). After these Motions were filed, the debtor filed Monthly Operating Reports for October, 2002 through July, 2003. The bankruptcy court subsequently entered an Order denying the Second Motion and the IRS Motion.

A third motion to convert the debtor's Chapter 11 case to Chapter 7 or to dismiss it was filed by the UST in March, 2004 (Third Motion). The debtor objected to the Third Motion, and filed Monthly Operating Reports for December, 2003 through February, 2004, whereupon the Third Motion was withdrawn by the UST.

Steve Powell, as an "interested party" (Powell), filed a motion to convert the debtor's Chapter 11 case to Chapter 7 in April, 2004 (Powell Motion).[4] The debtor and Hough objected to the Powell Motion. The Powell Motion was never noticed for hearing, and no order was entered disposing of it.

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[4] A motion filed by Powell indicates that he and his spouse are the owners of the real property on which OL does business. Motion to Convert Case to Chapter 7 at 1, in Appellant's Appendix at 58; *see also* Transcript at 3, in Appellant's Appendix at 3. The bankruptcy court found, and it is undisputed, that the debtor and Powell are either partners, or have a joint venture related to OL. *See* Appellee's Appendix at 59. The debtor in possession commenced an adversary proceeding against Powell seeking injunctive relief. Id. at 9/10/03, in Appellee's Appendix at 11.

In September, 2004, the UST moved to dismiss the debtor's Chapter 11 case pursuant to 11 U.S.C. § 1112(b) (Motion to Dismiss). Ashley filed a statement supporting the UST's Motion to Dismiss. The debtor objected to the Motion to Dismiss, stating that although it could not confirm a plan, it would be in the best interests of creditors to convert its Chapter 11 case to Chapter 7. At that time, the debtor also filed Monthly Operating Reports for March, 2004, through August, 2004. None of the debtor's creditors opposed the Motion to Dismiss, or filed papers in support of the debtor's request to convert. Powell and his spouse, as "interested parties," moved to convert the debtor's case to Chapter 7 while the Motion to Dismiss was pending, but their motion was never noticed for hearing.

The bankruptcy court held a hearing on the UST's Motion to Dismiss in November, 2004. None of the debtor's creditors appeared to oppose the Motion to Dismiss, or to support the debtor's request for conversion. Of the parties who appeared (the debtor, the UST, Powell and Ashley), none argued that the Chapter 11 case should continue. Rather, the dispute centered on whether the Chapter 11 case should be converted to Chapter 7, as requested by the debtor, or whether it should be dismissed for the reasons stated in the Motion to Dismiss. Although the UST requested that the debtor's Chapter 11 case be dismissed in its Motion to Dismiss, it refused to take a position at the hearing as to whether it should instead be converted; but pointed out that if the case were converted, most of the debtor's assets would be used to pay administrative claimants, and unsecured creditors would receive little, if any, distribution. The debtor agreed with the UST that unsecured creditors would not receive a meaningful distribution if its case were converted to Chapter 7.[5] Notwithstanding, the debtor argued that conversion was more appropriate than dismissal because Ashley's Divorce Lien would be

[5] Transcript at 18, in Appellant's Appendix at 18.

reinstated if the case were dismissed.[6] Powell supported conversion because he wanted a trustee to administer the debtor's assets. At the close of the hearing, the bankruptcy court took the matter under advisement.

In December, 2004, the bankruptcy court reconvened the hearing on the Motion to Dismiss, and granted the Motion, issuing its findings of fact and conclusions of law on the record. Subsequently, the bankruptcy court entered a separate Order granting the Motion to Dismiss, incorporating by reference its findings of fact and conclusions of law made on the record (Dismissal Order).

The debtor timely appealed the bankruptcy court's final Dismissal Order.[7] The parties have consented to this Court's jurisdiction because they have not elected to have this appeal heard by the United States District Court for the Western District of Oklahoma.[8]

II. Discussion

The bankruptcy court dismissed the debtor's Chapter 11 case pursuant to 11 U.S.C. § 1112(b), which states:

> [O]n request of a party in interest or the United States trustee or bankruptcy administrator, and after notice and a hearing, the court may convert a case under this chapter to a case under chapter 7 of this title or may dismiss a case under this chapter, whichever is in the best interest of creditors and the estate, for cause, including–
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> (1) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation;
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> (2) inability to effectuate a plan;
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> (3) unreasonable delay by the debtor that is prejudicial to creditors;
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> . . . .

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6 *See* 11 U.S.C. § 349(b).

7 28 U.S.C. § 158(a)(1); Fed. R. Bankr. P. 8002(a).

8 28 U.S.C. § 158(b)-(c); Fed. R. Bankr. P. 8001(e).

(10) nonpayment of any fees or charges required under chapter 123 of title 28.[9]

Under this section, when "cause" exists, a bankruptcy court has broad discretion to either convert a Chapter 11 case to Chapter 7, or to dismiss the case, depending on the best interest of creditors and the estate.[10] It is appropriate for a bankruptcy court, in determining whether conversion or dismissal is in the best interest of creditors and the estate, to take into account the fact that no creditors have opposed a motion to dismiss or independently moved to convert the case.[11]

All parties below agreed that the debtor's Chapter 11 case should be dismissed or converted to Chapter 7. Thus, there is no question that "cause" exists under § 1112(b). The question herein is whether the bankruptcy court erred in choosing to dismiss the case, as opposed to converting it to Chapter 7. We review this decision for abuse of discretion.[12]

The bankruptcy court made the following findings of fact and conclusions

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[9] 11 U.S.C. § 1112(b)(1)-(3), (10).

[10] Hall v. Vance, 887 F.2d 1041, 1044 (10th Cir. 1989) ("The bankruptcy court has broad discretion under § 1112(b)" to dismiss or convert a case) (citing S. Rep. No. 95-989, at 117, (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5903); H. R. Rep. No. 95-595, at 405 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6361 (§ 1112(b) "gives wide discretion to the court to make an appropriate disposition of the case when a party in interest requests. . . . The court will be able to consider other factors as they arise, and to use its equitable powers to reach an appropriate result in individual cases."); *accord* In re Preferred Door Co., 990 F.2d 547, 549 (10th Cir. 1993) ("Under section 1112(b) . . . a bankruptcy court has broad discretion to convert a Chapter 11 case to a Chapter 7 proceeding or to dismiss a case for several causes, including the debtor's inability to effectuate a plan."); Frieouf v. United States (In re Frieouf), 938 F.2d 1099, 1102 (10th Cir. 1991) ("Section 1112(b) provides a nonexhaustive list of grounds upon which a bankruptcy court may dismiss a Chapter 11 case for 'cause.'").

[11] Hall, 887 F.2d at 1044-45 (in response to the argument that the bankruptcy court abused its discretion in choosing to dismiss a Chapter 11 case, as opposed to appointing a Chapter 11 trustee, the Court of Appeals stated: "[A]ll creditors had notice of the motions to dismiss, yet during the three months between the filing of those motions and the hearing on them, none filed objections or moved to convert. If conversion were in the best interest of the creditors, they would have so moved prior to the . . . hearing.")

[12] Id. at 1045.

of law related to its decision to dismiss the debtor's case, as opposed to converting it to Chapter 7:

> [U]nder section 1112(b), the Court has the discretion to either convert the case . . . to one under Chapter 7 or to dismiss the case. And in the words of the statute, quote, "whichever is in the best interest of creditors and the estate."
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> According to Collier on Bankruptcy, . . . if all the parties agree, the Court should grant their desire. The parties in interest here would be the creditors. Here, Ashley . . . while she's listed as a creditor in the schedule, is not actually a creditor of the estate but is a lien holder pursuant to the divorce decree I mentioned earlier. Ashley . . . , although not a creditor, favors dismissal. Steve Powell favors conversion to Chapter 7, but he's not a creditor either, but rather a partner or joint venturer in the [OL] investment. The [UST] does not take a position with respect to conversion or dismissal, and the debtor favors conversion.
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> The only unsecured creditors listed in the schedules are three in number if Ashley . . . is excluded, as she should be, and also Kent Klingenberg should be excluded because he also is not a creditor of this estate. So, if you eliminate those, the three unsecured creditors, the total debt of those unsecured creditors is roughly $13,000. None of the unsecured creditors have appeared in support of or in opposition to the [UST's] motion. Washita State Bank is a secured creditor, who in the schedules is shown as having a partial unsecured claim, but the bank's not taken a position either.
>
> The debtor's statement of financial affairs indicates that there was no pending litigation or collection activity when bankruptcy was filed. The statement of financial affairs does not indicate any preferential payments. So, if that's correct, there would be nothing to pursue if the case were converted.
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> If the case were dismissed, there would not be any continuing additional administrative expenses to be paid. If the case were dismissed, the secured creditors could pursue foreclosure or collection activity. There are a small amount of unsecured claims, and unsecured creditors again have not indicated, have not initiated any collection activity.
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> Dismissal of the estate rather than conversion would maximize the estate's value; thus, it seems that the case should be dismissed.[13]

The bankruptcy court did not abuse its discretion under § 1112(b) because from these findings of fact and conclusions of law we do not have "a definite and firm conviction that [it] made a clear error of judgment or exceeded the bounds of

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[13] Transcript at 9-11, in Appellant's Appendix at 31-33.

permissible choice in the circumstances."[14] Accordingly, we affirm the Dismissal Order.

In addition to the findings and conclusions supporting its decision to dismiss, as opposed to convert, the debtor's Chapter 11 case, the bankruptcy court stated that dismissal was warranted under § 1112(b) because the case was filed in bad faith. The debtor attacks this conclusion, stating that the bankruptcy court improperly imputed Hough's acts to the debtor-corporation. This argument fails because even if we disregarded the bad faith conclusion, the undisputed findings of fact set out above support the Dismissal Order.

The debtor contends that dismissal of its Chapter 11 case denied it its constitutional right to bankruptcy protection. This argument is without merit as a matter of law, as it is well-established that there is no constitutional right to a bankruptcy discharge.[15]

The debtor also argues that it was denied due process because the bankruptcy court "employed several fact findings that the debtor was not given an opportunity to attempt rebuttal."[16] This argument is without merit. Not only has the debtor failed to set forth with any specificity the fact findings that it would rebut, but it misunderstands the process. The debtor had notice of the Motion to Dismiss, and it opposed that Motion, arguing that its Chapter 11 case should be converted to Chapter 7 instead of being dismissed. As the proponent of conversion, it had the burden to show that conversion, rather than dismissal, was in the best interest of creditors and the estate at the noticed hearing on the Motion to Dismiss. The debtor failed to present any evidence at that hearing.

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[14] Moothart v. Bell, 21 F.3d 1499, 1504 (10th Cir. 1994) (citation omitted).

[15] *See, e.g.*, United States v. Kras, 409 U.S. 434, 446-477 (1973); In re Stewart, 175 F.3d 796, 811 (10th Cir. 1999).

[16] Appellant's Brief at 4.

Significantly, the debtor admitted at the hearing that unsecured creditors would not likely receive a distribution if its case were converted to Chapter 7. It was this admission, together with representations made by the debtor in papers filed in its case, including admissions made in a fact stipulation filed with the UST in conjunction with the Third Motion (summarized above), that formed the basis of the bankruptcy court's decision to dismiss, as opposed to convert, the case. This being so, the debtor cannot complain that it did not have an opportunity to rebut facts.

Finally, the debtor makes two arguments related to Ashley and the Divorce Lien, both of which are without merit. The debtor first maintains that dismissal of its case "is tantamount to circumventing the appeals process, by effectually undoing the Bankruptcy Court's summery judgement [sic] granted [the debtor] regarding Ashley Hough's liens."[17] The appeal process is not circumvented by dismissal of the debtor's case, but rather is rendered moot because Ashley's Divorce Lien is reinstated by the Dismissal Order as a matter of law pursuant to 11 U.S.C. § 349(b). There being ample grounds to dismiss the case resulting from the debtor in possession's admitted acts and omissions, it cannot complain about the effect of § 349(b) as only debtors who comply with the Bankruptcy Code are entitled to its benefits.

The debtor also argues that the bankruptcy court erred in dismissing its case because Ashley was the only party who requested dismissal and she lacked standing to do so. This argument lacks merit for numerous reasons, the most important of which is that the bankruptcy court did not dismiss the debtor's case on Ashley's motion, and in fact, discounted Ashley's role, holding that she was not a "creditor" to which the § 1112(b) "best interest" test applied. The Motion to Dismiss was made by the UST, and it has not been nor can it be disputed that

[17] Appellant's Brief at 7.

the UST may request dismissal.[18] Although the UST refused to take a position at the hearing on its Motion as to whether dismissal or conversion was appropriate, it did not withdraw its Motion to Dismiss, and its argument favored dismissal. Indeed, it was the UST's argument that conversion would result in increased administrative expenses and little or no distribution to unsecured creditors that compelled the bankruptcy court to dismiss the case.

III. Conclusion

The bankruptcy court's Dismissal Order is AFFIRMED.

[18] 11 U.S.C. § 1112(b).